

12th EADI General Conference  
**Global Governance for  
Sustainable Development**

The Need for Policy Coherence  
and New Partnerships



**From Project Aid to Budget Support:  
How Far Have We Come and What Have We Gained in Latin  
America?**

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## **Abstract**

The problems associated with traditional project aid are widely recognized in the aid literature. Traditional projects come from donor initiatives rather than from national priorities and initiatives; as a result, project activities rarely survive the end of project funding. Traditional projects are single-donor initiatives with high transaction costs for governments. Many projects create independent implementation offices and use their own budgeting and accounting systems. This works against the goal of strengthening national planning, implementation, and budgeting systems.

A central objective of the Poverty Reduction Strategy process and of the Paris Agenda has been to improve the efficiency and effectiveness of aid through harmonization and alignment with government plans, priorities and procedures. This is to be achieved in part by moving away from donor-driven projects and towards more coordinated and programmatic aid modalities, such as general and sectoral budget support. The European Commission and some European bi-lateral donors have been leading advocates of this change.

In this paper, we assess to what extent the donor communities in Bolivia, Honduras, and Nicaragua (three countries that participated in the HIPC initiative and the PRS process) have made the transition from project aid to program-based approaches. We also examine to what extent new aid programs in the three countries achieve the Paris Agenda objectives of ownership, harmonization, and alignment. The paper draws on the results of a just-completed five-year research project that has monitored and evaluated the Poverty Reduction Strategy process in these three countries.

Data on aid by modality is limited in Bolivia, Nicaragua, and Honduras, but available information suggests that there has not been a systematic increase in budget support since the start of the PRS process. National ownership and leadership of the aid process as envisioned in the Paris Agenda remains limited and goes down over time, even in the context of program aid. There is fair extent of alignment to national systems in budget support or sector budget support in these three countries, but in these programs there is little harmonization among donors. In SWAs and common funds, there has also been progress towards use of national systems, but these modalities retain characteristics of projects in many cases – with independent execution units and/or many different procedures required by the involved donors. The degree of donor coordination in program aid varies widely.

## I. Introduction

A central objective of the Poverty Reduction Strategy process and of the Paris Agenda has been to improve the efficiency and effectiveness of aid through harmonization and alignment with government plans, priorities and procedures. This is to be achieved in part by moving away from donor-driven projects and towards programmatic aid modalities that use national systems and place governments in the driver's seat of aid relationships. The European Commission and some European bi-lateral donors have been leading advocates of this change.

Multi-donor budget support is the aid modality best suited to meeting the Paris Agenda objectives of ownership, alignment, harmonization, and increased donor coordination. This modality provides resources for governments to use as they choose and to incorporate into normal budgeting and expenditure systems. What distinguishes general budget support from other forms of program aid is that the associated policy dialogues and conditions are multi-sectoral in nature and/or focused on the strengthening of national systems (e.g. budgeting and financial management). A variant of general budget support is sector budget support – budget support for which the policy dialogue or conditions are focused on just one sector or sub-sector.

Between traditional projects and budget support are a number of other, intermediate modalities that belong to the family of program-based approaches. One of these is SWAps – a mix of projects, common funds, and sector budget support provided by various donors and organized around a sector plan or strategy. Another is a sector or thematic common fund or basket – pooled funds that are used to support a plan or agreed set of activities. These modalities approach the Paris Agenda objectives to the extent that they involve multiple donors, use government systems, and support government-driven plans or strategies.

A number of studies have examined experiences with program-based aid modalities and assessed to what extent the anticipated benefits of the transition from projects to coordinated, aligned aid have materialized (Booth *et al.* 2004; Batley 2005; IDD and Associates 2006; Donge 2007; Lawson *et al.* 2007; Molenaers and Renard 2007; White 2007, ODI 2008). To date, these studies have focused mainly on the African experience. This paper complements the existing literature by examining the Latin American experience. We assess to what extent the donor communities in Bolivia, Honduras, and Nicaragua (the three countries in Latin America that participated in the HIPC initiative and the PRS process) have made the transition from project aid to budget support and other program-based approaches. We also examine whether general and sectoral budget support programs and intermediate modalities such as SWAps and sector common funds manage in practice to achieve the objectives set out for program aid in the Paris Agenda. The paper draws on the results of a just-completed five-year research project that has monitored and evaluated the Poverty Reduction Strategy process in these three countries.<sup>1</sup>

We begin in section 2 by reviewing the motivation and expectations for moving away from projects and towards programmatic aid and budget support. Section 3 presents empirical evidence about the transition in aid modalities in the three countries. Section 4 examines how the aid modalities have performed in practice. The final section draws conclusions.

