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Effects of Budget Support
– A Discussion of Early Evidence

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Preface

This literature review is part of the preparation of a comprehensive Joint Evaluation of General Budget Support (GBS). The preparations of the evaluation started in late 2001 when the UK Department for International Development (DFID) launched an Evaluability Study of GBS. The Joint Evaluation of GBS was formally launched in Brighton 2003, with 28 members in the Steering Group.[1] The evaluation will involve seven country evaluations and several thematic evaluations. A synthesis report will summarise the main findings from all aspects of the joint evaluation.

The purpose of this literature review was to review and summarise existing literature on GBS (ongoing and completed studies and evaluations), and apply this new information to the GBS evaluation framework.[2] It should provide donors with early evidence and lessons on the effectiveness of GBS as an aid instrument, making clear where sufficient existing evidence supports or contradicts the framework and where the picture is less clear. Another objective was to produce a useful input for the evaluation team in the inception phase of the GBS evaluation, indicating the issues where more evidence is necessary and the issues appropriate for the evaluation.

The literature review was conducted by Maria Nilsson, CEDICON. The report represents the views of its author and not necessarily the views of the Joint Evaluation of GBS or Sida.

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[1] Members of the SG as of April 2004:

Governments of: Burkina Faso, Malawi, Nicaragua, Rwanda, Uganda and Vietnam.

Australia, Belgium, Canada (CIDA), Denmark, European Commission, France, Germany (BMZ), Inter-American Development Bank (IADB), the IMF, Ireland, Japan (JBIC, MoFA), the Netherlands, New Zealand, Norway, OECD/DAC, Spain, Sweden (Sida), Switzerland (SECO), United Kingdom (DFID), USA (USAID), the World Bank.

[2] Booth, D. and A. Lawson (2004). "Proposed Evaluation Framework for General Budget Support: Framework for Country-Level Case Studies", Final Report to the OECD-DAC Technical Working Group on Evaluation of Budgetary Aid, ODI

Table of Contents

1 Introduction

Budget support is not a new aid form but its importance and nature has changed since the late 1990s. Many reasons explain this change including; growing disappointment about the unsatisfactory results of project aid in reducing poverty; the declining importance of other programme aid forms; and the change in the donor – recipient relationship paradigm towards a greater focus on partnership.

This report adds to the core documentation supporting the ongoing Joint Evaluation of General Budget Support. It builds on the Booth and Naschold (2002) *General Budget Support Literature Review* and the Booth and Lawson (2004) *Framework for Evaluation of General Budget Support*. The aim of this paper is to complement the other two documents by tracing the process to date and look at early indications of problems and positive development across a number of recipients and donors. It will do this in an introductory way, not attempting to go too deep into each area. Its contribution will be an overview of the current situation as far as it can be deduced from available secondary sources.

1.1 Assumptions

In order to be able to approach the literature in a coherent way three assumptions have been made covering:

– What will be meant by budget support in this report

– The time period

– The model used for preliminary deductions

1.1.1 The Budget Support Package

The approach to budget support needed to cater for two major factors, its changing nature and the difference between donor views.

In the late 1990s budget support was defined, if at all, as quick disbursing funds, often accompanied by policy dialogue[1] in the context of structural adjustment programmes. This definition does no longer represent a correct picture of the support form.

Table 1.1. (in appendix) gives a useful illustration of the development of objective and rationale for budget support. It also indirectly highlights the increase in importance of the aid instrument for the donors. Prior to the late 1990s it was almost impossible to find any specific objectives and rationale for budget support, whereas they are abundant today.

However, the fact that budget support has grown in importance has not meant that there is a common definition of this form of support. This is made clear by table 1.2. (in appendix). Nevertheless, some more or less common features may possibly be extracted. The basic concept is a transfer of resources to be added to the government budget of the recipient country. These funds are supposed to be allocated, used and audited according to the most efficient and effective way possible, which may require technical assistance from the donor. In order to not put an undue burden on the government the

[1] Meaning mainly conditionality

donors often try to harmonise procedures and align with the Poverty Reduction Strategy Papers (PRSP) or equivalent document. As a further input into the appropriate use of funds policy dialogue and conditionality is frequently added.

Together these factors form a package that both adequately reflects the new view of budget support and also avoids excluding any donor definition. This is the approach that will be used here:

The Budget Support Package

Funds
Technical Assistance Donor
Harmonisation
Alignment
Conditionality
Policy Dialogue

1.1.2 The Time Period and the ”Old” and ”New” Budget Support

To be able to compare changes between the older and the newer forms of budget support, the time frame (1994–2004) has sometimes been divided into pre– and post–2000 taking the year 2000 as the switchover point. This is of course not entirely correct since the change has been gradual (and is still ongoing in some areas) but it provides a useful, albeit rough proxy.

The old budget support will refer to pre–2000 budget support including mainly funds and policy dialogue/conditionality. The new budget support is post–2000 and in design refers to the package presented above.

1.1.3 The Model

Based on the above concept, and again in order to be able to approach the literature in a systematic way, a model of how budget support contributes to poverty reduction is assumed. This model is a stylised version of the one found in the Booth and Lawson (2004) *Framework*. The links within this model are sometimes based on established causalities but more often on loosely held assumptions found in the literature. This assumed model only serves as a backdrop to the specific findings in this report and the report does not aim to discuss the merits of the links within the model.

The dynamics of this tentative model are very simple:

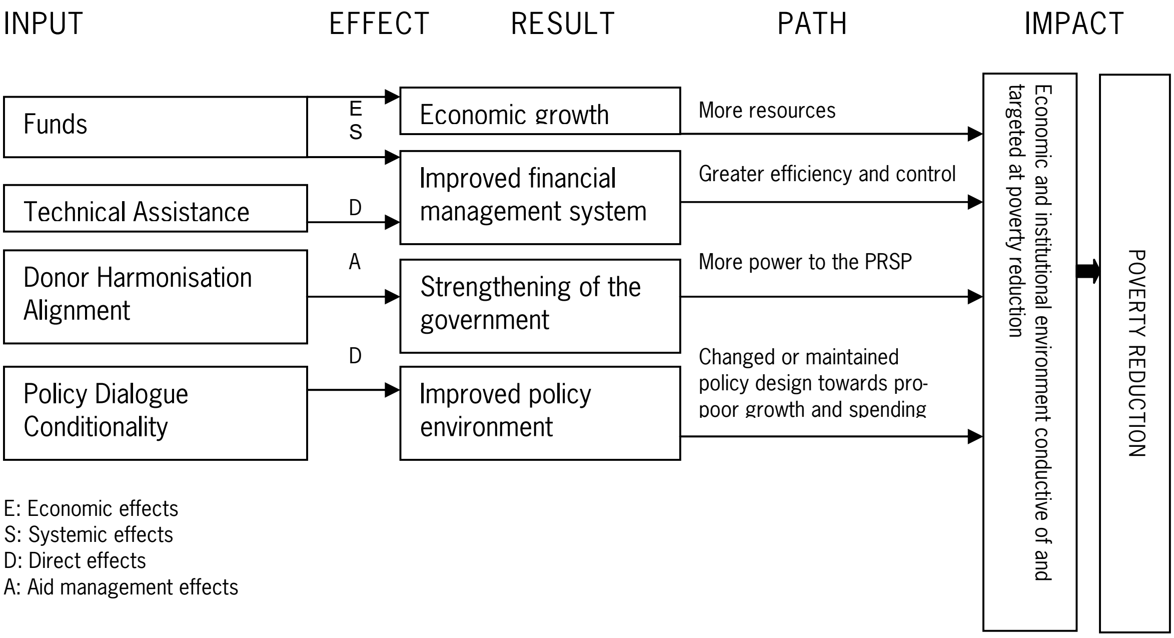
1. An input will be supplied
   Question to be answered: Is the input supplied?

2. This input will have an effect, either directly or through changes taking place because of it.
   Q: Are the stipulated changes (effects) taking place?

3. The effect will lead to the expected result.
   Q: Are the effect having the intended results?

The reasons why the changes are or are not happening and the transmission mechanisms (the hows) will also be discussed briefly. However a thorough analysis would need a much deeper investigation.

The Model



This report does not test the framework all the way to poverty reduction, mainly because the new partnership approach to budget support, as well as aid in general, recognises that the ultimate responsibility for pursuing poverty reduction is in the hands of each individual government. This does not mean that the donors have no hand in the final process, quite the contrary. Budget support at its best contributes to a strengthening of the economic and institutional environment that is essential for poverty reduction to be possible.

A general shortcoming of the model is that it does not take into account the effects the individual results will have on each other. To some extent this is captured by the impact box, stipulating that the budget support results will work together to create an economic and institutional environment conducive to and targeted at poverty reduction. However, it would also be possible to assume arrows directly between some of the result boxes.

1.2 Limitations

In general, findings in the existing literature are relatively few. There are several reasons for this:

a) The only comprehensive studies on budget support (programme aid) were either completed before 2000 (White 1999a) or focuses on pre–2000 support (IDS, 2002) so they do not reflect any impact of the new approach to budget support.

b) Some elements of the budget support package are at an early stage, in particular donor harmonisation and alignment.

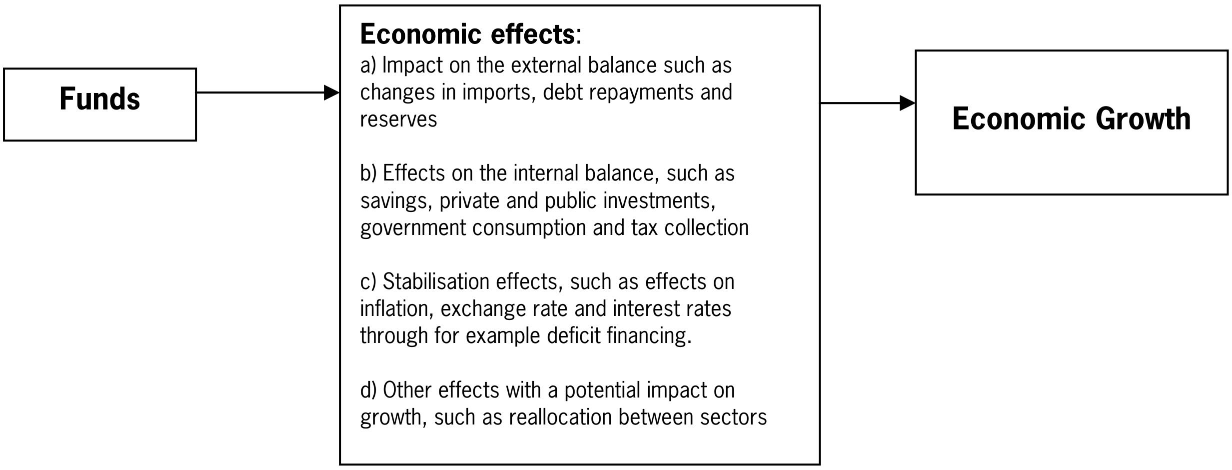
c) Some areas, such as actual design and implementation of financial management systems require a much more profound study than can be conducted here.

The International Financial Institutions (IFIs) are underrepresented. This should not be viewed as a reflection of any lack of activity on the parts of (mainly) the World Bank and IMF but rather to the choice of focus made by this report. It is, however, an unfortunate limitation since important insights may have been lost, and attempts to rectify this shortcoming in further work would be welcome.

2 From Funds to Economic Growth

2.1 Introduction

The first link to be discussed is the one between funds, economic effects and growth. This link is deliberately investigated first since it provides an illustrative bridge between the old and the new budget support.



Throughout this chapter the term programme aid will be used instead of budget support, for two reasons:

1. There is no difference between the economic effects of the *funds* from different programme aid modalities (of which budget support is one, alongside the now almost extinct import support and debt relief). Even though the other elements of the new budget support package (technical assistance, harmonisation/alignment and conditionality/policy dialogue) may have impacts on the institutional and policy environments, possibly not achieved through the other programme aid modalities, the actual funds, regardless of being debt relief, import support or budget support, will all meet the same policy and institutional environment (provided they are all disbursed during the same time period) and thus have the same economic effects based on this environment.

2. In the instances where it would have been interesting to look at budget support specifically, for example to see to what extent the donor focus actually has changed, this has not been possible due to the poor quality of the DAC aid data system on which the data in the chapter are mainly based.

2.1.1 Background

Economic growth is the "original" objective for programme aid, including budget support (see table 1.1. in appendix). With the new approach to aid in general and budget support in particular this could be forgotten easily. Under the paradigm "*Growth is necessary but not sufficient for poverty reduction!*" growth has been, at best, demoted to a rationale for budget support and at worst omitted altogether. A close investigation of table 1.1. shows quite clearly that growth does not feature strongly in the post-2000 donor policy papers, to the extent of giving the impression that growth may not even be perceived as *necessary* for poverty reduction.

There are a number of possible reasons for this. Even at the time when economic growth was the only explicit objective for programme aid, understanding of the mechanisms behind this was generally low among aid officials. A finding from the Swedish programme aid evaluation (White, 1999a) was that there was a ”*general shortcoming in the documentation, whereby the links between the programme aid funds and their intended outcomes is not made. This gap reflects an apparent weak understanding of the working of PA* [Programme Aid] *on the part of many Sida officials*.” (White, 1999a p. xv) Judging from other documents (e.g.Tarp and Kragh, Caputo, Koichi, Koht Norbye, in White, 1996) this was not an uncommon feature in other countries as well. Some notable exceptions were the Netherlands and UK (Eeckhout, de Jong and de Valk, Healy, in White, 1996)

This confusion was of course not reduced by the new growth theories focusing more and more on the policy and institutional environments as important determinants of growth.

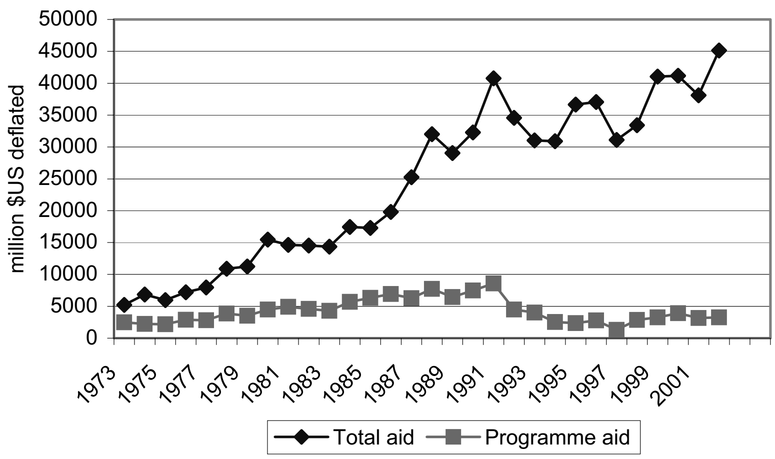
2.1.2 Chapter Layout

This chapter will investigate a number of issues related to economic aspects of budget support. Section 2.2. will track down the trends in fund disbursements and discuss the volatility of disbursements. Section 2.3. makes a brief survey of some of the most commonly used economic models on the effects of aid, followed by a review of to what extent the literature has presented indications in support of these intended effects. In section 2.4. actual growth effects (if any) of programme aid will be presented and the last section concludes.

2.2 Input: Funds

2.2.1 Trends

Programme aid disbursements have declined rather dramatically in relative terms during the last 30 years and also in absolute terms since the late 1980s/early 1990s (see figure 2.1). This coincides with the ”beginning of the end” of the import support systems. When import support started to decrease it was not replaced by budget support but rather by debt relief (albeit not on a one-for-one basis)[2].



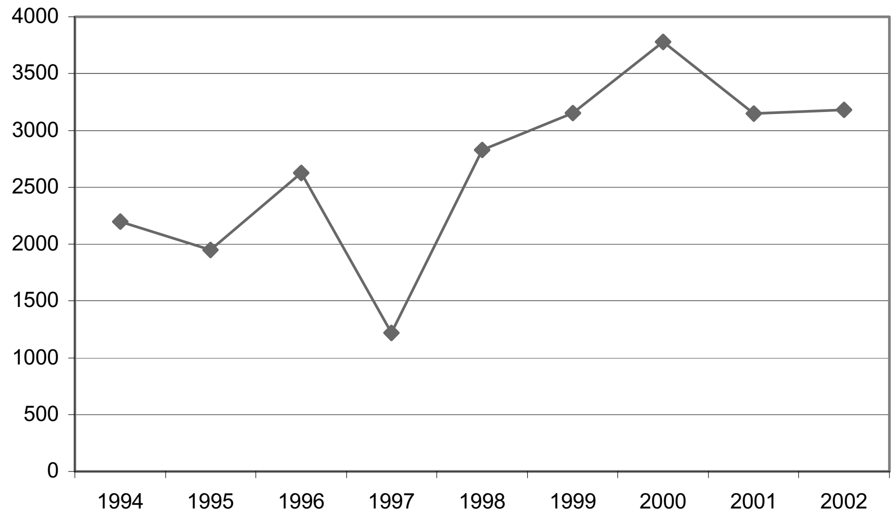
Source: www.oecd.org/dac

[2] For a thorough analysis see for example Danielson and Nilsson, (1999)

Although 30 years is too long a time horizon for this report, it is important to bear in mind that providing development assistance as programme aid is not a new phenomenon. Moreover, programme aid used to contribute a much larger share of total aid than it does today.

However, as figure 2.1. also shows that the downward trend seems to have been reversed. Isolating the 1994–2002 period, as in figure 2.2., makes the reversal more marked. It also highlights the all time low that was reached in 1997.

Table 2.2. Programme Aid Disbursements 1994 - 2002 (million $US deflated)



Source: www.oecd.org/dac

<u>To sum up</u>: After a long period of decline, it looks as if programme aid is starting to increase again.

2.2.2 Volatility[3]

Volatility and the related question of predictability are best examined on a country-by-country basis, since aggregated figures may cancel out fluctuations, giving the impression of no volatility.

Looking at figure 2.3 it becomes obvious why volatility of programme aid in particular is an much discussed issue. In five of the seven evaluation focus countries there are substantial year-to-year variations in programme aid flows and even though it may be too early to make any definite conclusions, the data does not suggest that the introduction of the new kind of budget support has reduced these variations. Rather, the volatility may have increased for some countries[4] towards the end of the period. The SPA (Strategic Partnership for Africa) actually warns that donors striving for unanimity under the new framework for budget support may in fact increase the volatility of aid since donors will react on the same set of performance indicators (SPA, 2004b).

