

Illusions and Disillusions with Pro-Poor Growth



Preface

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

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

Each year five reports will be elaborated, including three country reports, one regional report and a thematic report. The country reports to be submitted in 2003 provide an in-depth analysis of the PRSP process itself, assessing in particular the process consultation and policy dialogue with civil society and to what extent these have laid the basis for a broad-based and effective poverty reduction strategy. The analysis of the country reports is supported by a detailed and systematic stakeholder analysis, including the stock taking of local actors through visits to several municipalities in the three countries. A comparative analysis of the experience in the three countries is presented in the regional report, highlighting lessons to be learned for governments, civil society and the donor community. The thematic report for 2004 concentrates on the potential of *local* economic development processes to achieve pro-poor growth.

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

Rob Vos
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"Illusions and Disillusions with Pro-Poor Growth"

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1. Introduction

PRSP framework was introduced in 1999 creating great expectations for the highly indebted poor countries (HIPC). It was not only visualized as a framework to pair debt relief with poverty reduction, but it was also seen as an opportunity for introducing a participatory process that would tailor the strategy to the country's needs, assuring ownership and a long term viability. Improved budgeting procedures would guarantee transparency and accountability in the policy process, allowing for a more efficient allocation of development aid.

This report compares the recent experiences with the PRSP process in Bolivia, Honduras and Nicaragua. It is divided into two sections. A first section focuses on the most important developments of the PRSP process, with emphasis on the "second generation" poverty reduction strategies, brought to light once the HIPC culmination point was reached or nearly attained. What new directions are these "revised" strategies taking? Is the participatory process still sustainable? Are electoral cycles and other changes in national politics affecting the course of the implementation of the PRSP? Has donor cooperation improved during the process? The second section evaluates how pro-poor growth initiatives have been incorporated in these strategies and if there is effectively a link between the policies proposed and poverty reduction. It raises questions as to what extent the PRSP effectively will change the economic growth process to the greater benefit of the poor. The analysis suggests this is no trivial matter as concepts vary as to what pro-poor growth means and there is even less consensus as to what are effective pro-poor policies.

2. The PRSP process in Bolivia, Honduras and Nicaragua in 2003–4: Steps forward and steps back

Fulfilling the expectations created by PRSP has been difficult. The country reports from Bolivia, Honduras and Nicaragua coincide in three points (see www.iss.nl/prsp):

- Although enormous efforts were made to undertake national dialogues with broad participation, translating popular demands into a workable poverty reduction strategy has been difficult. Key stakeholders in the three countries perceive some important concerns are not adequately dealt with in the PRSP. This has led to a weak sense of national ownership and a persisting view that the PRSP is essentially an invention of the donor community and yet another condition to comply with for obtaining debt relief. This weak sense of national ownership within civil society and to a lesser extent of the governments has made it more difficult to gain the necessary support to effectively implement these strategies. New governments in office in Bolivia and Nicaragua have launched new “National Development Plans” with (initially) no clear links to the PRSP. Honduras has presented a revised PRSP by which the government, without major participation from civil society, has made a clear choice to strengthening of the growth pillar. On paper, this implies putting more emphasis on the market mechanism and on investments in sectors with little mention of the poverty issues included in the initial PRSP. In practice, however, the resulting strategy contains nothing much new. Rather, it consists of a set of policies already tried in the past.
- The PRSPs take a comprehensive approach towards poverty reduction. In practice, however, this has led to broad-ranging plans but generally without much priority setting in actions and clear indications on how these interventions are expected to meet the poverty reduction targets. Also the revised PRSPs (as in Honduras) or the new national development plans (as in Bolivia and Nicaragua) suffer from this lack of priorities, leading to the conclusion that they are not actual strategies, but rather a list of good intentions. This lack of priority setting makes decision making more complicated when adjustments are required under volatile economic conditions which time and time again demand imposing new budget constraints. The PRSPs are weak in connecting proposed interventions to budget allocations for poverty reduction programs and expected outcomes.

This lack of progress towards more result-oriented budgeting is hampering the transparency and accountability in the use of funds for the PRSP as well as the monitoring of the impact of fiscal policy on poverty reduction.