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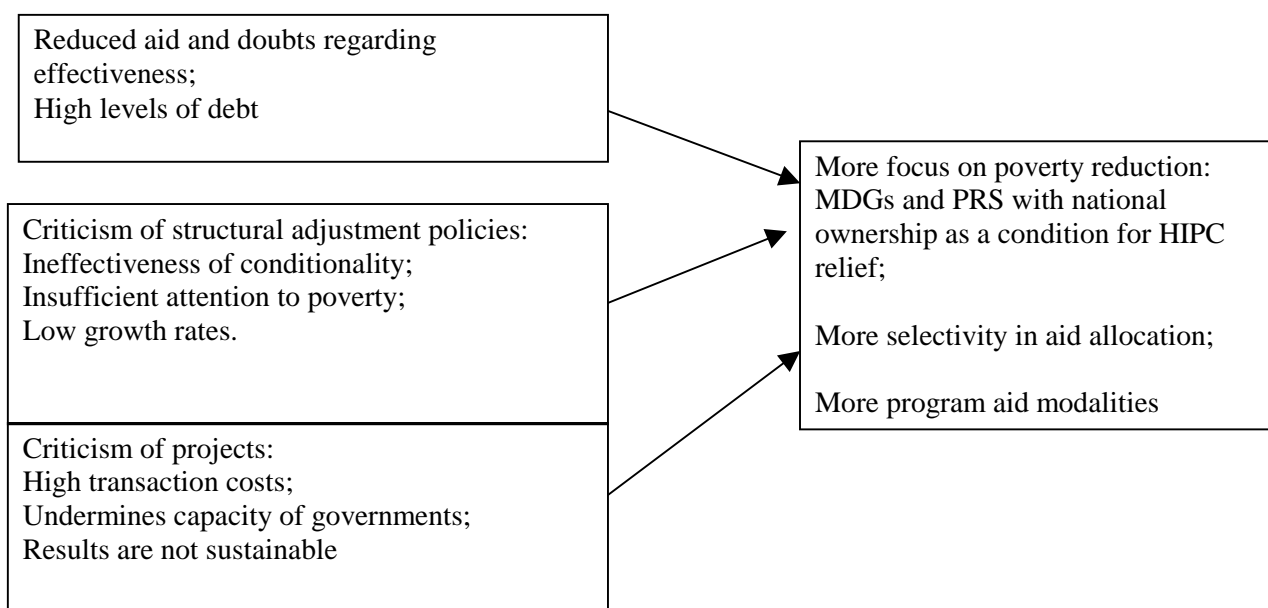
<sup>1</sup> This project was funded by the Swedish International Development Cooperation Agency between 2003 and 2008. In addition to the authors, Niek de Jong, Joao Guimaraes, Rafael del Cid, Nestor Avendano, and Juan Carlos Aguilar contributed to the research on which this article is based. All project reports can be downloaded at [www.iss.nl/prsp](http://www.iss.nl/prsp).

Data on aid by modality is limited in Bolivia, Nicaragua, and Honduras, but available information suggests that there has not been a systematic increase in budget support since the start of the PRS process. National ownership and leadership of the aid process as envisioned in the Paris Agenda remains limited and goes down over time, even in the context of program aid. There is fair extent of alignment to national systems in budget support or sector budget support in these three countries, but in these programs there is little harmonization among donors. In SWAs and common funds, there has also been progress towards use of national systems, but these modalities retain characteristics of projects in many cases – with independent execution units and/or many different procedures required by the involved donors. Both donors and governments contribute to the perpetuation of many project-like practices within sector-based programs. The degree of donor coordination in program aid varies widely.

## **2. Motivations and expectations for program-based aid modalities**

In the latter half of the 1990s, international aid had decreased, and there were growing doubts about its effectiveness. Poverty had not declined, and many poor countries were suffering from high foreign debts. The academic debate about the effectiveness of aid was intense. On the one hand, there was growing discontent over the World Bank and IMF structural adjustment programs of the 1980s and 1990s. It was increasingly recognized that conditionality of these programs was hardly effective, and doubts also existed about the impact of these programs on social indicators and poverty. The effects on growth also began to be questioned. On the other hand, there was also a great deal of criticism of the dominant modality of aid—that of project support. Projects are not able to produce sustainable results if they do not have the firm underpinning of local commitment and appropriate macroeconomic policies. Furthermore, the existence of multiple projects funded by multiple donors—each with its own requirements—tended to increase transaction costs and to undermine local capacity for planning, management, execution and monitoring.

In response to these criticisms a new aid architecture was proclaimed around 2000 (See Figure 1). Future aid would be focused more on poverty reduction, as expressed in the adoption of the Millennium Development Goals and the introduction of the Poverty Reduction Strategy Papers (PRSP) in the context of and as condition for the Initiative for the Heavily Indebted Poor Countries (HIPC Initiative). In response to the lack of effectiveness of conditionality, donors would become more selective in their aid allocation, targeting aid to poor countries with - proven- good policies and good governance and with commitment to poverty reduction, as evidenced by a nationally-owned PRSP. At the same time, donors would move away from project support and towards program support. This move was very much related to the other changes: with more selectivity and with governments committed to poverty reduction, donors would no longer need to design separate projects but could instead rely on the national strategies for poverty reduction to ensure that aid money would be well spent. The desired transition to program aid is also consistent with the Rome (2003) and Paris (2005) Declarations on aid effectiveness. These Declarations call for more local ownership, more alignment with local systems and more harmonization and coordination of donor activities.



**Figure 1. Changes in International Aid around the Year 2000 and the Factors that Led to Them.**

The essence of program aid is that the money is not tied to specific projects. In general, however, this form of aid is attached to policy conditions (OECD 1991). In the past, program aid mainly took the form of balance of payments support or debt relief, but since 2000 the dominant form of program aid is budget support. To the extent that debt relief actually frees resources for the government (if it reduces debt service that actually would have been paid in the absence of the relief) there is no difference between the three in terms of the resources provided to the government. There may be a difference in entry conditions and in the policy dialogue accompanying the different modalities. The policy dialogue around budget support tends to be more focused on government policies for poverty reduction, as well as on budgeting systems.