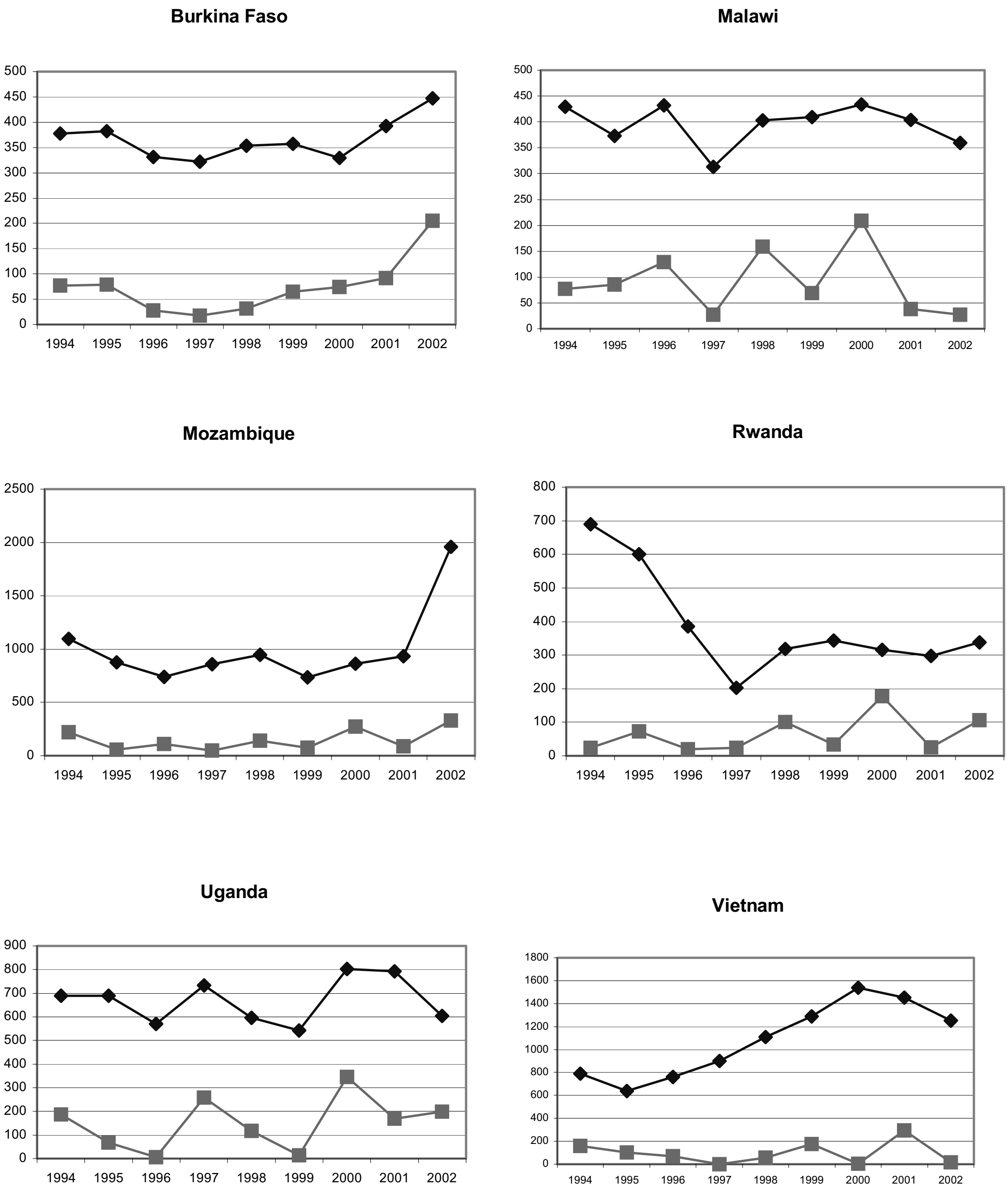
[3] Figures in the section are derived from DAC (www.oecd.org/dac) and subject to the usual reservations regarding quality. Information on World Bank and IMF credits from www.worldbank.org and www.imf.org.

[4] This is far from being a complete sample

Figure 2.3. Total Aid and Programme Aid to Selected Countries 1994–2002
(figures in million $US deflated)

—— Total aid

—— Programme aid



However, volatility is possibly most economically damaging if it is not predictable. Predictable volatility can be managed through the budget if the recipient country knows that its revenues will fluctuate.

There is reason to believe that the fluctuations experienced in the presented countries could at least to some extent have been predicted, since they seem to coincide with IFI agreements on major credits.

Burkina Faso, which has experienced very little fluctuations also has received at least one of either World Bank Poverty Reduction Support Credit (PRSC), HIPC initiative support (original or enhanced framework) or a credit under the IMF Poverty Reduction and Growth Facility (PRGF or the predecessor Enhanced Structural Adjustment Facility – ESAF) every year since the late 1990s.

Mozambique has also had continuos arrangements with the IMF but the peaks in 1998 and the year 2000 coincide with HIPC activities.

Malawi received an ESAF credit in 1995 and a PRGF credit plus an HIPC decision point arrangement in 2000. The 1998 peak has been more difficult to trace but coincide with the completion of a new World Bank Country Assistance Strategy, which may have opened additional credits.

In Uganda it is most noticeable that both 1997 and 2000 are years when no new (major) IFI agreement of any kind was signed and the same is true for Vietnam in 2000 and 2002, whereas in 2001 the country received both a new PRSC and PRGF credit.

Even though the volatility of programme aid seems correlated with IFI agreements at first glance, the responsibility for it cannot be put on the IFIs. Volatility is probably accentuated by the tendency of bilateral donors to tie their programme aid to the ESAF/PRGF, and more recently to the PRSC. However, again, this is not necessarily a negative feature since it may provide the recipient country with a level of predictability, at least regarding timing.

<u>To sum up</u>: Programme aid does seem to be more volatile than total aid, but a superficial investigation indicates that the peaks have a tendency to coincide with IFI activities and should therefore be to some extent predictable.

2.3 Economic Effects

2.3.1 Models

Economic models are always stylised descriptions of reality, based on assumptions about relationships, with more or less foundation in empirical evidence. Some models of particular relevance to budget support are presented below. The oldest and, until lately, most widely spread is the two-gap model which is highly simplified. Others represent a move towards the new growth theory, which has a closer relationship to empirical evidence and also take into account economic policy and the institutional environment. In general the models are not mutually exclusive but attempt to explain different aspects of growth.

2.3.1.1 The Two-gap Model

The Harrod-Domar two-gap model is not only the first but also the most widely used model for explaining aid effects on growth. The argument states that in order to grow a country needs to invest and there are two constraints to investment: investible resources (savings) and investment goods (which in a developing country needs to be imported and therefore requires foreign exchange). The ”gap” emerges when the country sets a desired growth rate and calculates how much ”extra” savings and/or foreign exchange are needed to achieve this rate of growth. The binding constraint is the larger for the two gaps and the assumption is that the donors only have to make sure that an amount large enough to fill this gap is extended in aid for the country to achieve the desired growth rate.

Founded on the attempt to explain a situation completely unrelated to foreign aid, it has over time been developed to include a number of assumptions that may possibly sometimes be considered somewhat heroic. Nonetheless, it has been the major model for aid on growth during the last 50 years and it was actively used by, for example, the World Bank well into the 1990s (Easterly, 1997).

This model is of particular significance to budget support since the two gaps were widely used as rationale for programme aid, at least until the late 1990s. Investigating the time trend of rationale in the Swedish programme aid evaluation also showed that references to the internal gap increased substantially towards the end of the period, coinciding with a stronger focus on budget support (Danielson and Nilsson, 1999).[5] This model in general does not take into account the impact of economic policy nor the impact of the institutional environment.

2.3.1.2 The Marginal Impacts Approach

The marginal impacts approach represents a move towards a more comprehensive approach to aid, economic effects and growth. It recognises that even though investments are important for growth, growth can also be promoted through other channels. White (1999a) suggests that programme aid's link to growth is not through supporting imports but rather through supporting stabilisation. Programme aid can help stabilisation both by providing a non-inflationary form of finance (used neither for expenditure increases nor taxation reduction but to offset deficit financing) and through its role in exchange rate management.

2.3.1.3 Gap Closing v.s. Gap Filling

The discussion about gap closing instead of gap filling moves one step further towards allowing policy and institutional environment into the discussion of economic growth. Hjertholm et al. (1998) suggest that gap closing is achieved by promoting policies that in the future will make aid obsolete. To close the trade gap they suggest three main channels:

(i) supporting a conductive policy environment;

(ii) financing infrastructural development; and,

(iii) direct support to export promotion.

The main objective of course being a continuous increase in export earnings.

The closing of the fiscal gap is slightly more complicated. It involves

(i) increasing government revenue in a manner, which minimises the distortionary nature of taxation; and,

(ii) promoting the effectiveness and efficiency of expenditure.

[5] From the pure model, it is difficult to interpret this since the binding gap is always the largest one and the economic effects will be the same regardless of which gap is binding.

However, unlike export earnings, government revenue cannot be expected to increase indefinitely, particularly in the absence of productive state owned enterprises. Tax revenue remains low in most developing countries and Hjertholm et al suggest that institutional capacity building could be a path towards furthering growth.

This approach is particularly relevance to budget support because the notion of gap closing is well in line with the new budget support concept.

2.3.1.4 The Fungibility Literature and the Impact of Aid on Sector Allocation

Even though fungibility was defined as early as 1967 by de Vries, interest in it has recently increased. This has been due in part to its prominence in the 1998 World Bank *Assessing Aid* report and partly due to concerns of budget support donors regarding the actual use of funds.

The basic framework is presented in figure 2.4 below (adapted from Deverajan and Swaroop, 1998)

Suppose a country spends its total resources on a single private good, Cp, and two public goods, G1 and G2. It pays for these goods with its own money. In addition to its own money, the country receives foreign aid earmarked towards the purchase of good G2.

The line BB' represents the countries alternatives of how to allocate its resources without aid. Given the preferences of the country (represented by the utility curves), A is its optimal choice. Now the country receives an amount F of earmarked assistance from a donor. From the donor's point of view, who has different preferences than the recipient, the optimal mix would be at point D. At this point the recipient has spent all the additional resources on good G2 and not increased consumption of any other goods at all. If the donor can make the recipient to do this, aid is fully non-fungible.

However, for various reasons, the donors may not be able to monitor the intended pattern of public spending. If the recipient can treat the entire amount F as an addition to its own resources, then aid is fully fungible. In this case the new budget line is given by B'C'C. The actual allocation of resources is represented by point E (where the optimal utility curve meets B'C'C). Thus the recipient will not use the entire aid amount to increase spending on good G2[6].

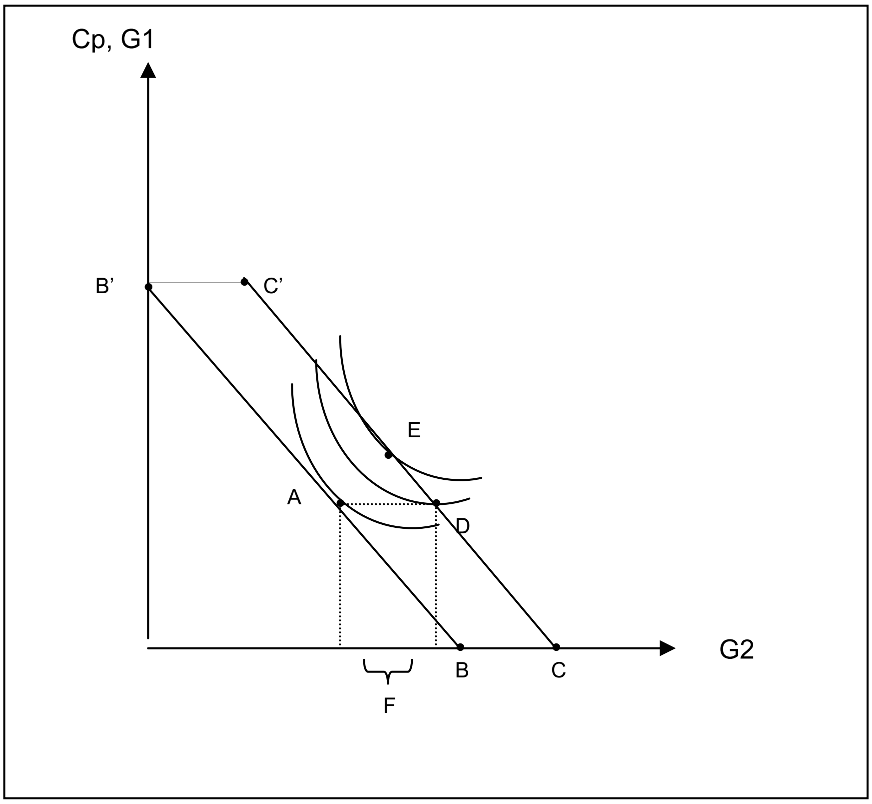
If the donor can to some extent but not entirely control the use of funds the funds will be partially fungible. In this case the recipients budget line would move out with the fungible part of the funds and the choice of basket would be somewhere between points D and E.

This model implies that if the donor and the government have the same set of preferences, as is assumed by basing support on the PRSP (more on this issue in chapter 5) fungibility will not be a problem since the values will be shared. However, McGillivray and Morrissey (2000b) show that this assumption may be upset if the officials implementing expenditure plans misperceive the intentions of the policy makers who set the expenditure plans.

A criticism towards the sometimes excessive focus on fungibility has been voiced by McGillivray and Morrissey (2002a) saying that much concern about fungibility is misplaced and that the relevant issues are rather how aid impacts on total spending and financing and how spending plans are implemented.

[6] The reason the new budget line doesn't go all the was up to the axis is that the one thing the recipient cannot do is spend less than the aid amount on good G2

Figure 2.4. The Fungibility of Aid



2.3.1.5 Fiscal Response

A further move towards a disaggregated approach to aid effects is supplied by the fiscal response models. The fiscal response literature focuses on the impact of foreign aid inflows on the fiscal behaviour of the recipient economy. It investigates the correlation between aid and public savings, investments, consumption and tax collection. The foundation was laid by Heller (1975). It has been developed since but remains sensitive to model specification (OPM, 2003).

Although suffering from modelling problems, in particular in connection with the often weak data found in developing countries, it is still of particular interest to budget support for two reasons:

1. It shares budget support's focus on the internal account
2. Attempts have been made to look at the specific effects of different types of aid (for example in Mavrotas, 2002 and OPM, 2003). This opens up the possibility of tracing the specific effects of budget support through the system.

2.3.1.6 Sectoral Allocations and Growth

There seem to be few studies about the effects of sector reallocations on growth.

A number of studies find that human capital (including health and education indicators) may have a positive impact on growth (Easterly and Rebelo, 1993, Ochikoya, 1995, Barro, 1997, White, 1997, Ojo and, Easterly and Levine, 1997, Lensink and White, 1999, Calamitis et al., 1999, all presented in

White, 1999a and Deninger and Okidi, 2003). However, this literature is only loosely connected to actual sector allocations.

A recent study by Williamson and Canagarajah (2003) discusses the risk around targeting budget support for pro-poor spending. In Uganda[7] they argue that the way the funds are spend may in fact not be conductive to sustainable growth. The authors found that not much effort was spent on balancing the immediate expansion of service delivery with interventions which could enhance the economic opportunities for the poor, through stimulating private sector growth and hence private sector demand for goods and services from the poor. Private sector growth, it was argued, would improve the ability of the government to sustain services in the future, through increased revenues for taxes. Further, Williamson and Canagarajah argued, since the economic growth in rural areas had largely come from an increase in demand stimulated by a donor funded increase in public expenditure, and not generated by private sector demand, it was very fragile.

<u>To sum up</u>: The economic models relevant to budget support have moved towards a greater inclusion of the institutional and policy environment. However, there seem to remain a lack of research about aid, sectoral allocations and growth.

2.3.2 Empirical Findings

The most comprehensive study on the impact of programme aid on growth is the 1999 White et al Swedish programme aid evaluation. It consists of 13 volumes including case studies of eight countries[8] and five thematic studies[9]. The study was originally envisaged as investigating the effects of Swedish programme aid but it was not possible to distinguish those from effects from other donors' programme aid. The study therefore looks at the effects of all programme aid. Since no other study of the same magnitude has been conducted the findings below will be slightly biased. To counteract this, as well as to provide a background and a point of comparison, results for aid in general (non budget support specific) has also been included.

2.3.2.1 The External Balance

Aid funds will mainly have an impact on imports (allowing more imports than without aid) and on interest payments (debt service). They also, to a lesser extent, effect reserves, leading to a larger reserve (something that may play an important role in stabilisation).

Imports

In Nicaragua Dijkstra claims that in the absence of programme aid, imports would have been 30 to 70 percent lower than actual (Dijkstra, 1999a). Similar figures have been found regarding Mozambique and Uganda (White, 1999b and Ddumba-Ssemtamu et al, 1999) and, to lesser extent, Bangladesh, Cape Verde, Tanzania, Vietnam and Zambia (White, 1999a).

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[7] Where there is clear indications that budget support has succeeded in increasing allocations for health and education through the Poverty Alleviation Fund

[8] Bangladesh, Cape Verde, Mozambique, Nicaragua, Tanzania, Uganda, Vietnam and Zambia.

[9] Development of Swedish programme aid, programme aid and conditionality, programme aid and reform, programme aid modalities and a critic of the World Bank Assessing Aid report (World Bank, 1998)

Debt Service

Studies have found external debt to have a negative relationship with growth (Ojo and Oshikoya, 1995, Lensink and White, 1999 in White, 1999a). White (1999a) found a strong positive link between programme aid and debt payments in most case countries but in particular in Nicaragua. One may argue that since HIPC this is no longer as relevant – but because a lot of programme aid prior to HIPC was used for debt servicing, post-HIPC programme aid is freed up for other uses.

Reserves

Several documents have pointed to the importance of the active use of the reserves for economic management in particular in Uganda. Since Uganda is so heavily aid dependent and a large part of total aid is in the form of programme aid, worries about Dutch disease occasionally surface. However, the government seems well able to counteract this by exchange reserve management (Adam, 2001 in OPM, 2003).

The efficiency of reserve management was also evident when donors decided not to disburse budget support to Uganda by the end of 2002[10]. The World Bank PRSC stocktaking points out: "… *shocks of this magnitude, although not welcome, were relatively easily handled by adjusting Uganda's ample foreign exchange reserves, typically running at 6 months' worth of imports*." (World Bank, 2003h p. 9)

2.3.2.2 The Internal Balance

Savings

As can be seen from table 2.1. it seems fairly well established in the literature that aid has little effect on savings. Nonetheless the White (1999a) study actually found increases in savings rates in association with higher aid in both Mozambique and Uganda (White, 1999a).

OPM, using an extended fiscal response framework also found a positive effect of programme aid on domestic savings in Uganda. By contrast all other aid forms (project aid, technical assistance and food aid) were found to have either a zero or negative impact on domestic savings (see table 2. 2).

Investment

The investment–growth relationship is a very well established one (see for example Savvides, 1995, Ojo and Oshikoya, 1995, Lensink and White, 1999 and Calamitsis et al, 1999 in White, 1999a). Therefore it may seem surprising that the aid–investment relationship has received less attention than the aid–savings relationship. However, most available studies indicate a positive relationship between aid and investments (see table 2.2)

Table 2.1. Correlation between Aid and Savings: Results from Selected Studies

Studies	Data	Coeff.
Griffin (1970)	32 countries (cross section)	-0.73
	13 Asian and Middle East	-0.82
Gupta (1970)	Columbia (time series)	-0.83
Weisskopf (1972)	50 countries (cross section)	0.03
Papanek (1973)	44 LDCs (pooled)	-0.23
	34 LDCs (cross section)	-0.73
Gupta and Islam (1983)	51 LDCs (cross section)	-0.64
	52 LDCs (cross section)	-0.47
	18 Asian	-2.00
	13 African	-0.37
Mosley (1980)	21 Latin American	0.33
Bowles (1987)	83 LDCs (cross section)	-0.11
	India	-1.10
	Tanzania	-0.61
	Paraguay	-1.10
Morriset (1989)	Argentina	-0.98
White (1992)	66 LDCs (cross section)	-0.09
Reichel (1995)	83 LDCs (cross section)	-0.79

Source: OPM, 2003 p. 19

[10] because of a sudden surge in military expenditure

White (1999a) suggests that programme aid can increase investments directly though the government budget or indirectly by creating an investment-friendly economy and by reducing the debt overhang. The evidence found in the evaluation concluded that these effects had not been very strong. Expenditure increases were mainly recurrent and not capital, with the exceptions of Uganda and Sri Lanka, where aid helped increase public investment, which was also associated with higher private investments. Reduction of the debt overhang was only found in one case (Nicaragua) and it was argued that in general market forces could not be relied upon for aid to create a good policy environment for investments (White, 1999a).

Dijkstra (1999a) found a positive relationship between programme aid and investments in Nicaragua during the 1990s.

The OPM study on aid to Uganda found a positive relationship between programme aid and both private and public investment. Moreover public investments also appeared to crowd-in private investment (OPM, 2003). The same result was found for technical assistance, whereas for project aid both these relationships were negative (see table 2.2).

The positive relationship between aid and public investment is also confirmed by table 2.4. presenting studies using the fiscal response approach. The Mavrotas, (2002) study is particularly interesting since it uses an aid disaggregation approach. It finds a positive correlation between programme aid and public investment in both India and Kenya.

