

PRS processes and harmonization & alignment: Reflections on aid effectiveness

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1. Introduction

This paper examines whether the introduction of Poverty Reduction Strategies, or the PRS approach, has led to more harmonization and alignment of donors and thereby to greater aid effectiveness.

The introduction of the Poverty Reduction Strategies in 1999, together with the definition of the eight Millennium Development Goals in 2000 can be seen as the start of a new “aid paradigm”, focused on achieving tangible results in poverty reduction (Renard 2005). Relationships between donors and recipients would change fundamentally, since from then on these relations would be based on the PRS principles ownership and partnership. Once these long-term, comprehensive and result-oriented PRSPs were in existence, donors would be able to align their assistance with these strategies. They would reduce the amount of individual projects and give more sectoral support and general budget support. They would also be able to harmonize their aid under recipient government country leadership. This harmonization and alignment is expected to enhance aid effectiveness for two reasons:

- Better coordination and harmonization among donors will lead to a much lower burden on domestic country’s capacities; it will reduce transaction costs and so improve the efficiency of aid and through that also its effectiveness
- More alignment will make an end to the undermining of domestic capacities especially in budgeting, planning and implementation; by making an end to, among other things, special implementation units, poaching by offering higher salaries for officers involved in aid projects, unpredictable and volatile aid and aid that was financed off-budget; this will also increase aid effectiveness.

On the instigation of the international donor community and under auspices of the OECD-DAC, several High-Level international meetings have been held in which the principles of harmonization and alignment have been further defined. This has led to the Rome Declaration on harmonization and alignment in 2003, and to the Paris Declaration on Aid Effectiveness in March 2005. The latter includes a list of five partnership commitments:¹

¹ It also defined targets for many of these, to be achieved by 2010.

- Ownership: Partner countries exercise effective leadership over their development policies and strategies and coordinate development actions
- Alignment: Donors base their overall support on partner countries' national development strategies, institutions and procedures
- Harmonization: Donors' actions are more harmonized, transparent and collectively effective
- Managing for results: Managing resources and improving decision-making for results
- Mutual accountability: Donors and partners are accountable for development results

There are many linkages between the principles of the PRSP approach and these five commitments of the Paris Declaration. It is expected that the application of the principles of the PRS approach and the implementation of the Paris Agenda will lead to greater aid effectiveness than the previous paradigm.

However, it is important to recognize that aid effectiveness not only depends on the implementation of the Paris agenda. More in general, aid effectiveness deals with three issues:

- The effectiveness of the aid *money*, including issues like the macroeconomic effects of aid (investment versus consumption, Dutch-disease effects, fiscal response), and the specific uses and destinations of (project) aid – to the extent that aid money is not fungible;
- The effectiveness of the *policy conditions* attached to aid, including effectiveness in a strict sense meaning the issue whether policies are implemented, but also the more important issue of whether policies implemented on the instigation of donors are the right policies;
- The effectiveness of specific *aid modalities* and their coordination or lack of coordination among donors: application, procurement, reporting, monitoring and evaluation requirements.

The Paris agenda is mainly concerned with the last of these. Though important, it is remarkable that so many efforts in the international donor “scene” are directed to this last issue and much less attention seems to be given to the other aspects of aid effectiveness. As Rogerson (2005) also observed, the Paris agenda is silent on policy conditions, while in practice it is still an important aspect of aid policies. And given the possible contradictions between the principles of ownership and alignment on the one hand, and conditionality on the other, the aid industry has become “schizophrenic” about conditionality (Rogerson 2005).

This schizophrenia is related to what Renard calls the two “narratives” behind the new aid paradigm (Renard 2005). There are in fact two views in the donor community on why the previous aid paradigm failed. According to the first view, project aid failed because of the donors. There were too many different projects with their different procedures and reporting and monitoring requirements, a lack of donor coordination, separate implementation units with higher salaries, and high transaction costs for both donors and recipients. To the extent that structural adjustment loans were extended, they were based on a simplistic view of reality with uniform policy recipes everywhere and too tough conditions. This view stresses the importance of domestic ownership and preferably broad-based ownership, thus increasing the probability that policies are supported and implemented.

But there is also another, contradictory view circulating in the donor community and sometimes with one and the same donor. In this second perspective that is more negative on

the recipients, project aid failed because of inadequate policies of recipient countries. Governments do not have sufficient attention for poverty reduction and donors have been too lenient in their conditions for structural adjustment loans. Donors should become tougher in their conditionality, and should use aid as leverage for reforms. In this view, participation of civil society is promoted in order to create an additional watchdog on governments.

With respect to the PRSP, practice has already confirmed that there are some inherent contradictions in the approach, and especially between the principle of ownership and the fact that strategies need to be approved by the Bretton Woods Institutions (BWI, IMF and World Bank) in order for countries to access debt relief. The requirement to make these strategies and to do so with broad-based participation can be seen as *new* conditions. In the meantime, the more traditional conditionality for IMF and World Bank programs has not disappeared.

Analyzing the Paris Declaration in more detail, it can be observed that it also contains elements of both narratives. Under “ownership”, the Paris Declaration stipulates that partner countries exercise leadership in the elaboration of national strategies or sectoral development strategies. As with the PRSP however, it can be questioned to what extent real ownership is possible given that these strategies must be approved by the donors. The Declaration goes on to mention that countries should operationalize these strategies in Medium-Term Expenditure Frameworks (MTEF) and annual budgets in a result-oriented manner. Countries are also expected to coordinate aid efforts in conjunction with donors and other parties, such as civil society and the private sector. Although the Declaration speaks about leadership and coordination, it is clear that additional conditions are set: for MTEFs, for participation of other parties, and for result-oriented plans and budgets. There is also a contradiction between national ownership of implementation and the big role that is expected to be given to donors in the coordination of sectoral policies (Hayman 2005). All in all, these conditions add to the conditionality burden set on recipient governments and form part of the second, more negative (for recipient governments) narrative. The question then becomes what the consequences of these inherent contradictions are for aid effectiveness.