In the group of program aid modalities, nowadays three broad forms can be distinguished:

1. General budget support, where the money goes to the Ministry of Finance and is freely usable; the policy dialogue can be on anything that belongs to the competence of the national government, including governance and democracy issues, national and sector policies
2. Sector budget support, where the money also goes to the Ministry of Finance and is freely usable, but the policy dialogue is focused on one sector in particular
3. Sector wide approaches (SWAs) in which donors work together to support a sector or sometimes sub-sector; this usually includes common funds or baskets in which donors pool their funds, but donors may also support separate projects as long as they are in line with the country's sector strategy.<sup>2</sup>

It is expected that these program-based approaches enhance the effectiveness of aid. In fact, the Paris Declaration stipulated that by 2010, 66% of aid should be in the form of these modalities and no longer in the form of project aid. Program-based approaches are expected to enhance all principles embodied in that Declaration. In particular, they should have the

<sup>2</sup> Technically SWAs and sectoral or thematic common funds are not program aid, but they can be seen as part of the family of program-based approaches.

following characteristics: leadership by the host country; support of a single comprehensive program and budget framework; a formalized process of donor coordination and harmonization of donor procedures for reporting, budgeting, financial management, monitoring and evaluation; and efforts to increase the use of local systems for program design and implementation, financial management, monitoring and evaluation (OECD 2005).

However, some qualifications can already be made. If we look at the different modalities within program aid, the first two probably meet the alignment objective but not necessarily the objective of harmonization, since general and sector budget support can also be provided by single donors, each having their own procedures, conditions and policy dialogue. The third modality (SWAs) advances the harmonization objective but not necessarily the alignment objective. The latter depends on the extent to which common pools and projects within these approaches use government systems of planning, budgeting, administering, procurement, execution, and monitoring and evaluation.

A more general problem that already has been observed is that the Paris Declaration assumes full ownership of country strategies, and is “silent” on conditionality (Rogerson 2005). It assumes that donor priorities are fully in line with recipient country priorities and that there is no need to set conditions on program aid or to push countries in a certain direction. Practice may be very different from these expectations.

In section 4, we examine how the different program aid modalities as applied in Latin America performed on these criteria of ownership and leadership, alignment and use of local systems, and harmonization and coordination.

### **3. Movement towards program-based modalities in Latin America**

It is very difficult to obtain reliable figures on the amount of program aid. The DAC Creditor Reporting System is notoriously unreliable for the figures on general budget support and does not have a category for sector budget support nor for SWAs or common funds. In this paper we use data obtained from local sources to evaluate the amount of program aid provided in Bolivia, Honduras, and Nicaragua between 1995 and 2006.

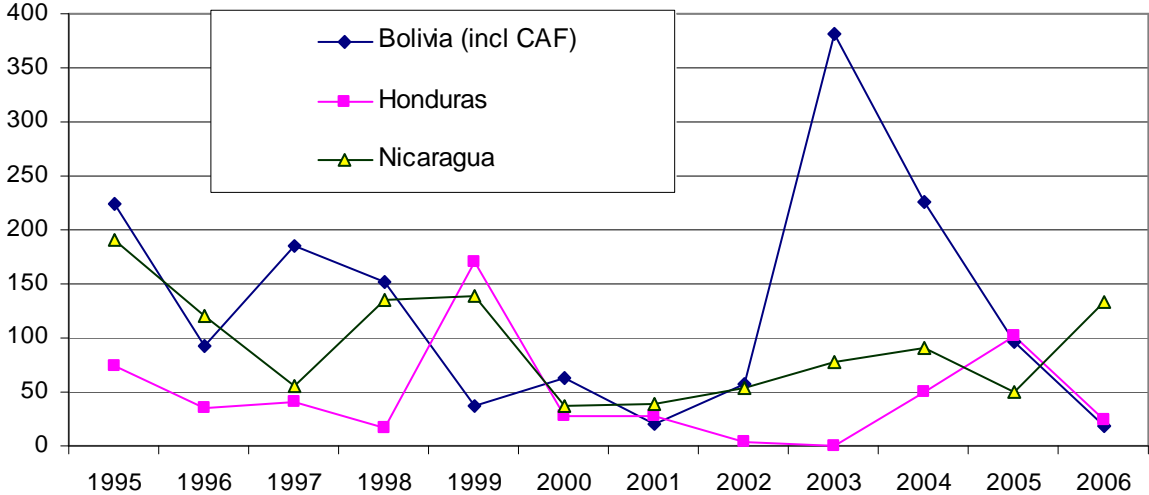
The three countries have slightly different systems for establishing the amount of freely spendable resources provided by the international community (general budget support and sector budget support). In Nicaragua, the Central Bank registers a category of “freely available liquid currency” that includes all balance of payments support and budget support. In Honduras, we have used three categories of “monetary support” as defined by the Ministry of Finance (Secretaría de Finanzas, SEFIN). These were “balance of payments,” “fiscal-structural adjustment,” and “fiscal-reorganizations.” However, SEFIN does not register all aid: the figures only include concessional loans, not grants. For measuring the quantity of program aid this hardly makes a difference since almost all program aid in this country has been provided by multilateral banks, and they provide loans, not grants. In Bolivia, the category of “aid by sector” as registered by the Ministry of Finance (Viceministerio de Inversión Pública y Financiamiento Externo, VIPFE) has been subtracted from total aid to get a category of aid not tied to specific sectors.<sup>3</sup>

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<sup>3</sup> However, the numbers for aid by sector include non-concessional credits from the Andean Finance Corporation (CAF), so the program aid numbers for Bolivia presented here also include CAF figures and overestimate the amount of program *aid*.

In Honduras, the amounts of program aid are lower than in the other countries (Figure 2). The fact that there is hardly any program aid from bilateral donors has to do with the composition of the group of bilateral donors in this country: out of the group that is usually in favour of program aid (Nordic countries, Netherlands, UK), only Sweden has a large presence. After Hurricane Mitch struck the country at the end of 1998, program aid rose in 1999. But that increase did not last, and there is no rising trend since 2000 when Poverty Reduction Strategies were first elaborated. In Bolivia and Nicaragua, program support from some bilateral donors has always existed alongside the program support of multilateral banks. Program aid (balance of payments support) has been volatile between 1995 and 2000 but overall there is a slightly decreasing tendency until 2000. In Bolivia, the political and economic crisis led to a very large increase in program aid in 2003 and 2004, but this was in the (old) form of emergency balance of payment support; it had nothing to do with budget support as it is now commonly defined, with a policy dialogue around poverty reduction policies. A group of bilateral donors was not happy with this, and in 2004 they agreed on a Multi-annual Budget Support Program (according to the Spanish acronym PMAP) with the government. There were hardly any disbursements in this Program, and the government of Evo Morales (in power since early 2006) does not seem interested in reviving it. In Nicaragua, a slight increase in program aid is visible after 2000. The Joint Agreement for general budget support established in 2005, along with the new sector budget support programs of the European Commission (EC), caused the increase in 2006.