Government Consumption

The evidence on government consumption are mixed. OPM (2003) found that programme aid had a positive impact on government consumption in Uganda, as did technical assistance. Project and food aid had a negative impact (see table 2.3.). Table 2.4. also shows that in general programme aid has increased both government non-development and development consumption in India but only development consumption in Kenya.

Table 2.2 Correlation of Aid and Investment: Results from Selected Studies

Studies	Data	Coefficient
Levy (1987)	39 LDCs (cross section)	0.86
Levy (1988)	22 Africa (cross section)	1.08
Bhalla (1991)	Sri Lanka (time series)	0.94
Hadjimichael et al (1995)	41 SSA (panel)	-0.05 (private)
		0.29 (public)
Boone (1996)	97 LDCs (cross section)	0.43
Snyder (1996)	35 LDCs (pooled)	-0.36 (private)
White and Edstrand (1998)	Zambia (time series)	0.84 (private)
		0.29 (public)
Lensik and Morrisey (1999)	75 LDCs (panel)	0.02
Hansen and Tarp (2001)	56 LDCs (panel)	0.71
Source: OPM, 2003 p. 20		

Taxation

A commonly held fear is that large inflows of aid, in particular programme aid, will reduce tax efforts in the recipient countries. OPM found no such effects from any aid form in Uganda (table 2.3.) and neither did Mavrotas for programme aid in India and Kenya. The White (1999a) evaluation actually found that revenue collection *increased* with higher aid inflows in Vietnam, Tanzania, Uganda and Zambia. Evidence from other studies is conflicting.

	Public Investment	Gvt. Cons.	Taxation	Borrowing	Domestic Savings	Private Investment	Growth
Programme Aid	Positive	Positive	Zero	Large negative	Positive	Positive	Positive
Project Aid	Negative	Negative	Zero	Small negative	Zero	Negative	Zero
Technical Assistance	Positive	Positive	Zero	Large negative	Negative	Positive	Negative
Food Aid	Negative	Negative	Zero	Large negative	Negative	Positive	Negative

Source: OPM, 2003 pp. 92 – 94

2.3.2.3 Stabilisation

When aid increases without any change in revenue and expenditure then it is highly probable that it has been used to finance the budget deficit[11]. Without aid the government would have borrowed on the domestic market, possibly resulting in an increase in domestic interest rates, crowding out of private investments and increasing inflation. Several studies testify to the negative relationship between inflation and growth (Ojo and Oshikoya, 1995, Barro, 1997 in White 1999a, Easterly and Fisher, 2000).

One of the main findings of the Swedish programme aid evaluation was that programme aid had been used for deficit financing, thus having a deflationary impact on the economy. The phenomenon was particularly noticeable in Tanzania and Mozambique (White, 1999a). The recent World Bank Rwanda Country Assistance Evaluation also concluded that post-1994 lending supported macroeconomic stabilisation (OED, 2004).

Table 2.4 Fiscal Response to Aid: Selected Studies

Studies	Data	Coefficients			
		Public Investment	Government development consumption	Government non-development consumption	Taxes
Heller (1975)	11 African (pooled) grants:	0.64	-0.23	-0.10	-0.19
	loans:	0.53	-0.09	-0.04	-0.18
Gang and Khan (1991)	India (time series) grants:	0.00	-0.22	-0.57	-0.31
	loans:	0.00	0.008	-0.02	0.18
Khan and Hoshino (1992)	5 Asia (pooled)	0.32	0.33	0.14	-0.02
		0.85	0.15	0.06	0.23
Otim (1996)	Low Income South Asia grants:	0.66	0.29	0.05	0.18
	loans:	-0.81	-0.16	0.03	0.22
Mavrotas (2002)	India (time series) programme aid:	0.008	0.005	0.05	0.06
	project aid	0.012	-0.042	-0.41	0.09
	technical assistance	-0.041	0.56	5.53	-0.32
	Kenya (time series) programme aid:	0.002	0.106	-0.013	0.20
	project aid:	0.002	-0.037	0.005	-0.23
	technical assistance:	0.002	0.138	-0.005	0.20

Source: OPM, 2003

[11] There is also a possibility that the reserve has increased

In two cases when programme aid was disrupted this practice of using aid for deficit financing was particularly obvious: In 1992/93 there was a conflict between the Ugandan Minister of Finance and bilateral donors about import support procedures. It resulted in the bilaterals and subsequently the IMF freezing support to the country. The government did not cut back on expenditure and the following inflationary surge was a direct result of the reduction in programme aid (Ddumba-Ssentamu et al, 1999) White noted that after that experience, Uganda did not resort to deficit financing again (White, 1999a). However, this statement is to some extent contradicted by the OPM study, which found a large negative relationship between programme aid and borrowing in Uganda (see table 2.3).

A more recent example is Malawi. In 2001, IMF and subsequently bilaterals suspended support because the country was off track with the IMF programme. According to the IMF/IDA joint staff assessment "*The suspension of budgetary assistance by donors did not result in reduced overall expenditure but instead in increased domestic borrowing, which contributed to high interest rates and a rise in domestic debt.*" (IMF/IDA, 2003 p. 2) The raise in real interest rates resulted in constraining private sector development and domestic debt was threatening to reach an unsustainable position. This coupled with other strains on the budget lead to a monetary expansion and subsequent depreciation and inflationary pressure (ibid).

In general White (1999a) found that the anti-inflationary impact also worked through increasing the supply of goods with higher imports and by providing the reserves to give credibility to the exchange rate anchor. DFID (1999) agrees with this, claiming that in Uganda, programme aid has been particularly valuable by providing macroeconomic stability and through that an exchange rate no longer contributing to the decline of the export sector.

2.3.2.4 Sector Allocations

Most of the results on sector allocations have been presented by the fungibility literature. Feyzioglu, (in Deverajan et al. 1999) has shown that governments receiving concessionary loans for agriculture, education and energy would reduced their own resources going to these sectors and use these resources elsewhere. Only loans to the transport and communication sector were fully spent in that sector. Deverajan, et al. (1999) tested the degree of fungibility in a number of African countries. They found that aid to energy and transport and communication, would increase spending in these sectors but not one-for-one. Aid to the education sector had an almost one-for-one impact on education sector spending. They also included the additional finding that aid is more fungible when there are many donors in a country, probably because it is more difficult for each donor to monitor its part of the programme. Earlier studies by Pack and Pack (1990 and 1993, presented in Gilbert and Vines, 2000) had found no fungibility in transportation and tourism in Indonesia and only very little in agriculture in the Dominican Republic.

<u>To sum up:</u> Although evidence is somewhat scarce and scattered, programme aid seems to have a positive impact on a number of economic indicators and possibly even more so than other aid forms. Particularly important is its relationship with investments since the link between growth and investments is undisputed, but also between programme aid and imports since this can also feed into investments.

Another important finding is the impact of programme aid on stabilisation through deficit financing. Even though it means that aid is not being used for investments it may still contribute to growth through reduced inflation and reduced crowding out of private investments.

The most important finding on aid and sector allocations seem to be that the results differ across sectors and countries. In some countries some sectors will receive the full benefit of the aid money but in others funds will be diverted towards other used. However, it is not necessarily the same sectors in every country or all sectors in one country.

2.4 Result: Economic Growth

As table 2.5 shows aid in general seems to have a positive relationship with growth (although not always).

White, (1999a) found that programme aid had some impact on growth, but that the impact was neither particularly strong nor sustainable. Van Donge and Dijkstra (1999) agreed that in the case of Bangladesh, programme aid may have created a higher growth rate, in particular through higher level of imports but the impact was relatively small.

By contrast Dijkstra found that the programme aid induced increase in imports in Nicaragua was particularly important for growth (Dijkstra, 1999a) and the OPM study also showed that programme aid was the only aid form that had a positive correlation with growth.

Table 2.5. Correlation of Aid and Growth: Selected studies

Study	Data	Coefficient
Papanek (1973)	85 LDCs (cross section)	0.39
Voivodas (1973)	22 LDCs (pooled)	-0.01
Gulati (1978)	17 LDCs (cross section)	0.32
Mosley (1980)	21 LDCs (cross section)	0.06
	30 LDCs (cross section)	0.98
	53 LDCs (cross section)	-1.04
	Asia (panel)	0.43
Dowling & Himenez (1982)	52 LDCs (cross section)	0.30
Gupta & Islam (1983)	52 LDCs (cross section)	-0.05
Mosley et al (1987)	15 LDCs (cross section)	-0.07
Boone (1994)	98 LDCs (cross section)	0.00
Mosley (1995)	19 LDCs (pooled)	0.15
Hadjimichael et al (1995)	41 SSA (panel)	0.098
Burnside and Dollar (1997)	56 LDCs (panel)	-0.580
Durbarry et al (1998)	68 LDCs (panel)	0.101
Lensik and White (1999)	111 LDCs (panel)	0.147
Hansen and Tarp (2000)	56 LDCs (panel)	0.182
Dalgaard and Hansen (2000)	56 LDCs (panel)	1.352
Hansen and Tarp (2001)	56 LDCs (panel)	0.117
Lloyd et al (2001)		0.035

Source: OPM, 2003 pp. 9 and 16 adapted

2.5 Summary and Concluding Remarks

After a long period of decline, programme aid funds are starting to increase again.

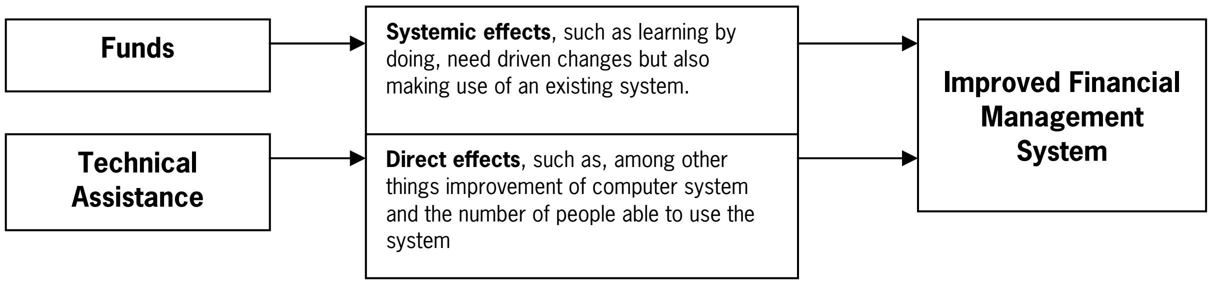
A number of models of increasing sensitivity to various economic indicators attempt to predict the impact of the programme aid funds on growth, but even though evidence suggests that programme aid in particular has a positive impact on many of the key variables, it has been difficult to show a strong relationship with growth.

The White (1999a) Swedish programme aid evaluation was the first and so far only comprehensive study of programme aid and growth. It was conducted in the policy environment of the 1990s. Since then the emerging approach to budget support has developed a greater consideration for, in particular, the institutional environment surrounding the support form (both with respect to financial and aid management). Added to this, the policy environment has also changed, increasing the focus on sectoral allocations as a means of promoting pro-poor expenditure. Even though a general study on potential (possibly different) growth effects from the new approach would be interesting, it would be of particular interest to further explore growth effects from pro-poor sector reallocation.

3 From Funds and Technical Assistance to Improved Financial Management Systems

3.1 Introduction

In this chapter the possible effect of two components of the budget support package, funds and technical assistance, on the financial management systems will be investigated.[12] These inputs work through two effects; systemic or flow-of-funds effects created by the funds actually passing through rather than outside the system and/or technical assistance provided in addition to the funds.



This chapter will show that the two effects probably interact and that direct effects without systemic effects may be less successful in improving the financial management systems.

A major concern in this chapter is the lack of literature. Few evaluations of financial management reform have been found so discussions of different aspects will be in a very tentative form. Also pure facts have posed a problem. It is beyond the scope of this report to track down in detail the development of technical assistance for financial management system improvement. The reason for this is that it would require a fairly thorough examination of agreements and donors' internal memos. However some preliminary conclusions can be drawn from the existing literature.[13]

3.1.1 Background

3.1.1.1 Prerequisite or Intended Outcome

A fundamental discussion surrounding the financial management systems of the current and prospective budget support recipients debates whether the improvement of the system is a prerequisites for or

[12] It could be argued that conditionality and policy dialogue could possibly have been added to this dynamics as well. However, to some extent the effects of conditionality can be captured by the existing framework. On the one hand conditionality or policy dialogue outcomes pertaining to changes of the financial management system could be viewed as a result of a growing realisation that changes are needed in order to cater for the increase in the flow of funds and hence be viewed as systemic effects. On the other hand conditionality could require a country to install a new accounting system in advance of the increase of funds and then the effects of the conditionality would be captured by the direct effects. In short, the expected effects of conditionality depend on how the conditions emerged.

[13] Mainly the World Bank homepage project files, as well as some bilateral donor information.

intended outcomes of budget support. Many donor policy documents, as well as some theoretical work, seem to lean towards a working financial management system being a prerequisite for budget support[14].

Jones and Lawson (2000), for example, claim that the key requirement for moving from project based planning and implementation to sector approaches with a common financing mechanism is the overall strengthening of the budget process. The USAID/Malawi 2000 Country Strategy agrees, stating that Non-Project Aid will be considered only when the financial management systems have improved (USAID, 2000).

The more recent European Commission budget support guide stipulates that budget support will be granted where:

a) public expenditure management is sufficiently transparent, accountable and effective;

b) well defined macroeconomic or sectoral policies are established by the country itself and agreed by its main donors are in place; and

c) public procurement is open and transparent.

(European Commission, 2003)

Sharing the same view, the Norwegian guidelines for the provision of budget support state that the quality of the public financial management system is crucial when considering budget support and that an appraisal has to be made in order to ascertain whether some minimum conditions are in place (NORAD, 2003).

By contrast the *Framework* (Booth and Lawson, 2004) seems to lean more towards institutional changes being brought about by budget support. Among the donors DFID is particularly firm in its view that the financial management system can only be changed from within:

> ”DFID's view is that the key to maximising aid effectiveness is for government-to government aid to be channelled increasingly through the central system in the form of untied direct budgetary aid. […] We recognise the weaknesses which exist in planning and budgeting, in expenditure management, and in the responsiveness of government to civil society, but these weaknesses can only be addressed if donors work within the system.”
>
> *(DFID, 2004 p. 17)*

Seco also only requires that the country is *committed* to public sector reform for it to be eligible for budget support (Seco, 2002).

Even though a small majority of the donor policy papers seems to advocate some minimum requirements for the financial management system, there are indications that in practice the situation may look differently.

One example is Malawi. The country has a very weak financial management system and recurring financial management problems (see for example Fozzard and Simwaka, 2002 and Sida, 2003a). Fozzard and Simwaka are also rather pessimistic when assessing Malawi's prospects as a budget support recipient:

> ”Given the poor compliance in Malawi's public expenditure management system, Malawi is an unlikely candidate for grant-financed budgetary support”
>
> *(Fozzard and Simwaka, 2002, p. 40)*

[14] Reservations for an incomplete sample.

Nevertheless, Malawi is receiving budget support, mainly through the Common Approach to Budget Support (CABS) donor group. A reasonable conclusion from this would be that the CABS donors recognise the apparently very large weaknesses of the system but that they share the belief that budget support can be instrumental in correcting this. The interesting point, though, is that two of the CABS donors are the European Commission and Norway. As was shown above their policy papers note that a working financial management system should be a prerequisite for budget support.

The fact that many donors are disbursing budget support to countries with weak financial management systems seems to indicate that, if not always in theory, at least in practice, donors agree that development of the financial management system is an intended outcome of budget support.

To sum up: Even though a number of donor policy papers stipulate that budget support will only be extended to countries with a relatively well developed financial management system – hence regarding it as a *prerequisite*, in practise it seems as if most donors consider the development of the financial management system an intended *outcome* of budget support.

3.1.1.2 A Note on Design and Assessment

The scope of this report does not allow for a deeper analysis of the actual and appropriate designs of the financial management systems, with respect to donor's and recipient's needs in terms of transpar-

Table 3.1. Good vs. Poor Budgeting Principles

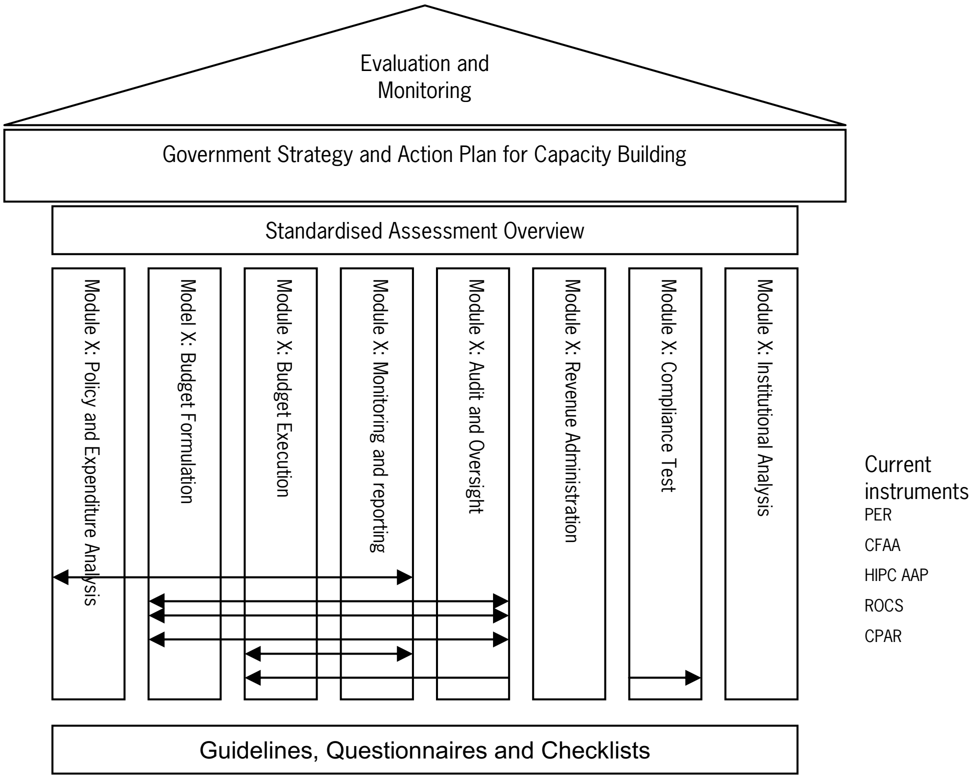
Good Budgeting Principles	Poor Budgeting Practices
1. Comprehensiveness: the budget must include all the fiscal operations of the government	1. Unrealistic planning/budgeting: both plans and budgets are not statements of intentions, but a wish list of political promises
2. Discipline: policy decisions with financial implications must be made against the background of a hard budget constraint and in competition with other demands	2. Short – term budgeting: no consideration of medium – term implications of budgets, such as the recurring operation costs of new investments
3. Legitimacy: decision makers who can change policies during implementation must take part in and agree to the original policy decision	3. Repetitive budgeting: the budget is frequently remade during the year, in response to economic or political conditions
4. Flexibility: decisions must be pushed to the point where all relevant information is available	4. Cashbox budgeting: government spends as cash becomes available, not according to preset budget priorities
5. Predictability: fiscal policy must take account of the need to ensure the timely flow of funds to spending units	5. Deferred budgeting: arrears build up as expenditures are pushed into subsequent years
6. Contestability: existing policies are subject to constant review and evaluation	6. Distorted priorities: scarce resources are spent on "showcase" projects that produce meagre social returns
7. Honesty: budgets are based on unbiased projections of both revenue and expenditure	7. Declining priorities: the size of the civil service expands in proportion to unemployment, but ghost workers under invest in training and IT, and poor working conditions degrade operational efficiency
8. Information: accurate and timely information on costs, outputs and outcomes is essential	8. Informal management: extralegal arrangements dictate how government operates in recruitment, procurement etc.
9. Transparency: information about budget decisions must be accessible, clear and communicated to the wider community	9. Corruption: lack of enforcement of formal rules breeds illegal behaviour, which goes undetected and unsanctioned
10. Accountability: decision makers must be held responsible for the exercise of the authority provided to them	

Source: From ODI, 2004, original sources: World Bank Public Expenditure Handbook (1998) and A. Schick (1998) *A Contemporary Approach to Public Expenditure Management*. World Bank Institute ency, accountability and the efficient revenue predictions, collections and allocations.[15] Instead, a short list of good and poor budgeting principles are presented, to serve as a background.