This paper examines the practice of this new aid paradigm in three Latin American countries, Bolivia, Honduras and Nicaragua. All three countries are highly aid dependent, and in all three the main multilateral donors are present (World Bank, Inter-American Development Bank and European Commission) as well as many bilateral donors. The paper uses the results of the project “Evaluation and Monitoring of Poverty Reduction Strategies in Latin America”.² It aims to answer the following questions:

- What are the advances in the Paris agenda in the three countries and what is the relation, if any, to the PRS processes?
- To what extent have the different narratives or the inherent contradictions in the new aid paradigm influenced the expected higher aid effectiveness of the approach?

This paper first briefly examines the state of affairs with respect to the PRS processes in Bolivia, Honduras and Nicaragua, and then looks at the implementation of the Paris Agenda in the three countries. Since budget support plays an important role in the efforts towards, in particular, greater alignment to national systems and processes, and is also the focal point for

² This project has been carried out since 2003 by a team of the Institute of Social Studies in The Hague, for the Swedish International Development Agency (Sida). The author has been “consultant donor coordination” from the start.

aid conditionality, the experiences with budget support in the three countries are dealt with in a separate section. Section 5 concludes.

2. Brief overview of PRS processes in Bolivia, Honduras and Nicaragua

The PRS process or approach in general implies that countries comply with certain procedures and actions, such as writing a PRSP and doing so with broad participation. However, the definition of PRS approach usually goes beyond that and also includes the implementation of the PRS, institutions for monitoring implementation in which preferably civil society is represented, the writing of new strategies with consultation, and in a broader sense also responses of the donors to that process, in particular the achievement of the HIPC Completion Point, and contracting an agreement with the IMF. These can be considered the elements of the process, or the symbols that show that the country is still following the PRS approach. However, being “on track” with the process does not guarantee that the objectives of the PRS approach are achieved or that all the principles as defined in the PRS approach are embodied.

There is broad consensus in most studies and evaluations that country ownership and participation proved to be limited and that strategies could not comply with the requirements to be both long-term and comprehensive, and sufficiently operational so as to provide the basis for aid efforts and national budgeting. Result oriented planning and budgeting is not possible in most countries (Vos *et al.* 2003; IEO 2004; OED 2004; Dijkstra 2005). Most of these studies also agree that in the strategies and in the consultations on strategies, poverty was often reduced to a technical issue and the more political issues (income distribution, access to land and other natural resources, among other things) were left out. The most skeptical views on the PRS process can be summarized in the statement by Gould that these processes led to two disjunctures (Gould 2005): between policy formulation and policy implementation, and between policy and politics. In other words, for domestic politics it is business as usual, implying a high degree of clientelism, and actual policy implementation has little to do with what has been written down in PRSses.

In the following I describe briefly how the three countries have followed the PRS process in a formal sense and to what extent the two disjunctures have occurred or are occurring. Table 1 gives an overview of the state of affairs with respect to the pickets or symbols of the process, indicating the months and years in which countries achieved them. The changes in government are also included because they often influence the other elements.

Bolivia followed the process rapidly and successfully in the first years. It was the first country to present an Interim Poverty Reduction Strategy and quickly after that a national dialogue was organized with broad participation in all municipalities. The full PRSP was approved in June 2001, and because the country had been on track with the IMF for a long time already, it could achieve the HIPC Completion Point in the same year. The country adopted a Law stipulating that national dialogues would be held every three years. The result of the 2000 dialogue that the resources freed by HIPC debt relief were transferred to municipalities, was also laid down in a Law.

However, this flying start did not guarantee a successful process. Already in 2003 there was debate about whether the process was still alive, and by 2006 there is general agreement that it has been buried. What happened?

It is too simple to conclude that the process was derailed because the country achieved the Completion Point – although the latter may have influenced the lack of agreement with the IMF between 2001 and 2003. But there are more fundamental causes. Since 1985 the country had already followed neoliberal policies in agreement with the IMF. This had led to some growth and, since the second half of the 1990s, also to an improvement in social indicators. But income poverty had not been reduced. This created frustration among the population and led to sometimes violent protests and to a lack of trust in the neoliberal model in general.

In 1997 the Bolivian government already organized a national dialogue on poverty reduction, which led to a “Proposal against poverty”. But in the following years, the government failed to implement this proposal and instead organized a new national dialogue in 2000 and elaborated a new plan, the PRSP. However, “politics”, in the sense of a debate on the deeper concerns of the population such as macroeconomic policies, the free trade agreements, access to land and the ownership of gas and water, was no part of this dialogue nor (with the exception of the macroeconomic framework) of the plan itself. This led to more frustration and more violence in the streets. Donor support for “civil society” in the context of the dialogues may even have supported these actions (Komives *et al.* 2004).

As the new government (from June 2002) rejected the “old” PRSP, the donors attempted to keep the PRS process alive by requiring a new strategy based on a new round of consultations. The government attempted to comply by writing progress reports on the old strategy and by writing a new one. But none of the progress reports were accepted by the staff of the BWI the revised strategy (in 2003) was not accepted by the donors because no consultations had been held for it. The government then organized a new dialogue in 2004. But in the meantime, again little was done to implement anti-poverty policies. It all led to two violent changes in government, followed by the election of the leader of the “street opposition”, Evo Morales, to President in 2006.

