

Evaluation of Poverty Reduction
Strategies in Latin America – 2005

Budgeting for Poverty Reduction



Preface

The poverty reduction strategy responds to a legitimate concern for the problem of persistent and high poverty in many developing countries. The PRSPs intend to reduce poverty through a participatory, long-term, and result-oriented strategy that seeks to bring together both government and civil society in finding solutions to the country's poverty problems. The commitment of the donors is to support the strategy with resources and debt relief.

The Swedish International Development Cooperation Agency, Sida, has requested the Institute of Social Studies (ISS) in The Hague, to monitor and evaluate the PRSP processes in the three Latin America countries eligible for debt relief: Bolivia, Honduras and Nicaragua. The study will be carried out over a period of 5 years, beginning in 2003.

Each year five reports will be elaborated, including three country reports, one regional report and a thematic report. The country reports to be submitted in 2005 provide an update of the progress with the PRSP process in terms of strategy definition and implementation. This year specific attention is paid to the budgeting process in relation to poverty reduction policies and the problems countries are facing in making the budget process more transparent and more results-oriented. The analysis of the country reports is supported by a detailed and systematic stakeholder analysis, including the stock taking of local actors through visits to several municipalities in the three countries. A comparative analysis of the experience in the three countries is presented in the regional report, highlighting lessons to be learned for governments, civil society and the donor community. The thematic report for 2005 focuses on the potential of result-oriented budgeting in the case of basic and secondary education.

The five reports aim to make a contribution to existing evaluations of the PRSP process through the regional focus and an impartial assessment of the PRSP, resulting from the ISS's complete independency in the process of design, implementation and financing of the strategies.

All reports can be downloaded from the following website: <http://www.iss.nl/prsp>.

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Glossary

ANB	Aduana Nacional Boliviana (Bolivian National Customs)
CAF	Corporación Andina de Fomento (Andean Development Corporation)
CAFTA	Central American Free Trade Agreement
CC-ERP	Consejo Consultivo de la Estrategia de Reducción de Pobreza (PRS Consultative Council)
CGE	Contaduría General del Estado (National Comptroller and Auditor)
CGR	Contraloría General de la República (National Comptroller and Auditor)
CSO	Civil society organization
DfID	United Kingdom Department for International Development
DNBP	Diálogo Nacional Bolivia Productiva (National Dialogue for a Productive Bolivia)
EBRP	Estrategia Boliviana de Reducción de Pobreza (Bolivian PRSP)
END	Estrategia Nacional de Desarrollo (National Development Strategy)
ERCERP	Estrategia Reforzada de Crecimiento Económico y Reducción de Pobreza (Enhanced Strategy for Economic Growth and Poverty Reduction)
FHIS	Fondo Hondureño de Inversión Social (Honduran Social Investment Fund)
FOSDEH	Foro Social de la Deuda Externa y Desarrollo de Honduras (Social Forum for External Debt and Development in Honduras)

FRP	Fondo de Reducción de Pobreza (Fund for Poverty Reduction)
FSLN	Frente Sandinista de Liberación Nacional (Sandinista Front for National Liberation)
GDP	Gross Domestic Product
HDI	Human Development Index
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IDB	Inter-American Development Bank
JFA	Joint Financing Agreement
KfW	Kreditanstalt für Wiederaufbau (German Financial Cooperation)
kWh	Kilowatt hours
IMF	International Monetary Fund
M&E	Monitoring and evaluation
MCA	Millennium Challenge Account
MDG	Millennium Development Goal
MDCS	Mecanismo Departamental de Control Social (Departmental Social Control Mechanism)
MEFF	Marco Estratégico para el Fortalecimiento de las Finanzas Públicas (Strategic Framework for the Strengthening of Public Finances)
MHCP	Ministerio de Hacienda y Crédito Público (Ministry of Finance and Credit)
MNCS	Mecanismo Nacional de Control Social (National Social Control Mechanism)
MPBS	Multi-donor Program for Budget Support
MTEF	Medium Term Expenditure Framework
NPV	Net present value
PBCS	Plan Bolivia Competitiva y Solidaria (Plan for a Competitive and Supportive Bolivia)
PLC	Partido Liberal Constitucionalista (Liberal Constitutionalist Party)
PND-O	Plan Nacional de Desarrollo Operativo (Operational National Development Plan)
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and social impact analysis
ROB	Results-oriented budgeting
SIAFI	Sistema Integrado de Administración Financiera (Integrated System for Financial Administration)
SIERP	Sistema de Información de la Estrategia de Reducción de la Pobreza (Information System for the Poverty Reduction Strategy)
SIGMA	Sistema Integrado de Gestión y Modernización Administrativa (Integrated System for Management and Administrative Modernization)
SIN	Sistema de Impuestos Nacionales (National Tax System)
SISER	Sistema de Seguimiento y Evaluación de la Gestión Pública por Resultados (Monitoring and Evaluation System for Results-Oriented Management)

SMS	SIGMA Municipal Simplificado (Simplified SIGMA System for Municipalities)
SSPSAC	Social Sectors Programmatic Structural Adjustment Credit
SUMI	Seguro Universal Materno Infantil (Universal Maternal and Child Insurance)
SWAp	Sector-wide approach
TGN	Tesoro General de la Nación (National Treasury)
UDAPE	Unidad de Análisis de Políticas Económicas y Sociales (Unit for the Análisis of Political and Social Policies)
UN	United Nations
UNAT	Unidad de Apoyo Técnico (Technical Assistance Unit)
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WB	World Bank

1. Introduction

In 1999, the elaboration of poverty reduction strategies (PRS or PRSP for the related document) became the prime conditionality for low-income countries attached to their eligibility for receiving debt relief. The new approach would ensure a focus on poverty reduction in the policies of the beneficiary countries and was also expected to serve as a framework for better coordination of development assistance among donors. By giving operational frameworks to governments to set development priorities and targets (more recently harmonized through the Millennium Development Goals), it was hoped to obtain the necessary political commitment and accountability from governments and donors alike. The PRS core principles are that the strategies should be country-owned, comprehensive and results-oriented, medium and long-term in perspective and oriented at strengthening partnerships between government, domestic stakeholders and external donors. International commitment to this agenda has increased, as reflected in increased flows of development assistance since 2002 and recent commitments made at the G-8 summit in July 2005 to further enhance aid flows and facilitate more debt relief for poor countries, including cancellation of multilateral debt.

Since 2003, the Institute of Social Studies (ISS), commissioned by the Swedish International Development Cooperation Agency (Sida), has evaluated the process in three of the poorest Latin American countries, Bolivia, Honduras and Nicaragua (see ISS 2003a-d and ISS 2004 a-d).¹ The assessments made in 2003 and 2004 did not sketch a very bright picture. Political problems in these three countries hampered progress towards achieving the broad objectives along the stated PRS principles and, most importantly, towards more effective poverty reduction. The assessment also pointed at the possible intrinsic problems with the approach when applied in contexts of initially weak governance and very weak institutions to carry a large and comprehensive agenda. While the three countries set in a broad-based participatory process to discuss the core issues to be dealt with in the strategy, the PRS process – promoted with enthusiasm by the donor community – created high expectations, led to major frustrations among civil society organizations and stakeholders and failed to generate national ownership of the strategy. It proved particularly difficult to come to proper priority setting, no matter the quality of the technical tools that were provided in support of the proc-

¹ All reports are downloadable from <http://www.iss.nl/prsp>.

ess. In Bolivia and Nicaragua it is not just that very little national ownership has been created, but to some extent the PRSP process itself has become much discredited among key stakeholders, and there is very little government commitment to implement the envisaged policies, at least not under the PRSP flag.

This picture is clearly less optimistic about the PRS process than the conclusions of the recent IMF/World Bank Review of the PRS approach (World Bank and IMF, 2005), which lists certain shortcomings in the implementation of the approach, but sees that “the principles underpinning the PRS approach provide a useful framework for translating mutual accountability into concrete terms, and for achieving sustainable development results at the country level” (ibid: p.3). The report concludes further (ibid.: pp. 3–5) that the PRS approach has contributed, among other things, to:

- enhancing domestic accountability in many countries by prioritizing development goals and establishing more explicitly links between poverty reduction policies, annual budgets and a medium-term expenditure framework (MTEF);
- increased attention to improving national monitoring systems;
- more space for stakeholders to engage in national policy dialogue on economic policy and poverty reduction;
- increased external accountability of governments vis-à-vis donors, thanks to improved financial management and results-oriented definition of policies and budgets; and
- greater commitment of donors in providing coordinated, predictable aid that is harmonized and aligned to country priorities.

Also in the cases of Bolivia, Honduras and Nicaragua we have reported progress in all these areas, but for some reason it does not seem to add up to a dynamic process of institutional change and, most importantly, we have no evidence of more effective poverty reduction. In fact, the PRS process in Bolivia and Nicaragua has become rather discredited amidst political turmoil. There are more positive signals from Honduras since early 2004, as the PRS process itself has gained momentum, yet none of this is at yet on firm ground and also here evidence of reaching poverty reduction goals is absent. The PRS core principles are undoubtedly meaningful. Yet, the experience in the three Latin American countries leads us to question of the practicality of these principles given the political realities of these countries.

In Section 2, we give an update of recent developments in relation to the PRS process in the three countries through early fall 2005 and raise the critical question as to whether this approach is still useful for the cases in hand. The short answer is that in Honduras it clearly is, but that much more is needed to show visible results. Bolivia and Nicaragua need to seriously review their PRS process, but this will most likely only be feasible and effective after having settled their political woes. In Section 3, we address at some length the issues of domestic and external accountability by assessing the progress the three countries have made in improving their budgeting systems. We examine to what extent governments and donors are putting money where their mouth is, that is, to what degree do the PRS objectives get translated in effective budget allocations? We sum up the main conclusions and recommendations in Section 4.

2. Where do we stand with Latin America's PRSPs and where to go?

2.1 Has the PRSP process already outlived itself?

It is more than tempting to raise this question. The great expectations with which the PRSP framework was introduced in 1999 for the highly indebted poor countries (HIPC) have not been fulfilled, not even close, in the cases of Bolivia, Honduras and Nicaragua. As concluded in the 2003 and 2004 reports, it has not brought country-owned poverty reduction strategies and the broad-based consultation processes around the PRSP have yielded frustration with civil society actors rather than enhanced social consensus. In Bolivia, in fact, it appears there is no longer an official PRSP: the original PRSP has for all practical purposes been declared “dead” and has not been replaced by a new PRSP-like plan. In the case of Nicaragua, the national development plan (PND-O) developed under the Bolaños government acted as a substitute PRSP for a time, after the government distanced itself from the original strategy. The PND-O was never put forward officially as a replacement of the original PRSP, however, and in 2005 the Nicaraguan government presented yet another revised strategy – the *Plan Nacional de Desarrollo para el Crecimiento Económico y Reducción de la Pobreza 2005–2009*. This appears to have been accepted by donors as a revised PRSP, though consultation with civil society, the international community, and even within the government was uneven. Only in Honduras has the PRSP process gained momentum, reaching HIPC completion point in April 2005 and with PRSP related resources flowing since 2004 (see Table 1). As the three countries have received the debt relief under HIPC terms, they should be ready to make a head start with what are sometimes called “second-generation PRSPs”, that is poverty reduction strategies which are not produced as part of external conditionality to obtain debt reduction. But, are the countries in a good position to make such a head start?

The three countries have obtained the debt relief promised under the enhanced HIPC-II terms with Nicaragua having received most, i.e. US\$ 3.3 billion in net present value terms (or US\$ 4.5 billion in nominal debt reduction; see Table 1).² From 2003 onwards this has brought visible relief in terms of reduced debt servicing obligations, as Table 2 shows. The same holds for Bolivia and Honduras, even though the absolute amount of debt reductions is less. They are also eligible for further debt

² The data in Tables 1 and 2 regarding debt relief are per June 2005 as recorded by the IMF. These figures tend to be subject to adjustment and may show some discrepancy with data as published by the countries themselves. In broad terms they do provide the same order of magnitude.

relief following the agreement at the G-8 Summit in Gleneagles in July 2005. This would involve cancellation of multilateral debt of the IMF and World Bank, though not that of the Inter-American Development Bank (IDB), a major creditor to the three countries. The precise terms of the debt cancellation promised at the G-8 summit still need to be fleshed out. Potentially, this could imply an additional debt reduction for Honduras and Nicaragua of more than US\$ 1 billion (nominal terms). The precise benefits in terms of additional resources cannot be established yet, as it will also depend on whether the debt relief will (in part) be financed through existing aid budgets. The key question for the poverty reduction effort is to what extent the countries will be able to channel additional resources into activities that are consistent with a poverty reduction strategy.

The resource bases of the governments in the three countries are currently further supported by a recovery of economic growth along with a strengthened performance of the global economy (Table 3). After slow and dismal growth in the first two years of the new century, growth rates are back to GDP growth in the 4–5% range per annum, which amounts to 1.5–2.5% in per capita terms. This is still much below required per capita income growth of 3.6% (with unchanged income distribution) to achieve the MDG of extreme poverty reduction by 2015, as we discussed in the 2004 evaluation (see ISS 2004a: pp. 37ff). The recent recovery of growth should further be seen in the light of a history of strong volatility (see Figure 1) and there have been no structural changes in the three economies which might make one assume that there will be any less volatility in the near future.

Table 1 Status of PRSP's and HIPC Initiative in Bolivia, Honduras and Nicaragua, per August 2005

	Bolivia	Honduras	Nicaragua
HIPC and PRSP Status			
HIPC A Decision Point	February 2000	July 2000	December 2000
HIPC A Completion point	June 2001	April 2005	January 2004
Approval date of original PRSP	June 2001	October 2001	September 2001
Status of PRSP	No official PRSP at the moment. New PRSP to be formulated and presented. Progress Reports: Several produced regarding original PRSP; now stalled due to uncertainty around strategy	PRSP being implemented. Progress reports: 1st - Feb. 2004, 2nd - March 2005	PND-O not accepted by donors as PRSP. New PRSP-like plan presented in 2005 .. Progress Reports: 1st - Dec. 2002; 2nd - Jan. 2004; 3rd - Jul. 2005
Debt relief			
Amount of debt relief under HIPC (US\$ billion)*			
- Reduction in NPV terms	US\$ 1.3	US\$ 0.6	US\$ 3.3
- Reduction in nominal terms	US\$ 2.0	US\$ 1.0	US\$ 4.5
Other external funding for PRSP			
Poverty Reduction Growth Facility (PRGF), IMF	Pending IMF Stand-by loan (April 2003, Third revision completed with extension until 2006)	Feb-04 2nd revision concluded	Dec-02 6th revision concluded
Poverty Reduction Support Credit (PRSC) and other World Bank assistance	No PRSC, but SSPSAC (2004)	US\$ 0.6 June 2004	US\$ 0.7 Jan. 2004
Millennium Challenge Account (USA)	Pending	June 2005	June 2005
Committed amount from MCA (US\$ billion)	-	US\$ 0.215	US\$ 0.175

Note: *Refers to Enhanced HIPC-II, as per June 2005. Data for Bolivia also include debt relief under original HIPC initiative.

With the debt relief in combination with substantial aid inflows, gradually more fiscal space should become available to finance the poverty reduction strategies, although some of that space may be washed away from time to time because of the volatility in GDP affecting the stability in tax income. Also, macroeconomic stability objectives may further limit space being freed up for enhanced spending on poverty-reduction

programs, as in Nicaragua, where part of the external debt relief went to the servicing of *domestic* public debt and strengthening of the international reserve position. However, the first concern in the three countries is not so much with the availability of resources. Rather, it is with the political conditions which are bleakening the prospects of getting to a coherent PRS. In Bolivia this goes to one extreme as the PRSP has become a much discredited plan amidst all political instability, such that even how one labels the efforts to poverty reduction has become a politically sensitive issue. More to the point, reaching broad-based consensus around a more or less coherent strategy is too much asked in a situation of social conflict and political fragility. Thus the question emerges how many of the PRS principles one should forego in such a context and whether it is meaningful to push for the (entire) PRS agenda? The answer to this question will differ from context to context. So, before reaching any conclusion, we will review first the situation regarding the PRS process in each of the three countries. We discuss the political outlook first then provide an update of observed trends in poverty reduction and finally discuss the role of donors in supporting the PRS process.