The instruments for assessing the status of financial management systems are lacking. This may seem like a strange statement considering that there are at least six major assessment mechanisms[16] but as the Nordic Consulting Groups 2001 assessment of *Public Financial Management in SPA Countries* explains:

> "Existing assessment mechanisms are often very large and cumbersome and sometimes politically sensitive and are therefore not often applied. None of the existing mechanisms provide SPA donors with a comprehensive assessment of the public financial management system function in practice, using a systematic assessment approach, covering all SPA countries. There is limited recipient involvement and ownership in the assessment process and limited follow up and implementation of the capacity building and technical assistance activities recommended in many of these assessments."
>
> *(Nordic Consulting Group, 2001, p. 4)*

Figure 3.1. A New Public Expenditure Assessment Framework



[15] This would have required access to donor and recipient documents on a project by project level and also some possibility to measure actual implementation and us.

[16] The World Bank Public Expenditure Review (PER), the World Bank Country Financial Accountability Assessment (CFAA), the World Bank Country Procurement Assessment Report (CPAR), the IMF report on the observance of standards and codes of fiscal transparency (Fiscal ROCS), the World Bank – IMF public expenditure tracking assessments and action plans for Heavily Indebted Poor Countries (HIPC AAP) and the EC audits.

A recent study by Allen et al (2004) agrees:

> ”…the instruments…focus on the legal framework and organisational structures and processes for public expenditure management – describing the laws, regulations, and operational procedures for budget formulation and budget execution. Though such information is useful and relevant, it is not clearly linked to aggregate fiscal discipline, efficient resource allocation and efficient and effective delivery of public services – the three basic public expenditure policy objectives…that have become widely accepted in the international development community.”
>
> *(Allen et al., 2004 p. 16)*

The Allen et al. study also suggests a conceptual framework that could be used for further discussion about the transformation of the current systems. Figure 3.1. reproduces a simplified version of the suggestion.

To sum up: This review is not intended to consider the appropriate design of financial management systems or assessment mechanisms, instead it provides some examples from the general discussion by way of background.

3.1.2 Chapter Layout

Section 3.2 of this chapter will consider the technical assistance input and try to assess whether there is any difference between the pre- and post–2000 periods (using that as a proxy for influence from budget support). It also discusses the inclusion by donors of technical assistance in the budget support package and the recipients´ views of donor co-operation. Section 3.3. discusses systemic and direct effects and look for evidence of both. Section 3.4. investigates the status of the financial management systems for some recipient countries and also includes a brief discussion on corruption. Section 3.5. concludes.

3.2 Inputs: Funds and Technical Assistance[17]

Since funds have already been examined in the previous chapter this section will concentrate on technical assistance.

3.2.1 Financial Management Reforms

3.2.1.1 Pre-2000

In general it does seem as if the early– to mid-1990s was the starting date for financial reform in many counties. This is true, for example, for Burkina Faso, which introduced a new financial management system between 1994 and 2001 (Heidenhof et al., 2002). Malawi initiated the implementation of the Integrated Financial Management Information System (IFMIS) in 1995/96 and Ghana started its Public Financial Management Reform Program in 1996 (Ibid). Mozambique began a bit earlier with Sweden and the UNDP as main contributors to a modern financial management system (Fozzard, 2002, Sida, 2002a). The World Bank and IMF were also active in promoting the Expenditure Management Reform Strategy. Uganda has undergone continuous reform since the early 1990s, with cumulative changes in the institutional framework (Bevan, 2001).

[17] All information on World Bank Projects from www.worldbank.org

3.2.1.2 Post-2000

Even though most processes seem to have started in the 1990s, there are also indications of an increase in financial management projects since 2000. In 2000 Burkina Faso initiated a process to develop a Medium Term Expenditure Framework and received technical assistance from the World Bank (Sida, 2002d). In 2004 the World Bank also approved a programme to create a National Statistics Office. In Malawi the World Bank Financial Management, Transparency and Accountability Project (FIMTAP) was launched in mid–2003 and in late 2003 a number of Bills with close relevance to financial management were passed into laws (CABS Aid-Memoire August 2003). In Mozambique an entirely new, donor supported, system for financial management was planned for 2003-04 and the auditing authority is being resurrected (Sida 2002a). Rwanda has recently received a number of credits related to but not directly targeted at financial management reform. The main issue here has been to address the country's acute lack of skilled staff in all public institutions (World Bank, 2004b). Uganda too, was initiating a large overhaul of the budget and expenditure management process at all levels in the early 2000s (Heidenhof et al., 2002).

An interesting case is Vietnam, a country that to date receives very little budget support but with a comparatively well developed financial management system. Still, according to Randel at al. (2003) public administration reform is a major preoccupation for donors and there is concern about the slow pace at which policy is being translated into action as well as the lack of progress at local levels. Subsequently, in 2003 the World Bank approved the Public Financial Management Reform Project. The objective of the project is to strengthen and integrate core treasury and budget management information systems, to strengthen the links between budget management and the developmental goals set out by the PRSP within a medium-term expenditure framework and to improve the management of public debt (World Bank, 2003h).

3.2.2 Technical Assistance in the Budget Support Package

There seems to be mixed evidence on whether or not the budget support donors actively include technical assistance for financial management reform in the budget support package. Danida seem to do so on a regular basis. It is discussed in their policy paper (Danida, 2003c) as well as included in agreements with Mozambique for 2000 – 2003, Tanzania for 2001 – 2004 (approx. 10%) and Bolivia for 2003 – 2004 (approx. 10%), (Danida, 2000d, 2001b and 2003b). The Seco budget support policy paper also states that *"…budget support is often complemented by technical assistance for public sector reform, such as the introduction of a new accounting system, new tax systems, or civil service reform…"* (Seco, 2003 p. 10), whereas the Norwegian guidelines do not mention technical assistance at all (NORAD, 2003). The European Commission guidelines take the middle way by stating that whereas most programmes will include a technical assistance component, it may not be financed from the budget support funds (European Commission, 2003).

3.2.3 Donor Coordination and Financial Management Reform

Table 3.2. Recipient Country Perception of Budget Support Donor Coordination in Support for Public Financial Reform			
Country	**Score** (1-5, 1-2:unsatisfied, 3: neutral, 4-5: satisfied)	**Country**	**Score** (1-5, 1-2:unsatisfied, 3: neutral, 4-5: satisfied)
Benin	3	Mozambique	2
Burkina Faso	3	Nigeria	4
Chad	2	Rwanda	4
Ethiopia	2	Senegal	3
Gambia	2	Sierra Leone	3
Ghana	5	Tanzania	3
Kenya	3	Uganda	2
Madagascar	3	Zambia	4
Malawi	2		
Source: Adapted from SPA, 2004 p. 28			

The 2004 SPA *Survey on the Alignment of Budget Support and Balance of Payment Support with the National PRS Process* (to be discussed at some length in next chapter) uses donor coordination with respect to support for public financial reform as one sub-category to measure donor coordination. The scores from this category are displayed in table 3.2. This table is no measurement of the level, or even quality, of coordination, but may give some indications on those issues through the level of satisfaction experienced by the recipient.

As can be seem, only Ghana is completely satisfied with the donors, whereas Nigeria, Rwanda and Zambia are mildly satisfied. However, on average the score is only 2.9.

<u>To sum up</u>: This very brief investigation suggests that many countries had initiated financial management reforms already in the early to mid 1990. However, there seem to be indications that the pace has either stepped up or a new wave of reform started after 2000. It is reasonable to believe that this has had something to do with the increasing focus on budget support and some, but not all, donors include technical assistance in their budget support package on a regular basis.

3.3 Systemic and Direct Effects

Direct effects are easy to identify. They come in the form of the number of computers available, the amount of staff trained or the size of the budgetary system introduced. However, Mozambique presents an example indicating that direct effects may not always be enough:

According to Fozzard (2002) technical assistance has played an important role in the design and implementation of the financial management reforms throughout the entire reform period in Mozambique. Progress has been made and the system was computerised starting in the mid–1990s.[18] Consequently counting computers in Mozambique would probably indicate a fairly advanced system. However, as Sida points out; the lack of a system has been less of a problem in Mozambique than the government and the donors not *using* the system (Sida, 2002a).

Systemic effects are those generated by the flow–of–funds through the system. The 1999 Swedish programme aid evaluation found substantial systemic effects from import support in the promotion of

[18] There has been some complications such as the Ministry of Planning and Finance sometimes having problems in consolidating the advice given by donors and at one point UNDP and Sweden were actually proposing rival accounting reforms. Fozzard also points out that technical advisors have tended to push ahead with the development of technical instruments, leaving staff at the Ministry to catch up if they can (Fozzard, 2002 p. 36).

foreign exchange market liberalisation. The study then suggested that: "*Budget support can potentially play the same role with respect to government budgetary systems.*" (White, 1999a p. xv)

The literature has presented a number of indications of systemic effects. Both in Burkina Faso and Mozambique recent studies have reported on conflicts between the sector ministries and the Ministry of Finance resulting from the fact that the sector ministries now have to depend on the Ministry of Finance for funding (Gerster and Sawadogo, 2003, DFID, 2004). While it is of course unfortunate that the Line Ministries are irritated, in particular if it leads them to try to sabotage the process, this fact still illustrates that the system is starting to work in a way that is consistent with a properly working financial management system.

Uganda also displays strong systemic effects. The country has made considerable progress in reforming the financial management system using a substantial amount of technical assistance in the process. However it has mainly been extended *when the country has demanded it*. The country itself has recognised when it has been time to reform and what kind of help it would need to do so – requesting this assistance from donors (Foster and Mijumbi, 2002)

<u>To sum up</u>: Direct and systemic effects seem to interact. As much as it is inefficient to disburse fund through an almost non-existing system, it is equally inefficient to put a system in place that is subsequently not used.

3.4 Result: Improved Financial Management System

It seems as if reforming countries can be divided into two broad groups; countries where progress has been made and countries where less progress has been made[19]:

Countries where progress has been made:

Uganda belongs to this category, as does Ghana and possibly Tanzania.

A recent Danish study concludes that the Ghanaian financial management systems are comprehensive, elaborate and state-of-the-art (PEM consult, 2002). According to Foster and Mijumbi (2002) Uganda not only has an efficient financial management structure but it is also successfully organised to address poverty.

Vietnam could also belong to this category based on the state of the financial management system. In 2000 the Public Expenditure Review (PER) concluded that for a country at Vietnam's stage of development, the system of public expenditure management was operating well. The Project Information Document (PID) for the World Bank credit also reports that:

> "Public financial management in Vietnam has some important strengths. Vietnam has earned a reputation for fiscal prudence, with relatively small budget deficits and low debt (both domestic and foreign). The existing treasury and budgetary management systems include some effective mechanisms to prevent over-spending and misappropriation of resources."
>
> *(World Bank, 2003h)*

However, it is less clear if this has really been a result of reform programmes supported by donor technical assistance or from in-house systemic effects generated by the increase in domestic revenue experienced throughout the 1990s (that is, before donors started to enter the country).

[19] The examples only include a few countries from each category.

Countries where less progress has been made:

Burkina Faso seems to belong to this category as well as Malawi and Mozambique.

In an evaluation from 2001 Danida was very clear when it comes to the weaknesses of Burkina Faso's institutions (Danida, 2001a) and in late 2002 Sida reported that the institutional capacity was still weak and that only a small circle of people within the Ministry of Finance knew how to develop an MTEF – strategy. Methods for forecasting government revenue and borrowing were still lacking. The budget process also needed to be adjusted to be coordinated with the MTEF. (Sida, 2002d)

Malawi has received no less than five World Bank credits for financial management reform but progress has been extremely slow and in August 2003 CABS reported that roll-out *"…is expected to start shortly – much as it was in February."* (CABS Aid-Memoire August 2003) As was shown above, in 2002 Fozzard and Simwaka found it unlikely that a country with such a poor financial management system could be a candidate for budget support. The suspension in 2001 was related to financial management issues (Sida, 2003a). Interestingly, the World Bank Country Financial Accountability Assessment (CFAA) concludes that compared with other developing countries, Malawi has a good institutional and legal framework for public sector management and accountability. Still the CFAA finds considerable fiduciary risks in the budgeting system, the controls are inadequate and the National Audit Office has staffing problems (World Bank, 2003j).

In Mozambique, Fozzard (2002) concluded that even though institutional barriers were a problem, the fundamental weakness of the institutional structure for public expenditure management lied in the acute shortage of qualified personnel. This did not mean that there were no points of concern regarding the institutional set up. Fozzard pointed to major weaknesses in particular regarding budget classifications, which did not provide a satisfactory basis for expenditure management and analysis since they were too broad. It was, for example, possible to see how much has been spent on education but not on primary education (Fozzard, 2002). A DFID financed consultancy report also noted that out of nine "Good Practice Principles", five needed major improvement and the remaining four needed further improvement. Moreover, there were no trained auditors in the country. In the late 2002, Sida started work to revive the internal audit function of the Ministry of Finance (Sida, 2002a). Interestingly, in spite of the remaining weaknesses a donor review of the financial management system changes between 1996 and 2001 showed that it was relatively safer to disburse through the government budgeting system than to keep funds off-budget (Sida, 2002a).

Corruption

The increase in corruption is a great worry for most donors in almost every country receiving budget support. However, this may be more a result of corruption being increasingly visible than of any actual increase in the amount of funds diverted.[20] This in turn would then be a result of increasingly improved and transparent financial management systems. If so, it is actually a positive indicator of financial management development.

<u>To sum up:</u> There seems to be two sets of countries, those where reforms have been successful and those where it has not been so successful in spite of large amounts of technical assistance.

[20] As was shown in the previous chapter programme aid (keeping in mind that all programme aid is channelled through the budgetary system regardless of what it is called) disbursement has, in the not to distant past, been much higher than they are today.

3.5 Summary and Concluding Remarks

One of the main finding from this chapter is that there seems to be a shortage of evaluations and literature about financial management reforms in general and on financial management reform and budget support in particular (which is not surprising). As a result this chapter mainly present some facts as well as tentative discussions. Some conclusions can be drawn.

Firstly, in spite of some donor policy statements indicating the opposite it does seem as if most donors regard financial management development as an intended outcome of budget support. Even though many financial management reform programmes started in the early- to mid-1990s, it also seem as if there has been an increase in technical assistance for financial management reform since the beginning of the 2000s.

It remains unclear if donors view technical assistance as an integrated part of budget support. Some donors include it in agreements and policy documents and some do not. Recipients (with some exceptions) reported recently that they were mostly displeased with the lack of coordination of these efforts.

Budget support can have an impact on financial management development through two effects, systemic effects from the flow-of-funds and direct effects from the technical assistance. There are indications that these effects may need to interact for reforms to be successful. Countries whose financial management reforms have not turned out so well provide potential illustrations of this. Most reform programmes started after programme aid had experienced a sharp drop in the early 1990s (see figure 2.1.). During the first few years of reform, programme aid continued to drop, with the all time low reached in 1997. In addition to this, as has already been shown for Mozambique, both the government and the donors refrained from using the introduced systems. In the early 2000s there were reports that much of the support remained off-budget in Mozambique (Fozzard, 2002) and in Malawi the majority of the 600+ projects are off-budget, or even unknown to the government (Fozzard and Simiwaka, 2002).

In principle there are two major forces driving the reform and design of financial management systems:

1. The recipient government receives money and realises that if it is going to be able to *use* that money in a reasonable way it needs to reform.
2. The recipient government receives money and *the donors* realise that if they are going to be able to *account for* their use of the money to their own government the country will need to reform.

Letting the first approach dominate will in the best case scenario lead to a financial management system that the country feels comfortable with and is able to operate and that satisfies the transparency requirements posed by the donors. If the second approach dominates this may in the worst case lead to endless discussion on design and focus areas of implementation, based on the different accounting and financial management traditions in the donor countries, ultimately leading to the recipient ending up with no or conflicting systems.[21]

However, the problem with throughout adoption of the first approach is highlighted by the Nordic Consulting Group (2001) evaluation of financial management systems in SPA countries. It found that a major concern was lack of political will on the part of the recipient to address the financial management issues in the context of the countries' development efforts. The conclusion from the evaluation

[21] This was the case in Mozambique in the early 1990s where Sida and UNDP tried ti implement different systems with sometimes conflicting features.

was that: ”…*the financial management problems in the SPA countries need more attention in the form of resources and technical assistance but, most importantly, more political attention at the highest level*.” (Nordic Consulting Group, 2001 p. 3). It will be very interesting to test if the new approach to budget support, through its increased focus on additional inputs of technical assistance and policy dialogue has managed put financial management reform higher up on the partner countries' agendas.

4 From Donor Harmonisation and Alignment to the Strengthening of the Government

4.1 Introduction

The third link goes from donor harmonisation and alignment, via aid management effect, to strengthening of the recipient government and an increased ability to pursue its goals.

Some words about the chosen definition of terms:

Donor harmonisation here refers to all activities undertaken by donors in order to coordinate procedures in relation to aid management. This includes, for example, reporting requirements, conditionality, disbursement mechanisms, co-operation regarding technical assistance projects etc.

Alignment refers to alignment with the Poverty Reduction Strategy Paper (PRSP) or corresponding documents and with the government budget process. This includes both prioritisation of the same issues as the PRSP as well as making sure disbursements and planning for future commitments are in line with government priorities and adjusted to the budgetary process.

Ownership is a difficult term to use since it can refer to a number of things and groups of people. Here ownership will be used to reflect recipient government ownership of the PRSP or a similar development strategy.

A number of different costs can be labelled as transaction costs. In this chapter transaction costs will be narrowly defined as resources spent on managing the aid *arrangement*, including negotiations, reporting, discussions with donors etc. This does not include the costs arising from the financial management of funds.

There is an abundance of material discussing harmonisation, including how meetings have been held and which groups have been established. There is even a harmonisation website (www.aidharmonization.org). Many countries have also prepared harmonisation strategies (CIDA, 2003a, Development Cooperation Ireland, unknown year, DGCD, 2003, Sida, 2003b). However, when it comes to progress, the information thins out and there is even less to be found about effects and concrete results. For example, the SPA Budget Support Working Group submits regular reports from missions to a number of countries (as well as other material regarding budget support) and they do report about progress in implementation but usually say little or nothing in concrete terms about effects.

4.1.1 Background

It is important to realise that the relationship stipulated above has no proper theoretical foundation and in fact it can be challenged in many of its assumptions. The main objections are:

Donor harmonisation may lead to decreased ownership.
Edgren (2003) found that donor dialogue could be seen as a means by which the donors increase their collective negotiating strengths in a way that reduces the ability of the recipient to pursue its development priorities and hence assume ownership. When donors meet and discuss development cooperation, in particular without the presence of the recipient, this can be viewed as "ganging up" against the absent party.

In general alignment should not face this problem since it is explicitly geared towards making the aid arrangement respect recipients' priorities. However, this requires the recipients' priorities to really be the recipients' priorities (i.e. that the PRSP is a domestic document).

The relationship may be reversed so that ownership leads to donor harmonisation and alignment.

In its harmonisation strategy Sida claims that: "*The point of departure shall be that for any coordination and harmonisation initiative to be sustained, the partner country must assume leadership*." (Sida, 2003b p. 3). Vietnam and Uganda are example of this approach actually working. However, the strategy may be difficult to apply to all countries and a gradual approach, whereby leadership is moving from the donors to the country, may be more realistic for many countries.

Donor harmonisation and alignment may lead to an increase in transaction costs.