Honduras did not have a good track record with the IMF and therefore reached the Completion Point much later. But the PRSP process is still said to be alive. Despite some problems with its 1999 Enhanced Structural Adjustment Facility (ESAF, later called Poverty Reduction and Growth Facility PRGF), international pressure for debt relief led to new Letters of Intent³ each time when a new step in the qualification process for HIPC had to be taken. The government organized a participatory process and the full PRSP was approved in September 2001. The new government (President Maduro, 2002-2006) at first did not accept this PRSP but later began writing Progress Reports on it, which, contrary to those in Bolivia, were accepted by the staffs of the BWI. It also maintained the formal structure of monitoring of the implementation of the PRS, the Consultative Council of the PRS (CC-ERP) with participation of civil society. Formally the process was therefore still alive, but not much happened in the implementation of the PRS – apart from the execution of donor-financed projects. Within the country the PRS had a low profile and it was mainly the donors who kept talking about it (Cuesta 2004).

The government finally managed to conclude a PRGF in 2004. After one year of keeping on track with that agreement, the country achieved the HIPC Completion Point. In 2005 and

³ A Letter of Intent formally states the policies that the government intends to implement but in practice these are the policies agreed with the IMF, and the letter is often written by IMF staff. If all goes well a three-year program only needs one Letter of Intent, but after deviations of the program new letters are necessary. In the case of Honduras there were new Letters in April and May 2000 and in September 2001 – coinciding or just preceding with the approval of I-PRSP, Decision Point and full PRSP.

2006, the PRS process seemed to experience a revival because HIPC resources finally came in and a lively discussion began on how they had to be spent – as of there was no PRS nor a Law stipulating how decisions on these resources should be made.

So far, Honduras has been on track with the PRS process but in a way it had to because it had not achieved the Completion Point yet. However, the process has been symbolic to a large extent, and there was evidence of both disjunctures mentioned by Gould (2005). First of all, there has been little relationship between the contents of the ERP and the policies actually implemented, especially if one looks at the government budget. Not much has changed in the composition of the budget; in addition, there is very little relationship between actual spending and budgeted spending (Cabezas 2005). The PRS process did change some aspects of politics, by giving some space to civil society representatives for the first time (Cuesta and Cid 2003; Seppanen 2005). However, the important decisions are still made in other arenas, and political relations are still dominated by clientelism.

The need for debt relief made that *Nicaragua* also went through the first steps of the PRS process rapidly. But like in Honduras, the country had a bad track record with the IMF and its 1998 ESAF was almost continuously off track. International pressures for more debt relief, and US pressure to support the governing party in the face of a possible Sandinista victory in the November 2001 elections led to the approval, first of the HIPC Decision Point and then of the full PRSP (with accompanying Letters of Intent on the IMF program, as in Honduras, see footnote 3). The new government (President Bolaños, 2002-2007) first rejected the old PRS saying that it had been written in line with donor wishes, but then also began writing Progress Reports. It maintained its own National Development Plan but began writing a revised version of it to bring it in line with donor wishes. This meant including paragraphs on poverty reduction and on health and education, among other things. After several attempts, a second PRS was finally approved in November 2005. The Bolaños government (with a background in the financial sector) had less problems with concluding an IMF agreement and staying on track. For this reason, it could reach the Completion Point earlier than Honduras, namely in January 2004.

But during the full period of this administration development plans played a subordinate role in actual policies and politics. The Bolaños administration had won donor support by putting the former President in jail because of his engagement in corrupt activities. But he lost domestic political support, as the members of the National Assembly who were supposed to be his faction, became his opponents as they continued to support former President Alemán. Bolaños therefore very much needed the support of the donors. He continued with the symbols of the PRS process although poverty reduction was not among his first priorities. His permanent fight with the National Assembly made the implementation of whatever strategy difficult and even endangered compliance with the IMF program – except in times of “emergency”, that is, when all members of parliament were convinced that compliance was necessary to get important debt relief or aid. In sum, also in Nicaragua there was a disjuncture between policy plans and implementation, and between formal policy formulation and the real political struggle, although the context was slightly different from that in Bolivia or Honduras.

Table 1 confirms that the process has been derailed in Bolivia: no approved national plan and no progress reports on the old plan at all. In Nicaragua there have been progress reports and a revised version of the NDP has finally been accepted as PRS 2 by the donors. But the PRS process plays a negligent role in domestic policies and in domestic politics. In addition, the situation is uncertain after the Sandinista victory in the November 2006 elections. Honduras

still appears to be on a PRS track: the recently (2006) presented national strategy is not fundamentally different from the original PRS and will probably be approved by donors. Since the arrival of debt relief resources in 2005, there is heightened debate on the use of these resources and this has given the PRS process a high profile in the country. However, the debate only focuses on a small percentage of national spending and of national policies, and is to a large extent a façade behind which traditional policies and politics can continue.

Table 1. Overview of the formal characteristics of PRS processes in the three countries

	Bolivia	Honduras	Nicaragua
Interim PRSP	January 2000	April 2000	August 2000
Decision Point HIPC	February 2000	July 2000	December 2000
Full PRSP approved	June 2001	October 2001	September 2001
Completion Point HIPC	June 2001	April 2005	January 2004
IMF Program	ESAF-PRGF 1998-2001 Standby February 2003, extended until ..2006 but often off track	ESAF 1999-2001 but with problems PRGF February 2004-	ESAF 1998- but often off track PRGF December 2002- end 2004, then off track PRGF December 2005-
Institutions monitoring PRS with participation civil society		Consultative Council PRS	CONPES has limited role
Laws resulting from PRS process	Dialogue Law Municipal Transfers Law	Poverty Reduction Fund Law	
Progress Reports, * if approved	Several 2002-2004, but none approved	November 2003* January 2005*	November 2002* November 2003* December 2005* (included in new NDP)
Government changes, * if after elections	June 2002* October 2003 June 2005 January 2006*	January 2002* January 2006*	January 2002* January 2007* (foreseen)
New national development plans, * if approved by BWIs	Government Plan 2002 Revised PRS 2003 Bolivia Productiva Plan 2004 National Development Plan 2006	National Plan 2002 Revised PRS 2006	National Development Plan (NDP) 2002 Revised NDP 2003 DDP-O 2004 New NDP = PRS 2 December 2005*
Participation for new plans	“Bolivia Productiva” dialogue 2004	Consultation on use of MDRI funds 2005	Regional consultations for NDP 2004-05

These disjunctures between policy and implementation, and between policy and politics, were also found to exist in the other two countries. In Bolivia this was already evident in 2001 and after that the PRS process gradually vanished. In Nicaragua the context was different but also in that country the PRS and the process around it merely had a symbolic value.