- A comprehensive poverty reduction strategy must be accompanied by a coherent mid-term macroeconomic scenario. This has proven to be another weak link in the PRSP process in the three countries, with three negative consequences for the implementation process. First, the focus on short-term macroeconomic adjustment and the exclusion of macroeconomic policies from the PRSP agenda has alienated important actors of civil society from the PRSP process and has been part of the weak sense of national ownership. Second, it has continued nourishing the perception that development financing is still subject to the traditional IMF conditionality. And third, it has kept the economic growth target at the centre of macroeconomic policy goals, but leaving rather unspecified how aggregate growth will lead to the targeted degree of poverty reduction.

An uncertain future

1. *Original sin:* The weak foundations of the PRSP in the three countries have tainted its future with uncertainty. The PRSP process in the three countries continues to face a number of challenges that originate from weaknesses that emerged early on in the process: the limited time that was devoted to the design of the programs, the weak transmission channels between the design and implementation of the strategy and the absence of dialogue regarding sensitive issues. These factors have contributed to the limited sense of ownership and actual participation in the strategy, thereby weakening the political support for the strategy. This is hampering the continuity of the process. Further, the PRSPs donor conditionality has spread to other spheres beyond the traditional economic indicators, increasing the tension and reducing the effectiveness of partnership between certain donors and countries. Thus, the country ownership of the PRSP is in question, as are the strategy's chances of political survival during electoral changes. In their short lives of existence, the PRSPs have undergone many changes. This could be a good sign of a dynamic process of policy formulation, but in fact it has been a source of confusion as with government changes new national development plans were produced in Bolivia and Nicaragua covering the ground of the PRSP but leaving unclear the status of the original PRSP. The poverty focus of the national plans in those two countries also appears to have weakened as the emphasis on aggregate economic growth objectives has taken centre stage. Nicaragua and Honduras have managed to build consensus (although it may be temporary) to fulfil the performance criteria behind the economic program. Nicaragua and Bolivia have not been able to anchor PRSP programs and policy action into a reformed budgeting process, ensuring sufficiency of resources for anti-poverty programs. Such anchoring would have allowed more immunity towards the political changes. Honduras has managed to pass laws which guarantee the consistency between the PRSP and the

national budget. The challenge now is to put this into practice and protect budgets for poverty-related spending even as the country is entering a new electoral process for the presidency in 2005.

2. *Uncertain future and short-sightedness:* The uncertain future of the PRSP process also stems from persisting volatility and vulnerability of the economies of the three countries. Economic volatility remains the order of the day. The three countries have faced a decline in their growth rates and a permanent vulnerability to shocks. More specific problems such as the gas reform in Bolivia, the impact of rising international oil prices for Honduras and the domestic debt in Nicaragua pose increasing threats to the fiscal and macroeconomic situation. Adjustment to such changing conditions while preserving priority for the PRSP targets is not helped by the lack of compatibility between the PRSP and the conditions of the Poverty Reduction Growth Facility (PRGF) of the IMF. The PRGF – once approved – triggers funding by other donors, but continues to emphasize short-term macroeconomic targets without sufficient consideration of the longer time span needed to effectuate the necessary investments and structural changes for ambitious growth and poverty reduction agenda. Macroeconomic instability thus also implies instability in the financial resources available for the strategy in the medium-run, thereby reducing the viability of the PRSP. Additionally risks have become more important than the progress achieved thus far in implementing the PRSP. Weakness of the financial system remains an issue in the three countries, as are recurring public debt sustainability problems despite the debt relief, fiscal fragility, corruption and the way decentralization and pension systems are being implemented. In the political sphere, Nicaragua still has to resolve a pending struggle between leading parties, which will probably lead to difficult negotiations. Bolivia is embarking in a new broad-based national dialogue focusing on sensitive issues of economic reforms (including the natural gas issue and agrarian reform). While a resolution of such issues is critical, the fragile political context could also easily turn this dialogue into a further deepening of the social (and regional) divide. Honduras is at the beginning of an election year, but in a situation where the present government has invested too little in trying to obtain broad support from civil society for the revised PRSP. It should not be surprising therefore that the PRSP would undergo another set of important changes in response to new demands and promises made during the election process. All of these elements of uncertainty and continuous change of plans make it very difficult to evaluate the PRSPs in terms of their outcomes. For now, all one can do is to assess the *process* of strategy design and implementation.