Table 2 Bolivia, Honduras and Nicaragua: External debt service after debt relief (US\$ millions and %)

	Average 1998–99	2000	2001	2002	2003	2004 (prel.)	2005 (proj.)
Bolivia							
Debt service paid	319.7	268.3	260.5	274.9	374.0		
Debt service due after HIPC relief						321.8	342.1
Debt service/exports (%)	23.8	18.3	17.1	17.6	20.0	13.2	12.7
Debt service/government revenue (%)	15.9	13.7	14.1	15.6	21.8	15.3	15.5
Honduras							
Debt service paid	275.5	214.3	171.2	215.5	236.6		
Debt service due after HIPC relief						201.7	147.8
Debt service/exports (%)	11.6	8.6	7.0	8.6	9.7	8.0	5.5
Debt service/government revenue (%)	27.3	20.4	15.1	18.4	18.8	14.2	9.7
Nicaragua							
Debt service paid	200.2	184.7	153.3	158.0	92.9		
Debt service due after HIPC relief						83.2	107.6
Debt service/ exports (%)	24.1	19.4	16.2	17.4	9.3	6.9	6.9
Debt service/government revenue (%)	36.5	23.3	20.1	19.6	10.5	8.6	10.2

Source: IMF. HIPC Statistical Update, April 2005. Data are till mid-March 2005. Hence, the data do not include Honduras' additional relief obtained after reaching completion point in April 2005.

Table 3 Bolivia, Honduras and Nicaragua: GDP growth (%), 2001–2004

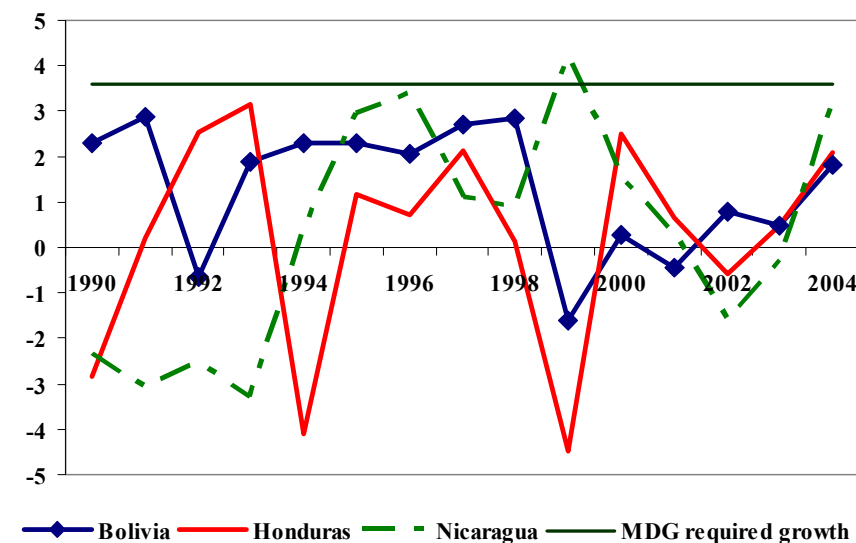
	Bolivia	Honduras	Nicaragua
2001	1.2	2.6	3.0
2002	2.5	2.7	0.8
2003	2.5	3.2	2.3
2004	3.8	4.6	5.1

Source: World Bank data for Bolivia and Honduras and Central Bank data (national accounts) for Nicaragua.

2.2 Political uncertainty, ownership and consultation

Our 2004 report emphasized that national political problems formed one of the major obstacles to getting to viable poverty reduction strategies and, more importantly, to getting them implemented.³ Events during 2005 have deepened rather than resolved the political woes of Bolivia and Nicaragua. In contrast, in Honduras the PRSP process gained impetus during 2004 after having witnessed initial delays, the government took strong commitment to implement the poverty reduction strategy, the HIPC completion point was reached in April 2005 and access to the US Millennium Challenge Account resources was obtained in May 2005. The upcoming presidential elections create some uncertainty around the continued government commitment around the PRSP process, but the outlook certainly looks brighter in Honduras than in Bolivia and Nicaragua in this respect.

Figure 1 GDP per capita growth (% annual), 1990 – 2004



Source: World Bank, WDI, 2004; and Central Bank – Nicaragua.

Note: “Minimum growth for the MDG” is the minimum level of sustained growth required (from 2002 on) to achieve the millennium development goal related to halving extreme poverty by 2015. It was calculated by CEPAL (2003a) as the average for the countries of the region with the highest poverty incidence in the late 90s. As explained in ISS (2004a), that minimum should be probably higher for Bolivia, Honduras and Nicaragua.

Bolivia

Government officials in Bolivia already had declared the PRSP to be dead in 2004 (see ISS 2004b, 2005a). Political turmoil has continued since 2003 culminating in the resignation of president Mesa in June 2005, following new waves of social unrest. The president of the Supreme Court, Eduardo Rodriguez, was eventually elected by congress to become the new president and lead the country to new elections in December 2005. This choice of president, unlike some alternatives, has helped stabilize the political situation, but what political direction the country will take after the elections is a wide open question, as favoured presidential candidates come from quite different segments of society. The political crisis manifested both huge regional and social chasms.

³ See ISS (2004a: 12ff.).

Poor farmers and other producers in the highlands and areas around Cochabamba protested (organised in a variety of social movements and under leadership of Evo Morales) against the lack of structural government support for changing their gloomy productive prospects and demanded more state control of natural gas production and exports and a fairer distribution of the revenues. Natural gas production along with more profitable large scale export farming is largely concentrated in the more prosperous and dynamic lowland areas of Santa Cruz and Tarija.

Santa Cruz wants autonomy along with the popular election of provincial governors, who are now appointed by the president. The social movements leading the protests overthrowing the Mesa government are willing to concede both. The row is over whether autonomy will come before the constituent assembly, allowing Santa Cruz to shield itself from its decisions. Most aspects of autonomy, such as empowering provinces to hire teachers, are relatively uncontroversial. The nub of the dispute is control of oil and gas, which as said lie in the richer eastern provinces, and of land. The social movements, divided amongst them as they may be, are determined to use the constituent assembly to redistribute the vast latifundia that belong to Santa Cruz's "oligarchy". Influential Cruceños, equally determined to stop them, have said that if the government does not call an autonomy referendum they will hold their own. The protests against the government cannot hide the severe deterioration in the social cohesion of the country. The prospects for future broad-based popular support for a common poverty reduction agenda are bleak, and the political fragility also could endanger the future of Bolivia as one single nation.

Amidst the evolving but fragile political situation the new National Dialogue for a Productive Bolivia (DNBP) was conducted in 2004, in compliance with the Ley de Diálogo Nacional, which requires that national dialogues take place at least once every three years. The DNBP was designed to discuss how to support productive activities in Bolivia, in the spirit of "creating wealth" rather "reducing poverty". The shift in emphasis away from the social services and social assistance themes of the original PRSP satisfied many actors who were left frustrated after the experience with the EBRP.

The dialogue took place at three levels and was preceded by a pre-dialogue to inform participants of the dialogue process. At the first level about 60,000 people participated in meetings in the 314 municipalities. Second, stakeholders met at the departmental level in all 9 departments. Third, the Dialogue also brought together representatives of the government, business groups and civil society organizations at the national level. The main vision coming out of the dialogue at the municipal level was that the fight against poverty should be based on the promotion of economic growth through support to productive activities, giving a prime role to local economic development, whereby municipalities should play a critical role in defining which priority activities should be supported. The discussions at the departmental and national level were more concerned with broader national issues, in particular the distribution of natural resource revenues and how departments (or regions) should position themselves in the debate about the Asamblea Constituyente (constituent assembly).

Parallel to the DNBP, the government of then president Mesa prepared a plan for a competitive and equitable Bolivia (Plan Bolivia Competitiva y Solidaria, PBCS), which puts the local economic development strategy in the context of broader spatial economic development at the

forefront. This Plan has elements similar to the national development strategy (END) prepared in January 2005 and contains many elements that were also part of the revised PRSP presented to the donor community in October of 2003. END was criticized for not incorporating the outcomes of the DNBP, but by the time this might have been done in March 2005, the escalating social and political conflict led to a cabinet change and END was shelved. From April 2005, the Mesa government elaborated the PBCS which contained the policies for productive development in line with END and the DNBP, combined with social policies emphasizing social safety net programs (targeted cash transfers, subsidies, and alike), but falling short of a more structural approach to human development. The PBCS was presented in May 2005 without any feedback to the actors of the Dialogue. The plan subsequently failed to make any impact due to the ensuing political crisis.

The DNBP repeated many of the mistakes of past dialogues by generating great expectations which the country will be unlikely to meet in any foreseeable future, adding to the lack of credibility of the government in living up to commitments and addressing what people perceive to be their main problems. This new frustrating experience is likely to jeopardize future national dialogues, as now in two successive occasions a broad-based dialogue process has failed to pave the way for a strategy building on social consensus. While the Dialogue has failed as an instrument for the design of effective poverty reduction policies, it has helped to strengthen a range of social organizations, particularly those participating in the pre-dialogue and in the municipal meetings. They were able to develop clearer views on the development of the country and their own position in it. It clearly did not help to get to greater consensus about poverty reduction policies and priorities.

Where does this leave Bolivia's PRS process? Insisting on a revision of the original PRSP, or at least labelling a plan this way, may be counter-productive, given the political sensitivity around the frustrated initial PRSP process and the frustrations among social actors after the 2000 and 2004 National Dialogues. Picking up on the various plans developed since 2000 may provide an organizing framework for on-going poverty reduction policies, but probably would not alter existing policies in practice.

One could reasonably argue that the PRS process has not hampered continuity of existing social and anti-poverty policies. In fact many of the policies contained in the original PRSP had been established much earlier, such as the education reform, the child and maternal health care program, and also the universal health insurance for child and mother care (SUMI). Also the emphasis on urban and rural development and social infrastructure projects, executed through the municipalities, has its origins well before the PRSP. In this sense, the PRSP and the PRS process have not added much value. Probably the main heritage of the PRSP process has been the distribution of (most of the) HIPC funds to the municipalities which is being adhered to despite the country's political woes. Also, the mechanisms of social oversight of government resources and activities (at the national level) have been established as part of the PRS process, building on existing experiences at the local level. The effectiveness of these mechanisms at the national level has thus far been very limited.

In sum, one could argue that, Bolivia did not need a PRSP to do what it has done since 1999. On the other hand, as we shall see below, what has been done falls well short of what is needed to reduce poverty in any significant way, let alone what is needed to meet the MDGs.

Honduras

In contrast to Bolivia, the PRSP process in Honduras gained impetus since 2004. Renewed steps were taken towards operationalizing the PRSP next to the implementation of a range of public sector reforms and measures to achieve greater fiscal discipline (essentially by trying to control public sector wages). Further, Honduras ratified the Central American Free Trade Agreement (CAFTA) with the United States as one of the first member states despite strong social protests. The policies oriented towards more fiscal discipline also encountered heavy protest, particularly from trade unions, which led to certain concessions by the government allowing some wage increases (ISS 2004c). During both 2004 and 2005 growth rates of more than 4% per annum have been or are expected to be achieved, which has further helped the country stay on track with macroeconomic and fiscal targets. Also, economic recovery has been favourable to the strengthening of the PRSP process. The government has been showing its commitment to support the PRSP process and reforms have been introduced to make allocations for the poverty reduction strategy explicit (and ruled by law) in the national budget. These policy moves contributed to reaching the completion point to qualify for HIPC funds (in April 2005) and to gain access to funds from the Millennium Challenge Account (in May 2005).

To reduce possible uncertainty regarding the continuity of the PRSP during and after the electoral process (presidential elections are to be held in November 2005), high-ranking government officials and representatives of the multilateral donors have met with the two main candidates to explain what they see as the risks of diverging from the current path, from the agreement with the IMF and the conditions attached to the Millennium Challenge Account resources. Both candidates, perhaps not surprisingly, confirmed their commitment to the poverty reduction strategy. Time will tell how much this promise will mean in practice. However, clearly at the level of government one can speak of continuity. Naturally, this commitment is also tied to the promise of greater access to external resources and debt relief.

The actual reforms that have been undertaken, as well as core components of the PRSP, are oriented at greater macroeconomic stability and stimulating economic growth. It is far from obvious that the envisaged growth strategy will be pro-poor, with much emphasis on infra-structural investment most of which is not directly targeted at the poor. Growth recovery as of yet has not translated into a visible reduction of income poverty⁴ and unemployment and informal sector employment have in fact increased. Only in specific social sector areas has there been clear progress with interventions aimed at the poor, such as the program improving the poor's access to health care, the education reform and a targeted cash transfer program providing a (very modest) income support to the poor of 80 lempiras (or US\$ 4) a month to electricity customers consuming less than 100 kWh per month. Hence the government's main commitment appears to lie with the macroeconomic stabilization program, but has extended this to a commitment to strengthen civil society participation in identifying poverty reduction projects and protect spending on social programs. Much of the new poverty-reduction efforts consist of rather specific projects, as also all donor support is provided in the form of project aid, and does not contribute to a more comprehensive strategy.

⁴ This trend can be found in the INE Household survey data and UNDP's Millennium Development Indicators and Human Development Indicators. See section 2.3.

Nonetheless, it can be argued that government support of the strategy has led to an enhanced sense of government ownership by the present administration led by President Maduro, and possibly to be taken over by his successor. In this sense, in the case of Honduras the PRSP process is pretty much alive and moving forward. Also, consultations with civil society representatives regarding the PRSP process broadened further during 2005, involving more meetings and more organizations. However, civil society groups remain divided about the orientation of the PRSP and about the participatory nature of the consultation process. Several groups not directly represented in the Consultative Group for the PRSP (even after an increase of civil society members in this group from 5 to 12 in December 2004) have complained about weak communication channels and those who do participate directly complain they are unable to engage in a more comprehensive discussion about economic and social reforms required to reach what they believe to be a more effective poverty reduction strategy (FOSDEH, 2004). In this sense it could be argued that there has not been much improvement in terms of gaining more “national ownership” of the strategy. However, this would sell short the renewed efforts made during 2005 to involve the participation of civil society in identifying priority projects for the use of the HIPC funds. Civil society groups have played a prominent role in decision-making about priority social projects and the “regionalization” of the poverty reduction strategy. Since 2002, DFID, Trocaire, FOSDEH and ASONOG⁵ have organized participatory processes to analyze the regional impact of poverty reduction programs and this assessment was completed in 2004. On this basis the Consultative Group for the PRSP decided to opt for a geographically targeted implementation of the PRSP whereby at the regional level (defined as combinations of municipalities and ‘mancomunidades’) civil society actors (organizations formally registered as such) will be enabled to indicate priorities during the selection of projects financed by HIPC resources. The intention is to make the implementation of the PRS more demand-driven and participatory (see Section 3.3 for further details on this process). This process might help to improve the sense of ownership of the poverty reduction strategy among broader groups of society.

Nicaragua

During 2005, political problems – manifested in clashes between the executive, parliament and judiciary branch – have put the poverty reduction strategy into the background. The PRSP essentially has been reduced to a platform for discussion between the government and the donor community. The original PRSP (now also labelled as ERCERP-I) built on a broad-based consultation process, but in the end failed to generate a broad-based national ownership (see ISS 2003d). The government of president Bolaños came with a new national development strategy (PND-O), which deviated in several ways from the poverty reduction in the original PRSP (ISS 2004d). While the government distanced itself from ERCERP-I, the donor community insisted the PND-O be turned into a revised PRSP or ERCERP-II. The PND-O was not rooted in circles outside the government and donor community and thus national ownership was even less than with the original PRSP. While there were interesting departmental and municipal level discussions about the PND-

⁵ DFID is the development agency for international development of the UK, Trocaire is an international NGO, FOSDEH is an NGO platform to discuss issues related to external debt and development of Honduras (*Foro Social de la Deuda Externa y Desarrollo de Honduras*) and ASONOG is the Association of NGOs in Honduras.

O and even efforts to create departmental-level development plans, a national debate on the poverty reduction strategy was missing. The PND did not achieve much in terms of actual policy making, and the government has proceeded to develop a third version of the PRSP, without any evaluation of why the PND did not move forward. This revised PRSP is informally labelled as ERCERP-III presented in 2005 to the donor community in the country. Once again so far this document has remained outside of wider national public debate.

Both ERCERP-II and III thus have come about without any significant formal national-level consultation process, but furthermore lack visibility in actual government policies. This way the PRSP seems to have become an instrument of communication with the donor community and not much else. Remarkably, the lack of a clear status of the PRSP has not become a bottleneck for obtaining donor support. The Poverty Reduction and Growth Facility (PRGF) provided by the IMF has been the framework for encouraging macroeconomic stability, but this is now officially off track. To date, the PRGF has ensured continued support from the donor community, despite the uncertainty surrounding the status of the PRS.