The question now is whether and to what extent the different paths in the PRS process and the nature of the disjunctures observed have consequences for the implementation of the Paris agenda in the three countries.

3. The implementation of the Paris agenda

National development plans are the basis for the first commitment of the Paris Declaration, namely *ownership*. As Table 1 shows, only Nicaragua has an approved national strategy at the moment, but given the election victory of Daniel Ortega in November 2006, this plan is likely to be rejected soon. New governments in Bolivia and Honduras have just (mid-2006) presented their development strategies and it is not clear yet what donor responses to these strategies are. In the case of Honduras, the new strategy very much resembles the existing PRS, but in Bolivia it is very different.

With respect to the government leadership in the sectoral coordination of aid, formally all three countries have roundtables with government and donor participation. But the experiences in practice are not always positive. After the political turmoil in Bolivia in 2003, sectoral roundtables were replaced by five thematic roundtables, which were co-chaired by a government agency and a donor. Themes included the (preparation of the) Constitutional Assembly, the National Dialogue, Aid coordination and Macroeconomy and the budget. Some of these had results, other roundtables were not functioning well. Both Nicaragua and Honduras have sectoral roundtables. In Nicaragua these tables were also co-chaired like in Bolivia, and in Honduras they were chaired by the government only. The general feeling among the donors in all three countries is that government interest and leadership in these tables has been insufficient, but in Bolivia and Nicaragua this varied among sectors and themes: where government leadership was better, roundtables were functioning better as well and did have results.

Civil society participation in these roundtables was absent in Bolivia, was sometimes present in Nicaragua and was more general in Honduras. In Honduras civil society participation in sectoral roundtables was stipulated in the Law on the Poverty Reduction Fund. But in this country not much happened in the tables; moreover representativeness of civil society participants was questioned. In practice, donors do not always insist on this participation. But donors do push governments for the establishment of the sectoral roundtables themselves. The current governments of Bolivia and Honduras have recently released proposals to reestablish sectoral roundtables (Bolivia) and in the case of Honduras, to revive the sleeping roundtables.

With respect to *alignment* to country systems, accounts and procedures, there is only limited progress. In Bolivia, all aid goes through the national budget already for some years now, and recently this has also been achieved in Nicaragua (Gobierno de Nicaragua 2006). In Honduras, 85% of aid is included in the budget (Gobierno de Honduras 2005). But many donors still maintain separate accounts so that governments have little insight in the actual

spending of these “on budget” donor projects. In addition, donors still establish separate project implementation units with higher salaries, maintain their own procurement rules and their own systems of monitoring and evaluation.

The *harmonization* in the Paris Agenda refers to establishing common arrangements, joint systems for auditing and monitoring, joint missions, and simplification of rules and procedures, all with a view to reduce transaction costs for the recipient government. The most far reaching way of doing so is to provide general budget support and to do so with common arrangements. In this sense, there have been some advances, especially in Bolivia and Nicaragua. These will be dealt with below. But in all three countries, most aid is still given in the form of project aid. In Bolivia the share of budget support has been highest over the years 2000-2005, with 25%. But this is largely due to a peak during the political and economic crisis in 2003; when the IMF finally concluded a Standby with Bolivia in February, several donors supported it out of fear of further destabilization of the country. The same happened after the new violence at the end of the year, when the multilateral development banks increased and advanced disbursements on a large scale in order to prevent capital flight to lead to complete standstill of the economy. In Nicaragua, budget support only constituted 14% of total aid during 2000-2005 and in Honduras there is no data available but it will certainly be less than in Nicaragua.

Apart from general budget support, sectoral support or sector wide approaches are also part of the harmonization agenda. In practice, progress in this area largely depends on the work in the sectoral roundtables. In case these have been operating well, for example in Education in Nicaragua, donors have moved to sectoral support in the form of basket funding with joint missions and evaluations. However, donors are currently not satisfied with the implementation of the sectoral education plan⁴ and in the case of at least one donor this has a backlash on the willingness to provide sectoral or general budget support. In Health a basket fund has just started. It includes a “silent partnership”⁵, which in itself can be considered progress. In Honduras there are a few coordinated efforts at subsectoral level, for example in the context of the Education for All-Fast Track Initiative. But also in this case implementation lags behind funding and plans. In Bolivia there were several baskets and joint donor efforts, but due to political turmoil and the change in government they are all paralyzed by 2006. Progress in simplifying and unifying procedures, or organizing joint missions and evaluations is limited in all three countries. The Nicaraguan government and donors established a “mission holiday” during six weeks in 2006, but it was hardly respected.

In none of the three countries, there are links between targets of the PRS and budgets, nor between budgets and results (Vos *et al.* 2005). So the *managing for results* agenda is still in its infancy. What does exist in all three countries, is a definition of “poverty reduction expenditure” and this can be traced in the budgets. But definitions are arbitrary, vary among the countries, and have sometimes also varied over time. A higher registered poverty reduction spending does not say much about actual poverty reduction. Budgeting processes have many weaknesses. One problem is that actual spending is always very different from budgeted spending. In Honduras, Congress, President and ministers all have the power to authorize deviations from approved budgets. In Nicaragua, cash rationing leads to the dropping of certain expenditure, and in Bolivia poor budget execution and one formal

⁴ Both political will and implementation capacity are said to be lacking.

