Deutsches Institut für Entwicklungspolitik

German Development Institute

d·i·e

3/2005

Discussion Paper

Programme Financing and Public Budgets

New Instruments and Starting-Points of Development Policy

Stephan Klingebiel / Stefan Leiderer / Petra Schmidt

Programme Financing and Public Budgets

New Instruments and Starting-Points of Development Policy

Stephan Klingebiel / Stefan Leiderer / Petra Schmidt

Bonn 2005

Discussion Paper / Deutsches Institut für Entwicklungspolitik
ISSN 1860-0441

Klingebiel, Stephan / Stefan Leiderer / Petra Schmidt: Programme financing and public budgets : new instruments and starting-points of development policy / Stephan Klingebiel / Stefan Leiderer / Petra Schmidt. – Bonn : Dt. Inst. für Entwicklungspolitik, 2005. – (Discussion Paper / Deutsches Institut für Entwicklungspolitik ; 3/2005)
ISBN 3-88985-283-1

Dr. Stephan Klingebiel, head of department Sub-Saharan Africa, studied political science, economics and history in Duisburg, where he obtained his doctorate in 1998. The main focus of work lies in bilateral and multilateral development policy, development cooperation and crisis prevention / dealing with conflicts. E-Mail: stephan.klingebiel@die-gdi.de

Stefan Leiderer studied economics in Mannheim. The main focus of his work lies in macroeconomic development and public expenditure management in Sub-Saharan Africa.
E-Mail: stefan.leiderer@die-gdi.de

Petra Schmidt studied economics and Latin American regional studies in Cologne. The main focus of her work lies in financial development and development financing.
E-Mail: petra.schmidt@die-gdi.de

Tulpenfeld 4, 53113 Bonn
☏ +49 (0)228 94927-0
🖷 +49 (0)228 94927-130
E-Mail: die@die-gdi.de
www.die-gdi.de

Contents

Abbreviations

ACP	Africa, Caribbean and Pacific
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung
CIDA	Canadian International Development Agency
DAC	Development Assistance Committee
DC	Development Cooperation
DFID	Department for International Development
DIE	Deutsches Institut für Entwicklungspolitik
ESAF	Enhanced Structural Adjustment Facility
GTZ	Gesellschaft für Technische Zusammenarbeit
HIID	Harvard Institute for International Development
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
INEF	Institut für Entwicklung und Frieden
KfW	Kreditanstalt für Wiederaufbau
LENPA	Learning Network on Program-Based Approaches
MCA	Millennium Challenge Account
MTEF	Medium Term Expenditure Framework
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organization for Economic Co-operation and Development
OPM	Oxford Policy Management
PBA	Program-Based Approach
PEM	Public Expenditure Management
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
SPA	Strategic Partnership for Africa
USAID	United States Agency for International Development

1 Introduction

For some years now, a reform of important instruments of international development co-operation has been taking place. In this, public budgets and their financing from outside play a decisive role. Budget support and other forms of programme financing (Program-Based Approaches – PBAs) have become a central building block of the new development cooperation.

Individual donors, such as the British Department for International Development (DFID), the Netherlands, the European Union and the World Bank are pressing for a reform of development cooperation and a consistent implementation of PBAs. Moreover, wide consensus, though not shared by all, exists meanwhile about the necessity to increase the effectiveness of development cooperation by means of such newer approaches.

While the importance of budget management and support extends beyond the African continent, it plays a particularly important role in the countries of sub-Saharan-Africa (SSA). Here, economic efficiency and above all public budgets depend to a significant extent on development cooperation. In part, clearly more than 50 % of public spending by central governments is donor-financed. At the same time, for donors, SSA is in many respects the "key continent" for development policy efforts.

The Strategic Partnership for Africa (SPA), which has as an objective a more effective development cooperation with African countries and is headed by the World Bank's Vice President for Africa, Callisto Madavo, already formulated a very wide-ranging principle back in November 2001: "*All donor assistance should be delivered through government systems unless there are compelling reasons to the contrary; where this is not possible, any alternative mechanisms or safeguards must be time-limited, and develop and build, rather than undermine or bypass, government systems*" (LENPA 2002, 10 f.). In fact, a consistent implementation of this so-called Addis-Ababa principle would lead to significant changes in development cooperation with Africa.