Progress with donor coordination

Donors have taken a number of steps forward in trying to improve donor coordination and more effective aid provisioning. These positive steps are mainly organizational. Donors are supporting roundtables (*mesas sectoriales*) to strengthen the dialogue for coordinating sector programs that are part of the PRSP. In addition, steps have been taken towards

more program aid and budget support and the establishment of Joint Financing Agreements among a large group of donors in support of the poverty reduction strategies.

Nevertheless:

- A good number of roundtables are not functioning well due to lack of political support or organizational capacity at the end of the recipient government. The roundtables have not yet been able to make an impact on aid modalities in practice. That is, they have neither led to any visible improvements in the effectiveness of aid allocation, nor to a stronger sense of ownership among civil society and government. In Honduras, the roundtables have been constructed around the implementation of the PRSP. In Bolivia, there is a roundtable to coordinate the new consultation process of the National Dialogue and the revised PRSP, which started in the second half of 2004. These roundtables, with different degrees of success, have opened a space for more dialogue, but not necessarily better coordination among donors. This is most obvious in the case of Honduras where most of the aid is still given to support individual projects. Bilateral donors generally do not offer budget support and only in the Health and Education sectors has there been a movement towards sector-wide support (SWAps). In Nicaragua and Bolivia, other sources of coordinated financing can be found in the form of joint financing and more program aid and budget support, although project financing remains predominant. According to a study carried out in Bolivia, the barriers to aid harmonization originate mainly at the end of donor headquarters, which tend to give priority to rapid disbursements and independent evaluation papers produced by each donor rather than coordinated financing.
- Conditionality related to foreign financing still remains a problem. Original sins prevail. First, an agreement on short-term macroeconomic policies with the IMF remains primordial to obtaining support from other donors. Second, most donors preserve their strong inclination towards ‘micromanaging’ aid conditionality and monitor a detailed list of policies and reforms that governments should follow. Given the weak governance and credibility of the PRSP countries, this tendency to impose specific policy conditions may seem reasonable in order to ensure program effectiveness. On the other hand, the same donor behaviour tends to erode government commitment and the sense of ownership of the PRSP among civil society.
- Also the move towards more program aid and budget support does not seem to have led to much improvement in the sense of ownership for the use of aid funds. First, donors maintain their own budget support conditions and procedures. Second, the number of conditions to comply with is enormous. These conditions not only reflect the opinions and priorities of donors, much more than those of the recipient country, but they also involve a whole range of actions and procedures to be undertaken by the recipient government in addition to their regular budget management procedures.

Excessive conditionality can be counterproductive. To avoid such an outcome, changes to the current approach should go in the following direction:

- Donors should evaluate if countries are *implementing a more or less* coherent set of policies for poverty reduction, and not only if they are fulfilling macroeconomic performance criteria.
- Donors should reconsider the primordial role of the typically short-term macroeconomic agreements with IMF as the catalyser for all other aid flows in support of the PRSP.
- The PRSPs themselves should be more concrete (not necessarily more comprehensive) in detailing the strategies for poverty reduction indicating how the proposed actions are expected to meet the Millennium Development Goals and the costs implications of these actions should be properly budgeted, on which basis a solid commitment may be requested from donors to finance the strategy over the medium and long run. Such ‘result-oriented budgeting’ may help move away from plans that only satisfy the requirements of the donors.
- Donors who want to lend under the above considerations, should do so using joint and multi-annual financing schemes (with one set of procedures and conditions).
- Donors should focus their dialogue essentially on improved budget management in a medium-term expenditure framework. This should also involve the support to countries in making the move towards more result-oriented budgeting processes, as already mentioned. As existing institutional capacity is weak and reforming budget procedures is cumbersome, a gradual approach on this path would seem recommendable.

3. Towards pro-poor growth?

Pro-poor policies

Poverty reduction strategies are at the top of the international development agenda and knowledge has increased about the determinants of poverty. Yet we know rather little about the effectiveness of policies to reduce poverty in practice. Good practices of pro-poor policies are not easily established as universal reference points, given widely differing initial poverty conditions and institutional settings across countries. This clearly complicates the task of the evaluator in determining the effectiveness of pro-poor growth policies. This report does not intend to propose a blueprint or a specific pro-poor growth strategy for Bolivia, Honduras or Nicaragua. Rather, it simply assesses the choices made by the three countries in their quest towards this objective.