Shifting policy orientations (at least on paper) are not confined to the PRSP. In fact in many areas the present Nicaraguan government has switched gears in short periods of time in important areas of public sector reform. For instance, it introduced no less than four tax reforms, including a law of “fiscal equity”. However, none of these reforms have been properly evaluated in terms of their effectiveness in reducing poverty.

During 2005, it has become increasingly unclear what to expect from the present government, and with the current outlook policies unlikely are to gain in coherence and stability. The executive, legislative and judiciary powers of the state are in a stalemate and the president is under a continuous threat of being impeached by the major opposition parties (PLC and FSLN) based on accusations of electoral fraud. The president, in turn, has been threatening members of parliament to return the favour and accuse them of illegal actions. With this political time bomb undermining decision making for long term development, it will not be very productive to press at this point for renewing the PRSP until this bomb has been dismantled. A provisional political cease fire was achieved early into the final quarter of 2005 as the president forged an unexpected, yet fragile coalition with the FSLN, but which has helped ease political tensions. It has allowed, among other things, for the ratification by parliament of Nicaragua’s insertion into CAFTA, despite the controversy the free trade agreement had stirred regarding its potential (or lack thereof) to promote the country’s growth and poverty reduction prospects.⁶

2.3 Is poverty being reduced?

With all complications in implementing the PRSPs, one would not expect much in terms of achieving poverty reduction targets. Yet even with the PRS process in limbo in Bolivia and Nicaragua, actual policies in place do include a range of existing poverty reduction programs and HIPC resources are being allocated for new programs. Meanwhile in Honduras, despite a stronger average performance in terms of aggregate economic growth and general support for the PRS process, there has been very little progress in poverty reduction.

⁶ See Sánchez and Vos (2005) for an in-depth general equilibrium analysis of the potential impact of CAFTA on growth, employment and poverty in Nicaragua.

Bolivia is clearly “off track” for reaching most of the MDGs. Only in the cases of reaching education targets (including gender equity in access to schooling) and improving coverage of basic sanitation is the country making sufficient progress, such that with unchanged trends the MDG could be reached by 2015.⁷ While the government has made improved efforts to monitor MDG achievement (see UDAPE 2005 and UDAPE/CIMDM 2005), these monitoring exercises are not accompanied by much analysis of why so little progress is being made in achieving the poverty reduction targets. This weakness is also reflected in a lack of result-orientation in the budgeting process, as we will discuss in Section 3.2.

Most studies coincide that the income poverty target (MDG-1) will be hard to achieve for Bolivia in any foreseeable future (see ISS 2004a for a summary), requiring growth rates well above historical patterns and/or substantial income redistribution. Over the past decade, aggregate growth has been slow and volatile and well below required levels. Income inequality has been on the rise, rather than declining and is politically sensitive. Difficulties at the municipal level to implement policies that will foster local economic development make it further unlikely that any significant income redistribution through a structural change in production will happen in the near future. A lack of sufficient, and more importantly, effective allocation of resources in health make it unlikely that the targets for child and maternal mortality reduction (MDG 4 and 5) can be reached. This despite the fact that, like the rest of the region, over the past forty years, Bolivia has made quite a bit of progress in improving child and maternal health, yet more recently progress has slowed and without additional efforts the given targets will not be met. The target for achieving universal basic education might also be within reach but will require a more effective use of resources, meaning more trained and less temporary teaching staff, more school infrastructure (to eliminate overcrowded class rooms and make sure also all rural primary schools offer all grades) and stimulate demand for schooling among the poor (for instance by expanding the school breakfast program).

Honduras has not made much visible progress in reducing poverty since the initiation of the PRSP process. At the current pace, the first MDG of halving extreme poverty by 2015 is unlikely to be met.⁸ Honduras continues to be one of the Latin American countries with the highest incidence of extreme poverty. According to the most recent UN progress report on MDG achievement in Honduras (UNDP, 2003), the country only seems to be on track to reach the targets for education, gender equality in schooling access, health (except child mortality) and access to drinking water. This assessment does not consider efforts in the last two years, but thus far the impetus has been towards growth and fiscal stability.

The growth-orientation of Honduras’ PRS does not seem to ensure an effective path to poverty reduction, and open unemployment and underemployment have risen since 2001. Budget priorities are now better protecting social spending, which could lead to improved social indicators in the years to come. Yet unsatisfied basic needs are vast and with important inequalities among social groups, rural and urban population and regions. The Human development Index deteriorated in a range of

⁷ Though the cost may be high, see ISS (2006a).

⁸ Extreme poverty fell from 47% in 2001 to 45% in 2002 to stabilize at that level in 2003 and 2004 (based on INE, Household Survey data). The overall poverty incidence (using a US\$ 2 per person, per day poverty line) has remained virtually unchanged since 2001 at around 64%.

departments, including Intibucá, Valle and Choluteca, while others show slight improvements, such as Copán, Santa Barbara and La Paz. At the national level the HDI did not change much, but showed a slight decrease from 0.672 to 0.657 (UNDP 2004). In urban areas, most households have access to drinking water (92%) and electricity (95%) while in rural areas only 73% have access to safe drinking water and 20% still use water from the natural sources, while 38% have access to electricity. The rural population also suffers the highest rates of illiteracy (27%), men and women alike.

Also for Nicaragua there is insufficient updated information to track poverty indicators. Information from the living standards survey conducted in 2005 is not yet available. Estimates of the World Bank suggest a decline in poverty and extreme poverty indices, but these refer to the period of high growth between 1998 and 2001. The UN data system for the MDGs, in contrast, reports an unchanged poverty incidence of 45% for people living on less than one dollar a day. Even if we take the World Bank estimates and calculate the elasticity of poverty reduction with respect to per capita income growth, the poverty incidence would have fallen by less than 1 percentage point between 2001 and 2004 considering actual growth in this period.

Completion rates in primary education are at about 70%; still far off the MDG target of 100%. Net enrolment rates for primary education have increased gradually from 72 to 82% between 1990 and 2001, nonetheless this is considered too slow to reach the millennium goal. Access to primary education is equal though for boys and girls alike. Data on births and child mortality are problematic, but from the information that is available, it appears that a substantial reduction in child mortality has already been achieved (from 68 to 38 per 1,000 live births between 1998 and 2003) and at this pace – assuming a linear trend – the MDG target of 22 child death per 1,000 live birth would be reached by 2015. Statistics on maternal mortality are not very reliable, but existing data suggest it may have increased significantly from already high levels (i.e. from 160 to 230 maternal deaths per 100,000 live births). About one-third of pregnant women do not receive any professional medical assistance at child delivery. Access to drinking water supply has improved though, covering 83% of the population in 2002 (up from 69% in 1990). Most of the increase in coverage has benefited rural areas (up from 42 to 65%), according to the UN database for the MDGs. At unchanged trends, Nicaragua would be on track for this goal (at least for the rural population).

Given the lack of sufficiently recent data it is hard to establish to what extent policies since the initiation of the PRS process have influenced these trends. However, the weakened economy since 2001 (until 2004) and slowness in the PRS process do not provide much basis for hope in this respect.

Table 4 Bolivia, Honduras and Nicaragua: MDG achievement

MDG	Target	Bolivia	Honduras	Nicaragua
1. Eradicate extreme poverty and hunger	1.1 Halve proportion of population with income less than 1\$ a day between 1990 and 2015	Little progress, off track	Little progress, off track	Little progress off track
	1.2 Halve proportion of people with hunger, between 1990 and 2015	Little progress, off track	Little progress, off track	Little progress off track
2. Achieve universal primary education	2.1 Ensure that all boys and girls complete primary school in 2015	Slow progress, probably on track	Slow progress, probably on track	Slow progress, probably off track
3. Promote gender equality and empower women	3.1 Eliminate gender disparities in primary and secondary education, preferably by 2005 and at all levels by 2015.	Progress, probably on track	Progress, probably on track	Progress, probably on track only for education
4. Reduce child mortality	4.1 Reduce by two thirds the rate of child mortality between 1990 and 2015	Slow progress, probably off track	Slow progress, probably off track	Progress, possibly on track
5. Improve maternal health	5.1 Reduce by three quarters the ratio of women dying during child birth between 1990 and 2015	Slow progress, probably off track	Progress, probably on track	No progress, probably off track
6. Combat AIDS/HIV, Malaria and other diseases	6.1 Halt and begin to reverse expansion of HIV/AIDS in 2015	Slow progress, probably off track	Slow progress, probably off track	No trend data
	6.2. Halt and begin to reverse expansion of malaria and other major diseases in 2015	Slow progress, probably off track	Progress, probably on track	Progress, on track (for tuberculosis)
7. Ensure environmental sustainability	7.1 Halve population without sustainable access to drinking water	Slow progress, probably on track	Progress, probably on track	Progress, probably on track only in rural areas
	7.2 By 2020 make significant improvement in living conditions of slum dwellers	Slow progress, probably on track	Progress, probably on track	No progress, probably off track
8. Develop a global partnership for development	8.1 In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries	Slow progress, probably off track	Not stated	Not stated

Source: MDG, UNDP.

2.4 Donor coordination and the PRSP process

The 2004 evaluation of the PRS process in the three countries noted that several concrete steps had been taken by donors during that year to come to better coordination of aid, more budget support (including multi-donor financing agreements) and strengthen the dialogue around sector programs that form part of the PRSP through the organization of roundtable meetings between donors and domestic stakeholders (see ISS 2005). It also concluded that the conditionality related to the aid flows and loans in support of the PRS remained an issue of concern, being conditioned at all times to a short-run agreement with the IMF on macroeconomic adjustment and continued 'micro management' of aid on the part of many donors. The first issue is seen as problematic by local stakeholders as it puts priority with short-term stability, rather than with the long-term goals of the PRS. The second is seen as a problem because of the large array of (often uncoordinated and donor-imposed) policy conditions governments have to comply with, undermining the sense of national ownership of the PRS. What has happened in this arena during 2004 and 2005?

Bolivia

Amidst all political uncertainty and governance problems, aid flows have continued to be forthcoming and HIPC resources have been transferred without delays to the municipalities as stipulated in the original PRSP and the National Dialogue of 2000. In addition, further strides have been made in strengthening donor coordination by setting up a Multi-donor Programme for Budget Support (MPBS). Fourteen donors (including the IMF) have been part of the negotiations, but only nine agencies

signed the Joint Financing Agreement (JFA) in September 2004: Denmark, Germany (KfW), Netherlands, Sweden, United Kingdom (DfID), USAID, and the multilaterals CAF, IDB and the European Commission. Ever since, the government has presented progress reports every three months regarding the implementation of the policy matrix agreed as part of the MPBS program. The policy matrix includes mainly measures and targets in the area of improved budget management, fiscal adjustment, payroll system reforms, and the like. There are also a few targets related to public expenditure policy and macroeconomic stability and one concerning the existence of a revised PRSP. The MPBS has been rather successful thus far in several ways:

- It is a good example of donor coordination. The JFA has common criteria, one policy matrix with a relatively limited number of actions and targets (23), and joint reporting and meetings about progress.
- Despite the difficult political situation, the government (that is, the Ministry of Finance) is implementing all that has been agreed and with a high degree of target achievement.
- The Ministry of Finance explicitly takes ownership of the policy matrix and the related targets are in its own “Strategic Framework”
- In turn, IDB and IMF who are also active in attempting to improve budget processes and financial management start from the Strategic Framework

However, disbursements under the MPBS have not been forthcoming during 2005 (till August), except for the budget support from the European Commission, the World Bank and the IDB which have met part of the committed funds for 2005. The official reason for some donors is that the government has failed to present a revised PRSP. This was actually one of the 23 conditions of the policy matrix and the government has always promised to present one. The current interim-government no longer promises to present a revised PRSP and the donor community has accepted this may wait until after the elections in December 2005. Nonetheless, bilateral donors are not disbursing budget aid. Some agencies state other reasons for this, for example, that the donor country does not have budget support money available for Bolivia this year, or the approval of the “hydrocarbon” law by parliament, which is seen as threatening legal security for private investors. Budget support is only forthcoming at the moment from the World Bank through the SSPSAC (which is similar to a PRSC), from the IDB and from the European Commission. The budget support that was committed in April 2005 amounted to US\$ 108 million, but the government is likely to receive only about US\$ 20 million this year, since WB and IDB for different reasons also cut on the committed amounts.⁹ However, this reduction should not create serious fiscal problems as tax income is expected to be higher than budgeted and, partly due to the political turmoil, many public investment projects suffer from delayed implementation.

The roundtables for donor coordination and policy dialogue, established in 2004 (see ISS 2004b), continue functioning, some with greater effectiveness than others. The roundtables tend to function better if there is stronger government leadership. But government leadership has been a

⁹ In the case of the World Bank it cut on disbursements because of the government's decision to end the contract with the French drinking water supply firm (*Aguas de Illimani*). The WB cut US\$ 10 million from a total of US\$ 25 million in commitments. The IDB is most likely to disburse a second tranche of US\$ 9 million on a policy based loan in promoting competitiveness, but to not disburse a US\$ 8 million tranche in a fiscal policy loan because the government did not comply with a stipulated reform in the pension system (SENASIR).

problem, especially recently, due to political turmoil and the accompanying high turnover in high-level government positions. The roundtable for fiscal policy has been most successful, as it has established the MPBS. The table for the Referendum and the *Asamblea Constituyente* has produced the referendum and continues working on the Assembly itself. The roundtable for the National Dialogue and the PRSP has delivered on organizing the dialogue on productive transformation, but has not been able to make progress on the revised PRSP. The roundtable on donor harmonization has produced a lengthy “Plan for Donor Harmonization and Alignment”, written by consultants, but this plan is not very concrete and there has been no follow-up by donors or government. Finally, the roundtable on productivity and competitiveness has produced some ideas, but during the last six months there has hardly been any activity. Most donors agree that donor coordination at the practical level was better during the Quiroga government than during the past couple of years.

In sum, the agenda of the donors for Bolivia is far from clear. Progress has been made in establishing a JFA for multi-donor budget support. In practice, however, more than 80% of aid takes the form of project aid and coordination for this type of aid has not improved. Despite the high extent of fulfilment of the conditions for budget support by the government (the Ministry of Finance), donors do not deliver on their promises with respect to budget support. In Bolivia, this is not due to problems with the IMF agreement, as the country is still on track meeting the conditions of the Stand-by loan. A formal reason for several donors is that they insist on seeing a revised PRSP, while at the same time acknowledging it is most reasonable such should wait (if anything) till after the elections. However, donor fatigue with Bolivia and its continuing political problems also seem to play a role. It is deplorable that the donors are withdrawing from a successful – albeit limited – coordinated policy dialogue that was leading to actual and important improvements in financial management. A more sensible approach for donors would be to continue this dialogue and to provide limited amounts of budget support in reward of good performance.

Honduras

Honduras reached HIPC completion point in April 2005. It received HIPC resources and debt relief prior to this point, but the larger impact in terms of external PRS funding should become visible in the budget and debt-servicing obligations from 2005 onwards. In June 2004, donors had already pledged a total amount of US\$ 1.8 billion for the PRS under the condition that the country would meet the requirements to reach HIPC completion point. At that point in time the requirements and allocation of these resources were rather unspecified, nor was it very clear how much of the pledged resources actually comprised new resources and how much related to money already committed before June 2004 (ISS 2004c: 16 ff). Debt relief under the enhanced HIPC Debt Initiative from all of Honduras’ creditors will surpass US\$1 billion over time (or US\$556 million in net present value (NPV) terms as of the end of 1999). Estimates made by the Ministry of Finance suggest that outstanding debt could be halved from US\$ 5.0 billion (March 2005) to US\$ 2.5 billion if all donors subject to debt relief (multilaterals, G-8 and other bilateral donors outside the G-8 are considered) are taken into account.