⁵ A donor just provides money and delegates decision power to other donors. It is one of the ways mentioned in the Paris Declaration to reduce transaction costs.

reallocation during the year are the main causes for the deviations. It is clear that political and legal (salaries must be paid, for example) considerations dominate these decisions on reallocations, and that poverty reduction strategies do not play any role.

Auditing systems are weak in all countries, and there are serious doubts about whether the money is spent where it is intended to be spent. In Honduras, part of the aid money – including the US funds from the Millennium Challenge Account, is still off-budget, thus limiting national control. Nicaragua has made most progress with improving its budget processes, and introduces a Medium Term Expenditure Framework in its 2007 budget. Bolivia was on a right track with the adoption by the Ministry of Finance of a “Strategic Framework for the improvement of Public Management” but the recent government change interrupted its implementation. Result oriented budgeting is still a far cry, and the ISS 2005 study concluded that countries need to get the basics in order in terms of better functional and operational classifications, more consistency between budgets and actual spending, and better auditing and control systems, before result oriented budgeting can be meaningfully introduced (Vos *et al.* 2005).

In the area of *mutual accountability*, the fifth commitment of the Paris Declaration, all three countries have shown progress in the sense that they have presented extensive Plans for Harmonization and Alignment, containing an overview of the state of affairs and plans to improve it. Bolivia already presented this Plan in Paris, and Honduras and Nicaragua elaborated these Plans after that meeting. Currently, the Nicaraguan Plan is most advanced as it includes concrete indicators and targets for most of the elements of the Paris Agenda. But all Plans run the risk of being papers only; one factor is the change in government in all three countries. But there are also real constraints on both government and donor side to advance on the Paris agenda.

A donor review with respect to Bolivia concluded that pressures and incentives from headquarters to disburse and to write individual country strategies were too strong to allow for more initiatives in donor coordination (“Nordics +” donors 2004). But the above analysis shows that governments (sector ministries and agencies) don’t seem to have sufficient incentives either to promote more coordination among donors or more sectoral forms of support.

4. Budget support

Budget support is part of the family of program-based approaches. Program aid is aid that is not linked to projects, but usually it is given with certain policy conditions attached. Other program aid modalities include balance of payments support and debt relief. Budget support can be general or sectoral. In both cases, the money is flowing into the Treasury, but in the case of sectoral budget support, conditions are linked to one or more sectors. In theory, budget support is the aid modality most fully aligned with country systems and procedures. If donors manage to establish common arrangements for budget support, it is also the most harmonized form. The motivations for budget support are the same as for harmonization and alignment: the reduction of transaction costs that burden project aid, and the strengthening of country (budgeting and accounting) systems and procedures by using them, instead of bypassing them through hundreds of donor driven and donor managed projects. The result should be greater aid effectiveness.

This is all in line with Renard's first narrative (Renard 2005). However, there is also another agenda to budget support and this is more in line with the second narrative. Since policy conditions can be attached to budget support, donors use it to influence governments in a particular direction. Moreover, before selecting a country for budget support, donors usually want certain conditions to be fulfilled: minimum requirements for governance and for public finance management, political conditions, a stable macroeconomic environment, and evidence of the political will to reduce poverty, usually operationalized in the form of the existence of a PRS or other similar strategy. As these conditions are seldom fully met, donors also wish to use budget support to bring about these "entry conditions".

If and to the extent that budget support is used for this conditionality purpose, it tends to limit the expected benefits of this modality. First, the setting of conditions may conflict with ownership and may reduce real alignment with country plans and systems. Second, the setting of conditions and the accompanying sanctions in case of non compliance reduces the predictability of aid flows and may therefore complicate macroeconomic management in recipient countries. Third, and to the extent that donors set *different* policy conditions for their budget support and also have different systems for their budget support, harmonization is not enhanced. In the following, experiences with budget support are analyzed with respect to these three issues: the extent of harmonization, the conditionality and the predictability.

Harmonization of budget support

In all three countries many different systems of budget support exist along each other. Bolivia and Nicaragua have established a Joint Financing Arrangement for budget support, signed by seven (Bolivia) and nine (Nicaragua) donors. These donors reached an agreement on the fundamental principles the country must adhere to, on joint procedures for monitoring, evaluation and disbursement, and on a performance matrix with actions and targets to be achieved. Since many donors participate in the meetings of the Budget Support Group, even those who did not sign the agreements, there is some harmonization and coordination of the policy conditionality in these countries. However, full harmonization of budget support has by far not been achieved in these countries:

- Some donors did not sign the joint arrangement yet *do* give budget support
- Some donors formally signed the Joint agreement but do *not* give budget support (United States in Bolivia) or continue their own budget support program outside the joint arrangement (European Commission has sectoral budget support grants in both countries, the World Bank has a Poverty Reduction Support Credit with German co-financing in Nicaragua, the IDB has several policy based loans in Bolivia)
- Participating donors attach different priority to the various fundamental principles and to the different actions and targets of the performance matrix, implying different assessment criteria leading to different assessments and disbursements in practice
- The bilateral agreements between a single multilateral or bilateral donor and the recipient government always take precedence over the joint agreement
- In some cases, donors participating in the joint arrangement even ask for a specific use of budget support funds; this leads to separate reporting requirements and clearly contradicts the definition of budget support – yet it happened in the case of the UK (DFID) in Nicaragua

With respect to coordination in conditions and in the assessment of performance, Bolivia and Nicaragua had different experiences. In Bolivia the donors set up the Multi-annual Budget

Support Program in 2004, when there was no approved PRS. Yet, to have an approved PRS was defined as one of the fundamental principles. Some donors hoped that this would enhance the change that the government would come up with it but actually, the criteria as to what would be an approved PRS were unclear, both as to contents and as to the extent of required participation of civil society. In 2005, Bolivia proved to have complied well with most elements of the performance matrix, but there was still no new PRS that was approved by the donors. The various donors of the Multi-Annual program assessed the situation in different ways. The multilaterals disbursed, but none of the bilateral donors did so, and often for reasons that were difficult to relate to the set of fundamental principles or the targets in the matrix – the lack of a PRS was only one of the reasons; political responses at headquarters to particular policies of the Bolivian government, for example, towards foreign companies, were often more important.