**Figure 2. Program Aid 1995-2006, in Millions of US\$**

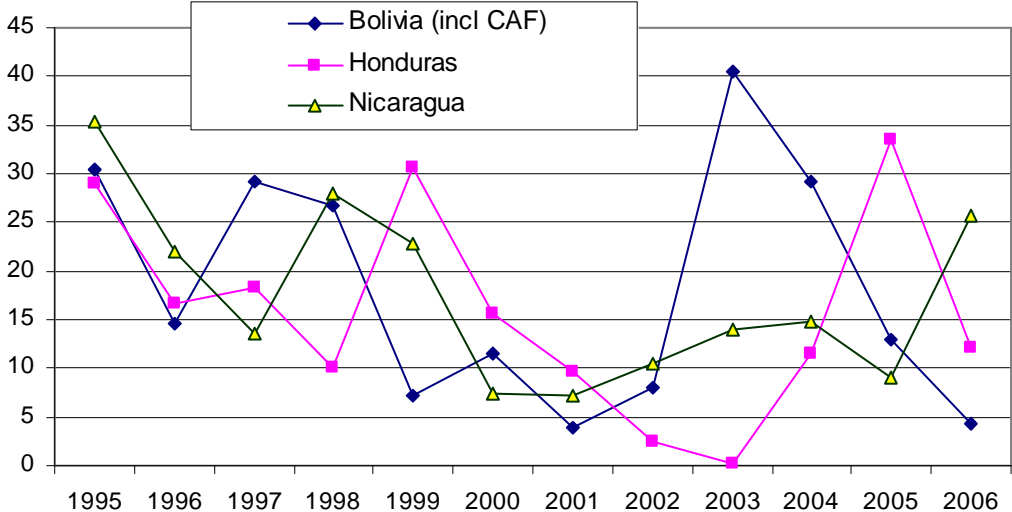


Sources: VIPFE for Bolivia, SEFIN for Honduras, and Banco Central de Nicaragua for Nicaragua.

As a percent of total aid, program aid has fluctuated a lot between 1995 and 2000 (Figure 3). To the extent that there is a trend, it is slightly decreasing between 1995 and 2000 and only in Nicaragua is there a slight increase after 2000. For Honduras, the data for total aid does not include grants (due to the data limitations described above), so the share of program aid in total aid is overestimated. The peak observed in this country in 2005 is probably related to the agreement with the IMF in 2004, which led to new programs by the World Bank and the Inter-American Development Bank. All in all, the figures do not point to a decisive movement from project aid to budget support since 2000. Multilateral banks and some bilateral donors

(especially in Bolivia and Nicaragua) have always allocated part of their money to program aid and continued to do so after 2000. Whether the conditions and the policy dialogue for these programs has changed after 2000 will be examined in section 4.

Figure 3. Program Aid as % of Total Aid



Source: see Figure 2.

#### 4. Effects of program-based modalities

This section examines whether program aid modalities have led to the assumed advantages for aid effectiveness laid out in the Paris Declaration. We look in particular at ownership and leadership of the aid process, harmonization, and alignment. We begin looking at intermediate forms of program-based aid -- SWAPs and common funds that support sectoral or sub-sectoral plans. We then consider general and sector budget support.

##### *SWAPs and common funds or baskets*

We look at three specific cases of SWAPs and common funds, one each from Nicaragua, Honduras, and Bolivia. All three cases involve coordinated support by multiple donors for a sector-wide or sub-sector plan or strategy, but do not qualify as sector budget support. Of the three, Nicaragua’s sector-wide program in rural development – PRORURAL – most closely approximates a true SWAP. It is organized around a plan for the rural productive sector and encompasses many projects (some of which predate the plan) and a common fund. Honduras’ Education for All is a sub-sector program in primary education, which is also supported by a combination of projects and a common fund. The “education basket” in Bolivia is a common fund originally created in 2004 to support an operational plan for the education sector (the POMA, by its initials in Spanish). The POMA was ultimately abandoned, so the fund now supports a series of activities agreed to in discussions between the government and the basket donors.

We first consider to what extent the three programs represent advances in national ownership and leadership of the aid process. In Bolivia, the impulse for starting education basket was to support the Education Ministry’s operational plan, which was written by the government. PRORURAL is also built around a sector plan that was developed over time by the

institutions involved in the rural development sector in Nicaragua and through numerous consultative processes (Kay et al 2008). However, the content of the program (e.g. the projects and activities funded through PRORURAL) still include many projects that were largely donor-driven initiatives. The EFA program in Honduras was a joint government and donor initiative, but its content is mainly determined by donors. The objectives, teaching measures, proposals for institutional reforms, and textbooks in the EFA program were actually all created and designed by donors like USAID, World Bank, and JICA.