Donors in Honduras continue to focus on defined areas for support and not much progress has been made towards donor coordinated budget support for Honduras. Sweden for a long time was the only supporter of budget aid for Honduras, but was joined during 2004 by the European Union and Germany (KfW), while other 'like-minded' donors, like The Netherlands and DFID no longer engage in new programs of development cooperation with the country. Meanwhile, there has been no change in the composition of donors who support SWAps. Some donors are still trying to set up a framework of what a SWAp should entail and welcome a gradual approach to SWAps. The project "Education For All" continues to make progress based on multi-donor support with more than ten donors subscribing to the agreement. Sector roundtable events have been organized, but without leading to anything concrete as, typically, high-level government representatives do not participate at such meetings and discussions did not aim at influencing resource allocation, which has discouraged several actors. In all, aid to Honduras continues being allocated mainly to individual projects. The fact that Honduras qualified for the Millennium Challenge Account (MCA) in 2004 has not altered this; rather, it has strengthened the focus on project aid and further enhances the diversity in conditions and procedures that different donors apply.

The IMF continues to play a crucial role in following through macroeconomic conditionality and being on track with these targets remains an important reference for continuation of the PRSC, the IDB policy based loans and for the fixed tranche of the sectoral budget support of the European Commission.

Nicaragua

In Nicaragua, as indicated, the macroeconomic framework agreed with the IMF as part of the PRGF continues to be the main reference for freely disposable donor support. This has also kept the PRS on the agenda of the Nicaraguan government, even though its label keeps changing (PND-O or something else). For the government, the PRS essentially has become something to be presented to the donor community, rather than a strategy consulted with civil society. Donors perceive they have been able to maintain a good dialogue with the government and have kept resources flowing, despite the political woes discussed above. In fact, further moves have been made towards increased and coordinated donor support for budget aid. For some donors (Sweden, the Netherlands, Switzerland), the amounts involved in budget support in 2004 were already much higher than those involved in project aid.

On May 18th 2005, a group of donors including Sweden, Switzerland, and the Netherlands – but also Norway, Finland, Germany (KfW), World Bank, IADB and the European Commission – and the Government of Nicaragua subscribed to a joint financing agreement (JFA) for budget support. Under this framework, bi-annual meetings will be held to evaluate the outcomes of the agreed policy matrix and to first – in May – determine and later – in August – confirm donor contributions for the following fiscal year. Meanwhile, the Nicaraguan government has agreed to a wide ranging set of policy conditions: (a) maintain the strict macroeconomic stabilization policies in line with the IMF agreement; (b) continue favourably supporting the PRS and (c) comply with the JFA conditionality, which includes preventing conflicts, respecting human rights, democracy and the rule of law, strengthening the independency of the judicial system, combating corruption and improving budgetary

accountability. The matrix is clearly the result of long discussions among donors in which each agency wished to include its own priorities. It contains a total of 160 actions and targets to be implemented and achieved by the government over two years. These negotiations took place in parallel, but separate from the government elaborating a revised PRSP (ERCERP III), so the extent of correspondence with (any version of) the poverty reduction strategy is not clear. Furthermore, although these donors agreed on this matrix and on the conditions and targets, the JFA also stipulates that bilateral agreements with the government take precedence over this multi-donor framework. Hence, the agencies that were already engaged in their own budget support programmes (World Bank with KfW in a PRSC, IADB, and European Commission) continue with these separate programmes. Although there is some overlap between the conditions and targets of the JFA and these separate programmes, the total amount of conditions and targets the government has to comply with is much larger than the conditions of the JFA policy matrix.

In May 2005, Nicaragua went off track from the terms of the IMF agreement: due to the lack of support in the National Assembly, the government was not able to have discussed and approved some crucial reforms laws (on taxes, on transfers to municipalities, the financial sector). There was no acute problem with macroeconomic indicators, but these reforms were considered important for financial stability in the medium term. The signatories of the JFA then decided to uphold their committed amounts of budget support. By August, the political problems had not been solved and an IMF mission concluded that its programme could still not be continued. But the IMF promised to write a comfort letter to the Nicaraguan government, in order to free the way for other donors to provide budget support. The donors of the JFA agreement decided to disburse their budget support once this letter arrived. By end-October the IMF wrote the letter and, in order to avoid an imminent increase in the budget deficit, required the government to increase electricity prices by 25% and to automatically adjust domestic fuel prices to the rising oil import price. The government agreed to these measures, upon which the nine budget support donors decided to disburse their budget support for 2005 and 2006. However, they subtracted US\$ 20 million from the US\$ 109 million committed for 2005, in view of the risks that the required reform laws would still not be approved by the National Assembly.

In sum, donors have been working together in setting up a joint financing scheme and several donors clearly are moving from project aid to budget support. Through the JFA, bilateral donors have bought a seat on the table of the negotiations with the government on general policies, where formerly seats were only reserved for the IMF and the World Bank. However, the exact nature of this policy dialogue is still unclear, and there seems to be little relationship with a comprehensive and broadly shared domestic PRS – as was the original idea. The government continues working on new versions of a PRS, and at the same time the donors were discussing the conditions and targets to be included in the performance assessment matrix; first among each other, and later with government. This resulted in a matrix with 160 conditions and targets, while multilateral agencies continue to add their own conditions and targets for their programmes. All this has been agreed with a government (and executive) that seems to have very little power to actually implement policies. This might change following a recent coalition

between the president and the major opposition party (FSLN), but this remains to be seen. It is also unclear how donors are going to evaluate a partial fulfilment of the matrix. In practice, compliance with the IMF programme seems to be the overriding criterion, but this raises the question why so much effort has been devoted to negotiating on the other criteria.

2.5 Summing up

In sum, there is little progress to report in the cases of Bolivia and Nicaragua in terms of moving steadily towards the achievement of the core principles of the PRS process. If anything, political problems have led to clear setbacks in the process. In contrast, in Honduras the PRS process has gained relevance in organizing government discussions towards a stronger focus on poverty reduction and a more transparent allocation of budget resources for that purpose. Nonetheless, even in Honduras this at best is a beginning. In practice, policies give priority to macroeconomic stability and investments stimulating economic growth, but with still rather weak attention for income redistribution and promotion of economic activities that directly benefit the poor. Table 5 sums up the outlook in the three countries.

Which directions should the PRS process take in the three countries?

- *Tailor-made solutions:* In Bolivia and Nicaragua, and particularly in the former, it does not seem productive to continue to insist on a rewrite of another comprehensive PRSP to be presented to the donor community. In Bolivia, even labelling it a PRSP could be counter-productive. In Nicaragua, much greater efforts are needed to transcend the current situation in which the PRS has continued to be principally a tool of communication between the government and the donor community, with little involvement of civil society. In both countries, a government with sufficient credibility and domestic support is a necessary condition to lead the process. In Honduras, the challenge is to maintain momentum in improving the PRS process, keep up support from major stakeholders during the electoral cycle and upcoming change of government, and – most importantly – translate the improvements in the process into effective poverty-reducing actions. During 2004 and 2005, the PRS in Honduras has brought positive externalities in fostering organization and participation and better budgeting for social expenditure. However, not much poverty reduction has been achieved and many programs included in the PRSP need to become more operational. Obvious as it may seem, the clear general recommendation is that the degree to which countries should follow the PRS approach as originally envisioned should be tailored to their means, institutional capacity and political reality.
- *What could that mean?*² Our previous evaluations (ISS 2003a, 2004a) already led us to the conclusion that PRSPs may need to be less comprehensive and more realistic in terms of what actually can be achieved and in fostering implementation capacity. Even in Honduras this seems to be the case. In view of the developments during 2005, these lessons seem to have become even more relevant for the three countries. A less comprehensive strategy may be a difficult sell politically, however, as stakeholders from civil society and the donor community will demand a more comprehensive approach in which poverty reduction efforts encompass a broad range of economic and social reform policies. Clear direction from the international commu-

nity on the need for a more limited action program would be a useful step, as it is more realistic to hold governments accountable for such a limited program. Improved budgeting processes that clarify both how money was intended to be spent and how it was actually used could also raise accountability towards beneficiaries and other national stakeholders, as well as towards the donor community. Another important step should be an evaluation of the budget to ensure that the budget allocation is effectively contributing to meeting poverty reduction goals. In the next section we will analyze at some length what this would entail.

- *Donors need to clarify how they perceive the PRS process and how they wish to support it.* Donors have continued support to Bolivia and especially to Nicaragua despite obvious problems of governance and the lack of a PRSP or unclear status thereof. Under the circumstances they have even moved to enhanced efforts for budget support. One could take this as a good sign of a flexible, tailor-made approach as we recommend. However, it is not at all clear that this is in fact the situation. It seems much more a resultant of ‘muddling through’ and hoping things will move forward, despite the obvious stagnation in the PRS process.

Table 5 Progress along the lines of the PRSP principles – Status in 2005

	Bolivia	Honduras	Nicaragua
Ownership	No official PRSP. PRS process itself has become political sensitive issue.	An enhanced sense of government ownership by the present administration led by President Maduro. National ownership and the socialization of the PRSP are still challenges	Government has presented revised PRS documents (PND-O or ERCERP II and ERCERP III) to the donor community, but these are still not accepted by civil society
Participation	Two national dialogue processes have helped to strengthen a range of social organizations, particularly those participating in the pre-dialogue and in the municipal meetings. The dialogue processes have also raised expectations without successfully leading to a clear picture of strategy or priorities.	Concrete efforts have been made to increase consultations with civil society representatives regarding the PRSP (decentralization, regional PRSP, project selection, broadening CSO representation in the CC-ERP) during 2005. CSO's that are not directly participating remain divided about the orientation of the PRSP and about the participatory nature of the consultation process. Differences in technical capabilities and lack of credibility among certain stakeholders hinder dialogue at equal footing.	There has been no formal national participatory process in the creation of a revised PRS (though the PND was discussed at a regional level). PRS discussions at the national level are mainly confined to negotiations within government and to some extent between government and donor community. CSO's appear to be absent from the discussions about the JFA and other funding for poverty reduction. Political turmoil has taken all social discussions off the immediate agenda.

	Bolivia	Honduras	Nicaragua
Partnerships	A JFA has been agreed on budget support, leading to policy matrix of only 23 conditions and targets, 18 of which related to financial management. Despite good compliance of government, less budget support than originally committed was forthcoming from bilateral donors in 2005.	Project aid remains the norm. There is no coordinated move towards budget support.	Political turmoil has deviated attention from the PRS. Nevertheless, a group of 9 donors negotiated a JFA on budget support with the government and reached an agreement in 2005 on a policy matrix with 160 conditions and targets. But budget support was held up due to the IMF programme being off track.
Results orientation	Although financing for poverty reduction continues, Bolivia remains off track for reaching most of the MDGs.	Although financing for poverty reduction continues, Honduras remains off track for reaching most of the MDGs.	Although financing for poverty reduction continues, Nicaragua remains off track for reaching most of the MDGs.
Sustainability	The PRSP process in Bolivia has been as good as dead for two years. Insisting on a revision of the original PRSP, or at least label it that way, may be counter-productive given the political sensitivity around the PRS process. Uncertainty surrounding the PRS has not stopped the implementation of existing poverty reduction programs.	To reduce political uncertainty regarding the continuity of the PRSP (presidential elections are in November 2005), several meetings have been held to obtain candidates' commitment that they will not diverge from the current path, from the agreement with the IMF and from the conditions attached to the Millennium Challenge Account resources. It remains to be seen if these commitments will be honoured.	
	The Nicaraguan PRSP is in its third incarnation. It is possible that the current version and related reforms will not survive the following change of government. Targets of the IMF agreement, which has helped keep aid flowing, are not being met.		

3. Result-oriented budgeting and poverty reduction: way to go?

3.1 MTEF, ROB and PRSP

One of the core principles of the PRSP framework is to make poverty reduction policies more strongly results-oriented, among other things through improved budgeting procedures. A common criticism of the PRSPs of Bolivia, Honduras and Nicaragua, and elsewhere is that they represent largely a wish list of desired policy actions with no clear priority setting and no clear link to the availability and allocation of budget resources. This criticism need not be confined to the PRSP process, but more in general it is found that the overall budget allocation is quite often de-linked from the goals and actions set in national development plans or sector plans. The multilateral agencies have been pushing for the development of Medium Term Expenditure Framework (MTEF) as the answer to this problem. The MTEF has also been put forward in this sense within the PRSP framework.

The MTEF would be an integral part of the annual budget cycle, making this annual cycle part of a multi-annual fiscal framework consistent with fiscal targets for macroeconomic stability and broad policy priorities defined for the medium term (say, three to five years at least). This framework would define the resource envelope and make it consistent with the current and medium term costs of existing national programs and priorities of sector strategies. Ideally then, through an iterative process of decision-making, the cost of existing and new policies are matched with available resources. While the resource envelope would be defined ‘top down’, the sector and program priorities and resource needs are preferably defined ‘bottom up’.¹⁰ The MTEF should also ensure that policy priorities drive funding and not the other way around. Budgetary adjustments could be made following the same procedure in response to changes in resource availability, in agreed priorities or in the strategy proposed to achieve policy goals. One could visualize such a top down-bottom up iterative process of budget decision-making as the scheme presented in Figure 2.

Depending on which actors are made part of the process, it could be seen as more or less participatory. The PRSP sourcebook (World Bank 2001) proposes a budgeting process with much room for participation of civil society actors. The same sourcebook also acknowledges that such a participatory budgeting process may not be possible in every context.

¹⁰ See PRSP source book (World Bank 2001), Holmes and Evans (2003).

What is more, even if it were possible, it may not be practical at all to have broad-based participation at all stages of the budgetary process. Perhaps more ideally, the participatory process should be confined to the definition of the overall strategy, while representative bodies (such as parliament) provide the check on the appropriate budget allocation in line with the strategy and ensure the government holds itself accountable (to parliament and civil society). However, parliamentary action need not always follow good practice of representative democracy and be sensitive to particular political interests and clientelism. In such a context, calls for extra-parliamentary influence in the budget process become understandable. Such checks and balances may well help improve the transparency of the budgetary process and the accountability of government's budget execution, but not necessarily needs to add up to a more transparent political process.

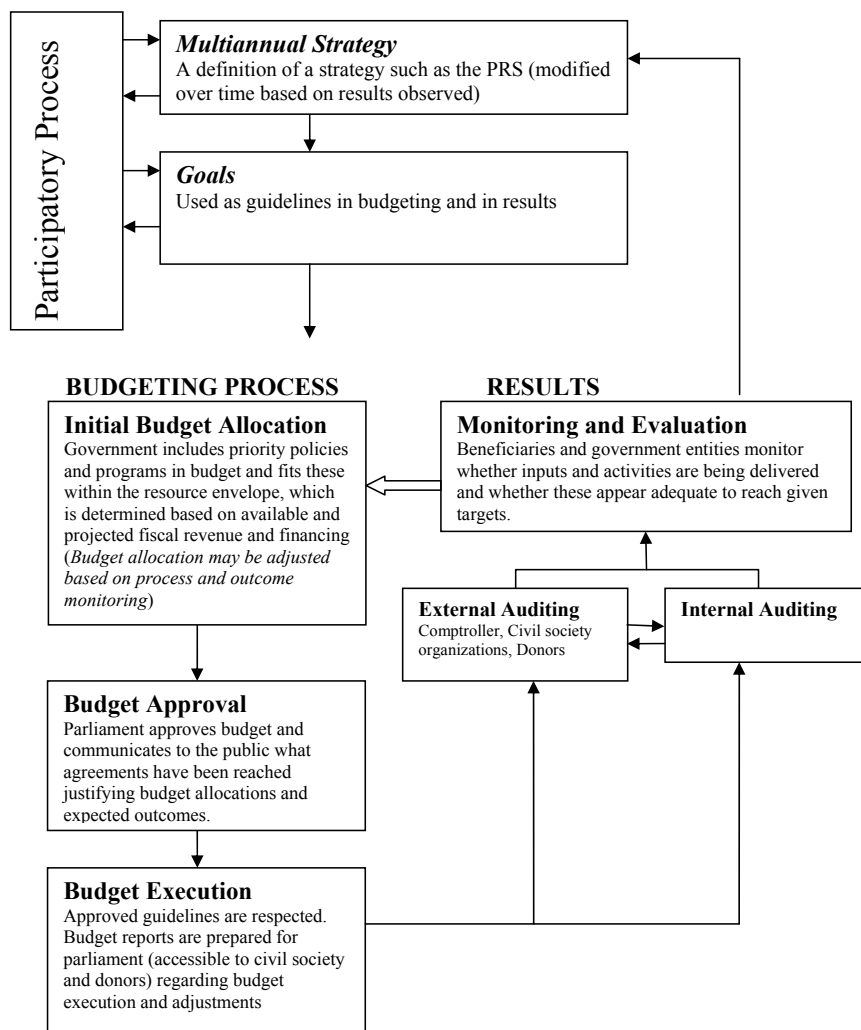
The existing practice in our three countries is pretty much a traditional process of annual budgeting whereby the previous year budget is taken as a starting point and budget negotiations concentrate on annual increases (or cuts) with very little clear view of the implications for outcomes in terms of poverty reduction. The management of HIPC resources has come on top of this process, sometimes with pre-fixed allocations agreed with the donor community (or enshrined in law as in Bolivia) and/or pressure for different forms of decision-making around the use of these resources. This has not necessarily enhanced the transparency of the budgeting system. Using Figure 2 as a base reference (and yet recognizing that this scheme will not be the ideal process for each country case), we examine to what extent the underlying principles of the MTEF and a greater results-orientation in the budgeting process is feasible and practical in the cases of Bolivia, Honduras and Nicaragua.