There is no consensus among academics or national policy makers about what should be the contours of a pro-poor growth strategy. The international donor community has sponsored studies in order to understand the relationship between growth and poverty reduction and, apart from putting the issue of pro-poor growth on the aid agenda, it has gradually changed its approach to pro-poor policies. The inclusion of safety nets in IMF Programs, debt alleviation in the HIPC context tied to poverty reduction, new financing modalities such as the Poverty Reduction Growth Facility (PRGF) and the PRSP framework and the links to the Millennium Development Goals are some examples to this end.

What is pro-poor growth?

In the search for the 'holy grail' it is sometimes forgotten that we may disagree as to what the 'holy grail' actually is. In this sense, also the literature on pro-poor growth has not reached consensus around one single definition of the concept. Two definitions dominate the discussion. The first concept speaks of pro-poor growth when the income of the poor increases at a higher rate than that of the non-poor. The second states that the poor should benefit in absolute terms, therefore depending only on the rate of change of poverty. The objective of a pro-poor growth strategy then would be to reach an economic growth path producing a maximum of poverty reduction. The first definition emphasises the need for a redistribution of incomes. The second is more concerned with poverty reduction per se, thereby closer in concept to the targets of

the PRSP and the first Millennium Development Goal, which aims at halving extreme poverty by the year 2015. It also simplifies the analysis by centring the impact of policies exclusively on the poor. This does not imply that the second approach need not have any concern with redistributive policies. Yielding a growth process enabling “maximum poverty reduction” in most contexts will require a strong emphasis on redistribution of wealth and incomes. This holds most in particular for the Latin American countries characterised by high levels of initial income inequality, implying that little of the growth benefits tend to trickle down to the poor. For the purpose of this study we will concentrate on this second definition.

Pro-poor growth in practice

Also there is no consensus among stakeholders in Bolivia, Honduras and Nicaragua about what they mean by pro-poor growth. As mentioned, the academic debate has not helped generating greater consensus. As a result no single definition is part of the policy debate, but rather a wide array of imprecise concepts.

In *Bolivia*, stakeholders generally associate the concept of pro-poor growth with the struggle for *monetary* poverty reduction, not so much with dimensions of non-monetary poverty. In the past, Bolivia has been more successful in reducing non-monetary poverty (education, health), than in reducing income poverty. One widely applied concept is that of “broad-based growth”, that is economic gains that benefit the broadest segments of the population, including the poor. In a general sense broad-based growth is understood as a different pattern of growth than that witnessed during the 1990s, which is seen *not* to have benefited the poor. Nonetheless, no stakeholder could provide a more precise definition of what broad-based growth implies. Hence, even though there is consensus that in order to reduce poverty a form of broad-based growth must be attained, but there is no consensus as to what this means exactly or how to achieve such a growth pattern.

In *Honduras* none of the interviewed stakeholders appeared to be informed about the pro-poor growth debate taking place in academic circles or the international financial institutions. This lack of information was common among government authorities, civil society and more surprisingly among the international community in Honduras. This likely is a sign that most of this debate is taking place in the headquarters of multilateral and bilateral donors rather than in the field. The lack of clarity about the meaning of pro-poor growth has given rise to a wide range of policy approaches as to how to achieve it. The opinions of stakeholders on this matter can be classified in four groups. Two of these emphasize that economic growth is the main channel for poverty reduction. One is a traditional macroeconomic, ‘trickling down’ view (IMF style), while the other seeks to strengthen selected economic sectors with growth potential. Two other approaches give more space for distributive concerns. One suggests that the PRSP goals should be central but with less government involvement and a greater role for market forces, also in social provisioning. The other believes in associating pro-poor growth with policies stimulating labour-intensive technology and employment creation for the poor.

In *Nicaragua* the public debate about pro-poor growth is yet to begin. The original PRSP (ERCERP) stated, without mentioning the word pro-poor growth, that a broad-based growth process was needed in order to generate sufficient jobs. Employment was considered the key determinant in the reduction of monetary poverty. While this view may still be present, the new agenda that has emerged focuses more on growth than on poverty reduction. The National Development Plan is essentially looking to reach the highest possible economic growth rate. Employment creation and poverty reduction are believed to follow more or less automatically from there. Among actors of civil society, such issues are being discussed, but not under the flag of pro-poor growth.