Even when a government-owned plan or policy forms the basis of a SWAp or common fund, however, the three cases demonstrate that it is hard to maintain government leadership and ownership of aid programs over the life of the agreements. The alignment of the aid programs with political priorities has declined over time. In these Latin American countries, there are regular changes of government, and new governments do not necessarily support the plans of their predecessors. In Bolivia, the Morales government quickly rejected the POMA created by President Mesa (and which the education basket was created to support). In the interest of keeping the education basket running, the donors decided to be flexible and support any new government initiative that has the same general goals as the rejected POMA. Today donors involved in the basket approve the expenditures that the government wants to fund out of the basket. In Nicaragua, the change of government has not led to a rejection of PRORURAL, but the Ortega government is still going outside of the PRORURAL donor framework to find support for its key rural development programs. The major supporter of the government's new *Hambre Cero* (Zero Hunger) program, for example, is Venezuela, a country that is not a party to PRORURAL. There may still be ownership of PRORURAL, but the government's key priorities lie elsewhere. In Honduras, donors had to remind the new Zelaya government of the existence of the EFA program (De Jong et al 2008). The disbursements stagnated after the 2006 change in government until the government eventually gave its general support to continuation of the program.

In the logic of the PRS process, medium-term national poverty reduction strategies should have been the guiding force behind sustained government leadership of the aid process. It was assumed that support for the PRSPs would survive elections (because of widespread ownership of the strategies would emerge from the participatory process used in their creation) and that the PRSPs themselves would be the basis for the sectoral plans around which program aid is organized. Neither was the case in these three countries.

Political support for the original PRSPs lasted no longer than was needed to reach the HIPC II Completion Point and to qualify for debt relief. In Bolivia, this came early (2001) so the new government of Sanchez de Lozada was able to announce his intention to revise the PRSP only a year after it was born. Three Presidents later (Mesa, Rodríguez, and finally Morales), the Bolivian national government no longer has any intention to prepare a PRSP, but has instead produced a National Development Plan. In Nicaragua and Honduras, new Presidents were initially forced to accept the PRSPs of their predecessors in order not to jeopardize the HIPC process. This did not stop President Bolaños of Nicaragua from beginning to develop his own national development strategy and to discuss it with donors, while the original PRSP was still officially the country's strategy. After many revisions made to satisfy donor wishes, the new development plan was officially recognized as the PRSP II. Honduras had a fairly stable PRSP until recently, but after reaching the HIPC Completion Point, President Zelaya announced that he would change the PRS. He has produced a draft strategy. The international community is now in limbo as the final version of this strategy has not been published. In short, PRSPs, like sector plans, have had trouble retaining support after changes of government. The conditionality attached to debt relief was the main motivation for

preparing PRSPs and for keeping plans in place, but that did not mean the governments were truly “owners” of these plans, let alone that new governments would feel committed to them.

In part for these reasons, the PRSPs were not the basis of the sector and sub-sector plans in any of the three cases. Bolivia’s education basket was created in 2004, and there has been no “nationally-owned” PRSP in Bolivia since roughly 2002. Honduras’ EFA was the result of joint government and donor wishes to participate in this worldwide initiative for improving basic education (coordinated by the World Bank) and to make a start with sectoral support modalities. It was not directly related to the PRS. Although the goals of PRORURAL (poverty reduction, sector competitiveness) are consistent with the country’s second generation PRSP, PRORURAL was actually developed in parallel to this national plan, by a different group within the government (Kay et al 2008). The lack of coordination between the development of the PND and the sector plan led to some contradictions between the two plans. This experience is not unique to PRORURAL or to Nicaragua: PRSPs tend to be developed under the leadership of the Ministry of Finance or of the Presidency, whereas the development of sectoral plans is usually under the auspices of sector-specific ministries. In sum, in all three cases, to the extent there is or was ownership of the aid programs it did not stem from the PRS process.

One of the main reasons for advocating government ownership and leadership in the aid process is to improve the results of aid and to increase the degree of compliance with conditions. If governments set the goals, they are more likely to be inspired to try to reach them. And if they set the conditions for aid disbursement, they are more likely to comply. Both are supposed to translate into better development results. However, in the baskets or common funds within these three sectoral programs, the disbursement conditions are focused on administration and financial management, not on content or development results. Program targets are not always clear, and meeting objectives is never a condition of disbursement. In this sense, the programs show a lot of confidence that governments are moving in policy directions that donors wish to support (that government priorities and donor priorities are aligned) and that these approaches will generate satisfying results.

For participation in PRORURAL, donors just ascertained whether the government of Nicaragua had the necessary capacity to implement a SWAp in practice. This was measured, among other things, by the existence of a sectoral planning process, of monitoring mechanisms, of a Medium Term Expenditure Framework and of a sectoral policy or program with appropriate targets. For disbursements from the common fund, fiduciary controls have been defined. When the World Bank joined PRORURAL through PTA2 project it brought the PTA2 conditions, which were mainly related to the country’s PRSP. PRORURAL also has monitoring indicators that were developed jointly between the government and donors, but there is no explicit consequence for failure to meet targets.

In Bolivia’s education basket, conditions relate to reporting, accounting, and expenditure. The agreement also includes a list of “points of dialogue,” which are updated annually and for the basis for dialogue with government. Officially, however, there are no strings attached to the outcomes of this policy dialogue. Initially the agreement was also going to have a set of indicators, but the development of these indicators stopped with the change in government and rejection of the POMA.

Aside from ownership and leadership, program aid is expected to improve alignment with national systems and procedures as well as donor coordination and harmonization. In these respects, PRORURAL represents a significant step forward. The government and all involved

donors<sup>4</sup> signed a Code of Conduct and developed an Ownership, Harmonization and Alignment Plan for Aid to the Rural Productive Sector (2005-2007). There are joint missions, a common set of monitoring indicators, and only one report is produced for all donors. Yet, most donors participate in PRORURAL through their projects, many of which already existed before PRORURAL started, and all these projects have their specific procedures. There is a donor-government roundtable (“sub-mesa”) for the rural productive sector, and the wide coordination around PRORURAL keeps donors informed about what others are doing. A recent study of the forestry sector in the three countries found that, thanks to this coordination, donor awareness of sector activities was much higher in Nicaragua than in Bolivia or Honduras (Kay et al 2008). Nonetheless, two important sector donors remain outside this agreement altogether—the Millennium Challenge Account and Venezuela, which is a major source of financing for the Ortega government’s new rural development program, *Hambre Cero*.