The appeal of the MTEF is the focus on the medium-term, providing a link between short-term fiscal adjustment targets that are part of macroeconomic stabilization objectives and longer-term demands on fiscal resources. To be effective for improved policy making, it will not be sufficient to just have a multi-annual framework. The MTEF should include methods to link budgets to actions and actions to expected outcomes in terms of clearly specified goals. In other words, the budget process should be linked to a multi-annual development strategy (such as a PRS), enjoy support from stakeholders involved (civil society, unions, ministries and donors) in order to provide continuity and fewer unexpected adjustments, and it should be results-oriented. We define results-oriented budgeting (ROB) here as precisely this process of trying to link budgets to concrete policy actions after having formed a clear idea how and to what extent these policy actions are expected to achieve specific targets. There could be various ways of linking budgets to actions to outcomes, running from experienced-based qualitative assessments to sophisticated, quantitative cost-effectiveness analyses. Either way, the central idea would be that budget allocations are explicitly justified based on such ROB insights, thereby making the budget more transparent in terms of what it is to achieve and policy makers more accountable as to whether they put the money where their mouth is.

The more specific (and quantifiable) the links between actions, costs and expected outcomes, the more the system will facilitate tracing the effectiveness of the budget implementation. It would also facilitate the use of the framework for budget scenario analyses, that is, to assess to what extent policy objectives will be jeopardized when resource availability tightens and/or after readjusting budget allocations.

These characteristics make the idea of an MTEF with a ROB focus attractive for effective PRSP implementation. The PRSPs have clearly defined poverty reduction objectives which comprise achievement of the Millennium Development Goals (MDGs).¹¹ The MTEF should thus discipline policy makers to engage in more precise costing exercises of the policies and actions that are seen to be needed to achieve those goals, to prioritise such actions within the given resource constraints, and to monitor the outcomes. Donor programmatic financing of PRSPs would also become more attractive to donors as an effective MTEF would equally determine aid effectiveness.

Figure 2 Results-oriented budgeting in the context of the PRS process



All of this, of course, is easier said than done. As previously mentioned, budget processes and procedures in developing countries are often little transparent, very cumbersome and part of a complex process of political decision-making, which involves permanent adjustments that are often isolated from the context of a development plan or strategy. PRSPs may have decentralisation as an important component of the strategy, as is clearly the case in Bolivia and to a lesser extent in Honduras and Nicara-

¹¹ It should be noted that in the case of Bolivia the objectives of the original PRSP (EBRP) were not fully in line with the MDGs. In the revised PRSP of 2003, the government tried to bring the objectives of the strategy closer in line with the MDGs.

gua. This increases the complexity of budget allocation decisions and thereby also of the effective application of an MTEF. The implementation of PRSPs is sometimes associated with specific resources (HIPC and related funds), while to assess the poverty reduction impact of expenditures it will be more relevant to look at the budget at large. Moreover, emphasis on ROB might overlook the fact that sometimes constraints are not in the budget allocations, but in the actual execution of the budget (e.g. no timely transfer of resources) and/or inadequate capacity to deliver the actions and inputs required to achieve the program's goals. Despite these challenges, the MTEF can provide the organising framework, particularly when seen not as a rigid, technical device, but rather as a set of principles that enable *a process towards* improving the transparency of the budget process, accountability of budget performance and effective priority setting consistent with the PRSP and fiscal and debt sustainability constraints.

This part of the report provides a synthesis of the findings for Bolivia, Honduras and Nicaragua, reviewing the experience with the budgeting process in support of the poverty reduction policies and highlighting how this relates to the principles of the MTEF and ROB as just defined. None of the three countries has an MTEF in place and, in previous reports, we have described weaknesses in actually prioritizing actions for poverty reduction, linking actions to outcomes and in making transparent costing exercises. Nonetheless, all three countries have set in motion efforts to improve the budgeting process. The next subsections describe these efforts and assess how much of that seems to be contributing to more effective implementation of poverty reduction programs (in general, not just of what is laid down in the PRSP, since, as mentioned two of the countries do not have an official PRSP). This will then lead us to draw some conclusions about the potential for an effective MTEF in support of poverty reduction in these countries and about where the bottlenecks might lie.

3.2 Bolivia

Bolivia does not have an MTEF, but has started a process of developing multi-annual budgets and in that context of making more realistic projections of the fiscal resource envelope. The under-secretary for budget and accounting of the Ministry of Finance is executing new performance-based contracts with the tax collecting agencies SIN (for national taxes) and ANB (import duties)¹² and with the ministries of education and health in order to reach a multi-annual programming of budgets. For these projects indicators are being developed to monitor budget execution. The government wishes to move away from cash flow based budgeting to a process which is commitment-based in order to make the budget reflect policy priorities more clearly. Moves towards greater results-orientation of the budget are still very timid (but see below). These improvements in the budgeting process are fairly new and the outcomes in terms of more effective budget allocations for poverty reduction remain to be seen. It should be reiterated that these changes are not directly linked to the PRSP process for the obvious reason that Bolivia has no functioning PRSP. Yet, the indicated changes do reflect pressures from multilateral and bilateral donors to improve the transparency of the budget and bring budget allocations closer to programs and plans supported by aid and external lending. The MBSP (or PMAP by

¹² SIN stands for *Sistema de Impuestos Nacionales* (a kind of Internal Revenue Service, IRS) and ANB for *Aduana Nacional Boliviana* (Bolivian National Customs).

its Spanish acronym) is trying to achieve just that (see section 2.4). The institutional challenges in moving in this direction, however, are huge, as we shall detail in subsequent paragraphs.

The budget process

The Bolivian budget process currently has six phases:¹³

- a) **Preparation** and identification of resource envelope: during each annual budget cycle the Ministry of Finance prepares an initial budget and sets the overall budget ceiling based on forecasts for economic growth and tax revenues and predicted efficiency gains in SIN and ANB. Normally, these projections provide over-estimations first in order to create some negotiation space, as it allows accommodating some of the regional demands for additional resources during the phase of budget adjustment (d) and execution (e). In each cycle this process starts in July–August.
- b) **Budget allocation:** In September, the Finance Minister provides each public sector entity with budget ceilings per sector, including a set of guidelines which define spending items and categories that need to be used in preparing the sector budget and instructions about how to justify the various entries. The sector budget ceilings typically are defined in an incremental way based on the budget of the previous year. In September/October, the entities of the central government and decentralized agencies (not including municipalities) have to present their detailed budgets together with an operational annual plan of activities.
- c) **Approval:** Parliament amends and approves the budget and publishes the agreements and compromises reached. As an outcome of this process, there are generally adjustments made to the original budget, which imply increases of specific budget items, quite often relating to public investments in response to demands from constituents. In recent years, such budget increases amounted on average to 0.6% of total original outlays.
- d) **Budget adjustments:** During budget execution adjustments are made to the approved budget. Formally, this can only be done once when approval is required for budget execution in the second half of the fiscal year and budget revisions can be submitted. On average, these revisions tend to yield budget increases of about 6% of the total approved budget, according to a multilateral donor report (World Bank and IDB 2004a).
- e) **Budget execution:** Expenditures are controlled on a cash flow basis by the Treasury of the Nation (TGN). During this process, actual expenditures tend to fall below the budget, but such cuts are not proportional for all types of expenditures such that a budget reallocation takes place, which is not based on policy priorities but on political pressure from interest groups (see below). The executed budget tends to be lower than the modified budget by some 8% (World Bank and IDB 2004a). This type of budget adjustment does not apply to the use of HIPC funds as a fixed amount goes to the Municipal Solidarity Fund (used to reduce the shortage of teachers and medical personnel, with fixed shares for education and health), while another part goes to the National Solidarity Fund of SUMI and the remainder of the resources enter into a Special Account and the shares by area/

¹³ Or perhaps only five, considering that steps (d) and (e), budget adjustment and execution, tend to be part of the same process.

program are established by law, i.e. 10% for health, 20% for education, and 70% for productive and social infrastructure. This allocation is mandatory by the Dialogue Law and rigorously controlled by the Minister of Finance.

- f) **Control:** Internal auditing is done by the Ministry of Finance and external auditing by the nation's comptroller (CGR). However, the CGR has very limited auditing capacity, particularly to cover 327 municipalities and more than 100 national, sectoral, and decentralized public institutions.

The process of budget formulation follows the scheme of top down (setting budget ceilings) and bottom up (preparing detailed sector budgets), but is not participatory (at least not at the national level) in the sense of involving actors outside government agencies in the budget discussions.¹⁴ The budgeting process is also very little results-oriented at the moment, although some steps towards ROB are being taken (see below).

The budget and the PRSP

The original PRSP for Bolivia (EBRP) made an attempt at costing the lines of action proposed for poverty reduction and concluded that not all items in the PRS could be funded with expected tax revenues and committed aid. The PRSP did not set clear priorities among the various lines of action, which could have assisted in deciding what to do with available resources. Nor did it provide a clear justification of the extent to which the envisaged budget and public actions would be expected to help the country reach the specific poverty reduction targets (see ISS 2003b, 2004b). It is therefore not surprising that the government budget does not make any clear priority setting between pro-poor and other spending nor among categories of pro-poor spending.

The government budget and the accounts for the use HIPC funds do make an attempt however, to present budget items along the types of spending categories of the EBRP and have continued to do so despite the fact that there is no longer an officially endorsed PRSP. In the government budget this is done as follows. Social expenditures are defined as the total of current and capital expenditures on: (i) Health; (ii) Education; (iii) Basic sanitation; (iv) Urban development; and (v) Rural development.¹⁵ Public "pro-poor" spending is then defined as total social expenditures *less* spending on pensions and university education (see also World Bank 2004). Beginning in 2006, this functional classification will be done automatically. In past years, it has been done manually and retroactively.

These are fairly traditional classifications of budget categories and the assumption is, therefore, that public spending on these items generally benefit the poor with little leakage to non-poor. According to the PSIA on social expenditure (World Bank 2004), there is some leakage to the non-poor. Moreover, the share of spending going to the poor increased less than the incidence of poverty in the period 1999–2002, making public spending actually less pro-poor.

¹⁴ At the local level there is some degree of participatory decision making of the use of the resources channelled through the Special Account to the municipalities. However, as said, these resources are not part of the national budget.

¹⁵ Social transfer programs and the emergency employment program (PLANE) are not included in the estimate of poverty reduction spending published by the Unidad de Programación Fiscal (UPF). That is, not explicitly. The emergency employment program, PLANE, is of recent date and creates mainly jobs in urban areas. It could be included within the given categories under "urban development", but maybe better it be included in a new category of social safety net or social security spending.

The HIPC funds are allocated according to a fixed allocation by categories (health, education and social and productive infrastructure), as indicated above. Most resources go to the municipalities (see Table 6). It should be noted though that HIPC resources only represent a very small share of social spending or resources available for poverty reduction programs run by the municipalities. In all, they represent around 0.2% of GDP (according to national budget data). Thus, the real issue for Bolivia is not only to have good accountability of HIPC resources, but more importantly also of the broader national and local government budgets for social spending and poverty reduction programs.

Table 6 Bolivia: Allocation of HIPC Resources, 2001–2005
(millions of US\$)

	Municipal Solidarity Fund (FSM) (to cover deficits in medical personnel and teachers)	Special Account for 2000 Dialogue (allocated to municipalities)	National Solidarity Fund for Universal Mother and Child Health Insurance (SUMI)	Total (US\$ million)	Total (% of GDP)
2001	5.0	32.7		37.7	0.1%
2002	27.0	80.5		107.5	0.2%
2003	26.8	46.1	3.6	76.4	0.2%
2004	27.0	39.0	3.4	69.4	0.1%

Source: ISS (2004b: Table 4.1), updated with data from the Ministry of Finance, UDAPE/CIMDM

Changes in poverty reduction policies and in the PRSP are not clearly reflected in the budget presentation. Part of the reason for this is that the PRSP itself is no longer supported by the government, but it is also because new programs are not clearly identifiable in the overall budget. Further, as indicated above, during the budget execution process, cash flow controls lead to implicit budget reallocations which are not based on PRSP priorities, neither on policy priority setting in general.

More pro-poor spending?

Pro-poor public spending as defined above has increased since 2000. It increased from 10.8% of GDP in 2000, to 13.1% in 2002 and then dropped in subsequent years to 12.3 and 12.4%, respectively, during 2003 and 2004 (see Table 7). During 2000–2004 there were only slight increases in the wage bills for health and education as a share of GDP. The non-wage component of the pro-poor public expenditures followed the trend of overall pro-poor public spending.

The HIPC funds are integrated into the national government budget. The allocation of the HIPC funds follows the criteria established by the National Dialogue of 2000 and the EBRP. As indicated, part of these funds is allocated by law in fixed proportions to different the categories of pro-poor spending. In this sense, the budget allocation has changed from the pre-PRSP era, and these criteria for the use of HIPC funds continue to apply, despite the fact that the EBRP no longer belongs to official government policy. However, given the small share of HIPC funds in total spending, this does not make a significant impact on overall pro-poor expenditures.

As indicated before, the system of cash control in Bolivia is an important source of more or less implicit budget reallocations. Specific demands from politicians and lobby groups may re-enter in this part of the process and generate a transfer of resources away from agreed policies and programs to meet such “new” demands. Pressure groups that typically come out on top in such “reallocations” tend to be the 120,000 person strong group of teachers, as well as the police and military. Until 2003, these pressures led to an increase of the wage bill (also as a share of GDP), particularly that for teachers. Thereafter this share dropped somewhat leaving more fiscal space for public investment.

Table 7 Bolivia: Poverty reducing expenditures by all levels of government as a percentage share of GDP (1999–2005)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Current Expenditures	5.6	5.9	6.1	6.1	6.2	6.0	6.8	7.3	7.3	7.4
Health (excl. Ben-eméritos)	2.1	2.3	2.4	2.4	2.4	2.4	2.7	2.6	2.8	2.6
Salaries of health workers	1.1	1.1	1.1	1.1	1.1	1.1	1.3	1.4	1.5	1.4
Beneméritos	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.3
Education (excludes Higher Education)	3.5	3.6	3.7	3.7	3.8	3.6	4.1	4.6	4.5	4.7
Salaries	2.8	2.8	3.0	3.0	3.1	3.0	3.2	3.7	4.0	4.0
Other social spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Capital expenditures	3.5	3.9	3.9	4.0	4.4	4.8	5.4	5.8	4.9	5.0
Health	0.4	0.4	0.4	0.4	0.5	0.7	0.6	0.7	0.6	0.7
Education	0.6	0.9	1.0	0.8	0.9	1.0	1.4	1.5	1.2	1.2
Basic sanitation	0.7	1.1	1.0	1.0	1.2	1.1	0.9	0.6	0.5	0.8
Urban development	1.1	0.8	0.7	0.7	0.6	0.6	0.8	0.8	0.8	0.6
Rural development	0.7	0.7	0.8	1.2	1.2	1.3	1.7	2.1	1.9	1.8
Rural roads	0.2	0.3	0.3	0.4	0.6	0.5	0.7	0.8	0.8	1.0
Total Pro-Poor Expenditures	9.1	9.8	10.0	10.2	10.6	10.8	12.3	13.1	12.2	12.4
excluding wages and salaries	5.3	5.9	5.9	6.1	6.4	6.7	7.7	8.0	6.7	7.0
Memo:										
Municipal pro-poor expenditures	0.1	0.4	0.5	0.6	0.7	0.6	0.7	1.3	1.5	1.4
– Current expenditures	0.0	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.4	0.5
– Capital expenditures	0.0	0.3	0.3	0.2	0.4	0.3	0.4	1.0	1.1	0.9

Source: Ministry of Finance, Bolivia, per April 2005

Note: a. Refers to poverty related spending by public sector. Excludes education spending at university level, pension contributions, and health and education spending by Ministry of Defense.