Finally, it must be emphasised that a series of cooperation partners expressly call upon the community of donors to adapt and adjust their development cooperation approaches to the partner structures and processes. Uganda and Ethiopia are examples of partners expressly expecting donors to act within the respective national budgets (on budget) and structures, instead of maintaining parallel structures and working outside of the respective public budgets (off budget).

After an introductory summary of the constitutive elements of PBAs, this article will first of all discuss the adjustments that are necessary on the donor side to support programmatic approaches as effectively as possible. In this, the main focus of the analysis will be on the conditionalities that accompany the financing of PBAs. Afterwards, the central demands made on structures and processes for a successful implementation of PBAs in developing countries are discussed. At the centre of our attention are the budgets whose structuring and quality are essential for the implementation of poverty reduction strategies. Finally, the experience that has been gained with PBAs to date will be summarised and explained.

2 Programme financing and budget support

2.1 What are PBAs?

PBAs can be understood as programmatic approaches that have a clearly recognisable conceptual roof, are answered for, endorsed and managed by the partner countries (including the effective co-ordination of donors) and supported by donors that adjust their behaviour to the concept (Klingebiel 2003, 5). A central reference document for the support within the context of PBAs is – where it exists – the national poverty strategy (Poverty Reduction Strategy – PRS).[1]

On the same lines as the CIDA (Canadian International Development Agency), in this, four principles must be taken into consideration (CIDA 2003):

— *Leadership* of the programme by the partner country,

— A single programme with a common budget framework,

— Donor coordination and harmonization of procedures,

— Efforts to increase the use of the processes and instruments by the partner, *inter alia* with regard to implementation, financial management, and monitoring and evaluation.

The financial support of the programmatic approaches can be given in the form of general budget support – which the article primarily considers –, sector-related budget support or through joint financing (basket funding or common pools*)* (see Overview 1). Besides the actual financial contributions by donors, PBAs also comprise such measures that serve to improve the administration and control of the resources made available, as well as the total budget.[2]

The international trend to programme orientation results from the endeavour towards greater effectiveness of development cooperation. PBAs are intended to counteract the administrative and organizational problems that are created by the project approaches previously followed by most donors. The community of donors currently finances a total of around 50,000 development cooperation projects and programmes (OECD / DAC 2003, 47). According to conservative estimates (Club du Sahel 2000, 7), in a "typical" African country, there are around 600 ongoing development cooperation projects (in the case of Burkina Faso, for example, there are currently 1500 projects), for which each year around 2400 quarterly reports must be drawn up, which in turn must be administered by the competent administrative units of the respective country. In addition, there are about 1000 annual missions, which make necessary corresponding spending for their preparation and implementation. Each mission would like to conduct talks with high-ranking representatives of the partner country and obtain government estimates for its own report. PBAs are intended to provide a remedy especially in this area and contribute to a conceptual and

1 To date, PRS have been developed or already implemented in 54 countries; 38 countries have a complete PRS paper (PRSP) or comparable strategy document (status: June 2004). Originally relevant merely as a precondition for a debt relief under the HIPC initiative, PRS are meanwhile considered as *the* central strategic frame of reference for the own efforts of the poorest developing counties to combat poverty and reach the *Millennium Development Goals* (MDGs) up to 2015.

2 Cf. on this Klingebiel (2003, 5 f.); Leiderer (2004, 1 f.).

Figure 1: From project-orientation to programme financing in development cooperation[a]

Traditional project financing

⇓

Project-related contributions to the programme of the partner

⇓

Project-related contributions with donor-harmonised procedures and standards to a programme of the partner

⇓

Joint financing of a donor-controlled *basket*

⇓

Joint financing of a jointly (donor and partner)-controlled *basket*

⇓

Joint financing of a partner-controlled *basket*

⇓

Sector-related budget support

⇓

General budget support

a Categories as per: Foster / Leavy 2001; Asche / Lauckner 2002, 13

Source: Klingebiel 2003, 9

administrative relief of the partners. Moreover, the selective support of partner programmes is also intended to lead to an improvement in the ownership, hence the commitment of the partners to implement the strategies resolved. Likewise, PBAs are intended to bring about a greater results-orientation in the planning, implementation and evaluation of development cooperation.