There is a general discussion about whether budget support can be expected to decrease or actually increase transaction costs for the recipient country:

As is indicated by Fozzard et al., this may be a matter of a short-run vs. long-run perspective:

> "While anecdotal evidence of high project transaction costs abound, moving towards a more programmic form of aid delivery is unlikely to reduce transaction costs. On the contrary, the prevailing consensus seems to be that transaction costs are higher for programme than for project aid – at least in the first few years of a sector programme. At the same time evidence suggests that the benefits in terms of improved transaction governance more than compensate for the costs."
> *(Fozzard et al. 2000 p. 9)*

In the short run, provided that the donors involve the recipient country in harmonisation efforts, transaction costs would probably be increased, for the recipient as well as the donors, through having to spend time on meetings and discussions. However, in the long-run there is no reason to believe that it would be more expensive to administrate one set of aid arrangements than multiple ones.

If the recipient country is not involved in the harmonisation process there should not be any increase in transaction costs even in the short-run (but there may be other undesirable side effects from this as was shown above).

In general, alignment should have a greater possibility of reducing transaction costs even in the short-run. However, it does require that a framework that allows the donors to align is in place at the recipient end. For example, to align reporting requirement with those of the recipient requires that there actually is a system for government reporting to align with. If systems to allow donors to align needs to be developed, alignment can only be expected to reduce transaction cost in the long-run.

This discussion is based on the definition of transaction costs made here. However, transaction costs also emerge through the management of the actual funds in the financial system. With an increase in budget support funds, these costs will naturally increase. This means that even though harmonisation and alignment is expected to reduce aid management transaction costs (at least in the long-run), on balance it is impossible to say whether or not budget support will reduce total transaction costs.

4.1.2 Chapter Layout

Section 4.2. will look at the progress in implementation of donor harmonisation and alignment as well as recipient country perception of progress. In section 4.3. indications of potential aid management and other effect will be investigated and section 4.4. will track down results. Section 4.5 concludes.

4.2 Inputs: Donor Harmonisation and Alignment[22]

Donor harmonisation and alignment will be investigated separately and both issues will be approached from two angles. First the level of progress will be assessed as far as possible, and secondly the recipient countries satisfaction with progress will be looked into. On the second issue there is one major source of information in the recent SPA *Survey on the Alignment of Budget Support and Balance of Payment Support with National PRS Processes* (SPA, 2004a).

4.2.1 Donor Harmonisation

4.2.1.1 Progress

The countries seem to be divided into two broad groups, those where many harmonisation activities have taken palace and those where there are less apparent efforts.

Countries with much harmonisation activity

In Burkina Faso the budget support donors are coordinated through the Soutien Budgétaire Conjoint – Cadre Stratégique de la Lutte contre la Pauvreté (SCB – CSLP) including Belgium, European Commission, Denmark, the Netherlands, Sweden and Switzerland, with Canada and France as associated members. Monthly meetings are taking place, but they do not necessarily include the recipient country. The aim for all participants is to have the same disbursement and reporting mechanisms but by 2003 conditionalities and procedures were not completely harmonised. The Netherlands relied on IMF conditionality plus the joint PRSP progress assessment by the donors, Switzerland retained the option of analysing progress in budget management, and the European Commission used result indicators for part of the support (Gerster and Sawadogo, 2003).

Gerster and Sawadodo report that:

> ”Despite the Budget Support Group, donor cooperation in Burkina Faso is usually perceived rather critically. The formulation ‘ Cooperation is correct but could be better’ was heard several times as an overall appreciation, combined with confidence that it will improve in the future. So far, bilaterals are excluded or sidelined: the IMF and the World Bank have special reports and dialogues with the Government, and have easier access to information. The bilateral donors largely recognise the efforts made by the Bretton Woods Institutions to improve the cooperation. In some cases internal rules of the World Bank (e.g. joint documents of bilaterals and Bank staff are said to be non-acceptable for presentation to the World Bank Board of Directors while joint missions are possible) created bureaucratic, artificial barriers to cooperation.”

(Gerster and Sawadogo, 2003 p. 21)

[22] The counties included does not constitute a full sample but are selected on the basis of available information. They should only be viewed as examples.

However, the aid harmonisation web site (www.aidharmonisation.org) reports that overall donor harmonisation is improving and the country is one of three IMF pilots for a framework on budget support, including alignment with the government budget cycle and common conditionalities across budget support donors.

In Ghana, BMZ reports the following achievements by 2004:

– the establishment of the MDBS;

– the policy matrix is the basis for donor disbursements; and,

– common accounting system monitors disbursements.

The high level of harmonisation of disbursements is also reflected in figure 4.1. but the BMZ account above would actually indicate that the donors not only share triggers as stipulated by the figure but also are very close to share the same disbursement mechanism.

By the time of the first SPA mission to Ethiopia, in late 2002, only European Commission was disbursing budget support, with World Bank, DFID and Sida agreements in the pipeline. At the time there was no common framework for budget support but the donors had drafted possible targets, ending up with a list of over 100 conditions (SPA, 2002c). The second SPA mission in late 2003 found that major progress had been made in both harmonisation and alignment (SPA, 2003)

– an indicator matrix had been produced;

– a joint government – donors harmonisation task force had been established;

– a High Level Forum for dialogue had been established;

– budget support donors had participated in joint preparation missions with the World Bank; and,

– commitment by budget support donors to use a common set of indicators.

In early 2004 BMZ added that a coordinated monitoring system had been agreed between DFID, IDA, EU, Sida and Germany (through KfW).

Malawi seems to have moved from a situation where donor coordination was almost unthinkable (World Bank, 2000a) to now having a strong budget support donor group, CABS, consisting of European Commission, NORAD, Sida, Danida, DFID, AfDB, UNDP, GTZ and USAID. (World Bank, 2003a) By 2003 the CABS had agreed on holding bi-annual reviews and a draft Partnership Framework had been presented. The group had also started work on a Performance Assessment Framework (PAF), which would be a joint assessment by the members. The intention is that indicators will be derived from the PRSP but that different members can base their assessment on different parts of the PAF, moving towards a tighter focus over time (Sida, 2003a).

The G14 + World Bank group including Belgium, Denmark, the European Commission, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Sweden, Switzerland and the UK is the forum for harmonisation in Mozambique. This is the largest budget support donor group in Africa.

The 2004 SPA mission to Mozambique found:

– streamlined conditionality using a common framework and indicators drawn directly form the PRSP and the annual Economic and Social Plan in the form of a short matrix, known as the Performance Assessment Framework, that includes policies, actions, output and outcome indicators;

– harmonised reporting requirements against the PAF;

– steps to increase predictability;

– joint review missions with specific calendars agreed by all involved; and,

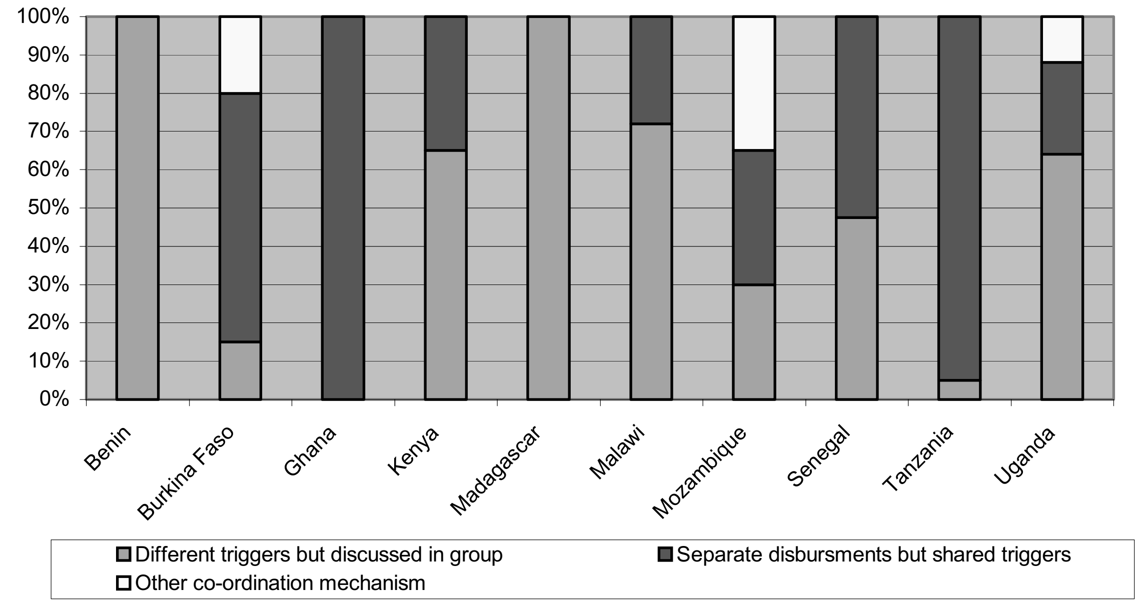
– mechanisms for stronger mutual accountability.

A recent review in Tanzania claimed that there had been ”…*significant progress in the field of donor harmonisation*” (Odén and Tinnes, 2003 p. 1). It pointed out that the Poverty Reduction Budget Support (PRBS) facility *”…has turned out to be a very useful instrument for improved harmonisation and continuous low-key policy dialogue with the Government.*” (Odén and Tinnes, 2003 p. 25) A credible attempt has also been made to merge the PRBS and the World Bank Poverty Reduction Strategy Credit (Ibid).

The 2003 stocktaking for the PRSC in Uganda reported: *”Donor coordination and harmonization of practices have improved…summarized in the recently signed Partnership Principles and in the draft Operational Guidelines for Budget Support.*” (World Bank, 2003h p. 23) Many sources point out that the government has fostered a great deal of the donor harmonisation by insisting that donors coordinate, first in the sector approaches and later in dialogue and disbursement of budget support.

Vietnam provides an example of a non-budget support recipient that has managed to coordinate donors. When donors started to return in 1993, they where reportedly ”…*rather competing than co-operating…*” (Danida, 2002c). But the country made a great effort, with the help of mainly the UNDP, and the situation has been greatly improved. The most important group related to budget support is the Like Minded Donor Group (LMDG). They are *”…committed to improving the quality of aid in Vietnam through harmonisation, joint activities, promoting the use of government systems, introducing new aid instruments that lower transaction costs and improve effectiveness.*” (Randal et al., 2003, p. 12)

Figure 4.1 Disbursement Mechanisms in Countires with Budget Support Groups



Source: SPA, 2004a p. 27

Figure 4.1 shows the disbursements mechanisms used for budget support in some African countries presented in SPA (2004a). Obviously disbursements are still not perfectly harmonised and in the majority of cases the donors retain the right to make their own final decision on whether to disburse or not.

Countries with less harmonisation activity
Donor harmonisation seems to be a problem in Nicaragua. Both Dijkstra (1999a), Danida, (2002a) and the European Commission (2002a) found weak cooperation and coordination. However, German and Cruz-Sequeira (2003) report that in mid-2002 the government held a major meeting with donors to lay the foundation for greater coordination between the government and external agencies, including steps to establish sectoral round tables out of which sector approaches could develop.

The SPA 2002 mission on harmonisation of budget support to Rwanda was very critical regarding the donor actions in the country. Its basic conclusion was that harmonisation efforts were at best weak. However, the aid harmonisation homepage reports that a harmonisation framework is shortly to be agreed by DFID, IMF, Sweden and the World Bank (www.aidharmonization.org).

To sum up: The harmonisation process seems to be underway in the majority of countries but it also seems as if there is some way to go before the processes are completed.

4.2.1.2 Perception

Table 4.1 presents the scores given by African budget support recipients on their satisfaction with the harmonisation process in their counties. The scores are based on an average of scores for six indicators[23]:

(i) Selection of conditionalities;

(ii) IMF selection of conditionalities;

(iii) Joint budget support related mission;

(iv) Use of government reporting;

(v) Support for public financial reform; and,

(vi) Support for statistic strengthening.

The scores for the individual categories vary a lot but on average the recipients are least satisfied with (vi) and most satisfied with (iv), which is the only category that receives an above neutral average score (3.1). The

Table 4.1. Recipient Country Perception of Donor Harmonisation

Country	Number of donors in budget support groups (2002 or 2003)	Level of satisfaction with donor coordination (1–5,1: completely unsatisfied, 3:neutral, 5:completely satisfied)
Benin	3	2
Burkina Faso	6	2.2
Chad	1	2.2
Ethiopia	n.a.	2.8
Gambia	1	2.25
Ghana	5	4
Kenya	3	3.2
Madagascar	2	3
Malawi	4	3.6
Mozambique	14[a]	2
Niger	1	3.6
Rwanda	n.a.	3
Senegal	2	1.5
Sierra Leone	1	2.8
Tanzania	12	3.8
Uganda	9	2.4
Zambia	0	2

Source: SPA, 2004a pp. 25 and 55
[a] SPA, 2004b p.1

[23]For some reason only Tanzania has scored category (ii) so that category has no relevance for the other countries or for total average.

total average for all categories and all countries is only 2.7, indicating that the countries are not particularly pleased with the harmonisation efforts.

Considering the information on progress with harmonisation presented above, two things are interesting to note. First, in spite Uganda being one of the countries in the forefront of harmonisation, the country is unsatisfied with the process. Second, harmonisation in Rwanda seems to be in its early infancy yet the country gives it a better score than Uganda does.

<u>To sum up:</u> On average recipient countries are relatively unsatisfied with progress in donor harmonisation and the level of satisfaction may not depend on the actual level of harmonisation in the country.

4.2.2 Alignment

4.2.2.1 Progress

Countries with alignment activities[24]

Many donors seem to be of the opinion that Burkina Faso's PRSP is a World Bank document (Sida, 2002d). Still, the European Commission and Sweden are tying parts of their support to PRSP indicators and Sweden is trying to fit disbursements to the countries budget process (ibid). According to Gerster and Sawadogo (2003) Austria, CIDA, the Netherlands and Switzerland are also making efforts to align.

The 2002 SPA mission to Ethiopia reported that in general donors believed that the PRSP represented a sufficiently credible strategy to warrant support, but the donors were unsure if the PRSP would have a real impact on the government's prioritisation and resource allocation process in the future (SPA, 2002b). However, SPA found progress in alignment during the 2003 follow-up mission, in particular with the development of the indicator matrix (SPA, 2003).

The Mozambican PRSP seems to be recognised as a country document by the donors but it is also claimed to have some weaknesses, particularly regarding the link between reforms and poverty reduction (DFID, 2004). The 2004 SPA mission found (SPA, 2004b):

– strong anchor in, and alignment with, the PRSP; and,

– good alignment with the budget process and calendar.

The PRSP is governing support to Uganda and the government actively encourages the donors to submit their disbursement plans, including projects, well in advance so that they can be budgeted for. According to the World Bank several factors have co-operated to increase the alignment with the PRSP (World Bank, 2003h):

– Rigor of the budget process linking the PEAP to the medium-term expenditure framework;

– Increased effectiveness of the Aid Liaison Department and the Development Committee in screening and reviewing projects;

– Increased budget support by donors; and

– Efforts by those donors still providing project support to ensure alignment with the PRSP.

Donors in Uganda at the forefront of aligning assistance with government development strategies are World Bank, DFID, the EU, Irish Aid, the Netherlands, NORAD and Sida (Ibid).

[24] Incomplete sample

Although there seems to be a clear tendency for most donors to try to align with the PRSP in Vietnam there remain some differences. According the Randal et al. (2003) the World Bank and the Like Minded Donor Group (LMDG) are supporting the PRSP, Japan (the second largest donors) is basing its programme on the ten Year Plan and the UN is subscribing to the Millennium Development Goals.

Countries with less alignment activities
The 2002 SPA mission was as critical towards alignment in Rwanda as towards harmonisation:

> "The PRS is not (yet) providing the basis for defining a new and better aid partnership. In rhetoric at least, PRS-priorities are said to be the foundation on which donors base their support. This rhetoric is more true for those agencies providing, or intending to provide budgetary assistance (e.g. Word Bank, IMF, the European Commission, Sweden, AfDB). However, even there is some way to go before aid relationships change significantly in line with PRS-principles…"
>
> *(SPA, 2002a, p.4)*

> "…alignment with the PRS and Government systems – whether at the level of policy, priorities, performance monitoring, and/or review – is either weak, or non-existent /…/ there is inconsistency between donors' programmes, the PRS and budget processes with respect to timing of review and disbursements"
>
> *(SPA, 2002a p. 6)*

The mission also concluded that lack of alignment was particularly noticeable in the two major programmes that were developed after the full PRSP was prepared, namely the World Bank's Institutional Reform Credit and the PRGF (SPA, 2002a).

It is not clear how far alignment has gone in Malawi, but Fozzard and Simwaka (2002) found major problems in the administrative set-up of the country, causing difficulties for donors wishing to adapt support to the development priorities of the Malawi government. There were, for example:

– no comprehensive data base of financing agreements;

– negotiations outside the budget process;

– signing of agreements without informing the core ministries;

– no information on project execution; and,

– no information sharing between management and budgeting departments.

<u>To sum up</u>: There seem to be activities moving towards alignment in many countries but not in all. The Malawi experience provides examples of factors that could make alignment difficult for donors.

4.2.2.2 Perception
The level of satisfaction score is again measured as an average, this time of eight categories[25]:

(i) Disbursement with budget cycle;

(ii) World Bank disbursement with budget cycle;

[25] For some reason only Tanzania again gave any scores in category (ii) and (iii) so those two categories have no weight in the average score for any other country. Also, Senegal only scored one item (i) and both Sierra Leone and Madagascar scored less than four. However, adjusting calculations to reflect this only has a 0.1. impact on the average.

(iii) African Development Bank (AfDB) disbursement with budget cycle;

(iv) Sector mission + sector reviews;

(v) Budget support related mission with Poverty Reduction Strategy (PRS) review;

(vi) IMF mission with PRS review;

(vii) Use of government reporting; and,

(viii) Usefulness of budget support conditionalities.

Table 4.2. Recipient Country Satisfaction with Alignment

Country	**Level of satisfaction with alignment** (1–5,1: completely unsatisfied, 3:neutral, 5:completely satisfied)	**Overall satisfaction with progress in alignment** (1–5,1: completely unsatisfied, 3:neutral, 5:completely satisfied)
Benin	2.8	3
Burkina Faso	2.2	3
Chad	2.8	2
Ethiopia	2.7	2
Gambia	3.4	4
Ghana	3.4	3
Kenya	3	3
Madagascar	3	2
Malawi	2.2	2.5
Mozambique	1.3	3
Niger	3.2	3
Rwanda	2	3
Senegal	1	2
Sierra Leone	3	3
Tanzania	3.2	4
Uganda	2.5	3
Zambia	3.2	3

Source: SPA, 2004 pp. 52 and 58

No sub-category received an average score above neutral, but category (viii) which is ”usefulness of budget support conditionalities”, at least reached a neutral 3 on average and it actually received a 5 from Gambia. Worst fared category (v) (2.4), possibly to some extent reflecting the size and frequency of in particular the PRSC missions. Uganda, for example is reported to be very irritated with this (see for example, World Bank, 2003h) and the country only gave a 1 in this category.

In general the recipients were just as displeased with alignment as with harmonisation, giving it a collective average of 2.7. Progress fared a little better and received 2.8 but both are still below neutral, indicating that the process is not viewed positively by the recipient countries.

To sum up: On average, recipient countries are no more pleased with alignment than with harmonisation.

4.3 Aid Management Effects: Increased Ownership and Reduced Transaction Costs

It could be argued that the links in the model should be more specifically from alignment to increased ownership, since alignment implies that the donors approve the countries poverty reduction strategy, and from donor harmonisation to reduced transaction costs since having to manage one set of requirements instead of multiple, should reduce recipient resources spent on aid administration. Although it would be interesting to test this hypothesis, in practice it has proven difficult to distinguish between effects from different inputs.