Budget financing

The government has undertaken efforts to improve the domestic resource mobilization to finance the budget. During 2003, the intended (income) tax reform proposed by the government of Sánchez de Lozada as part of an IMF agreement proved highly controversial and one of the factors instigating social protests that eventually led to the fall of this government. Subsequently the new government under President Mesa was more successful. Amidst much controversy, it managed to raise government revenue from the production and exports of natural gas and to improve of income tax and custom duty collection. Income tax collec-

tion increased from 12 to 15% of GDP during 2000 and 2004, but customs duties stabilized around 1% of GDP during that period. Meanwhile, revenue from other sources – particularly the sale under government control of natural gas – dropped, leading to an overall decline in government revenue from 33.7 to 28.5% of GDP. As overall government spending remained more or less constant as a share of GDP, budget deficits increased consequently during 2000–4 as compared to years preceding the introduction of the PRSP. External funding (about two thirds) is covering most of these deficits.

Fiscal deficits could be sustained as donor funding kept flowing to poverty reduction priority areas (education, health and basic sanitation), despite the lack of an approved PRSP and the poor governance situation. Much of aid still comes in the form of project support, but increasing amounts have been committed in the form of sector-wide programmatic support and more broadly as budget support, not all of which has been forthcoming as explained in section 2. Debt relief as such thus far has not contributed much to broadening the fiscal space in Bolivia. HIPC-related debt relief finances about 0.2 of GDP.

Local governments (municipalities), in contrast, have increased their dependence on central government funds (including the HIPC funds) and the share of own revenues has decreased. HIPC resources have helped prop up municipal budgets in times when decreased national revenues led to decreased transfers to municipal budgets (aside from HIPC resources, municipalities receive 20% of national resources). However, given the pre-fixed allocation of HIPC funds, the HIPC transfers have not provided municipalities with completely discretionary spending power, which in a way contradicts the original intentions of the decentralisation process, in the sense of bringing budget allocations closer to the needs of the poor.

ROB and institutional capacity

Institutional capacity to move to a more results-oriented budgeting framework is rated to be very weak. This is recognized by the government and training programs have been started to assist officials of the ministries of education and health in the preparation of multi-annual budgets and budgets which are closer linked to the development plans for the sector. The institutional weaknesses are most manifest though at the level of the municipalities, where a process of continuous training in this sense will be required for some foreseeable period.

Decentralisation

Overall tracking of pro-poor spending is particularly difficult in Bolivia because a part of the overall budget is executed at the municipal level – especially as far as public investment is concerned and because the national government does not get detailed budget information from all municipalities. In fact, by 2005 it only gets this detail for one third of all municipalities (111 out of 327) and therefore budget tracking is still deficient. It should be noted, though, that the 111 largest municipalities account for 84% of the population and 75–80% of total expenditure of municipal governments.

Monitoring and evaluation

Despite the indicated difficulties to track overall spending, important steps forward have been made in facilitating greater transparency in the budget execution and in developing monitoring and evaluation systems.

The SIGMA system tracks budget execution at the central level but integrates nearly all of the public sector. At the local level coverage is much smaller but a simplified version of the system (SMS, *SIGMA Municipal Simplificado*) is gradually being introduced by the municipalities. SIGMA falls under responsibility of the Ministry of Finance and as yet is at best weakly linked to the M&E system for the “Results-oriented Public Administration” (SISER)¹⁶. SISER, despite its label, is still a far cry from a tracking system which would be part of ROB. In practice, it is essentially a system which monitors budget execution of programs that are implemented at the departmental level (*prefecturas*) or by the line ministries. It does not cover the entire annual operational plan and does not link the degree of delivery of “inputs” to the expected outcomes. It operates fully independently of the “social control mechanism” (see below), which in part has the same objective as SISER.

In addition, the government produces sets of informative tables to monitor the implementation of the multi-donor budget support (JFA, see below), including data that track public social spending and pro-poor spending as defined above. This information covers the entire public sector, including local governments (111 municipalities and all *prefecturas*). Tables produced are made available to main stakeholders.

Finally, the “social control” mechanism (*Mecanismo Nacional de Control Social*, MNCS) which involves civil society representatives in monitoring government programs continues to be operative on paper. However, the system lacks a national authority at the moment. Further, this system has always lacked funding to adequately play its role. When it tried to get 2% of the HIPC resources, this idea was dismissed by the municipalities, because any allocation to the MNCS would reduce their share. Nonetheless, there are some isolated local experiences, such as in the department of Potosí where the *Mecanismo Departamental de Control Social* (MDCS) has exercised an effective monitoring role and has denounced cases of abuse of funds by local authorities.

In all, despite some steps forward, the development of these systems still leaves much to be desired. The lack of funding, the lack of coordination between them and the lack of actual results orientation stand in the way of making more visible progress in enhancing the accountability of government in the management of the budget process.

Donors

Donors have been supportive of moving towards a multi-annual and results-oriented budgeting system, primarily through support for improved budgeting techniques. This support has come with the multi-donor Joint Financing Agreement for budget support which came about in 2004. Monitoring tools are being developed within this framework, and several activities relating to improving results-oriented budgeting, such as the preparations to report a functional classification of budget execution as of 2006, were completed in August 2005 (Minutes of Quarterly JFA meeting, August 2005). The Technical Assistance Fund (FAT) financed by a group of donors (Germany, Sweden, and Denmark for now) will reserve funds for technical support in the development of an MTEF and other improvements in the budgetary process that are to lead to a more results-oriented budgeting system. The Inter-American Development Bank is providing support to the SISER.

¹⁶ The Spanish acronym stands for *Sistema de Seguimiento y Evaluación de la Gestión Pública por Resultados*.

Are an MTEF and ROB realistic options at all for Bolivia?

Some clear progress has been made in making the budgetary process more transparent and results-oriented. This holds most in particular for developing the technical aspects towards an MTEF, tracking mechanisms for budget execution (SIGMA) and some monitoring tools (SISER) which are supportive of ROB. The various instruments do require much better integration though. Institutional weaknesses, lack of coordination between institutions (within the central government and between central and local governments) and political pressures to alter agreed budgets at critical stages of the execution, make ROB still a far cry from reality. Once the institutional problems are resolved and the elements currently under development have in fact been integrated into the national budget process, serious steps towards ROB will be in place. However, one should expect that the resolution of institutional bottlenecks will take several years or more.

3.3 Honduras

Like Bolivia, Honduras does not have an MTEF, but has made important legislative steps to make pro-poor social (and thereby PRSP-related) spending explicit in the national budget. In addition, the budgeting process has now been integrated with the national development plan (and thus also the PRSP), implying that the financial programming of the budget has been extended to three years to be adjusted annually. This is an important step in the direction of an MTEF, even though for now the medium-term parameters guiding the three-year budget framework are essentially macroeconomic. Moves towards results-orientation of the budget are still very modest (see below). These improvements in the budgeting process are fairly new and the outcomes in terms of more effective budget allocations for poverty reduction remain to be seen. Yet, the indicated changes do reflect compliance with conditions set by multilateral and bilateral donors to improve the transparency of the budget and bring budget allocations closer to programs and plans supported by aid and external lending. The institutional challenges to make visible progress along the initiated path are daunting, as we shall detail in subsequent paragraphs.

The budget process

Honduras' budget cycle has four main phases:

- a) **Budget formulation** and identification of resource envelope: during each annual budget cycle the Ministry of Finance prepares an initial budget and sets the overall budget ceiling for the next three years based on forecasts for economic growth. The three-year period forecasts are revised annually. The multi-annual projections still need fine-tuning, but the important gain so far is that policy trends are made visible. The budget formulation process also incorporates the budget needs as specified in the National Development Plan. Subsequently, the Ministry of Finance gives guidelines to the line ministries and other public entities, given the budget ceiling. The preparation of the sector budgets does not involve any consultation with agencies outside the central government, but must be within the macroeconomic framework agreed with multilateral institutions. With the budget detail and after some negotiation with the ministries, the President – through the Ministry of Finance – establishes the final budget to be submitted for approval by Parliament.

- b) **Budget execution** and adjustment: Congress may decide to adjust the budget during approval, but also during execution. During execution, reallocation can occur between the judiciary and executive powers, or between ministries or within a ministry. Depending on the case, Congress, the President or a Minister can authorize this reallocation. Only Congress can change the budget limits. This is not unusual, as congressmen receive pressures from their constituencies or have to give in to trade union pressures for salary increases for public employees. Adjustments ignore given budget ceilings, thus affecting the allocation by sectors, regions or spending categories. It is difficult to put hard numbers on how much fiscal adjustment this entails. In Honduras, such adjustments are perceived to be substantial (whether actually true or not), which creates problems regarding the credibility of the government's handling of the budget. It reduces the transparency of the allocation of budget resources and weakens further the link between the budget and the sectoral government plans and the PRSP.
- c) **Monitoring & Evaluation:** Tracking of budget implementation has been eased with the introduction of the integrated system for financial management (SIAFI by its acronym in Spanish). This system only tracks the flow of spending by budget items and categories. Budget data are now also accessible through the Internet, which has increased visibility for the public. The government publishes quarterly reports of the budget execution which further eases monitoring of the budget process, but coverage of these reports is still limited to line ministries of the central government and needs to be expanded to the rest of the public sector. Monitoring of program implementation and impact is hardly developed though (see below).
- d) **Budget control:** Expenditures are controlled on a cash flow basis by the National Treasury. Several reforms have been implemented to strengthen the supervisory and auditing controls of the national budget. These also include new appointments for the budget control agency (Tribunal Superior de Cuentas) and the assignment of new, expanded competences to audit and control the budget. Auditing is done by the nation's comptroller (CGE). However, the CGE has very limited auditing capacity and therefore capacity building has been an issue. The World Bank has recommended the use of external auditing companies to enforce budget control.

In sum, the process of budget formulation follows the scheme of top down (setting budget ceilings) and bottom up (preparing detailed sector budgets), but is not participatory in the sense of involving actors outside government agencies in the budget discussions. However, as we shall discuss below, civil society actors are now being involved in the poverty reduction related spending. The budgeting process is also very little results-oriented at the moment, although some steps towards ROB are being taken (see below). The government has no track record of making itself accountable for the budget implementation to the public and, more generally, our stakeholder analysis among various representatives of civil society suggest that there exists a fair amount of distrust among the public in the government's use of resources (ISS 2005b).

The budget and the PRSP

The annual budget for the PRSP is elaborated by an inter-institutional technical group (GTI) with the support of UNAT. This budget involves

the allocation of the HIPC funds and other resources committed to poverty reduction programs as defined by the PRSP. The work of the GTI is supported by the international donor community as part of efforts to improve public sector management for social sectors. The budget as defined by the GTI is discussed at the consultative council for the PRS (CC-ERP) and approved by the social cabinet (the ministerial platform for the social sectors). This budget specifies in some detail the programmatic, geographic and institutional focus of the projects to be financed by PRSP-related resources. The eligibility and priority of these programs and projects is subsequently established by a special committee consisting of three members of parliament appointed by the speaker of the national congress. Congress approves the projects, and the related budget is subsequently incorporated in the overall national budget.

This way, though via a separate approval procedure, the PRSP is integrated in the annual budget cycle. The process is presented schematically in Figure 5. The established budget ceilings will not be violated, as it refers to the allocation of existing financing resources. The budget entries related to the PRSP are clearly identified in the presentation of the income and outlays of the national budget. In addition, following a recommendation from the World Bank, the available PRSP resources flow into a special Fund for Poverty Reduction (FRP), which should both protect the level of social spending and make the monitoring of the PRS resources more transparent.

The integrated system for financial management SIAFI is used to guide the monitoring process. SIAFI is an indicator system still in development. It is to become a fully automated system, but at present much of the data handling is still to be done manually. The system essentially only tracks the resource flow, that is, the budget execution money wise. It is not linked to a tracking of actual program execution (are inputs being delivered?) or program outcomes (are program targets being achieved?).

In any case, by law, since 2004 nearly all allocations for the poverty reduction programs are made visible (including some donations which were not previously registered) within the national budget and so are budget changes related to adjustments in the PRSP itself. The budget figures also show transfers of the PRS resources to local governments. This is quite a bit of progress from the past in terms of transparency in the budget presentation.

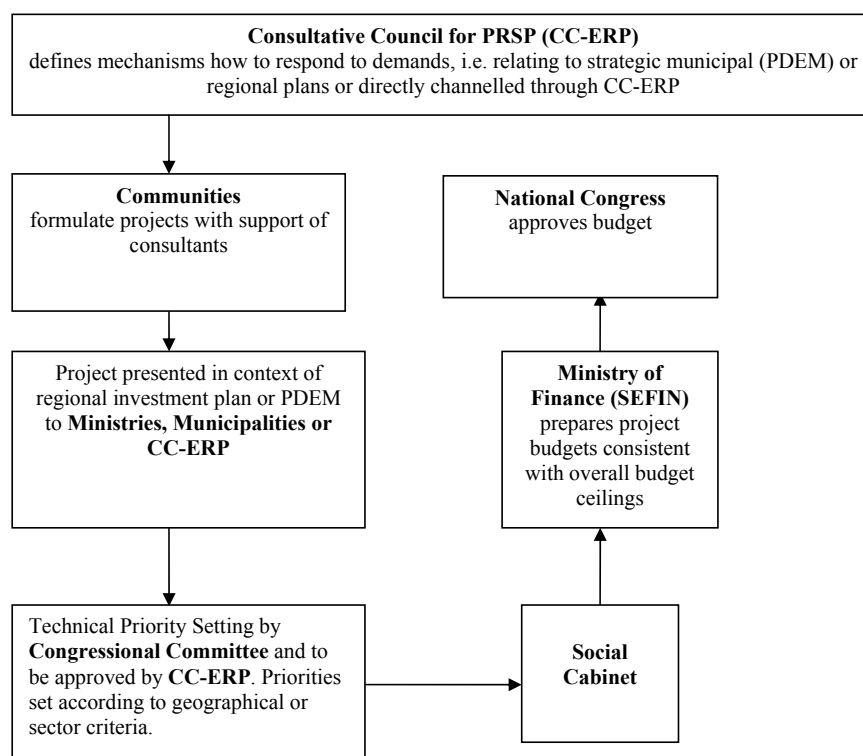
More pro-poor spending?

Pro-poor public spending (defined as resources for the PRSP) has increased since 2002. It increased from 7.5% of GDP in 2002 to 8.3% by the end of 2004. PRS spending does not include all regular spending. That is, not all wages and salaries paid to public employees in education and health are included in the definition of pro-poor spending. In order to avoid that social pressure for wage increases could become a main source of recorded changes in pro-poor spending, it was decided that wages are accounted under this heading only up to a level of 3.5 times GDP per capita for teachers and 5 times for health workers.¹⁷ Investment in human capital (education and health) comprise more than half (57%) of total PRSP related spending (see

¹⁷ In 2003, the definition of PRS spending was changed by also including counterpart funds to the external funding for the PRSP. Counterpart funding includes all domestic spending on salaries in specific areas (education and health), but excluding the wage bill for support personnel, as well as current transfers to specific projects such as PROHECO (Honduras Community Education Program) and AECO (Community Education Association) and all funding for FHIS (Honduran Social Investment Fund) and PRAF (Family Cash Transfer Program). The numbers in Tables 8a and 8b use the same definition for the whole period.

Tables 8a and 8b). Between 2000 and 2004 the relative allocations for rural poverty and strategy sustainability decreased, while those for urban poverty and social protection increased (Table 8b).

Figure 3 Honduras: Civil society participation in project selection for use of HIPC funds



Source: Metodología para el uso de recursos de condonación de la deuda (August 2005) and Ley de FRP (Decreto 76-2004)

During 2002–2005, most PRS spending was mainly financed from domestic resources. HIPC funding comprised on average about 30% of total PRS resources. Medium-term projections (that is, till 2012) from the Ministry of Finance estimate that debt relief will come to the tune of US\$ 2.5 million from multilateral and bilateral (G-8 and non-G-8) donors, including the US\$ 1 billion already mentioned above granted for reaching completion point under the HIPC terms. If the current approach is sustained this will enhance the resources for poverty reduction and it will make the funding of the PRS more predictable. It is more difficult to say whether the increase in spending on poverty-reduction programs has so far helped to reduce poverty, because of the lack of a proper link between budget and poverty reduction targets.