The donors of the Nicaraguan Joint Financing Arrangement managed to achieve a unified assessment in 2005, and so far also in 2006. In 2005, this led to a suspension of disbursements due to the government's failure to comply with the IMF program. Macroeconomic targets were all complied with, but the government had difficulties in having certain laws approved by the National Assembly. According to the IMF, this could affect macroeconomic targets in the future and all participating donors followed this assessment. The suspension was effective, in the sense that the National Assembly by the end of the year at last formally approved most laws required by the IMF.

In Honduras, a joint "Budget Support Group" (BSG) has just been established in 2006, but there are only five members and so far it has not led to any common system although donors begin to talk about coordination of their conditions. The World Bank has a Poverty Reduction Support Credit co-financed by Sweden and Germany, the European Commission has a sectoral budget support program, and the IDB has three sectoral policy based loans and one sectoral performance based loan. This means the government has to deal with different donors and their requirements. On the other hand, the BSG was said to be too small to have "leverage" on the government.⁶

In sum, there are still many different systems of budget support and sectoral budget support in place. On top of that, budget support only constitutes at most 15-20 of total aid in the three countries, with an additional 5% of aid (maximum) in sector based approaches. This means that transaction costs are still high. Bolivia and Nicaragua managed to achieve some harmonization in the conditions.

The conditionality

Conditionality can be assessed in four different ways:

1. Whether it is *ex post*, assessing past performance, or *ex ante*, meant to induce future performance. Conditionality *ex ante* is often said to be ineffective: donors may have some influence but only if the government already intended to implement the policies wanted by the donors. Conditionality *ex post* or selectivity is the tougher one of the two: in case conditions are not met, no or lower disbursements are forthcoming.

⁶ Interview with donor representative and member of BSG, June 2006.

2. Whether the conditions apply to *processes* (policies, measures, actions) or to *results* (qualitative or quantitative targets to be achieved). Domestic ownership will be less in case of the former, since donors are prescribing the recipes and policies and do not leave this to the recipient. It is also more likely to lead to micromanagement. On the other hand, there are also risks involved in assessing results: there is not always a clear link between recipient's efforts and results, and the system may enhance data manipulation and strategic behavior.
3. The type of policies or sectors to which the conditions are applied; this gives an idea of the interest of the donors (the kind of policies that need improvement) and the extent of comprehensiveness of the conditions
4. Whether conditions are based on the country's own (and owned) development strategy or on donor views. In the former, the degree of ownership is of course higher than in the latter.

These issues will now be explored for the three countries. On the first one, and in comparison with the conditionality of the late 1990s, there is now more ex post conditionality (selectivity) for program aid. However, this usually does *not* mean that countries are now excluded from setting up budget support systems. Bilateral donors began to set up joint donor agreements on budget support in Bolivia and Nicaragua, although in Bolivia the PRS process was derailed. In Nicaragua the Executive did not get any Laws passed in the National Assembly so that it could be expected that any conditions to be agreed with the donors would be difficult to implement. The Bolivian matrix included a new and approved PRSP, and Nicaraguan donors responded to the uncertain political implementation capacity of the government by including a record number of 160 actions and targets for two years. In addition, there was a list of fundamental principles the government had to adhere to as a kind of preconditions, including the respect for human rights, independence of the judiciary, the fight of corruption and a commitment to reduce poverty. Some of these, like independence of the judiciary and commitment to poverty were hardly met at the start, and yet the agreement was concluded.

The increasing weight of ex post conditionality relative to ex ante conditionality is also evident in the high number of preconditions and triggers⁷ in the World Bank PRSCs, the preconditions in the IDB policy based loans and the result based disbursement in both IDB performance based loans (a new instrument) and in the variable tranches of the sectoral budget support grants of the European Commission. All this means higher chances of non disbursement or partial disbursement of the committed money.⁸

The triggers for the second tranche in the 2004 PRSC in Nicaragua include, for example, the percentage of poverty reduction spending in the budget (in relation to GDP) and the maintenance of a stable macroeconomic framework, but also institutional reforms such as the restructuring of the Rural electricity fund "in a way acceptable to IDA (i.e. World Bank)", the elaboration of a water and sanitation strategy that defines a division of labor between the national water company ENACAL and the Social fund, changes in the Municipality law and in the pension system to make them more financially viable in the view of the Bank, and the transfer of 80 primary schools to the participatory regime favored by the Bank.

⁷ A trigger is a condition that must be met for disbursement. Other conditions have less weight in that decision.

⁸ In the programs of the European Commission, disbursement on the variable tranche can be reduced to zero or 50% depending on an assessment of the degree of achievement of the defined (quantitative and qualitative) variables for the sector.

On the second issue, there is evidence that the number of result based indicators has increased since the late 1990s. The matrices in the joint financing agreements, but also the PRSCs, the IDB loans and the programs of the European Commission contain some qualitative and quantitative targets. However, there is also still a great number of process indicators. The above list of triggers of the World Bank PRSC indicates that there are still many process indicators. The donor(s) attempt to influence deeply the institutional structure of the recipient country. This can still be called micromanagement.