The eleven donors in Honduras’ Education for All program also signed a Memorandum of Understanding and participate in a donor-government roundtable for the education sector. Six donors of the donors contribute to the common fund (Sweden, KfW, Canada, Spain, the European Commission, and, to a limited extent, the World Bank). The fund has a Memorandum of Fiduciary Understanding that establishes the common conditions for disbursement of contributions. The procedures are based on a format that the World Bank uses for projects and are not always consistent with national standards and systems (Salomonsson and Sjölander 2005).

Bolivia’s Education Basket, in contrast, adopted local accounting and financial procedures. Donor coordination, however, is more limited than in the other two cases. The Education Basket was created by The Netherlands in 2004, following its decision to leave the Education Reform program (Reforma Educativa), a long-standing sub-sectoral program under the leadership of the World Bank but with waning national support. It now includes only 3 donors, soon to be 4. At various points in the past there has been a functioning education roundtable for wider sector coordination, but many of the current government’s key priorities for the sector (such as a new alphabetization campaign) are financed by Venezuela and Cuba, who do not participate in these discussions.

The administrative and financial requirements of the agreements are in some ways reminiscent of projects. In the education basket and in EFA’s common fund, for example, donors are now asked to approve specific expenditures, even if that was not the original intention of the agreement. Nicaragua’s PRORURAL had 38 different sources of financing in 2006, many still with different procedures. In Bolivia and Nicaragua at least there is more attention to using national systems than has been the case with projects traditionally.

#### General and sector budget support

SWAps and basket funds are program-based approaches, but do not pass as much control to governments as do other forms of program aid. In theory, one could achieve more harmonization, alignment with national systems, and government ownership and leadership achieved with general and sector budget support than with the intermediate program-based approaches. In this section, we examine whether that has been the case in Nicaragua, Bolivia, and Honduras.

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<sup>4</sup> Sweden, Switzerland, Finland, Italy, Austria, Norway, France, Denmark, the European Commission, Germany, Japan, Spain, AID, FIDA, FAO, UNDP, IBD, World Food Program, and the World Bank .

A first issue is the extent of harmonization of budget support among different donors. In practice, several different budget support systems are present in the three countries and not all involve donor coordination.

The World Bank provides its Poverty Reduction Support Credits (PRSC). This is general budget support with conditions for almost all sectors of public policy. PRSCs are offered to countries with an on-track agreement with the IMF and an approved Poverty Reduction Strategy. Without an approved PRS, Bolivia could not qualify for a PRSC. In 2004, the World Bank instead concluded a Programmatic Structural Adjustment Credit (PSAC), which was similar to a PRSC, but included a slightly smaller number of sectors. A second PSAC was initiated in 2005.

In Nicaragua, the 2004 and 2006 PRSCs have been set up in cooperation with KfW, and KfW also co-financed them. KfW also participated in the policy dialogue and the financing for the PSACs in Bolivia. In Honduras, Sweden, KfW, DfID and Canada participated in the dialogue for the 2004 PRSC but none of these donors provided financing. Sweden, KfW and Spain have been involved in the drawing up of a second PRSC and consider providing parallel financing or co-financing, but this PRSC has not started yet.

The World Bank and the Inter-American Development also provided several credits involving sector budget support. Each agreement was negotiated separately with the government and no other donors were involved. Since 2004, the European Commission (EC) also entered the scene with sector budget support. These are single donor operations, but in the case of the PASAAS program for water and sanitation in Bolivia, the EC hoped that other donors would join the program once the agreement was in place. None did, however, because a government change led to uncertainty about the future of the water sector policies PASAAS was meant to support and about budget support in general. See Table 3 for an overview of sector budget support programs from EC, IDB and WB that started between 2004 and 2006.

**Table 3. Sector budget support programs of the European Commission and the IDB in the three countries, begun between 2004-2006**

<b>Donor</b>	<b>Country</b>	<b>Sector</b>	<b>Initial Year</b>
European Commission	Bolivia	Water and Sanitation	2004
	Honduras	Decentralization	2005
	Nicaragua	Education	2004
		Support to NDP, especially in Health and Education	2006
IDB	Bolivia	Public Administration	2005
		Tax Reforms	2006
	Honduras	Social: Health and Education	2004
		Financial Sector	2004
		Health	2005
		Fiscal Management	2006
	Nicaragua	Fiscal Reforms	2004
		Social	2006
World Bank	Bolivia	Bank and Corporate Sector Restructuring	2004
	Honduras	-	
	Nicaragua	-	

There have been some attempts at wider harmonization of budget support in all three countries. In 2004 in Bolivia (the PMAP), and in 2005 in Nicaragua, a group of donors agreed on a Joint Financing Arrangement for General Budget Support. The agreements were signed by seven and nine donors respectively. This means that the donors came to an agreement about some fundamental principles that the government needed to abide by in order to receive general budget support and about a Performance Assessment Matrix (PAM) with actions and targets the government would have to meet in various years. In Bolivia, the PMAP did not last long. In Nicaragua the Joint Financing Agreement is still in operation in 2008.