Starting 2005, as indicated in section 2, civil society groups have played a prominent role in setting priorities in the selection of social projects and the “regionalization” of the poverty reduction strategy. The amount of funding involved in this participatory process is not substantial. However, the learning process to promote local participation has been rather important and inclusive. In the final quarter of 2005, the Honduran government planned to organize a national participatory process to discuss the allocation of HIPC funding and to identify priority projects. It will be important to keep a close watch on the results of these events as Honduras is pioneering this type of participation.

**Table 8a Honduras: Poverty reducing expenditures as a share of GDP
(2000–2005)**

	1999	2000	2001	2002	2003	2004	2005b
Total poverty-reducing expenditures ^a	n.a.	8.2	8.8	7.5	7.7	8.3	9.0

Source: Ministry of Finance of Honduras.

Note: a. Includes spending on education, health, water and sanitation, rural infrastructure, and social safety programs. b. Estimated

Budget financing

The policy reforms implemented during 2004 were accompanied by improvements in the fiscal balance. The budget deficit fell from 5.1% to 3.0% of GDP between 2003 and 2004. Government revenue did not respond very strongly to the economic recovery and tax income remained stable as a share of GDP. The deficit reduction thus was mainly due to reduced spending, specifically, the government managed to cut on wages and salaries despite the strikes of public employees that took place during 2004. The government managed to strike a deal with the trade unions based on the promise of a significant wage adjustment to take place after reaching completion point of the HIPC terms and freezing wages up to that point. In effect, the promised salary increase is to be given in 2006 and the new government will have to deal with the serious fiscal adjustment problems this will likely give.

Despite a lower deficit, external funding increased, mainly from the multilaterals (IDA and IDB). In 2004, 62% of the fiscal deficit was financed from external sources (aid and foreign loans). Tax collection efforts have been stepped up to 19.3% in 2004, mainly by raising indirect taxes (sales tax on credit card transactions and tobacco), as intended in the tax reforms agreed with the IMF in April 2003.

Table 8b Honduras: Poverty reducing expenditures by pillars of the PRSP
(millions of US\$ and percentage shares)

	2001	2002	2003	2004	2005 (P)
Classification by 6 Pillar programmes of PRSP					
in US\$ millions					
Accelerating Economic Growth	0	0	0.8	1.5	0.1
Reducing Rural Poverty	99.6	68.6	68.9	81.3	82.4
Reducing Urban Poverty	31.4	29.4	46.1	43.2	87.8
Investing in Human Capital	291.5	305.8	328	356.3	409.6
Strengthening Social Protection	31.2	22.8	23.6	26	64.3
Guaranteeing Strategy Sustainability	111.1	70.8	70.8	115.7	97.8
Total	564.8	497.4	538.1	624.0	742.0
in % shares of total					
Accelerating Economic Growth	0	0	0	0	0
Reducing Rural Poverty	18	14	13	13	11
Reducing Urban Poverty	6	6	9	7	12
Investing in Human Capital	52	61	61	57	55
Strengthening Social Protection	6	5	4	4	9
Guaranteeing Strategy Sustainability	20	14	13	19	13
Total	100	100	100	100	100

Source: Ministry of Finance of Honduras.

ROB and institutional capacity

Institutional capacity to move to a more results-oriented budgeting framework is rated to be very weak. This is recognized by the government and training programs have been started to assist officials of line ministries in the use of the SIAFI and monitoring PRS spending. This should help improve the process of preparing multi-annual (three-year) budget plans and make sure budgets are closer linked to the development plans for the sector. In practice, the elaboration of sector budgets, particularly in health and education, continues to be pretty much a process of adjusting the previous year wage bill and adjusting everything else in line with the given budget ceiling.

The institutional weaknesses that would have to be overcome to improve the budgeting process are most severe at the level of the municipalities. Only recently has the government commissioned consultants to provide technical support to the municipalities and communities in the preparation of budgets and the formulation of projects to be presented as part of the Strategic Municipal Plan and the Regional Development Strategies. These plans are prepared by civil society agents. Any CSO can participate; there are no selection criteria for who may and who may not participate. Additional support to municipalities in preparing budg-

ets and projects is being provided by the social investment fund (FHIS). All of this is still in an experimental stage and being implemented in a limited number of the larger municipalities. In the second half of 2005 a campaign will be held throughout the country to define, through participatory processes, a redistribution of HIPC resources. This campaign will take place in 17 departments. These initiatives form a good start of local capacity building in this area, but a process of continuous training will be required to make a more sustainable impact on an improved budgeting process.

The initiatives taken to improve the budgeting process should provide the basis for greater transparency and results-orientation. Another big obstacle on the road to this objective, though, has received less attention: the very weak external control and auditing mechanisms with parliament and external agencies. Improving external auditing along with more effective M&E systems should be the next priority.

Decentralisation

Local governments only recently are effectively receiving transfers that amount to 5% of the tax revenues from the national budget in compliance with the Municipal Law. Transfers are linked to multi-annual budgets justifying spending at the local level in order to avoid discretionary allocations based on purely political criteria. Initially, the criteria for the distribution of transfers have been based on an equal distribution among municipalities and on population size. With the reforms introduced at the end of 2004, poverty also became a criterion (10% of transfers). Still more efforts could be made in decentralization and regional redistribution of expenditures. Investment per capita and poverty indicators at the departmental level are negatively correlated (Bolaños 2005), which is precisely contrary to what the PRS proposes to do.

Monitoring and evaluation

SIAFI has provided some monitoring of the use of the PRS funds at the level of ministerial spending. However, coverage of municipalities is far from complete and should be increased to get the full picture. Moreover, as mentioned earlier, SIAFI only tracks the execution of the flow of resources, not the implementation of programs and policies. The other PRS-related information system, SIERP, is still under construction. This system is to include a whole array of input, process and outcome indicators to monitor the results of the PRS. The existing data base of SIERP is not being used very much as yet. Also, actual mechanisms and methods to assess the impact (both ex-ante and ex-post) of the PRS policies and programs still need to be operationalized and linked to SIERP. Again, institutional weaknesses and shortage of local experts make it difficult to achieve more progress in this area. However, along with adequate external auditing practices, this aspect is critical in order to come to an effective and results-oriented budgeting system.

Donors

Unlike in Bolivia, donors to Honduras have been rather reluctant to move to multi-annual and coordinated aid programs and budget support. This also has reduced the pressure to move to a more results-oriented budgeting system and increase external accountability. Donors also have been reluctant so far, with the exception of the multilaterals, the Swedes, the Germans and the European Union, to engage in budget support and SWAps. Most aid continues to take the form of project aid

The MCA resources are off-budget and thus the spending of these funds is not part of SIAFI, hence outside the budget tracking system. This is a further step away from moving towards sectoral budget support and ROB.

Are an MTEF and ROB realistic options at all for Honduras?

Some clear progress has been made in making the budgetary process more transparent. This is particularly true in technical improvements that could contribute to multi-annual budgeting, tracking mechanisms for budget execution (SIAFI) and some monitoring tools (SIERP) which can become supportive of ROB. However, results-orientation in the budgeting process still has a long way to go and much of the signalled improvements point at changes in the legal framework. Many of the existing flaws of the budgeting process are still prominent, as various recent donor assessments have shown (see World Bank, 2000 and IDB, 2005). In fact, the World Bank still rates Honduras' budgeting system as the Achilles' heel in the efforts towards poverty reduction. Actual budgeting still takes place on an incremental and input-basis, that is, adjusting wage bills and other items from previous year's budget without priority setting and then adjusting to the given budget ceiling. None of this budgeting practice bears a close relationship with operational plans, sector needs and poverty reduction targets. Weak budget control and auditing keeps the system subject to pressures from interest groups and particular interests of members of Congress. Nonetheless, the legal changes to the budgeting system and the participatory process of deciding on the use of HIPC funds are seen as first steps towards an improved budgeting system thanks to the PRSP process. This has still a long way to go though:

- The various instruments (SIAFI, SIERP) require better integration and enlarged coverage.
- These budget tools need to be developed further to make them more genuinely results-oriented.
- There is an urgent need to improve capacity (at ministries, municipalities and other public entities) to handle these instruments to monitor the budget process and above all to prepare budgets consistent with operational development plans; and, in the future, to perform ex-ante and ex-post impact evaluations of poverty reduction policies.
- Improvement of external budget control and auditing mechanisms should be given the highest possible priority. Currently, there is a widespread feeling of mistrust in the government's handling of tax payer and donor resources. Making the budget practice more transparent, clarifying how budget allocations are to lead to developmental goals and making the government more accountable should help improve the government's credibility.

3.4 Nicaragua

Like Bolivia and Honduras, Nicaragua does not yet have an MTEF, but the government is making serious steps to move in this direction with pilot MTEFs for some sectors. Nicaragua has some experience with ROB, labelled as programmatic budgeting, which was tried in the 1980s and revived again under the present government, though without much success. The general weakness in the PRSP process to set priorities among policy actions and determine which actions seem most cost-

effective to reach the poverty reduction goals also manifested itself in this renewed attempt at ROB. The government has since moved back to a more traditional budgeting approach, more realistic where it comes to determining the resource envelope, but throwing away at the same time the results-orientation of the budget.

The original PRSP (ERCERP-I) did not have a precise costing, but did contain a broad financing plan based on what turned out to be rather optimistic GDP growth assumptions.¹⁸ The revised medium term macroeconomic and fiscal framework (MEFF) agreed with the IMF in late 2002 used much scaled-down growth projections in view of the negative per capita income growth performance during 2001–2. Actual growth has remained even below these projections.¹⁹ The MEFF has defined much of fiscal adjustment giving priority to macroeconomic stability, and aggregate government spending has been cut since 2001, providing a severe constraint to the intentions to increase poverty reduction expenditures.

However, as said, fiscal restraints are not the only concern to managing Nicaragua's budgeting system. Despite advances in some areas, there has not recently been much progress in strengthening the institutional capacity needed to apply the budget principles outlined in Figure 2. The institutional challenges that need to be overcome to reach ROB are enormous, as we shall detail in subsequent paragraphs.

The budget process

Nicaragua's budget cycle has four main phases:

- a) **Budget formulation** and identification of the resource envelope: during each annual budget cycle the Ministry of Finance prepares (in May) an initial budget and sets the overall budget ceiling based on forecasts for economic growth and annual inflation in line with the IMF agreement and which are updated every year. With the new Financial Administration Law, it is expected that the budget for 2006 will include an annex with an MTEF containing projections for at least two budget exercises for income and expenditures classified by category and spending institution. Based on the overall budget ceiling, the Ministry of Finance and External Credit (MHCP) prepares sector-specific budget ceilings. Line ministries (education, health, etc.) are asked to formulate their budget needs, but are informed of the spending limits. The budget cycle remains strictly annual and is cash-based only. The definition of the budget ceilings is determined primarily by "incrementalism" and a "fair share" principle (fixed increase from last year's budget for all sectors). The preparation of the sector budgets does not involve any consultation with agencies outside the central government. With the sector budget detail, the economic cabinet of the government establishes the final budget to be submitted for approval by Congress.

The formulation (in 2004) of the 2005 budget deviated somewhat from traditional procedures and was more 'sui generis', as there were no budget ceilings imposed from the outset. This had the obvious result of generating an excess demand for fiscal resources and generating a budget which lacked proper financing. This theoretical exercise was then dismissed with a budget proposal for 2005 that complied

¹⁸ The ERCERP assumed growth with gradually increase from 3.7% in 2002 to 4.5% in 2003 and 5% in 2004. Growth projections of the PND-O have been even more optimistic (see ISS 2004c).

¹⁹ For 2005, the growth outlook is better helped by high coffee and other export commodity prices and dynamic developments in the maquila textile sector.

with the fiscal limits agreed with the IMF. As a consequence, line ministries essentially look at previous year's budget and the given ceiling and do not negotiate for a desired budget based on an analysis of what would actually be needed to achieve the MDGs and other poverty reduction targets.

- b) **Budget approval by parliament.** The National Assembly (Congress) discusses and approves the budget. The executive subsequently endorses the final approved budget and makes it public before January 1st of each year, the start of budget execution. The national assembly is entitled to make changes in expenditures as long as they are compensated by corresponding revenues. The national assembly may not alter recurrent expenditures derived from contractual obligations such as wages and interest payments. It should be noted though that Congress was hardly involved in the 2001 PRSP (ERCERP-I) and not in the PND-O (ERCERP-II). It was informed about the elaboration of a new version in 2005, but did not play an active role in this process either. As a consequence, when approving the annual national budget, the PRS priorities do not tend to get any prominent place in the discussions.
- c) **Budget execution and adjustment:** The Ministry of Finance coordinates and rules the implementation of the budget. It has to inform Congress and the national auditing agency (CGR) periodically about the status of the budget execution. The Ministry of Finance authorizes transfers to ministries and other entities and, as in the case of Honduras, budget reallocation is allowed between ministries with the authorization of the President, who must inform the national assembly of any changes.
- d) **Budget control:** The Ministry of Finance has to conduct its own internal auditing, consolidate the nation's accounts, and evaluate the degree of execution of the approved budget. It subsequently has to present a budget execution report (*Informe de Liquidación del Presupuesto*) to the President and the CGR. The president subsequently has to submit this report to Congress prior to March 31 of the year following budget execution.

In sum, the process of budget formulation follows the scheme of top down (setting budget ceilings) and bottom up (preparing detailed sector budgets), but is not participatory in the sense of involving actors outside government agencies in the budget discussions. The 2004 experiment with a fully bottom-up procedure failed and essentially led to a budget that could not be financed and, because of a lack of priority setting, led to an inadequate allocation of resources once spending limits were set back at feasible levels. The budgeting cycle is still annual and there is no multi-annual programming.²⁰ Efforts aimed at improving the results-orientation of the budgeting process are beginning (see below). The government has no track record of making itself accountable for the budget implementation to the public and, more generally, our stakeholder analysis among various representatives of civil society suggest there exists a fair amount of distrust among the public in the government's use of resources (ISS 2005c).

²⁰ Only the public investment program (essentially for road infrastructure, sanitation, health and schooling infrastructure and other public buildings) traditionally has had a multi-annual programming and still applies. The public investment program covers a three-year period (currently: 2005–7). On the other hand, the MHCP plans to introduce multi-annual programming for the Ministries of Education and Health in the 2006 budget, and for another 19 institutions in the 2007 budget. In this way the new law on financial administration will be gradually implemented.

Recognized weaknesses of Nicaragua's budget system are, among others:²¹

- Nicaragua receives large amounts of extra-budgetary grants from donors, which makes fiscal spending less easy to monitor. Increasingly though, off-budget items are reported in the budget (without making them “on budget” though).
- Budget execution tends to deviate significantly from the original budget, since during the year moments of cash rationing lead to substantial deviations from the budgeted allocations.
- Data on donor funding are incomplete, and there is no systematic or updated inventory of donor contributions.

The budget and the PRSP

The functional breakdown of budget follows a traditional, yet meaningful specification by sectors and specific programs. Poverty reduction expenditures are defined as a combination of the resources channelled through a special (virtual) account, the *Fondo Social Suplementario*, and a classification of budget items for both current and capital expenditures. Education and health make up the bulk of what is defined as poverty reduction expenditure, though the share of other programs has increased in recent years (See footnote 2, p. 17, ISS 2004d). The definition of poverty reduction expenditures has changed over time, which makes tracking difficult and the criteria for distinguishing such spending have been subject to criticism. In essence, pro-poor spending is defined as the sum of social sector expenditures, including for instance universities in education spending. Also, all salaries in education and health are included (including administrative overhead) and some doubt whether all of this should be defined as pro-poor spending.

As in Bolivia and Honduras, the current budgeting process is by and large de-linked from specific targets, let alone the MDGs. For instance, in education there is a budget for the literacy campaign, but no specific target is formulated for reduction of illiteracy. Similarly, the justification of the budget for education makes no explicit link to education plans or clarifies which schooling inputs should be prioritized to reach any specific target for the enrolment rate. For health spending, there is mention of the desired coverage of health centres that should be reached, but no link is made to health outcomes (e.g. reduction of child mortality or reversal of trends in tuberculosis, HIV/AIDS, and so on). To the extent the ERCERP-I, II or III have been more explicit in this respect, all of this gets lost in the formulation of the budget. In addition, as mentioned above, since parliament approves the budget, but has not been actively involved in the definition of the PRS (I, II, or III), budget amendments typically are unrelated to the strategy's priorities.