4.3.1 Ownership

There are several indications that recipients may be less than happy about the donor harmonisation efforts. Gerster and Sawadogo (2003) found that several of their interviewees in Burkina Faso mentioned that aid coordination often met with passive resistance from the government and in Mozambique Fozzard (2002) discovered that the government expressed concern about closer donor coordination leading to the donors having excessive influence in policy matters. The 2004 SPA mission also warns the donors against giving the impression of "ganging up" when consulting among themselves prior to meeting the government. In addition it warned against the risk for growing intrusiveness, reflected by an ever-growing PAF matrix (SPA, 2004b).

Confirming Mozambique's sensitivity to donor pressure Sida is unusually candid when it claims that:

> "The Mozambican capacity for policy implementation has always been limited but there are reasons to suspect that there sometimes also is a lack of willingness to do so, in particular when it threatens the interests of the elite or when the donors take over the process."
>
> *(Sida, 2002a p. 21, emphasis in original)*

According to Odén and Tinnes (2003) Tanzania could also run into similar problems, due to limitations of government capacity. They highlighted the risk of weakening government ownership for two reasons:

(i) less capacity in government than on the donors side; and,

(ii) the impatience from some donors to see progress may overload the government system.

According to the Odén/Tinnes study donors often form communication channels between different parts of the government and are often taking an active role in setting up baskets, etc. This is a result of the imbalance in capacity and competence between donors and ministries and although in the short run it is working well, it may in the long run further increase the gap between donors and the government.

Odén/Tinnes also found the risk that other Tanzanian stakeholders could become frustrated because their influence on the process was too weak. In particular the parliament and local councils have played a limited role. A discussion on "ownership by whom" was emerging in Tanzania, mainly driven by civil society actors. The discussion is focused on the PRSP process, but due to the strong link between that, budget support and harmonisation the authors finds it relevant in a harmonisation context.

To sum up: There are indications that harmonisation and alignment may weaken ownership.

4.3.2 Transaction Costs

4.3.2.1 Progress

There are few concrete examples of the impact of harmonisation on transaction costs. Those that are available generally note an increase in transaction costs due to harmonisation. From Ethiopia, the 2003 SPA mission reported that both donors and country found the process to be taking longer than expected and that they were getting increasingly frustrated (SPA, 2003).

In Mozambique a very recent SPA mission found that concerns were expressed both by some government officials and some donors representatives that in particular the Joint Review process imposed an excessively heavy burden on government time (SPA, 2004b).

A Dutch study on local level coordination and sector support in Uganda found that the high intensity of coordination increased transaction costs for Ugandan partners, especially because not all relevant donors participated in the cooperation (Ministry of Foreign Affairs, the Netherlands, 2003b).

By contrast, Williamson and Canagarajah (2003) claimed that the Poverty Alleviation Fund (PAF) in

Uganda had helped limiting transaction costs by presenting a set of commitment with respect to allocations and expenditures, which donors could use collectively as conditions for disbursement and funding arrangements. This, however, implies that even though transaction costs were reduced by the donor acting collectively, it was achieved through an initiative presented by the country.

Vietnam is another example of a country where reports are relatively clear on the benefits from donor harmonisation in terms of reduced transaction costs. However, this coordination was initially unrelated to budget support and also country driven (Danida, 2002a).

<u>To sum up</u>: There are indications that the processes of harmonisation and alignment may both be increasing and reducing transaction costs.

4.3.2.2 Perception

The SPA (2004a) study also asked recipients about whether they perceived that transaction costs had increased or decreased as a result of the harmonisation and alignment processes.

Table 4.3. The Degree to which Harmonisation and Alignment is Perceived by Recipient Countries to have Reduced Transaction Costs

Country	**Average score of satisfaction with level of coordination**, level of alignment and progress in alignment	**Extent to which transaction cost has been perceived to have changed** (1,2: transaction costs have increased, 3: no change, 4, 5: transaction costs have been reduced)
Benin	2.6	5
Burkina Faso	2.4	3
Chad	2.3	2
Ethiopia	2.5	2
Gambia	2.3	3
Ghana	3.4	4
Kenya	3.1	3
Madagascar	2.7	3
Malawi	2.7	3
Mozambique	2.1	2
Niger	3.2	3
Rwanda	2.7	3
Senegal	1.5	1
Sierra Leone	2.9	3
Tanzania	3.7	4
Uganda	2.6	5
Zambia	2.7	1
Source: SPA, 2004 p. 59 and adapted		

The average score in this category was 2.9, which would mean that the recipients perceived that the harmonisation and alignment processes had indeed increased transaction costs. However this result need to be interpreted with particular care and benefit substantially from a country-by-country investigation. For example, whereas there are indications of countries in the relatively early stages of harmonisation and alignment experiencing increased transaction costs, as was suggested by the examples from Mozambique and Ethiopia above and confirmed by the scores given by these countries, countries at a more advanced stage of harmonisation/alignment (Uganda, Ghana, Tanzania) indicate reduced or even substantially reduced transaction costs. This would confirm the argument that in the short run transaction costs will be expected to increase but that the process will indeed reduce transaction costs in the longer run.

There may also be a distortion of the results due to the possibility that some countries have scored high transaction costs for non-activity instead of as a result of the actual processes. Senegal could be such a case. As can be seen from the table Senegal claims that the harmonisation and alignment processes have substantially increased transaction costs for the country but the report from the 2002 SPA (PSA in French) mission indicated that donor presence in general was actually very low in the country and that there were no budget support donors at all due to the worrying financial management situation (PSA, 2002). By contrast Rwanda have "correctly" indicated that the apparently non-existent harmonisation and alignment process has neither increased nor reduced transaction costs[26].

In the fist column of table 4.3. the averages of the three satisfaction scores have been listed in order to test if there may be any correlation between satisfaction and transaction costs. As can be seen this correlation is relatively weak. Of the four countries that are satisfied with the processes only two indicate a reduction in transaction costs (Ghana and Tanzania) and the two countries that record the most reduction in transaction costs (Benin and Uganda) are not satisfied with the processes

To sum up: There may be some indications confirming the argument that the harmonisation and alignment processes may increase transaction costs in the short run but reduce them in the longer run.

4.3.3 Other Effects from Harmonisation and Alignment

The documents have also presented indications of disharmony *within the donors groups*:

In Mozambique, for example, donors were unsure of whether the Mozambican government was really committed to financial management reform in general and cleaning up after the 2000 bank collapse and fighting corruption in particular, Sweden and Norway wanted to possibly withhold budget support (Sida, 2002a). The other donors were not of the same opinion and Sida claimed that: *"In practice this has led to Sweden (and Norway) being subject to hard pressure to get in line"* (Sida, 2002a p. 18)

In Tanzania there are also some indications, although not as strong as in Mozambique that, again Sweden and Norway again, may feel a bit "crowded out" by the superior capacity of DFID. DFID is clearly one of the main contributors to the harmonisation process in Tanzania and the Nordic donors, given their limited resources in comparison, seem to be unsure of how to handle this situation (Odén and Tinnes, 2003).

To sum up: There seem to be some signs of disharmonies within the donor groups.

4.4 Result: Strengthening of the Government

There is one concrete example of where coordination and alignment seem to have played a large role in strengthening the government. It is given by Tanzania in connection with the negotiations on merging the PRSC and Poverty Reduction Budget Support (PRBS) facility:

> "A number of World Bank officials coming from the headquarter in Washington had a different approach as they wanted to include actions/prior actions linked to sector level into the PAF, and actions covering other sectors than those linked to the PRSP. They thus wanted to use the PRBS/PRSC as a lever to put pressure on the Government in other areas. Tanzanian authorities and the PRBS group members argued against this /…/ A number of suggested actions by the World Bank were dropped from the PAF in this process."
>
> *(Odén and Tinnes, 2003 p. 25)*

[26] Possibly distorting this result is the fact that Rwanda only indicates a relatively mild dissatisfaction with processes that by other accounts do not even exists. Again this serves to highlight the fact that the results need to be interpreted with care.

In Uganda harmonisation and alignment may have played an indirect but still very important role. By all accounts, Uganda is very strong in its leadership of reform:

> ”Ugandan ownership extends well beyond macroeconomic policy reforms such as trade liberalisation and exchange rate reform. Most importantly it manifests itself in the design of the Poverty Eradication Action Plan (PEAP) and in the effective way in which relations with donors are managed from the highly respected Aid Liaisons Office of the Ministry of Finance, Planning and Economic Development (MFPED). The Aid Liaisons Office circumscribes the role of donors: increasingly they are expected not to initiate and develop their own projects but to support activities identified, designed and implemented by the Government of Uganda (GOU).”
>
> *(Adam and Gunning, 2002, p. 7)*

This means that the harmonisation and alignment activities have been supporting a path already chosen by the government, thus facilitating progress. As Ddumba – Ssentamu et al., pointed out in 1999: ”…*the role of the donors have been important in being patient*”. (Ddumba – Ssentamu et al., 1999 p. viii)

To sum up: Contrary to what may have been expected from a process at such an early stage there seem to be some concrete results.

4.5 Summary and Concluding Remarks

This chapter clearly shows that the process of harmonisation and alignment is still very young, manifested mainly by the thinning out of information the further along the intended impact chain you go.

In most countries harmonisation and alignment activities seem to have been initiated but recipients are not particularly pleased with the progress.

It is very difficult to draw any firm conclusions since this is a process still at an early stage but two features stand out:

1. Donor harmonisation *may* reduce ownership through recipient countries viewing it as ”ganging up”. This said, according to SPA Rwanda also provides an example of *lack* of harmonisation threatening ownership (SPA, 2002a) Also, there are countries, such as Malawi, where alignment may not yet be an option because of the very weak institutional set-up (Fozzard and Simwaka, 2002).

2. There may be reason to believe that the processes will increase transaction costs in the short run but reduce them in the longer run.

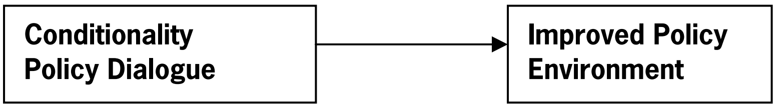
Since this is such a new process it is actually surprising to find examples of concrete results, but Tanzania would possibly provide one such example.

Points for further investigation includes almost everything related to these processes but at this stage it would be particularly interesting to find out if there are possibilities of increasing the speed of implementation in order to avoid unintended effects but also to highlight potential risks of moving to fast.

5 From Conditionality and Policy Dialogue and Improved Policy Environment

5.1 Introduction

The last link in the framework goes from conditionality and policy dialogue to improved policy design and execution. There are not assumed to be any intermediate effects here: either the inputs change the policy environment or they do not.



5.1.1 Background

Conditionality is not a new budget support input, but has been a part of the programme aid arrangements for a long time.

According to the IDS 2002 study on Swiss budget support there are a number of arguments in favour of its use: (i) influence of recipient-country policies on aid effectiveness in order to ensure that the donor money is well spend; (ii) safeguard against moral hazard so that the provision of funds will not weaken instead of strengthening the government's will to undertake necessary reform; (iii) aid can be used as a political resource by reformers within the government so that unpopular reforms can be carried out (as will be shown below, the White 1999 evaluation found evidence of this); and, (iv) in connection with soft loans, conditionality can be viewed as a substitute for collateral assets.

However, by the end of the 1990s there was a growing realisation that conditionality had not been particularly useful. As Dijkstra puts it:

> "The emerging consensus from the literature is that 'buying' of reforms via programme aid is not very effective. If recipient governments are not convinced themselves about the usefulness of the reforms, they are not likely to implement them."
>
> *(Dijkstra, 1999b p. 1)*

This called for a move towards a different approach. The *Assessing Aid* report suggested that aid should only be extended to countries with a good policy environment (World Bank, 1998), meaning that in those countries conditionalities would be obsolete and could be replaced by a dialogue between recipient and donor instead. This was translated into the PRSP being a sufficient guarantee that the recipients were at least aiming for a god policy environment and this document was supposed to be the foundation for dialogue.

Terminology may be a bit confusing since pre–2000 conditionality was also often called policy dialogue. Sometimes it was actually referring to a dialogue, but more often to a discussion between recipient and donor about the (non-) compliance with conditions.

Weeks et al (2002), make a useful distinction between four different types of conditionality

1. *Technical considerations.*

   This used to be most relevant for project assistance but increasingly applies to budget support via the requirements on the design of the budgetary system. This discussion is very briefly touched in chapter 2, but has in general been left out of the report for reasons explained there.

2. *Legally binding requirements for the donor country based on the agency's relationship to its own government.*

   These set the basic legal and operational framework for the support and include such things as reporting, transparency, effectiveness and adherence to the mission of the aid agency as set out by its own government. According to Weeks et al. (2002) recipient governments, with rare exceptions, accept this category of conditions as inherent in the development assistance partnership. However, as was shown in the previous chapter, this is an area where great changes are taking place and where recipients may no longer be asked to accept a multitude of different conditions.

3. *Those conditions motivated by the donor's desire to modify the behaviour of the recipient government with respect to political, social and economic development.*

   This category represents the original form of conditionality (what will be referred to as conditionality here). The Weeks et al study takes as an example a situation where DFID suspended the release of funds to Tanzania in response to the decision by the Tanzanian government to purchase a particular air traffic control system. This is an extreme example. A more common one would be the withdrawal of funds because the country fails to carry out a certain reform, such as privatising the banking system.

4. *Conditions derived from shared values*

   These are for example respect for human rights or the recipients' commitment to poverty reduction. These are the foundations for the policy dialogue. The conditions can be negotiated with regard to concrete circumstances but cannot be suspended. The PRSPs could be considered a manifestation of such shared values. The design and execution of the PRSP can be discussed – the policy dialogue – but if the recipient stops following its own development strategy (that has been accepted and respected by the donors) the foundation for the policy dialogue disappears and the cooperation breaks down completely.

Weeks et al point out that the optimal process would be one in which the initial partnership dialogue on shared values eliminate the need for category three conditionalities. If the values are shared and the government has a clear strategy, as well as the capability to implement it, then shared values will be enough for cooperation (Weeks et al, 2002).

5.1.2 Chapter Layout

Section 5.2 will look for evidence of conditionality and policy dialogue under the new budget support approach (post-2000 arrangements) and see if a move towards more policy dialogue can be discovered. It will also take a very brief look at earmarking and the nature of conditionality. Since no intermediate effects are expected, section 5.3 will look at results, including some examples from the pre–2000 period for comparison. Section 5.4 concludes.

5.2 Inputs: Conditionality and Policy Dialogue

5.2.1 Use of Conditionality and Policy Dialogue

In spite of the reported unsatisfactory results of conditionality in the past, conditionality is still in use in most counties. SPA (2004a) reports on the frequency of use of different types of conditionalities in budget support arrangements (see table 5.1).

Table 5.1 Frequency of use of Different Types of Conditionalities

Type	**IFIs** (sample of 32)	**Bilaterals** (sample of 69)
Policy conditionality only	31%	20%
Macro conditionality only	0%	0%
Result indicators only	3% (1 case)	6%
Policy + Macro conditionality	50%	33%
Policy conditionality + Result indicators	13%	23%
Policy + Macro conditionality + Result indicators	0%	16%
No conditionality	3% (1 case)	2% (1 case)

Policy conditionality: Policy actions, including policy-process improvements such as for example privatisation of a marketing board
Macro conditionality: Macro-economic performance criteria such as target inflation rate.
Source: SPA, 2004a pp. 33-34 adapted

The study also found that donors still tried to enforce conditionality by suspending or delaying disbursements. At least six countries (Kenya, Malawi, Rwanda, Senegal, Sierra Leone and Uganda) did not receive all or part of the support in 2002 and in another five (Burkina Faso, Gambia, Ghana, Mali, Mozambique), disbursements were delayed. Reasons given for this included:

(i) Government failed to meet conditions: 53%

(ii) Administrative problems: 18%

(iii) Government failed to meet conditions + administrative problems: 22%

(iv) Other: 7%

Three quarters of the instances of failure to disburse where caused by conditionality related problems.

Table 5.2. Some Examples of Donor Approaches to Conditionality		
	General	**Country specific**
Belgium		Burkina Faso**:** Through the World Bank
Danida	Most cases not sufficient leverage for own conditionality. Conditionality only within areas absolutely critical for macro stabilisation. "In general, Denmark does not favour the often used mixed model of conditionalities, where part of the tranche is released against compliance with a few critical conditionalities and the release of the remaining part is negotiable depending on how the partner government and the donors evaluate overall progress of the reform."	Bolivia: earmarked for technical assistance Tanzania: About 50 prior actions: policy actions in the commonly agreed Performance Assessment Framework, which includes prior actions of the World Bank (but overall progress is sufficient for tranche release) + 60 result indicators selected by PRSP monitoring system (for policy dialogue, not trance release) Examples of indicators: establishment of taxpayers unit in TRA, eliminate VAT exemptions for government, full finance of priority areas in the Annual Budget 2001/2002, publication of quarterly execution reports from public accounting system, PER review process established with the participation of all relevant stakeholders.
DFID	Structural adjustment: macro conditionality no earmarking General budget support: macro and budget conditionality, no earmarking Sector budget support: sectoral conditionality, sector earmarking Sector earmarked: sectoral conditionality, within sector earmarking	Ethiopia: progress in PRSP, like key governance and public finance issues as well as targets in poverty focused sectors Ghana: disbursement against teachers salaries, progress on PRGF Malawi: 2001: disbursement against multilateral debt repayments, improvement of public financial management indicators 2003: Some budget support will be linked to performance in key sectors. Indicators consistent with key PRSP monitoring indicators Mozambique: disbursement against civil service payroll, improvement of financial management system Rwanda: disbursement against salaries for teachers/civil servants, progress on PRGF Uganda: disbursement against non-educational pro-poor public expenditure
European Commission	Fixed tranche: release depends on fulfilment of the general conditions (in general satisfactory implementation of the programme for IMF: IMF "on track") Variable tranche: Support is disbursed in the light of performance measured with the help of agreed indicators and results set out in the programme such as financial management and social service delivery. The analysis of the performance should be made in the course of a close dialogue with the government and it is taking into account the effects of any internal or external factors that may explain performance. Mixed tranche: A single tranche is made up of one fixed and one variable amount.	Burkina Faso: first tranche tied to PRGF Second tranche flexible and tied to poverty indicators within the PRSP (health, education, macro and financial management) Mozambique: Since 2002 two tranche model. Zambia: First tranche: Eight policy process conditions, including implementation of IMF programme + one public financial management outcome indicator Second tranche: four health and three education outcomes as basis + 19 elements of a matrix to address weaknesses in public financial management
NORAD	"In most cases Norway will provide budget support to countries implementing a poverty reduction and economic reform programme with the IMF and the World Bank, supported by the PRGF, PRSC or other policy based instruments. The bilateral budget support agreement will normally have to relate to the IMF and World Bank conditionality. Whereas coordination with the IMF and the World Bank is important, Norwegian budget support agreements should not include automatic tying to the IMF or World Bank decisions." "Norway does **not** favour the introduction of variable tranches or mixed models of condlitionalities, where part of the tranche is released against a few critical performance criteria, as practised by the European Commission PRBS. Norway will evaluate overall performance, and may consider adjustments of budget support volumes in future agreements."	
Seco	Selected number of key policy conditions usually either included or compatible with the IFI agreements. Must be based on policy dialogue with country.	Burkina Faso: earmarked for education, internal debt and multilateral debt fund, increased budget allocations for social sectors, improved internal resource mobilisation. Since 2001 also though common budget support arrangement.
Sida		Burkina Faso: 2001 through the the European Commission, 2002 through budget support group Malawi**:** Tied to PRGF (together with rest of CABS): satisfactory progress in the implementation of the economic reform programme, satisfactory fiscal performance, adequate governance Mozambique: 75 % on-track, 25% result indicators. Assessment will be made with other donors but Sweden will not automatically follow conclusion.
Sources: Danida, 2001b, 2003b, 2003c, DFID 2001 c, 2001d, 2003b, European Commission, 2003, NORAD, 2003, Seco, 2002, Sida, 2002a, 2002d, 2003a, SPA, 2004a		

Two features stand out:

Firstly, there seems to be a division between donors moving towards the European Commission system of conditionality (two tranches, one fixed tranche linked to PRGF or other IMF programme, and one variable tranche linked to commonly agreed poverty indicators and the implementation of the PRSP) such as Sweden and possibly the World Bank and others explicitly and resolutely renouncing the system such as Norway and Denmark.