The new aid paradigm with its focus on poverty reduction seems to have led to an increase in the number of policies and sectors in which donors interfere, the third issue. Judging from the PRSCs in Honduras and Nicaragua, conditionality remains strong in the macroeconomic area, in infrastructure and in the financial sector, but has become very extensive in the social sectors health and education, in water, environmental policies and in the area of governance, in particular in public financial management. The same is true for the Nicaraguan performance assessment matrix of the joint financing agreement. It includes actions and targets in macroeconomics, poverty, social sectors, productive sectors, environment, water, and governance. The matrix of the Bolivian Multi-annual Budget Support Program was a positive exception: it only contained 23 actions and targets, out of which there were 18 related to public financial management. The IDB and EC programs are usually sectoral and together cover a wide range of sectors (see Table 2).

Table 2. The sectoral budget support programs of IDB and European Commission

Donor	Country	Sector	Starting year
European Commission	Bolivia	Water and sanitation	2004
	Honduras	Decentralization	2005
	Nicaragua	Education	2004
		Support to the NDP, in particular health and education	
IDB	Bolivia	Public management	2005
		Tax reform	2006
	Honduras	Social: health and education	2004
		Financial sector	2004
		Health	2005
		Fiscal management	2006
	Nicaragua	Fiscal reforms	2004
		Social	2006

Perhaps the most important aspect to assess the extent of domestic ownership is the extent to which the conditions are derived from national strategies (the fourth issue). Donors usually maintain that they deduce the policies and indicators from the PRS – if there is no approved new strategy, they use the original PRSP. However, the extent of domestic ownership of the original strategies can be questioned. This also holds for the newer national development strategies – to the extent that they have been approved by the donors, such as the finally approved version of the National Development Plan in Nicaragua. Often there are also practical problems in defining policy conditions on the basis of these strategies: the strategies are not sufficiently concrete. In practice, the donors usually come up with their proposals and

negotiate them with the relevant government sectors. Not much has changed in comparison with the old structural adjustment conditionality. This means that conditions are probably only complied with if the country intended to implement the policies anyway. This held, for example, for most of the 18 indicators and policies regarding financial management in the Bolivian performance matrix: they were in line with the Ministry of Finance's own strategic framework for the improvement of financial management.

In conclusion, conditionality has become tougher in the sense that there are more preconditions and triggers, has a stronger focus on results although the attention for processes has not diminished and has probably increased as well, and conditionality applies to all possible sectors and themes within public policies. Finally, the existence of a national poverty reduction strategy or national development strategy does not guarantee ownership, because conditions are hardly based on these strategies. All this does not mean that conditions will be implemented: responses such as cosmetic implementation, partial implementation, or delays are still possible. But if donors conclude that triggers or targets have not been met, there are probably more real sanctions than there used to be in the 1990s, in the form of reduced disbursements.

The predictability of budget support

The predictability of aid flows in general is an element of the Paris Declaration, under "mutual accountability". For budget support this predictability is even more important since it is part of the general revenues that may also be used for current expenditure; but government can only plan to spend it if it is a reliable flow. There are two aspects to this predictability (IDD and Associates 2006): the predictability of the flow in the short term, during the budget year, so whether actual disbursements are forthcoming as promised, and the predictability in the medium term. With respect to the latter, there is a fundamental tension between conditionality and predictability. Conditionality and especially if it is of the "ex post" type, may lead to a reduction or suspension of the aid flows.

This predictability has been a problem in all three countries. In Bolivia, many donors reduced or suspended their committed budget support in 2005. For the IDB some specific conditions had not been met. The donors participating in the Multi-annual Budget Support Program had a variety of reasons for not disbursing, one of them being the lack of a new PRS but there were political factors as well. Since Bolivia received more tax revenues than expected in 2005, the budget support reductions did not affect fiscal stability. In Nicaragua there was a problem between May and November 2005. All nine donors participating in the Joint Financing Agreement that had just been signed in May 2005, suspended their disbursements. When the lion's share of the committed funds finally arrived at the end of the year, the government had difficulties to spend it. The money was just added to the international reserves. In 2006, disbursements have so far been in line with the agreed schedule. Most donors in Nicaragua made commitments, in principle, for two or three years. But it remains to be seen whether they will honor their 2007 commitments in the face of the change in government.

In Honduras, there have also been some problems with the limited amount of resources entering the country as budget support. The World Bank, for example, did not disburse the second tranche of its PRSC in 2005 because the Assembly did not approve the Civil Service Law. This Law would potentially have made an end to clientelism in Honduran civil service, and was a trigger within the PRSC. This non disbursement affected the expected inflows in 2005. In 2006, a new PRSC was concluded in which this Civil Service Law was no longer a

condition: it was agreed that a pilot on new forms of recruitment and promotion would be carried out in a limited number of public agencies that had volunteered for this pilot. This shows that even with the tougher variant of conditionality, the domestic political system still determines whether required reforms are carried out.

Conclusions

This paper aimed to assess to what extent Bolivia, Honduras and Nicaragua are implementing the Paris agenda on harmonization and alignment and to what extent this implementation related to the state of affairs in the Poverty Reduction Strategy Process. In addition, the question was how the conflicting narratives on the failure of the previous aid paradigm (Renard 2005), and in particular the “schizophrenia” on conditionality (Rogerson 2005) work out in practice and what the possible consequences are for aid effectiveness. These questions cannot be addressed in a comparative way without looking at the political contexts in these countries.

The background for the PRS process in Honduras is a clientelist political system with elections every four year that lead to a complete turnover in government agencies. The PRS process is formally on track. But there is little relation between the formal plans and processes, and actual policy implementation. The PRS process has led to some transparency and openness in the political process, but the most important decisions are still taken behind closed doors and according to the laws of clientelism.