More pro-poor spending?

Pro-poor public spending (defined as resources for the PRSP) has increased since 2000, although it should be noted that a part is explained by a change in the definition described above. It increased from 8.8% of GDP in 2000 to 11.7% by the end of 2004. A decline is expected in 2005 as estimates show it could reach 10.8% of GDP. Expenditure in education is higher than in health. Budget expenditure for education increased from 3.8% of GDP in 2000 to 4% of GDP in 2004, while expenditure in

²¹ See IDA and IMF (2005) 'Update on the assessments and implementation of action plans to strengthen capacity of HIPC countries to track poverty-reducing public spending', Washington D.C. (April).

health declined from 3.1% of GDP to 2.9% in 2004. The weight of education and health spending in total poverty reduction expenditures declined from 84% in 2001 to 59.5% in 2004, but is expected to increase again during 2005 (see Table 9).

Outlays for poverty reduction have increased as a share of total government spending: from 34% in 2001 to 46% in 2005. Expenditure cuts thus do not seem to have affected poverty reduction programs. It is another matter though, how pro-poor these programs are. The PSIA of the Public Investment Program indicated a geographical bias in spending in favour of the better-off municipalities and regions. Although this is not a proof that the poor are not being reached, it does suggest targeting of spending could be more effective. Further, the actual spending that was financed with domestic resources decreased as HIPC relief funds increased (ISS 2004d).

Table 9 Nicaragua: Poverty reducing expenditures as a share of GDP (2000–2005)

	2000	2001	2002	2003	2004	2005a
Poverty Reduction spending (% of GDP)b	8.6	7.7	9.1	10.9	11.7	10.8
of which:						
Educationc	3.8	3.6	3.8	4.3	4.0	3.9
Healthd	3.1	2.8	2.9	3.2	2.9	3.1
Share in total poverty reduction spending (%)						
Education and health	80.4	84.0	73.7	69.2	59.5	65.1
Education	44.6	47.4	41.8	39.6	34.4	36.5
Health	35.8	36.5	31.9	29.7	25.1	28.6

Source: Data from Ministry of Finance (MHCP) and Central Bank (BCN).

Notes: a. Budget projection for 2005. b. For 2000 and 2001 corresponds to total spending on social sectors. c. Includes Ministry of Education, universities and polytechnic schools of higher education. d. Includes Ministry of Health.

Trade unions have a strong influence on the budget allocation process. Teacher unions and those for health workers periodically press (through strikes and protests) for higher wages, leading to both the temporary suspension of school activities or attention at health centres and to budget adjustments favouring the wage bill at the cost of other types of expenditures. Government responses to these pressures are typically ad hoc and not negotiated in the light of budgetary needs for sector or national development targets.

In practice, the main pressures for budget adjustments during the phase of preparing the budget come from the international community (to ensure fiscal discipline) and from trade unions (seeking wage increases). In order to avoid confrontation, the government tends to shy away from trimming expenditures and instead alternative sources of revenues are being sought. Recently, new taxes on financial transactions and casinos were introduced to mobilize additional resources to finance the increase in expenditures. Another important source of pressure comes from public demands for transport subsidies in a context of escalating oil prices. There was some room to manoeuvre in 2005, without requiring additional measures, but there was no scope for further increases in the 2006 budget.

Budget financing

Several measures have been taken to increase fiscal revenues, such as tax reforms, widening of the tax base and improvements in tax administration. Tax revenues have increased from 13.3% in 2001 to 15.5% in 2004.

The Fiscal Equity Law was reformed in 2004 to give incentives to agricultural producers and the transport sector, to increase the number of products exempted from taxes in the basic basket of goods and to promote the tourism sector by introducing a value added tax on cars passing through the borders and on plane tickets. Continuous efforts are being made to eliminate import duty exemptions and to improve tax administration in order to comply with the projected budget deficit.

ROB and institutional capacity

Already during the 1980s, UNDP supported a government project to achieve a system of “programmatic budgeting”, that is a system by which the budget for each major program would be elaborated on an analysis of linking “inputs” to “outputs” of the program. In essence, this would be a form of results-oriented budgeting. This approach was abandoned with the first government of the 1990s. Under the present government, the idea of programmatic budgeting was revived. As indicated, the preparation of the 2004 budget followed this basic idea in a bottom-up process, but actual “input-output” analysis should also provide a basis for priority setting as it should make clear which are the more effective “inputs” to reach specific goals. As this did not happen, this process led to a long wish list of spending needs inconsiderate of any financing constraint.

One of the problems with the needs-based budget process was the complete lack of training of public employees in the line ministries and other public entities in the application of the ROB approach. Even recently, the customary annual budget workshops at which the budget guidelines would be explained to the responsible government officials have not taken place. In short, the current institutional capacity to move to a more results-oriented budgeting framework is weak, and the government has not been pro-active to improve this capacity, despite its own attempts to move again to programmatic budgeting. Clearly, such institutional weakness is even more severe at the level of local governments.

Experience with donor-sponsored sector-wide programs and projects gives a somewhat more optimistic picture as stated program goals are to be linked to budgets. As donors are intending to increase the share of general budget support in total aid to 20%, such forms of ROB may also become less important, unless for the general budget formulation and execution the government takes the programmatic or ROB approach much more seriously.

Decentralisation

Decentralisation has not been a prominent process in practice in Nicaragua. During 2004, municipal development gained some importance as the central government increased transfers to municipalities from 1.5% to 4% of total tax income. These transfers have no strings attached; that is, municipalities are free to decide how to spend these resources. Actual transfers could reach 6% of central government revenue (instead of 4.5% approved by the government), since it has become a political issue that is responding to agreements being reached between mayors of municipalities and representatives in the National Assembly who share political affinity.

Probably the biggest obstacles to further (fiscal) decentralisation in Nicaragua are:

- The lack of resources of most municipalities, implying among other things, they cannot hire adequate and qualified personnel and quite often during the year resources are missing even to pay the personnel that is hired.
- The social investment fund (FISE) and the rural development institute (IDR) are important actors in local development projects. However, because these entities are well funded and have their own bureaucratic dynamics, stakeholders seem to agree that they work against intergovernmental coordination and harmonization of economic and social policies at the local level.
- The agreement with the IMF stipulates that the 6% of government revenue going to the municipalities should be matched with a transfer of responsibilities (delivery of basic services, and alike) and the capacity for local governments to make their own decisions on how to raise revenues in order to administer and manage projects and services.

Monitoring and evaluation

In Nicaragua, monitoring and evaluation is done by the Ministry of Finance. The Ministry produces quarterly reports for the Congress and the CGR. These are financial reports, which compare the goals for income, expenditure, deficits, and deficit financing to what was actually achieved. There is no evaluation of the progress made in project outcomes or of the relationship between expenditure and poverty reduction. These reports are posted online, where the approximately 20% of the population that has internet can review them.

Donors

Nine donors in Nicaragua have set up a joint financing scheme for budget support. However, out of the huge amount of policy conditions and targets attached to this budget support (160), only thirty-one are related to the improvement of budgetary processes. On the other hand, it can be assumed that the government (the executive) is more able to carry out the conditions in the area of financial management than in many other areas, where implementation often depends on the cooperation of parliament and other actors in society. In practice, however, the most important condition for these nine donors seems to be whether the government is on track with an IMF programme. This means that the value of having a policy dialogue on all other issues, including issues related to budgetary processes, can be questioned.

Are an MTEF and ROB realistic options at all for Nicaragua?

Nicaragua has some early and more recent experience with ROB. However, application of this approach failed, due to a lack of capacity to set clear sector and programmatic priorities in development plans and a lack of institutional capacity to push through more result-oriented budgeting processes. The present government has attempted to push for the approach, but failed to support it with training of its staff to effectively implement it. As a result, the budgeting process remains determined in a fairly traditional way, that is, confined to an annual cycle (no medium-term programming), a top-down setting of sector budget ceilings, and with the budget allocation mainly guided by last year's budget structure and pressures from interest groups. As mentioned earlier, an important

initiative has been made to include in the 2006 budgeting proposal an MTEF containing projections for at least two budget exercises for gross income and expenditures classified by category and spending institution, defining guidelines more clearly for fiscal performance. This will already be a significant step towards an MTEF, but much remains to be done to increase the transparency of the budgeting process as well as to put ROB to work.

3.5 Summing up

In sum, the three countries have taken some limited steps toward ROB and the use of a MTEF. When fully integrated into the budget process, many current initiatives to improve budgeting will help further solidify the foundations. However, as Table 10 shows, the countries are still a very long way off from being technically, institutionally, or politically able to implement ROB. In all three countries, lack of capacity seems to have hindered some of the ongoing reforms. The capacity problem will only increase as the budgeting bar is raised, unless serious capacity building efforts are undertaken. Moreover, we observe a general lack of appreciation in these three governments and in many cases in the donor community as well for how a results-orientation in budgeting could contribute to poverty reduction efforts. This finding is consistent with a general weakness in the evaluation of government and donor programs and projects, which we have noted in previous reports.

ROB and the effective use of an MTEF are still a long way off in these countries. Continued commitment to increasing transparency and improving budgeting procedures will be important if the slow but steady progress in the budgeting arena is to be continued. Better budget classifications and improved comparisons of budgeted and actual expenditures will be an important first step. At the same time, developing the technical and decision-making capacity to link budget creation to desired outcomes and to evaluate program and project impacts will be required to help a move towards ROB and a more effective design of poverty reduction strategies.

**Table 10 Budgeting in Bolivia, Honduras, and Nicaragua:
Stepping stones toward ROB and MTEF**

	Bolivia	Honduras	Nicaragua
The budgeting process is a bottom up approach (line ministries and other spending agencies are actively involved in determined resources needed to meet sectoral objectives)?	No (mainly top down process, although line ministries get opportunity to specify budget needs within strict budget limits.)	No (mainly top down process, although line ministries get opportunity to specify budget needs within strict budget limits.)	No (but did experiment unsuccessfully with bottom-up process in 2004)
The budget has a meaningful functional breakdown (e.g. primary vs secondary education) and operational breakdown (e.g. teacher salaries)?	No	Yes	Yes

	Bolivia	Honduras	Nicaragua
Expenditures are clearly related to specific expected result or outcome (e.g. # of students enrolled or graduated)	No	No	No
The budget is clearly linked to a PRS or national development plan.	No (except allocation of HIPC funds to municipalities)	Partially (HIPC resource and “pro-poor” spending are identified)	No
Opportunities for post-budget modification of allocation and expenditure are limited and controlled, so that the final budget execution closely relates to budgeted expenditure both in terms of allocation and total spending.	No (modifications take place, in large part due to low execution)	No	No
There is a performance-orientation to the budgeting process	No	No	No
Some form of MTEF is used in the budget process.	No	Yes (Three year forecasts of revenue based on growth projections)	Yes, for some sectors (As an annex beginning with the 2006 budget)
There are NO substantial restrictions to ROB, as there is sufficient/adequate: – implementation capacity – legal framework – interinstitutional coordination	No	No	No
ROB is politically workable in the sense that there is no continuous distorting pressure by particular interest groups (e.g. trade unions, clientelist behaviour of politicians)	No	No	No

4. Conclusions and policy recommendations

Future of the PRS process in Bolivia, Nicaragua, and Honduras

There are two main messages coming from this report. First, implementation of the PRS approach continues to encounter problems in Bolivia, Honduras and Nicaragua and there are doubts that the PRS process will remain a credible framework for poverty reduction interventions. In Bolivia and Nicaragua, such problems are severest, amidst tense political conflicts and ever-changing positions on what the countries' PRS is. In Honduras, at first sight the PRS process has gained momentum, and there are indications this can be carried over to the new government to be elected in November 2005. However, also here the process needs to gain credibility to become effective as an instrument in combating poverty and institutional weaknesses detract from its potential. Moreover, the fate of the PRS in Honduras over the next year will be telling as the motivation to maintain the process in order to reach the HIPC completion point is gone.

In short, the basic principles of the PRS approach may be useful in theory, but unlike World Bank/IMF review (WB-IMF 2005: pp. 66), it is hard for us to conclude (at least in the cases of Bolivia and Nicaragua) that these countries need just to "consolidate progress" in the PRS process. In fact, any effort to preserve the principles of the PRS process (participatory, medium-term, results-oriented, based on partnerships) probably implies a step away from the much politically discredited PRS process in Bolivia and Nicaragua, or at least from the idea of a PRSP-style poverty reduction strategy. Both the Nicaraguan and Bolivian cases lead us to ask to what extent the principles of the PRS approach can be preserved in politically fragile environments, where there are severe difficulties in reaching political or social consensus on the central point of the whole PRS process – the country's chosen approach to poverty reduction.

Bolivia

Bolivia has changed directions on the PRS several times, but currently still lacks any plan that the government or donors consider to be its PRSP. Much attention has been paid to participatory processes (due both to the National Dialogue law and to the insistence of the donor community), but reaching consensus on a broad-based PRS has not been possible in the current environment. This is widely recognized, but failure to produce a revised PRSP or a monitoring report continues to be cited as a

reason for non-disbursement of aid and for the lack of a PRGF. In this sense, insisting on a PRSP could hinder rather than help the fight against poverty. One must acknowledge, however, the possibility that the lack of a PRSP is simply a convenient “out” for international institutions whose primary concerns lie elsewhere. Either way, the focus at this stage on the need for an approved strategy appears to be an unfruitful distraction from serious issues that the country currently faces and from the progress Bolivia has made (despite the turbulent environment) in maintaining social expenditure and meeting other conditions set for multi-donor budget support.

Nicaragua

In Nicaragua, the government has produced several poverty reduction strategies (under different names) with almost no involvement of other actors who might have put pressure on the government to stick to a particular plan. Unlike Bolivia, problems with the PRSP have not stood in the way of aid in Nicaragua. A major lesson from Nicaragua’s experience is that even so-called second generation PRSPs, which are expected to enjoy greater national ownership, will not necessarily be stable guides for policy making and budgeting over the medium-term once the HIPC completion point is past.

In cases like Bolivia and Nicaragua, it would be helpful to officially lower the bar for the country’s PRS (by clearly signalling flexibility in terms of process and content) and to accept the possibility that the “strategy” come directly out of established national planning or political processes (i.e. a national development plan or a government’s political agenda). A focus on realistic agendas rather than comprehensive plans would also be useful at this stage.

Honduras

The Honduras case currently looks more promising than the other two. There has been some progress at deepening the involvement of civil society actors and the regional focus in the process of developing annual implementation action plans. The stability of the PRS and the apparent commitment of the candidates for the Presidency to this agenda are also promising. It remains to be seen, however, what happens after the elections, especially now that the need to stick with the PRS for the purpose of receiving HIPC debt relief is gone. The national government could choose to follow its current path of finding room for political manoeuvre within the approved PRS framework, or to follow the examples of Nicaragua and Bolivia, where the governments found it politically useful to reject and distance themselves from the strategies. Even with a stable strategy, we cannot say that budgeting and activity planning in Honduras is “results-oriented”.

Improving budgeting for poverty reduction

This brings us to the second major message of this report: moving towards a results-orientation in policy making and budgeting are important goals for all three countries, but there is clearly much to be done before this can become a reality in the budgeting process in Bolivia, Honduras, and Nicaragua. The link between the PRS and the budget system is weak, due to a general lack of results-orientation in the budgeting process and weaknesses in the overall fiscal management system. This contains lessons for governments and donors alike. The route to a MTEF and ROB is still very long in all three countries, because much of

the basics of a good budget performance management is lacking. Countries have started improving budgeting systems as part of the PRS approach or as an independent initiative. However, one needs to get the basics of the entire process right in order to also be able to make significant improvements in making budgets for poverty reduction spending more transparent and accountable as well. The key message is that a more focused (sectorally, perhaps), but less comprehensive approach is needed to make credible steps forward and should be followed before embracing more sophisticated budgeting tools. Without strengthening the institutional capacity of internal and external controls of complying with budget procedures and agreed budget allocations, one will have little benefit from more advanced budgeting tools such as an MTEF and ROB. Now that many technical issues are gradually resolved, it becomes most critical to truly strengthen the links between poverty reduction policies and programs (whether they are part of PRSP or not) and the budget. Donors can support these processes by linking multi-donor (and multi-annual) budget support programmes to improvements in budgeting processes, which in the short run enhance transparency and accountability of government expenditure and may ultimately lead to a more result-oriented budgeting.

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