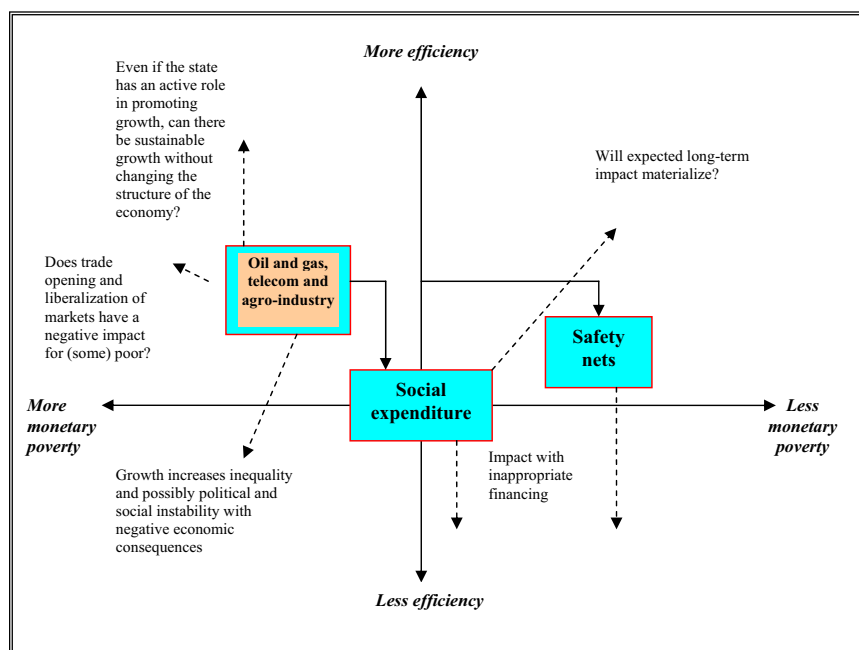
Taxonomy of pro-poor growth policies

An analytical framework has been developed to evaluate the effectiveness of policies in reducing poverty and stimulating growth. A two-by-two matrix is used to assess the relationship between poverty reduction and growth. On the vertical axis the impact of policies on economic growth (efficiency) is measured and on the horizontal axis the impact on poverty (equity). This framework is used to obtain a taxonomy of pro-poor policies as embedded in the PRSPs of Bolivia, Honduras and Nicaragua.

In *Bolivia* gas could provide the country the best currently available opportunity to change its future. It offers the state the resource base for the required investments in infrastructure, redistribution of assets (credit programmes), financing of social spending and debt payment. The revenues should thus not only be used for social investments but also to foster productive activities within the country. Two major challenges must be met in order to accomplish these objectives. The first is to effectively turn gas revenues into public revenues, which requires reaching political agreements on the exploitation of gas and on how it will be exported. The second challenge regards the design of an appropriate decision-making process on how to allocate and manage the resources. The outcomes in the long-term of this proposal are uncertain. Not only because of the degree in which the indicated challenges can be met, but also because of the intrinsically unstable conditions of the economy as well as the conditions indicated in the graph below. The national policy dialogue which should lead into a revised PRSP is the opportunity to turn this into a viable proposal.