In Honduras, a Budget Support Group was established in 2006 in which Sweden, Germany, Spain and the three multilateral donors (WB, IDB and EC) participate. The group aims to harmonize conditions for budget support but so far it has not managed to unite the different systems of the three multilateral donors. The three bilateral donors participated in the design (the conditions) for the World Bank's second PRSC and are considering co-financing or parallel financing it. But as of early 2008 the PRSC 2 had still not materialized because the country has disagreements with the IMF on fiscal management issues. As long as there is no new PRGF, the World Bank cannot conclude a PRSC.

Even where and when these joint financing agreements exist or existed, budget support was completely harmonized, for various reasons:

- The World Bank did not join the agreement in Bolivia, and the IDB did not join in Nicaragua. They had negotiated and started financing their own budget support programs and wanted to continue them as they were
- Some donors signed the joint agreement out of a desire to be present in the negotiations or under pressure from their headquarters; yet they continued operating their programs outside of the joint agreement (European Commission in both countries, World Bank with KfW in Nicaragua, KfW and IDB in Bolivia)
- Bilateral agreements generally take legal precedence over the joint, multilateral agreements.
- Different donors sometimes assign different levels of priority to the entry conditions (the fundamental principles) or to the actions and goals of the Performance Matrix. For example, DFID in Nicaragua makes its own evaluation of the fiduciary risks and its disbursements depend on this evaluation.
- In some cases, donors even require budget support funds to be used in a certain way. This leads to various reporting and monitoring systems (DFID and some others in Nicaragua), though this is contrary to the definition and spirit of the budget support.

A second issue in evaluating budget support agreements is the extent of alignment with national systems. The PMAP in Bolivia contributed to reinforcing the national system of financial management, especially because the contents of the policy matrix supported the government's medium term action plan for improving the government's fiscal management and transparency. The IDB's fiscal sustainability program also supported this strengthening through its conditions, but its implementation was somewhat contradictory in that it was managed from a separate implementation unit and used a special account. In reality, it was more a project than budget support. Similarly, in the first years of the PASAAS program, the Bolivian government decided to create a new internal body for implementing the PASAAS-funded water and sanitation projects, rather than rely on existing implementation agents within the government. This was ultimately unsuccessful, and the approach was abandoned. In Honduras the government also set up a separate implementation unit for the EC sector support program for decentralization. This was deemed necessary in order to secure execution of the

program and especially the achievement of the performance indicators, but it was contrary to the intention of the EC to support existing government systems. The PSACs and PRSCs of the World Bank contributed somewhat to strengthening the statistical information systems. But a general weakness of all of these programs was that they never identified the need to create a base line for verifying progress in the various areas.

In Honduras, the PRSC 1 helped to reinforce an electronic public management system and a statistical information system for monitoring progress on certain indicators. The IDB also supported the latter, but overall financial aid for strengthening this system, especially through systematic support to the national statistical institute was not sufficient.

In Nicaragua, public financial management systems improved during the Bolaños administration, but it is not clear to what extent the provision of budget support contributed to this. Improvement in public financial management systems was a priority of the government itself, and was supported by a technical assistance program of the World Bank and several other donors, the PSTAC (Public Sector Technical Assistance Credit).

A third point is whether budget support agreements have led to better alignment of aid and conditions to government priorities and plans, in short, whether they have increased national ownership and leadership over aid and aid-funded activities. There is some difference here between general and sectoral budget support. In the case of general budget support, donors usually have some more entry conditions before starting this modality: the move towards general budget support is closely linked to more selectivity. In theory, budget support would only be appropriate in countries with good macroeconomic policies and with good governance, including reasonably well functioning budgeting and accounting systems. Second, recipient countries should have a nationally owned, long-term and comprehensive Poverty Reduction Strategy with concrete goals that was conceived with broad participation of the population. Budget support would be provided to help the country carry out the strategy and achieve the defined goals and targets.

In practice, however, these conditions are seldom fulfilled. Sometimes there are problems with respect to governance criteria, ownership of PRSPs can often be questioned, and PRSPs are often not concrete enough to form the basis for performance criteria. Yet, multilateral banks want to continue their policy-based loans, and the headquarters of several bilateral donors, as well as the European Commission want to move towards budget support. In these circumstances, they begin to *use* budget support to try to influence government policies and achieve certain results. For example, the preamble of the Nicaraguan Joint Financing Agreement speaks about an independent judiciary, freedom of press, and commitment to poverty reduction. At the start it was already clear that Nicaragua did not meet all of these criteria. Yet, the drive for budget support was so strong that donors went on. In Bolivia, the PMAP was agreed while there was no approved PRS. Donors hoped to induce the government to elaborate a new PRS that was acceptable to the donors, so a PRS was the first item in the Performance Assessment Matrix (PAM). When political problems made this impossible, donors faced a credibility problem: the country had met most of the conditions mentioned in the PAM, yet donors did not disburse. The non-existence of a PRS was one reason, but the lack of political stability and discontent about some government measures towards foreign investors were also mentioned. This resulted in donors being a less reliable partner. Bolivia confirms what the DAC donor evaluation in seven other countries found, namely that “donors underestimated the political risks (while setting up a budget support program” (IDD and Associates 2006).

In Nicaragua, the content of the PAM was the result of extensive negotiations; first among donors, and then between donors and government. But it was only loosely linked to the PRSP. In Honduras, many of the conditions in the PRSC come out of the PRSP or are at least consistent with it, but other conditions are also included (e.g. the requirement of a Civil Service Law).

Turning to sector budget support, these agreements suffer from many of the problems described above in relation to SWAs and common funds. Also in this case, donors have generally found that PRSPs are not specific enough to provide the basis for a sector budget support program. Equally importantly, if PRSPs do not reflect the priorities of (current) administrations, then just aligning conditions to the PRSPs is not enough to guarantee government ownership of an agreement. The sector plans may be the initiative of the governments in power at the time they are negotiated, but this does not ensure continued support for the ideas on which they are based. The EC's PASAAS program in Bolivia, for example, was created to support a new policy framework for the water sector, but parts of this framework were abandoned when the Morales government entered office.