Governments in both Bolivia and Nicaragua enjoyed limited support from the population. In Bolivia this was related to the lack of real progress in poverty reduction, which was seen as the result of the long-term and intensive cooperation of consecutive governments with the donors and in particular with the BWI. In the past five years, the frustration and distrust among the population led to frequent and sometimes violent government changes. In Nicaragua, confidence in the donors is still high. As a result, the executive government became very dependent on the donors: only when the donors brought pressure to bear (in order to reach the HIPC Completion point in January 2004, and in order to get an IMF agreement plus budget support in 2005), the National Assembly was willing to go along with the executive’s proposals.

These political contexts broadly explain the fate of the PRS processes in the three countries. Gould’s (2005) disjunctures between policy and implementation, and between policy and politics were already evident in Bolivia in 2001. The poverty reduction plan was discredited almost immediately after writing, and attempts of consecutive governments to revive the PRS process did not succeed. In Nicaragua the process is still formally on track but it means very little for actual policy implementation. The government is not really interested in poverty reduction but uses the PRS process and the donors for getting at least some policies approved by Parliament.

All countries have written their Plans for Harmonization and Alignment. There has also been some progress in alignment and harmonization of donor efforts. On the positive side, most aid is now visible in the budgets, and some donors now give part of their aid in the form of budget support or sectoral budget support. However, there is hardly any progress in the actual coordination of project aid – which still constitutes the bulk of aid efforts. To the extent that there is budget support, many systems coexist. Donors face real constraints for alignment and

coordination: the planning and reporting requirements of their own headquarters take precedence. Some donors are not allowed to provide budget support.

The extent of progress on the Paris agenda on the donor side proves to have little relation with the PRS process: Honduras has been most on track with this process, but this is the only country where part of the aid money is still off budget and also the country where no joint donor agreement for budget support has been set up. Progress seems to be more related with the particular composition of the donor community: in Honduras fewer donors are committed to the Paris agenda.

The progress in leadership and ownership of aid efforts on the government side was also limited. All countries set up roundtables with donor participation, but actual government leadership and interest was often lacking. In Bolivia, the political turmoil led to thematic instead of sectoral roundtables. One of the themes was donor coordination and this table produced the Harmonization and Alignment Plan. But the roundtable was merely *talking* about coordination and not actually doing it. Honduras followed the donor prescriptions on sectoral roundtables with donor and civil society representation most closely, but in this country the roundtables had least tangible results. It seems that there are also real constraints on the government side to improving donor alignment and coordination. Furthermore, also in this area there is little relationship between the (formal) state of affairs in PRS processes and the results on the Paris agenda. To some extent, the Paris agenda also has its symbols: High Level Meetings, National Alignment and Harmonization Plans, the establishment of Roundtables in the countries. But realities in actual alignment and coordination are a completely different matter.

The experiences with budget support programs in Bolivia, Honduras and Nicaragua show that conditionality has become tougher than it was in the late 1990s under the old aid paradigm. There is more ex post conditionality, more results based conditionality – while process conditionality has not diminished, conditionality covers more sectors and policies than ever before and conditions are hardly based on national strategies. The three last findings imply that conventional conditionality dominates as before, and that the ownership principle of both the PRS approach and the Paris agenda is not much respected.

In principle, the first finding, the increase in ex post conditionality as against ex ante conditionality, may imply that donors have chosen for ownership plus selectivity – the recommendation from many studies at the end of the 1990s. However, practice shows that donors are not selective in setting up their budget support programs. The multilateral banks simply provide part of their loans as program aid with policy conditions, as they have always done. Other donors such as the EC and bilateral donors provide budget support because there is an international pressure to do so, no matter whether entry conditions are satisfied. As a consequence, they attempt to influence policies through budget support – which means that the old type of conditionality is in place. In sum, the larger share of ex post conditionality within total conditions does not imply selectivity in the entry decision, but may imply that more sanctions are applied: budget aid is reduced in case of non-compliance or partial compliance of conditions – in particular, the conditions defined as “fundamental principles”, preconditions, triggers or performance measures for certain tranches of the grant or loan.

With respect to the effectiveness of setting of policy conditions, the three countries present some contradictory experiences. On the whole, it seems that the conclusion from the studies of the 1990s is still valid: conditions are implemented if they are in line with what recipient

countries intended to do. If conditions are clearly in contrast with the clientelist political culture and are perceived to affect vested interests, which was the case with the new Civil Service Law in Honduras, they are not implemented.

In Bolivia, the donors had responded in a realistic way to the uncertain political situation in their joint performance assess matrix: there was a small number of conditions and conditions had a strong focus on the improvement of public management – a feasible objective. However, despite good performance of the government disbursements were suspended – often for reasons not stated in the agreement or in the policy matrix. The effectiveness of the policy matrix can thus be questioned.

In Nicaragua, on the other hand, the policy matrix contained 160 actions and targets over two years, plus some fundamental principles that the government had to respect. This large number may be due to the limited confidence in the political will to reduce poverty in this country, and to the difficult political situation. A large amount of conditions gives a sense of pseudo control. Effectiveness is difficult to assess, as some conditions will be implemented and others will not. But given the political situation and the high aid dependence in this country, donors did have influence. In practice however, they used their leverage for supporting the IMF program and especially its structural reforms – not for bringing about policies for poverty reduction.

In sum, there has been a move towards budget support, but it has not been related to the PRS process. Conditionality has dominated ownership and the negative narrative seems to have taken precedent over the positive. If anything, conditions have become more extensive, more intrusive and tougher than they used to be in the 1990s. And the effectiveness of this conditionality can still be questioned.

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