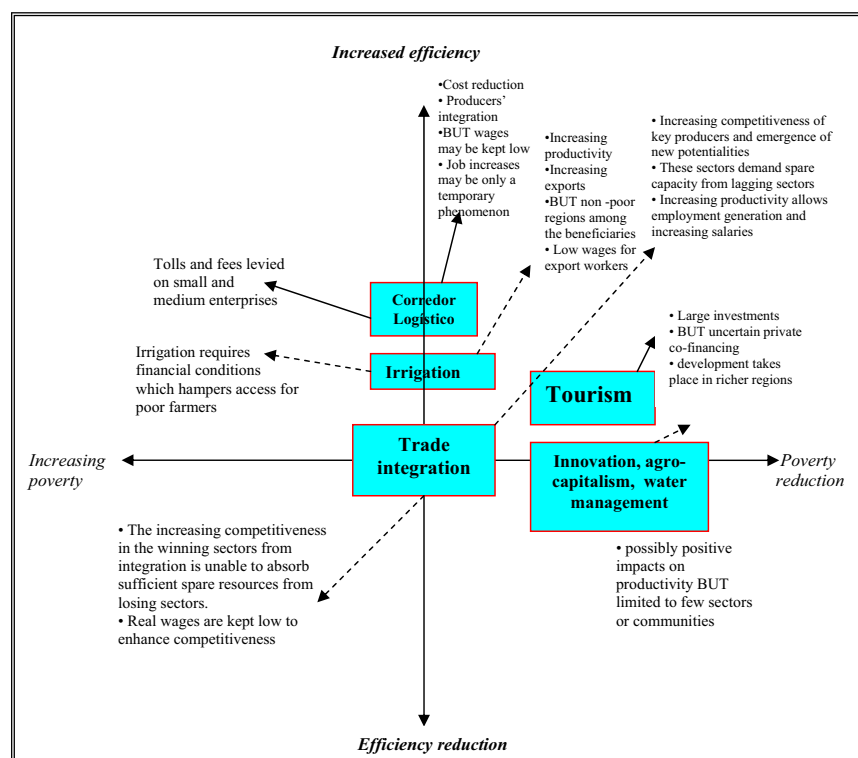
Graph 1 Taxonomy of Pro-Poor Growth Policy Proposals in Bolivia

The revised PRSP for *Honduras* seeks to enhance the economy's competi-



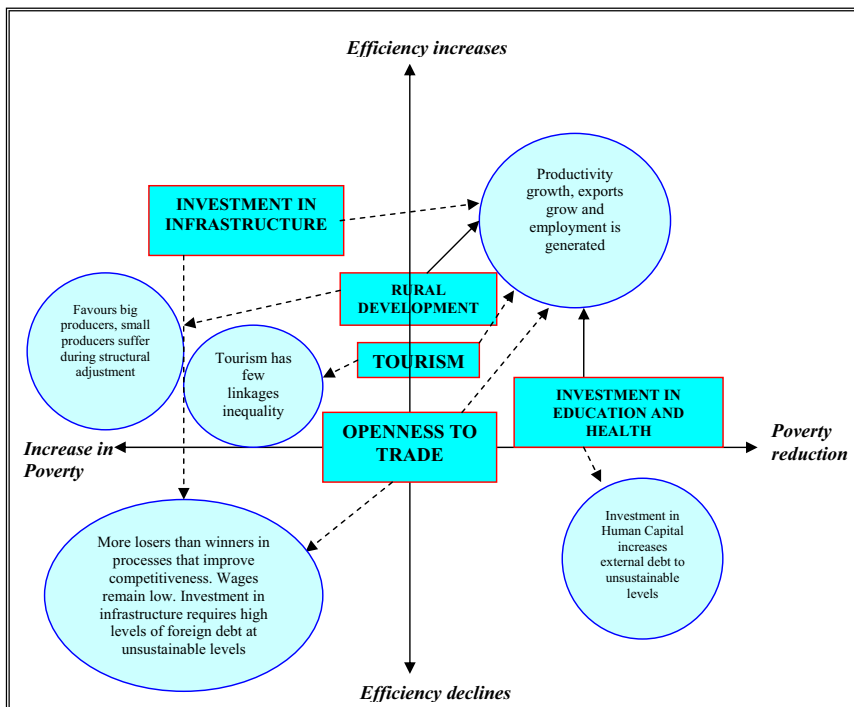
tiveness through investments in infrastructure, deepening of trade integration and promotion of tourism. The government expects that these actions will in themselves foster pro-poor growth, but aims to strengthen the process through increased social expenditures. Taking all these proposals together, there could emerge a large pro-poor growth potential when implemented. However, there is also a large degree of uncertainty about the outcomes, which are associated with the effectiveness in which the policies will be implemented. The taxonomy of policies for Honduras shows that indeed a great deal of the envisaged impact concentrates on the northeast quadrant; that is, where economic growth goes hand in hand with poverty reduction. On the other hand, there are also possible outcomes that may fall in the quadrants of no growth and poverty reduction, growth with increasing poverty, and recession with increasing poverty. As a result, it is hard to predict what it all adds up to. Interestingly, one can foresee that the magnitude of these identified impacts varies considerably from an expected strong growth with reduction of poverty (coming from expected efficiency gains from the infrastructure investments in the so-called '*corredor logístico*') to strong negative effects on economic growth and poverty (resulting from unemployed resources not absorbed by sectors that gain from the regional trade agreement, CAFTA). Although the final outcome of these effects is difficult to predict, the important message is that not *any* single policy will yield pro-poor growth.