Another way of looking at ownership in general and sector budget support programs is to examine the nature of the policy conditions of the policy matrixes. If conditionality is focused on *processes* (policies, measures, and actions), it means that donors have come up with the prescriptions and do not give much leeway for the recipient governments to elect their own ways of reaching an objective. Conditionality in the form of *results-based* targets and indicators is more compatible with ownership, in principle, because donors limit themselves to defining goals and allow the country the freedom to choose its own measures and policies. Defining results-based indicators and targets also carries risks, however. On the one hand, it can lead to data manipulation,<sup>5</sup> and on the other hand it can lead to difficult assessments and decisions because it is not always possible to establish a direct relationship between government efforts and results.

In this area, we observe that there are more results indicators now as compared to before 2000 when these indicators were practically non-existent. Most sector and general budget support programs now have a good number of results-based indicators. The official policy of the EC is to only have result indicators of performance, but in practice this is not always the case. At the same time, however, the number of process indicators (required policies, actions, and measures) has not decreased. All of programs and matrixes are full of policies and actions to be implemented. In general, the number of actions, measures, policies, and indicators has increased. This means there is still a great deal of detailed interference in policies.

Given that selectivity was not really applied and that budget support agreements are not necessarily aligned with government priorities, it is not surprising to find that there are many instances of non-compliance with conditions. In general, Nicaragua has a tradition of approving policy conditions when there is a great deal of pressure from donors, but afterwards it tends to accept, accommodate, or approve setbacks or exceptions, or invent other ways of not completely implementing the things that it committed to do.

In Honduras, the most visible case of non-compliance is the Civil Service Law that the Congress had to pass so that the second phase (second year) of the 2004 PRSC could be

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<sup>5</sup> One government representative interviewed for this study said that if donors kept insisting on results indicators, it would force the government to deceive the donors.

approved. The government was able to draft the law (condition for the first phase), but Congress did not pass it. The World Bank then did not disburse the second phase and instead negotiated a new PRSC 2, which only introduces some pilot projects for establishing merit-based administrative careers, based on an already existing law.

In Bolivia, there have been many instances in which the country did not meet the conditions of budget support. The response of the donors has varied: in some cases, they reduced the amounts of their disbursements, as the IDB did in the fiscal sustainability program when the government did not implement reforms in the national social security system. In other cases, donors adjusted and softened their conditions. The World Bank combined the two responses: it removed the conditions on the water and sanitation system in its SSPC 2, but at the same time, it reduced the amount of its commitment from \$25 million to \$15 million. The EC (PASAAS) disbursed less money than it had planned on its variable tranche in 2006 due to lack of compliance with some targets in 2006. But this money is not lost and can be disbursed at the end of the program. Furthermore, the EC negotiates each year on new targets and has proven to be quite flexible in adjusting them when the government has been unable to meet the goals that it played a major role in setting during negotiations the previous year.

## **5. Conclusions**

Data on aid by modality is limited in Bolivia, Nicaragua, and Honduras, but available information suggests that there has not been a systematic increase in budget support since the start of the PRS process. There are a number of reasons why more aid has not moved to budget support. The lack of an accepted PRSP or an agreement with the IMF has been a barrier at some points. Lack of interest in budget support among some donors (e.g. Honduras) and in the national government (e.g. President Morales in Bolivia) is another explanatory factor. The agreements have also proven difficult and time-consuming to negotiate. A number of the budget support agreements and common funds have had problems with disbursement due to lack of compliance with conditions, slow execution, changes in government policy, and/or lack of compliance with administrative procedures. This has led some country-office donor officials interviewed for this study to question the logic of moving too many resources into program aid.

The main argument for moving toward program aid and away from projects was that program aid would increase aid effectiveness by improving ownership, alignment, and harmonization. These Latin American cases show the national ownership and leadership of the aid process as envisioned in the Paris Agenda remains limited, even in the context of program aid. PRSPs and many sector plans (few of which spring from the PRSPs) are not solely government initiatives; donors often play a large role in shaping them, which can undermine ownership. Even when there is ownership by one government, subsequent administrations rarely choose to accept the strategies, plans or policy matrixes of previous governments as their own unless there is a very strong incentive to do so. This means that national ownership of the agreements goes down over time.

When government support wanes, donors have a number of choices. They can take the initiative and convince entering governments to give priority to an existing program (at the expense of government leadership). They can be flexible and adjust to new government priorities (at the expense of continuity and possibly of results), or they can stop aid programs prematurely (at the expense of disbursements). None of the three options is attractive, but the last is particularly difficult for donors. It is most common, therefore, to find donors looking for ways to push the continuity of agreements and being flexible with government's changing

interests and/or non-compliance with conditions. In practice, there is a delicate balance between government leadership and alignment with national priorities on the one hand and continuity and development results on the other hand.

There is fair extent of alignment to national systems in budget support or sector budget support in these three countries, but in these programs there is little harmonization among donors. In SWAps and common funds, there has also been progress towards use of national systems. Nonetheless, these modalities retain characteristics of projects in many cases – with independent execution units and/or many different procedures required by the involved donors. The degree of donor coordination in program aid varies a lot – from budget support agreements with most main donors to agreements with a single donor. Coordination involves high upfront costs, but has more potential to reduce costs for governments later. New donors to the countries – Venezuela, Cuba, the Millennium Challenge Account – are not involved in coordination efforts. The Nicaraguan and Bolivian governments have turned to Venezuela and Cuba to fund flagship new programs, which means that the center of political attention is not in the multi-donor programs.

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