The World Bank has suggested a two tranch system in Uganda, which in the case of this country would actually be a step back from a basically condition free system. However, the suggestion was made in recognition of the risk that a suspension for political reasons (more on this below) may have some severe economic effects:

> ”There is no reason why the basic amount under the PRSC could not be segmented. There could be a core amount that is given virtually without conditions, based on a continued good performance of Uganda seen in the past and within a stable macroeconomic framework. Further amount could be calibrated to harder demands for reform, whether these are of deep institutional nature or reforms that are more political in nature and call for strong political leadership.”
>
> *(World Bank, 2003h p. 19)*

Secondly, most donors show signs of a move towards a more policy dialogue based approach, at least on paper. The Danish cooperation with Tanzania (presented in table 5.2) indicates that overall assessment is more important than specific targets and in a 2003 appraisal document for budget support to Bolivia, Danida concludes: ”*The Danish budget support should be seen as instrumental in a Danish dialogue with Bolivian authorities on issues of poverty reduction, economic policy and financial management.*” (Danida, 2003b p. 3) The European Commission guidelines on the provision of budget support also clearly state that:

> ”In no case may the analysis of a country’s performance be limited to the mechanical interpretation of indicators. Such analysis must be made in the course of a close and deep dialogue with the country’s government. The Government has primarily the responsibility to make the analysis which will be then assessed by the Commission on the basis of supporting documents. The analysis must take account of the effect of any internal or external factors that explain a given situation.”
>
> *(European Commission, 2003 p. 53)*

In general it has been difficult to assess potential progress towards a greater use of policy dialogue instead of conditionality *in practice* in the donor–recipient relations. However a closer examination of some major ”crises of confidence” between donors and the recipient countries found since 2000 may give a hint.

The Mozambican 2000 Bank Crises

A major crisis occurred in Mozambique in 2000 when two of the country’s largest semi-privatised banks almost went bankrupt due to bad debts, some of them to government officials, leading politicians and businessmen. When the government decided to save the banks with public funds, economic instability followed and it was also unacceptable to donors that resources were directed away from poverty reduction purposes to subsidising some of the richest people in the country. As a result IMF and the World Bank postponed the HIPC decision point and ten of the budget support donors tied their disbursements for 2001 to the IMF and World Bank condition that the country should present a credible strategy for handling the crisis. Such a strategy was presented and the donors agreed to disburse funds for 2001. Many promises were made to the donors during the late 2001 but in the early

2002 there were signs of weakening resolve to address the crisis on the part of the Mozambican government. This lead to Sweden and Norway delaying disbursements until late 2002 by which time some new plans had been presented (Sida, 2002a).

Uganda 2001 Education Review
The April 2001 Education Review in Uganda identified several serious problems. Most importantly the undertakings regarding fiduciary assurance had not been met. The education spending of local governments simply could not be checked since only one (1) out of 106 local governments had submitted accounts. This was clearly a breach of conditions but after much debate donors declared the outcome satisfactory. If they hadn't they would have had to withhold funds completely, something they did not want to. In spite of the clear non-compliance with the conditions set up for support, the donors where still convinced that it was not out of neglect, but rather due to inability, that the conditions had not been met. On a basic level the dialogue still remained sound (Adam and Gunning, 2002).

The Malawi 2001 Suspension

In 2001 bilateral donors suspended budget support because the country was off track with the IMF programme (IMF/IDA, 2003). The IMF declared the country off track because of lack of fiscal discipline, which also violated the CABS conditions (Sida, 2003a). In spite of repeated pleas from the IMF for the donors to resume support (to save the country from economic collapse), the CABS donors would not budge from their decision until the country's public expenditure monitoring improved, in spite of the fact that the Malawi government showed a strong willingness to prioritise pro-poor spending in the budget (Ibid.). In 2003, following the resuming of the IMF programme, CABS decided to restart support.

The 2002 Ugandan Military Expenditure Surge
The Weeks et al (2002) report found that although on the surface the dialogue with Uganda appeared constructive and harmonious there were serious underlying tensions related to democratisation as well as the conflicts in the Congo and north-east Uganda. They further found that there was a strongly held, if non-public, view among donors that development assistance was funding military expenditure. This problem was manifested in 2002 when the country became subject to a donor cut-back of about $US 30 million due to the sudden surge in military expenditure (World Bank, 2003h).

These situations point to different levels of development towards a co-operation by policy dialogue rather than conditionality.

The Malawi suspension shows all the signs of the "old" system where IMF suspends because of non-compliance with the PRGF (formerly ESAF) and the bilaterals follow. Surprisingly, most documents speak in positive terms about the donor-country dialogue in Malawi. However, the MWH 2003 evaluation of European Commission support to the country found that the general political deterioration in the country has "*…pushed the EC* [European Commission] *to become more critical in its policy dialogue with the Government and in the Common Approach to Budget Support (CABS)*." (MWH, 2003 p. 17) The Joint Staff Assessment of the PRSP by IMF and IDA also concluded that although the PRSP process used to be highly participatory the momentum seems to have been lost (IMF and IDA, 2003).

Mozambique seems to be in an in-between situation where donors are reluctant to suspend and would like the issue to be solved by dialogue, but where the confidence that it would be resolved in this way was not strong enough.

Both examples from Uganda indicate that here policy dialogue has moved on to another level. The non-compliance with explicit conditions was not enough for support to be suspended. However, when the more fundamental question of the government's budgetary prioritisation was raised by the increase in military spending, the donors seem to have felt that the basic foundation for the policy dialogue was being upset, thus causing the donors to consider and execute delays and suspensions of aid funds.

The indication that the Uganda – donor partnership has reached this stage of development is also confirmed by Adam and Gunning (2002) who say that the European Commission is the only donor linking aid to performance and even there it is only the second tranche. Sweden also declared in the 2001 country strategy that: "*Swedish support is conditional on continued democratisation and respect for human rights*" (Sida, 2001 p. 12).

Rwanda seems to be at the other end of the spectrum. The criticism from the 2002 SPA mission towards donors' use of conditionalities is massive. One example used was the PRGF specifying 13 structural conditionalities, with 6 sub-conditionalities and 49 core actions. The mission concluded that: "…*the number of conditionalities, activities and information…is onerous for the Government and usurps ownership*" (SPA, 2002a p. 6). It is also interesting to see (table 5.3.) that Rwanda is the only country presented where more than 50 percent of budget support funds are earmarked. For other countries the vast majority of funds are not earmarked.

Table 5.3 Earmarking of Budget Support Funds (2002)

	Number of donors programming not earmarked support	Percent of funds not earmarked
Benin	3	100
Burkina Faso	7	100
Chad	3	75
Ethiopia	n.a.	n.a.
Gambia	1	100
Ghana	3	100
Kenya	2	No funds disbursed
Madagascar	2	100
Malawi	2	No funds disbursed
Mali	2	100
Mozambique	9	95
Niger	4	90
Rwanda	2	45
Senegal	1	100
Sierra Leone	3	100
Tanzania	10	95
Uganda	9	90
Zambia	3	100

Source: SPA, 2004 p. 24

Rwanda also presents an example of the fact that donors seemingly forgetting at times that dialogue is a two way street. The Rwandan government has complained about the non-transparency of donors and their inability to share information more actively (SPA, 2002a).

The same tendency was found in Vietnam:

> "…while there is increased access to government information, including the national budget, there could be wider sharing of development information – by having it translated into Vietnamese, for example."
>
> *(World Bank, 2003a p. 84)*

Finally, an interesting statement is made by the USAID:

> "…USAID should consider a minimal buy-in so the United States is a full partner in the donor-government dialogue."
>
> *(USAID, 2003b)*

This indicates that budget support is viewed as an entry ticket to policy dialogue with recipient countries. The same opinion is expressed by the IDS 2002 Swiss budget support evaluation, which concludes that a notional minimum amount is required in order for Switzerland to buy ”a place at the table”.

To sum up: There are indications of a possible move towards more policy dialogue based co-operation but this has not meant, in general, that conditionality has decreased.

5.2.2 Nature of Conditionality

Even though it seems that the amount of conditionality has not been reduced, there are indications that its nature has changed towards being more result-based. Result orientation is one of the four principles of the Comprehensive Development Framework (CDF) launched in 1999 by the World Bank (World Bank, 2003a). As can be seen from table 5.1 result indicators is a major feature among bilateral conditions (55 percent includes some element of result indicators. The IFIs only include it in 16 percent of the cases.).

The IDS 2002 study found that in response to the growing realisation of the limitations of conventional conditionality some bilateral donors, in particular the UK, some Scandinavian countries and to a lesser extent the World Bank, had begun to downgrade it in favour of other approaches. In addition the European Commission guidelines stipulate that:

> ”The purpose of the mechanism proposed [the two tranche system] (and also implemented in many countries) is to evolve from the traditional conditionalities (requiring governments to implement measures/conditions) towards performance indicators. Such indicators may be designed to reflect improvements in public services offered to populations in the health and education sectors and improved efficiency in certain sectors, such as justice and especially the management of public finances, which are deemed to be priority sectors.”
>
> *(European Commission, 2003 p. 51)*

It is easy to see the benefits of result orientation, particularly in view of the rather well known Reinakka and Svensson (2001) study which found that although education in Uganda recorded and increasing budgetary allocation between 1991 – 1995, thus satisfying the input condition, schools actually ended up with only 13 percent of the government allocations meant for non-wage expenditures. The rest was lost on the way.

However, the approach is not without its critics. Central to this criticism is that knowing about outcomes is also insufficient. It is equally important to understand the result chain and the sequence of inputs and events needed to achieve the results (World Bank, 2003a). Booth and Lucas point out: ”*Most PRSPs have a 'missing middle'…They do not spell out how the identified activities can be expected to result in achievements of the identified goals*” (Booth and Lucas in Black and White (eds.), 2004) The authors cite Uganda as an example of a country that has made an effort to bridge this missing middle but measurements of quality is still missing (Ibid.). This is further illustrated by the indications from the 2003 World Bank PRSC stocktaking which found that in spite of an increasing share of budgetary spending going to health and the increase in the utilisation of the health facilities, infant and maternal mortality, as well as incidence of malaria, had increased. In water and sanitation the quantitative indicators also showed a rapid expansion in coverage and targets were substantially exceeded. However, the resources seemed skewed towards urban areas and small towns, with only 15 percent of the population receiving over 50 percent of the resources (World Bank, 2003h).

There are also indications that result orientation may increase conditionality. SPA in particular warns against the ever-growing Performance Assessment Framework (PAF) matrices, evident both in Mozambique (SPA, 2004b) and Ethiopia (SPA, 2003).

The move towards result indicators was supposed to be a way of basing the donor–country relationship on the shared values established by the PRSP. However, it does seem as if result indicators may in many cases be turning into another form of conditionality.

To sum up: Even though the amount of conditionality does not seem to have decreased there seems to be a change in the nature of conditionality, with a move towards a more result-based approach. However, it is difficult to see how this has furthered a move towards less conditionality and more policy dialogue.

5.3 Results: Improved Policy Design and Execution

The results below have been divided into the pre- and post–2000 in order to try to assess impact, if any, of the new approach. The basis for the pre–2000 period is the White 1999 Swedish programme aid evaluation but there is unfortunately no corresponding document for the post–2000 period.

5.3.1 Pre – 2000

The main finding from the Swedish programme aid evaluation was that, in most of the instances where reforms had been implemented, the processes had either started before the donors arrived (Bangladesh, Nicaragua, Vietnam) or would have taken place anyway (Cape Verde and Uganda) (van Donge and Dijkstra, 1999, Dijkstra, 1999a, van Donge et al., White and Leefmans, 1999, Ddumba-Ssentamu et al, 1999).

In Nicaragua, donor influence started in 1999 with the first IMF/World Bank agreement. By then the most important reform, the liberalisation of the foreign exchange market, had already been implemented. The government had also liberalised all prices and had begun the privatisation of state enterprises under its own initiative. Donors focused on stabilisation and further reforms such as trade and financial liberalisation. From 1991 onwards a cyclical pattern emerged, where strict monetary and fiscal targets were set and structural reforms agreed upon but after about a year the government did not meet targets anymore (Dijkstra, 1999a). The bilaterals stressed governance issues, such as making development assistance transparent in the budget, which led to some changes in the agreement *with the IFIs*. Bilaterals also had some success in influencing the political situation but could have been more effective if they had not left the macro issues to the IFIs. Dijkstra concluded that on the whole, during the 1990s policy dialogue (including conditionality) was not very effective (Ibid.), an opinion that has also been shared by Danida (Danida, 2002a).

For Tanzania van Donge and White (1999) conclude that: ”*The pace and pattern of reform in Tanzania have been determined by a number of factors, of which donor involvement has been one, but only one*.” (van Donge and White, 1999 p. 34) Policy dialogue played a role in the introduction of a multi-party system, civil service reform and privatisation. But possibly the most important role was as an instrument in breaking the influence of powerful partial interest in order to overcome collective choice dilemmas (Ibid.).

This role of conditionality as a scapegoat was also found in Bangladesh. Just prior to 1999 the dialogue in the country got stuck on issues of reform of state owned enterprises and the banking sector. Both the major political parties in the country were backing up reform but it was opposed by sectoral interests that made it difficult to implement. Due to this the negotiations for a new ESAF broke down in 1998 and the evaluation predicted that programme aid and policy dialogue might have played a major role in attempts to break this stalemate (van Donge and Dijkstra, 1999)[27].

In spite of the generally weak track record for conditionality and policy dialogue in the pre–2000 era there are at least two examples were they had substantial and sustainable effects:

The first one (already referred to in chapter 2) regards the liberalisation of the foreign exchange market in Uganda. In 1992, there was a major clash between government and donors. It began by some donors suspending programme aid because they required donor money to be sold at the parallel rate. When the Minister of Finance continued spending in spite of lower income and heavily borrowed from the Central Bank, the IMF also suspended support. The President reacted by unifying the exchange rate, sacking the Minister of Finance, and introducing a cash budget in order to eliminate monetary financing of deficits (the introduction of the cash budget was, however, not part of conditionality).

The second example is from Vietnam. Probably due to aid making up such a small share of the government budget in Vietnam (taking the edge off any threat of suspension), there is no or very little donor conditionality in the country. In the late 1990s the non-transparency of the government budget (it was a classified document) was a big issue among donors, partially brought on by the possibility of future budget support, and the donor community lobbied as hard as it could[28] for it to be made public, which also happened in 1998.

<u>To sum up</u>: With very few exceptions, conditionality and policy dialogue has not been very effective in promoting reform in the pre–2000 period.

5.3.2 Post – 2000

There are only a few indications of conditionality/policy dialogue impact from the post–2000 period, all of them based on the crises examined earlier.

In Mozambique, the donors dialogue in combination with waving the suspension threat apparently made the country change its way of dealing with the bank crises, albeit reluctantly and with apparently decreasing intensity (Sida, 2002a)

The suspension in Malawi also made the country keep expenditure under better control, but the country has a history of cyclical behaviour regarding government expenditure control, so there is a risk that this will slip again (Fozzard and Simwaka, 2002).

In Uganda the donors were apparently correct in trusting the country to take the necessary adjustments to the system of local budget control and it was subsequently improved (Adam and Gunning, 2002). However, the activities in the north-east of the country still strain the relationship between the government and some donors.

A very preliminary conclusion from this would be that conditionality and buying reform might still not work very well.

27 It is interesting to note that this is a role that conditionality and policy dialogue will not be able to play in the future if the process proceeds as it is intended. Basing cooperation on shared values means that recipient governments can no longer carry out unpopular reforms under the pretence that they are forced to do so by donors.

28 Van Donge et al.(1999) conclude that policy dialogue is a difficult issue in Vietnam, not because it does not exist but because the complex structure of the political and administrative systems.

To sum up: There is too little evidence to say if there has been any change in the effectiveness of conditionality and policy dialogue since the new approach to budget support started.

5.4 Summary and Concluding Remarks

Available literature seems to reveal a change, at least on paper, both towards a greater emphasis on policy dialogue and towards more result based conditionality. However, this does not seem to have meant any reduction in conditionality in the post–2000 period. It could actually be the opposite. SPA in particular warns against the ever-growing Performance Assessment Framework (PAF) matrices, evident both in Mozambique (SPA, 2004b) and Ethiopia (SPA, 2003).

Even if policy dialogue has not replaced conditionality, it is possible to argue that result based conditionality is a move in this direction. By focusing on outcomes instead of inputs the country may be more closely involved in the process of setting the goals and it opens up for assessment of performance in close cooperation with the country. This should contribute to an increase in ownership. However, Randel et al highlight the risk of viewing policy dialogue as a complement rather than a substitute to conditionality: "*Policy dialogue is labour intensive, meeting intensive and software intensive*." (Randel et al, 2003 p. 6). Coupled with the reportedly growing amount of result conditions there is a threat that the process, in spite of its good intentions, could exhaust the country and possibly reduce ownership. It would be very important for future studies to look into this risk, as well as make a proper evaluation of possible differences in pre- and post-2000 handling of crises.

6 Summary and Concluding Remarks

This report stops short of presenting any potential impacts from budget support on poverty reduction since it is assumed that budget support mainly contributes to poverty reduction by creating an environment where the recipient governments are able to pursue this strategy.

This is done through promotion in four areas:

Growth
This is the original objective of budget support and albeit found no longer to be sufficient, it seems safe to say that it is still necessary for poverty reduction. This is the area where most literature can be found, but even though a move towards a greater increase of variables reflecting the policy and institutional environment can be discovered, there is still a lack of economic models and research on the impact of budget support on growth. However, studies made have found that budget support seems to have a positive impact on a number of economic variables and can be particularly beneficial for economic stability. The final link to growth has been more difficult to establish though. Additional literature on pro-poor growth would be most welcome.

Improvement of the Financial Management Systems
There seems to be a growing consensus among donors, at least in practice, to view the improvement of the financial management systems as an intended outcome of rather than a prerequisite for budget support. Financial management systems can be improved through two effects: systemic effects from the funds using the system and direct effects from technical assistance. Indications were found that these effects might need to work together to be efficient.

The report found that many financial management reform programmes seem to have started in the early 1990s but there are also indications that activities have increased since the beginning of the 2000s. The early reform programmes started at a time when programme aid was declining and thus less and less aid was channelled through the budgetary systems of the recipient countries. A number of these early reform programmes seem to have lacked success, possibly highlighting the importance of systemic effects. There are also some successful implementations of financial management systems and the report hypothesises that the perceived increase in corruption reported from many countries may rather be a reflection of improvements in the financial management system than an actual increase.

Strengthening of the Government through the Improvement of the Aid Management System
The donor harmonisation and alignment processes are still very young and this is reflected in the lack of literature regarding effects and results. Progress seems to be made both in alignment and harmonisation but there is still some way to go before the processes are completed. The recipients have not been particularly content with the efforts.

So far, two effects have been found: (i) there are some indications that recipients could perceive the process as ”ganging up” and (ii) transaction costs seem to have increased in the short run but declined in the longer run. An increase in transaction costs in the short-run is not particularly unexpected.

Since the process is still in its infancy the report did not expect to find any concrete results but there were indications in one country that the processes had lead to strengthening of the government in pursuing its objectives.

Improved Policy Environment
A growing realisation during the 1990s that conditionality was not working called for a new approach to the donor–recipient co-operation. An increasing emphasis was put on sharing common objectives and a move towards a dialogue about the achievement of these objectives. Indications seem to show that although there is a growing dialogue, conditionality has by no means disappeared and reports have even warned that it may be increasing due to the ever-growing sizes of the Performance Assessment Frameworks. Comparing pre- and post–2000 results also shows some, but not much, difference, although the post–2000 results are based on very shaky grounds due to lack of sources.