Graph 2 Taxonomy of Pro-poor Growth Policy Proposals in Honduras



Our assessment of the policies included in **Nicaragua's** National Development Plan suggests that we should not be too optimistic about its results. As in Honduras and Nicaragua, the strategy is promising on paper, but the potential impact of these policies is full of risk. The graph with the taxonomy gives the broader picture of the diverging paths these policies could eventually take. More economic integration (through CAFTA) could deliver modest pro-poor growth gains, but there are obvious losers to further trade integration, most in particular producers of basic grains which mainly consist of poor farmers. If we also take into account the potential market loss for textile exports once the multi-fibre agreement has concluded (this may have even a stronger impact in Honduras), the pro-poor benefits become even more uncertain. Investment in infrastructure should improve competitiveness in the country, but its positive impact will not be in the short run. In addition, these investment plans require high upfront financing, most likely with foreign debt, which could again affect Nicaragua's debt sustainability. The development of the tourism sector could generate more employment, although it is not clear to what extent this will favour job creation for low-skilled (poorer) workers. If progress can be made with land reform in Nicaragua, the proposed rural development policies make agricultural production more pro-poor. If the land tenure problem is not resolved and access to rural credits for poor farmers cannot be ensured (and the National Development Plan is far from clear as to how to resolve these issues), then the upshot could well be that plans for agricultural development will only benefit the large scale farmers, thus doing little for poverty reduction.

Graph 3: Taxonomy of Pro-poor Growth Policy Proposals in Nicaragua



Comparison of pro-poor growth strategies

1. In the three countries the idea of pro-poor growth is still very much an illusion. There is no consensus about what it is and it is not a central topic in the public policy debates.
2. The initial growth strategy as proposed in the PRSPs has changed in the three countries as PRSPs have been revised. Since growth has been modest in the three countries emphasis has turned now simply to economic growth. Redistribution through public expenditure is thus postponed for the longer run. In Bolivia almost all hope for future growth is based on gas exploitation and in the use of its revenues for poverty reduction. In Honduras and Nicaragua emphasis is placed in increasing competitiveness and gains from trade in regional and world markets. The poverty reduction strategy is made almost fully dependent on achieving a higher aggregate economic growth target.
3. The PRSPs of the three countries pay little attention the policy trade-offs that may emerge between the short and long-term objectives and also do not address the issue of gaining sufficient support with civil society for the strategies to make these politically viable. Honduras and Nicaragua rely on enhanced competitiveness, but gains in this area depend on new investments in infrastructure and human capital with returns that can only be obtained in the medium run. The PRSPs assume in contrast that such gains will come more or less instantaneously. This lack of attention to inter-temporal trade-offs, creates doubts as to whether the financing of these investments will be sustainable and whether the existing political support for the strategy will not quickly evaporate as no results become visible in the short run.

4. All PRSPs put some considerable emphasis on rural development and the importance of dealing with land distribution and property rights. However, in none of the three countries much progress can be reported in this field. In Bolivia, agro-industrial production chains could generate incomes for the rural poor, but in practice incentives are biased towards modern export farming and the lack of access to land for the poor will likely be decisive in excluding the poor from the gains of these rural development policies. In Honduras and Nicaragua this bias for modern crops is even larger, leaving few alternatives for the poor as the incentives for the development of off-farm activities in rural sectors are very limited.
5. Economic volatility and vulnerability are important sources of risk for the pro-poor outcomes of these strategies. By enhancing competitiveness, Nicaragua and Bolivia expect to diversify their exports and reduce the vulnerability to external shocks. As already mentioned, tangible results are unlikely to show in the short run. In addition, both countries aim at strengthening (new) agricultural exports and maquila industries which are no less sensitive to world market fluctuations than traditional exports. For Bolivia this risk is even greater as it plans to collect its revenues from a single product, natural gas, sensitive to highly volatile world oil prices. It calls for the creation of an efficient stabilization fund, but such a fund is yet to be created. It is noteworthy and worrisome at the same time that the three PRSPs pay so little attention to mechanisms that could deal with the volatility in output growth and government revenues and soften the impact of such volatility on resources to finance the PRSP and on the incomes of the poor.

4. Pro-poor growth and foreign aid

Donors agree that the link between growth and poverty reduction requires more in-depth study. A recent report from the IMF which evaluates PRSP experiences puts it as follows: "...it is worth emphasizing at the outset that knowledge of the links between policies and growth remains limited and understanding of the links between policies and poverty reduction even less so." This implies that quite a bit of experimenting with what policies work and which not seem unavoidable. It also implies that 'one-size-fits-all' approaches or policy solutions based on cross-country experiences simply will not do. The strategies will need to consider the country-specific institutional and structural characteristics as a starting point.

Absence of a multi-annual framework for aid

When evaluating the implementation of PRSPs, one of the problems identified in the three countries is the lack of stability in financing within a multi-annual framework. One of the reasons is that IMF financing tends to be pro-cyclical. When the economic outcomes weaken and there are deviations in the adoption of the "correct economic policies", disbursements are suspended or are postponed until certain criteria are met, as in the case of Honduras and Nicaragua. This obeys to the fact that there are no clear guidelines of how the IMF should proceed with countries that have governance problems, but that are giving positive signs in implementing policies that favour the poor. Since the IMF is a catalyser of resources, the most immediate impact comes up in the HIPC support. Donors should therefore evaluate under which circumstances monitoring should go beyond macroeconomic criteria.

There is also uncertainty on how to proceed with countries that have marginalized the PRSPs from the broader national policy agenda, as happened in Bolivia and Honduras during 2003. It appears that sticking to an agreed PRSP is not a requirement for continued financing by donors. Official lending and aid to Bolivia kept flowing despite the fact that the status of the PRSP was being questioned, even by the country's own authorities. In order to reduce the impact of the political crisis that affected the country, the World Bank provided Bolivia in 2003 with a *Social Safety Net Structural Adjustment Credit* to protect the budgets of health, education and social safety nets, as well as social services in remote poor

areas. In 2004, Bolivia received financing through a *Social Sector Programmatic Structural Adjustment Credit* (SSPSAC) in order to support programs designed to meet the Millennium Development Goals. This flexibility can be beneficial for the country as long as there is accountability in the use of this funding.

Foreign aid for pro poor growth

For aid to be more efficiently allocated in the PRSP context, donors and HIPC governments will need to agree on clearer guidelines that have to be clarified by donors. Some of these have been already mentioned in the section on donor coordination. Three additional aspects require additional attention:

- *External debt:* Once countries reached the culmination point in the HIPC framework, this does not imply that the solvency problems of the country are over. When it comes to funding poverty reduction strategies donors have no defined preference for donations or loans. This is an issue that still needs to be debated and it should take into account the specific situation of poverty in each country and its growth capacity. Both Nicaragua and Bolivia have reached their culmination points in the HIPC initiative and the threat of debt insolvency has not disappeared, as external borrowing continues to be an important source of financing in countries proposing Second Generation PRSPs.
- *Multi-annual programming:* The strategies propose economic reforms in the long run. As has been mentioned, in the short run countries continue to be vulnerable to external shocks. Economic instability and uncertainty in financing prospects are important risks that could countervail the PRSP objectives and its implementation. In this sense multi-annual programming seems to be a necessary option that would complement longer term financing, which is more compatible with PRSP. Part of this multi-annual programming could take the form of a financial insurance that would cover macroeconomic risks that have been mentioned. This proposal will not be elaborated here, but it is understandable that new options need to be presented to reform the existing PRGF and PRSC.
- *Conditionality and budget support:* The implementation of multi-annual programming under HIPC-II and PRSPs was thought to be able to provide (i) fiscal relief, (ii) social expenditure protection related to poverty reduction, and (iii) additional financing for social expenditures. Although, in practice, this has not been the case, the initiatives favouring budget support and joint financial agreements by donors are signs in the right direction. Governments should be more decisive in their transition towards multi-annual programming and budgeting. In this framework donors would need to rely less on conditionality based on immediate results and rely more on procedures that are effectively leading to poverty reduction in the long term.

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.



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