Economic and Institutional Environment Conductive to Poverty Reduction
To re-cycle an old and worn, but very appropriate analogy:

Who is pushing the car?

Your car has stopped and you can't get it to move again by yourself so you ask a friend to help you. The two of you still can't move the car so you ask a third person for help, but the car won't budge. Not until a forth person has joined you does the car finally start moving. So, who is pushing the car? Since the car wouldn't move until the fourth person joined in, is it the forth person? But he wouldn't be able to move it either if any of the other three stops pushing. And it can't be one of the other three since nothing happened while they were pushing.

The answer is of course that they all push the car together and that they are all needed to get the car to move.

The same applies to budget support. Danida puts it very wisely already in an 1996 evaluation of poverty reducing effects of the Danish support to Uganda:

> "While it is not straightforward to isolate any poverty–reducing effects of these issues, it is possible to conclude that, to the extent that the policies of GOU [Government of Uganda] in general are poverty reducing, untied balance of payment support [budget support] contributes thereto."
>
> *(Danida, 1996 p. 68)*

The White (1999a) Swedish programme aid evaluation found very difficult to say anything about programme aid and poverty reduction. In Nicaragua, Dijkstra found that liberalisation brought greater income inequalities and an uneven trickling down of benefits from growth whereas White (1999) concluded that in Mozambique it was likely that the programme aid funds did help to increase goods availability, including to some extent, rural areas. However, policy reforms had yet to deliver lasting benefits to large sections of the population.

Uganda provides an interesting case for further discussion. In 1999 Dsumba–Ssentamu et al. found that programme aid had contributed to more expenditure for health and education, but also for feeder roads enabling better access to markets. But Lenz (2002) argues that, based on a participatory rural appraisal in one of the districts in Uganda:

> "Due to their precarious economic condition, smallholder farmers adopt risk-averse behaviour and use available time, energy and resources to secure food and other basic needs. With the exception of water, smallholder farmers do not feel that the PAF [Poverty Alleviation Fund] services provide them with means to achieve their basic needs. As a result men and women place a lower value on projects such as new schools, health clinics and feeder roads. They perceive the services these institutions provide as goods to be consumed after basic needs are assured or, in some cases at the expense of those needs."
>
> *(Lenz, 2002, p. 1)*

Deininger and Okidi (2003) also found that, although improved access to basic education and health-care are determinants of poverty reduction, the most important determinant is prices of agricultural outputs. This concurs with the Williamson and Canagarajah (2003) suggestion that a better poverty reduction strategy than increased service delivery to the poor would be interventions to enhance their economic opportunities. However, donors, through the PAF, insist on service delivery as the best option.

Even though budget support is not supposed to reduce poverty directly the way it goes about creating an enabling policy and institutional environment will have a great effect on the partner countries possibility to do so. The major question then, must be how to do that in the most efficient and effective way.

Appendix 1. Terms of Reference

1 Background and Rationale

The literature review is part of the preparation of a comprehensive joint-evaluation of General Budget Support (GBS).

The preparations of the evaluation started in late 2001 when the UK Department for International Development (DFID) launched an Evaluability Study of General Budget Support (GBS). This initiative responded to the increased financial as well as political importance of GBS faced by many donors and partner Governments alike. The aim was to explore the evaluability of GBS and develop an evaluation framework, which would subsequently be applied in a joint-evaluation of GBS.

DFID facilitated workshops in Glasgow and Kampala that clearly indicated that further joint-partner evaluation activities on GBS were both needed and demanded. A meeting of the DAC Evaluation Network in Paris, March 2003, endorsed the creation of a technical working group for preparing the joint evaluation of GBS. The workshop in Brighton, October 2003, brought together over forty evaluation specialists, economists and policy makers from a range of bilateral and multilateral agencies. The planning workshop agreed on the scope and focus of the evaluation and established a Management Group (MG) and Steering Group (SG) and the joint evaluation of GBS was formally launched. At the SG meeting in Paris the in January 2004 it was agreed that the evaluation should involve eight country evaluations and several thematic evaluations drawing further conclusions from the county studies as well as earlier research and evaluation evidences. A synthesis report will summarise the main findings from all aspects of the joint evaluation.

The Evaluability Study included a literature review of evidence available to early 2001, primarily focusing on published articles[1]. Since 2001, several further studies and evaluations have been launched by many donors concerning experiences with GBS. There are also a growing number of grey literature documents, which remain unpublished yet, which capture early lessons around GBS. Furthermore, several donors have expressed their need for early evidence and indications on the effects of GBS to inform ongoing policy development. There are also concerns that the evaluation team should get started as soon as possible after being contracted. Hence, it was decided at the Management Group meeting in November 2003 to conduct a literature review during the first half of 2004. The review should feed in to the inception phase of the GBS evaluation (where the evaluation's scope of work and more specific issues should be specified). The review should also guide the prioritisation and details of the thematic evaluations.

2 Purpose and Objectives

The purpose of the literature review is to review and summarise existing literature on GBS (ongoing and completed studies and evaluations), and apply this new information to the GBS evaluation framework.[2] The review should be clear on the quality, rigour and depth of earlier evidence and type of methodology used.

[1] Naschold, F. and Booth, D (2002). "GBS Evaluability Study Literature Review", Version 2, DFID.

[2] Booth, D. and A. Lawson (2004). "Proposed Evaluation Framework for General Budget Support: Framework for Country-Level Case Studies", Final Report to the OECD-DAC Technical Working Group on Evaluation of Budgetary Aid, ODI.

There are two main objectives for the Literature Review. Firstly, it should provide donors with early evidence and lessons on the effectiveness of GBS as an aid instrument. Making clear where sufficient existing evidence supports or contradicts the framework and where the picture is less clear.

The second main objective is to produce a useful input for the evaluation team in the inception phase of the GBS evaluation. From the Literature Review the team should be able to get an overview of the background literature (research and evaluations), the main issues arising from earlier work, as well as methodological strength and weaknesses. The review should indicate the issues where more evidence is necessary and the issues appropriate for the evaluation.

Moreover, the review will be an input to the detail of the thematic evaluations. The review shall comment on the existing evidence base for potential thematic evaluations and comment on the type of further evidence required, suggesting appropriate methodologies. This information will be used to flesh out thematic evaluation topics and tighten focus.

3 The Assignment

The literature review should cover all available research and evaluation evidence on experience with GBS at the national, regional and global levels. It would be helpful if specific findings relevant to the countries included in the GBS evaluation (i.e. Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda, Vietnam and Papua New Guinea) could be highlighted. Evidence from donor and partner Government's grey literature should be included as well as relevant evidence from research bodies and NGOs.

The main tasks during the work are:

Documentation:

– The review should identify the existence of earlier work related to experience with GBS, including among other things, research and documents produced by different donors (including unpublished literature).

– Identify the main documents for each issue of the framework (or suggested additional issues) and flag documents of relevance to each case study country.

A main reference list of all documents of interest should be included. It must be annotated to make clear which documents are crucial for a general understanding of GBS, for specific issues at different levels, and for a specific country. Where documents are sourced as part of this review, they should be passed to the MG for future reference at the end of the study.

Analysis:

– Identify the main conclusions for the different issues at different levels of the framework and compare findings from different studies. Is there consensus or disagreement? Are there additional impacts at any level not captured in the framework that seem significant?

– Specify the main methodologies and indicators used for different issues. The purpose of this is to exemplify how to measure the specific effects of GBS and to identify what is possible to study during a field study and what is possible to study during a desk study.

Recommendations:

– Identify the extent of earlier evidence for each issue and to what extent the evaluation should provide additional knowledge, through the country evaluations and/or the thematic evaluations.

Limitations

The author should be aware of the planned thematic studies. These are supposed to expand on certain themes by desk studies. Hence, the literature review should identify the main documents on each issue and the extent of other evidence but should not go into too specific details. Moreover, the evaluation team are contracted to include earlier evidence and should be aware that there might be other important documents then the ones specified in the literature review. However the review will be an important document in guiding them to the main documents and conclusions. These limits, and how to deal with them, will be discussed with the management group during the work period.

The literature review will be published before the evaluation results are ready and will hence not include these results.

4 Methodology

The literature review will be a desk study where the main documents of GBS should be considered but personal interviews might be necessary to extend information on certain issues, these should be agreed with Sida in advance. The main sources of information are:

– The Evaluation Framework (provided by the MG)

– The Evaluability Study Literature Review and the included reference list (provided by the MG)

– Documents submitted by donors upon request at the Paris SG meeting in January, and subsequently through follow up by the consultant

– Documents collected from databases, web pages, etc., and from research bodies and NGOs as identified by the consultant and the MG.

The consultant should also be familiar with the GBS evaluation and will be provided with necessary documents from the MG.

The consultant should work closely with the MG at all stages to ensure a timely, policy relevant report of sufficient quality.

5 Reporting

5.1 The report

The literature review shall be written in English. Subject to decision by the MG (informed by the SG), the reports will be published and distributed. The final report shall be presented in a way that enables publication without further editing, and should include an executive summary of key findings and full references.

A draft report shall be submitted to the MG and after receiving the MG's comments on the draft report, a final version shall be submitted.

5.2 Presentations and meetings

The draft report shall be presented and discussed with the MG in March 2004.

The main findings of the literature review shall be presented to the evaluation team. This meeting should be held as soon as possible after the team is contracted (June 2004) in order to speed up the inception phase of the evaluation.

The findings shall also be presented to the SG at a meeting in October 2004.

6 Preliminary time schedule

Submission of draft report	mid March 04
Presentation for the MG	mid March 04
Submission of final report	end April 04
Presentation for the evaluation team	mid June 04
Presentation for the SG	end October 04

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Extra bold type **indicates document specifically referred to in the text**

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Donors

www.ausaid.gov.au	Australia
www.bmz.de	German Development Co-operation Agency
www.danida.dk	Denmark
www.dec.org	USAID
www.dfid.gov.uk	UK
www.minbuza.nl	The Netherlands
www.norad.no	Norway
www.sida.se	Sweden

Poverty Reduction Strategy Papers

http://poverty.worldbank.org/files/Countryname_PRSP.pd

Others

www.aidharmonization.org	(harmonisation)
www.imf.org	(International Monetary Fund – IMF)
www.oecd.org/dac	(DAC)
www.worldbank.org	(the World Bank)

Research

www.odi.org.uk

www.wider.unu.edu

www.worldlearning.org

Appended tables

Table 1.1. Objectives and Rationale for Programme Aid and Budget Support		
Publication	**Objectives**	**Rationale**
Tarp and Kragh, 1996*'	Get rid of the money	Lack of absorptive capacity in the receiving country
Caputo, 1996*'	Economic growth and basic needs	
Koichi, 1996*'	Promote structural adjustment	Import goods are needed (external gap)
Eeckhout, de Jong and de Valk, 1996*'	1. Alleviate acute BOP problems 2. Support structural adjustment programmes	For budget support: liberalised forex systems have reduced the attention to use of forex
Koht Norbye, 1996*'	Balance of payment problems	Quick disbursing Reduced because it was **no**t a good instrument for poverty reduction
De Vylder, 1996 *'	1. Growth 2. National independence	Shortage of foreign exchange (external gap)
Healy, 1996*'	1. Economic reform 2. Relieve foreign exchange constraint 3. Good governance	External gap
White, 1999'	1. Economic reform 2. Economic development/ growth 3. Economic reform and development/growth	Finds: 1. External gap 2. Internal gap 3. General economic problems 4. Disbursement imperative 5. Reward Suggests: Marginal impact
White, 1999a"	1 and 2 from above	Finds: All of the above Suggests: Systemic effects form donor attention directed towards the budget.
Danida, 2000c"*	Overall: Poverty reduction according to plan Intermediate: Economic growth through reform Poverty focused level and pattern of recurrent exp. Encourage domestic resource mobilisation Improved financial management	Fiscal deficit
Foster and Leavy, 2001	Structural adjustment	Raise spending, reduce borrowing, reduce taxes
IDS, 2002"	Promotion of prosperity and strengthening of the framework for sustainable development	1. Increase capacity utilisation 2. Appropriate to support policy conditionality 3. Quick disbursing 4. Systemic effects 5. Partnership and ownership 6. Donor coordination 7. Lower transaction costs 8. Non-inflationary way of supporting poverty reduction
Seco, 2002"	Poverty reduction	1. Improved financial management system 2. Increased ownership 3. Reduce transaction costs 4. Increase transparency and efficiency 5. Better allocation of donor funds 6. Effectiveness and efficiency of public sector strengthened

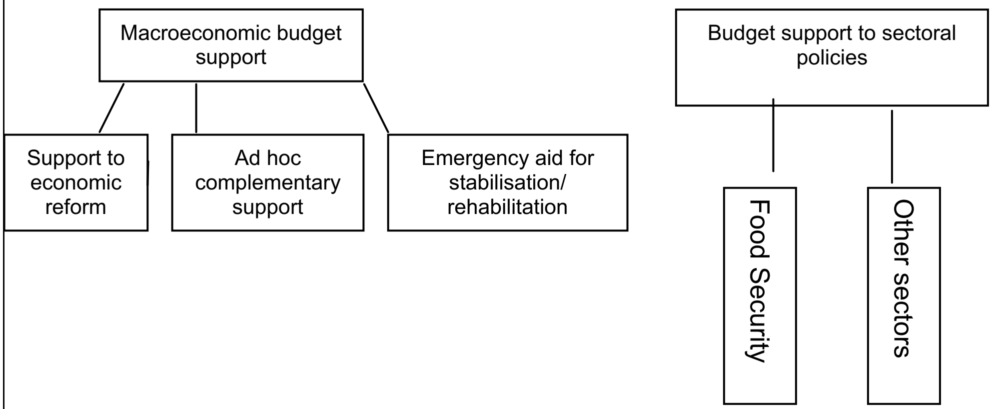
Danida, 2003c"	1. Poverty reduction 2. Promote the CDF principles 3. Promote the OECD/DAC principles of good donor and partner country behaviour	1. Partner country led 2. Partner country owned 3. Promotes rational and efficient public spending 4. Increases predictability and transparency 5.Focuses on results of public spending as a whole 6. Reduces transaction costs 7. Provides a framework discussion and coordination.
European Commission, 2003	Ultimate: Poverty eradication Intermediate: Sustainable development The gradual integration of the developing countries into the world economy. Combat inequality.	
NORAD, 2004"	Poverty reduction	1. Provide resources to increase services and investment 2. Reforms will be implemented 3. Macroeconomic balance improved 4. Stronger donor control and ownership 5. Increased transparency and accountability 6. Reduced transaction costs
Booth and Lawson, 2004"	Poverty reduction	1. Better budget financing structure 2. Partner government empowered, donor harmonisation and policy alignment 3. Increased efficiency in public spending 4. Intragovernment incentives strengthened 5. Democratic accountability enhanced

* in White (ed.)
‘ refers to programme aid in general or import support
“ refers specifically to budget support
" budget support to Mozambique

Table 1.2. Donor Definitions of Budget Support				
Donor Document	**Variations**	**Definition of General Budget Support**	**Definition of Sector Budget Support**	**Other**
JICA, 2001	Program-type grant aid: (1) Non-project grant aid for structural adjustment support(including Sector/Non-project grant aid) (2)Grant aid for debt relief (3)Emergency grant aid (4)Food aid (KR) (5)Aid for increased food production			
DFID, 2001c	General Budget Support Sector Budget Support Sector earmarked	Conditionality focused on general policy, such as overall budget. No earmarking.	Sector conditions (agreement and execution of agreed policy)	Sector earmarked: limited to specific expenditures within the sector
Seco, 2002	General Budget Support Sector Budget Support Debt Relief	Can be used at the full discretion of the recipient government. However, "inseparable link between budget support, policy dialogue and conditionality" (p.8)	Earmarked for government expenditures in a specific sector.	Debt relief: "a special form of general (sometimes sector) budget support…, which frees part of the budget for financing other public actions." (p.9)
DGCI, 2002	General Budget Support Sector Budget Support	No or nominal earmarking. Disbursed through treasury. Controls vis a vis general budget execution plus dialogue.	Earmarked towards a sector budget or a sub-sector but not a particular item. Control mechanism to allow the funds to be directed towards a certain sector should exist. Regular meetings with other donors and the ministry required.	
Danida, 2003c	General Budget Support Sector Budget Support Debt Relief	No earmarking Policy dialogue and or/conditionality focused on macro issues, PRSP, budget composition, MTEF, PEM, public sector implementation capacity Disbursed through Government system Accounted for against public expenditure	Earmarking to sector budget/sector expenditure plan Policy dialogue and/or conditionality focused on macro policies and central PEM, sector policies, budget share and sector expenditure plan, sector PEM Disbursed through government system and accounted for against public expenditure/sector expenditure	Either no earmarking or ring-fencing Policy dialogue and/or conditionality focused on debt and debt servicing, macro, PRSP, budget and the MTEF, PEM, tracking Disbursed through government system and accounted for against public expenditure/ring-fenced categories
NORAD, 2003	General budget support Earmarked budget support Sector budget support Debt relief Budget support through Trust Funds	Provided to the overall budget without any specific earmarking and is merged with the partner government's own funds as well as with budget support from other donors.	Provided for one specific sector, often linked to multi-donor sector programme and involves policy dialogue with respective line ministry.	Earmarked: provided in support of a set of identified expenditures or sectors within the overall budget, that may be considered more directly linked to poverty reduction. Debt relief: normally provided as part of

				multilateral debt relief operation, linked to set of policy reforms. Trust Funds: provided in particular as part of peace-building programmes and normally provided as general or earmarked budget support
CIDA, 2003b	*CIDA's Programme Based Approach* CIDAs Programme Based Approach (PBA) is a broader concept of which budget support is a small part (CIDA, 2003b p. 4). The PBA is defined as: "A PBA is a way of engaging in development cooperation based on the principle of coordinated support for a locally owned program of development. The approach includes four elements: • Leadership by the host country or organisation. • A single program and budget framework. • Donor coordination and harmonization procedures. • Efforts to increase the use of local procedures over time with regard to program design and implementation, financial management and monitoring and evaluation." (CIDAb, 2003 p. 2)			

<table>
<tr>
<td>European Commission, 2003</td>
<td>
European Commission Budget Support

<u>Objectives:</u>


<u>Methods of generation and delivery:</u>
<table>
<tr><th></th><th>Targeted</th><th>Untargeted</th></tr>
<tr><td>Indirect</td><td>Indirect targeted budget support
Eg: General Import Support (GIP)/Sector Import Support (SIP) with counterpart funds targeted in the budget</td><td>Indirect untargeted budget support
Eg GIP/SIP with untargted counterpart funds</td></tr>
<tr><td>Direct</td><td>Direct targeted budget support</td><td>Direct untargeted budget support</td></tr>
</table>

Targeted budget support is support provided on condition that its counter-value is used for specific application points (e.g. specific budget chapters or headings, the discharge of domestic debt, rationalisation of the civil service) It is “justified in the presence of serious liquidity problems at the treasury and/or incomplete or inadequate budget programming, by the desire to guarantee that implementation of priority expenditure, particularly in social sectors, which might otherwise not be covered.” (European Commission, 2003 p. 22) It is approximately equal to earmarked budget support.

Non-targeted “is the option which should be preferred.” (European Commission, 2003 p. 21) and both the Commission and the Council have supported a move towards more aggregate targeting (e.g. by sector) and towards non-targeted budget support. (Ibid.)

The European Commission is the only donor who still uses the concept of import support. However the European Commission Guide to the Programming and Implementation of Budget Support for Third Countries concludes that “In practice, use of GIPs or SIPs will be marginal since most countries now have fully convertible currencies.” (European Commission, 2003 p. 20)
</td>
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Definitions, Preconditions and Sida Support
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– with Special Emphasis on Bosnia and Herzegovina: A Preparatory study
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Sida's support for promotion of gender equality in partner countries:
Inception Report
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