Criticism of PBAs, on the other hand, relates to deficient budget management and accounting structures in many of the partner countries stated further below. Budget support and similar instruments are considered to be very difficult to account for due to the high risk of their being diverted from their intended use and a misappropriation of the funds (see Box 1). On the other hand, a possible difficulty here is that such criticism hardly ever gives meaningful answers to the question as to what form a "bailing out" of the budget support – for example if the partner government makes incomprehensible purchases of armaments – might take. If, for example, areas of basic health care were no longer financed due to the cessation of budget support, a new quality of responsibility would emerge on the donor side.

To achieve the objectives of programme orientation, an adjustment of financing mechanisms and in particular the conditionalities accompanying these is necessary on the donor side. On the partner countries' side, on the other hand, first and foremost a new course in the area of policy formulation and budget management must be set, in order to guarantee the success of PBAs.

Box 1:	**Fungibility of development cooperation**[a]
Development cooperation is described as fungible if, due to the support, it becomes possible for the partner side to reduce its own spending for the anticipated purpose. The funds saved may then in principle be used for another purpose. It must be emphasised here that project-related or sector-specific approaches can by no means guarantee that the fungibility problems will become less important.[b] For example: development cooperation funds made available to one country for the educational sector (for example: the building of schools) may lead to a situation in which, in the budget of the partner country, it would be possible to save one part, or if necessary the whole of the education budget at this place and, at another place, to carry out spending (in the area of education or in other sectors) or savings in the budget. To what extent the fungibility effect in the individual case contributes to a situation in which spending for development policy priorities is only partially or even completely not carried out additionally depends on the specific conditions. Empirical investigations give proof of very different effects. Whether the budgetary funds of the respective country and development cooperation resources are being used fungibly is only verifiable within the framework of the overall budget procedure.[c] Advocates of PBA see here an important preference for the approach, since it attaches great importance to the budget process.	
a The World Bank study "*Assessing Aid – What Works, What Doesn't and Why*" provides a good overview of the subject: World Bank 1998, 60 ff. and 130 ff. See also: Foster / Leavy 2001, 14. b Cf. World Bank 1998, 72 ff.; Devarajan / Haque 2002, 6 f. c Cf. e.g. Dutch Foreign Ministry 2001, 11 f. Source: Klingebiel 2003, 11	

2.2 Conditionality and ownership in the context of PBAs

At the international level, consensus has existed since the end of the 1990s that conditionality in the traditional sense has not been successful. Questions about what form a reform of conditionality in the context of PBAs might best take or whether conditionality should be dispensed with completely have, however, still not been debated conclusively. PBAs are based on the conviction that untargeted aid for good policy strategies of the partners is more efficient than aid in the form of projects. A basic renunciation of conditionality is, however, – not foreseen in the PBAs, independently of whether this relates to loans or grants. Doubts about traditional conditionality stemmed from the economic policy conditions of the structural adjustment programmes that were connected with the payment of the funds:

— Firstly, the conditionalities were frequently similar to theoretical blueprints that were only inadequately adjusted to local conditions (Wood / Lockwood 1999, 6). Central contents were generally a restrictive monetary and fiscal policy, the application of market economy principles and the withdrawal of the state. Through this, economic growth was intended to be promoted and sooner or later benefit poor people. Critics have their doubts about the economic meaningfulness of this approach and point to the negative economic, ecological and social consequences of structural adjustment.

— Secondly, the conditionalities were often too detailed. Combined with a lack of coordination between the individual donors, in the final outcome, often incoherent and largely incredible conditionalities were formulated, which were viewed by the host countries rather as a necessary evil than as useful reforms (Adam et. al. 2004, 2).

Correspondingly small was the will of the partners to implement the policy reforms promised beforehand in a consistent manner.

- Thirdly, the omnipresent pressure of outflowing funds led to a high degree of indulgence on the part of the donors, which further undermined the credibility of the conditionality.
- Fourthly, the "all-or-nothing approach" is characterizing a system, in which the funds or tranches had either been distributed in the full amount or completely frozen, hindered a continuous reform process in the partner countries.
- Fifthly, the traditional policy of constraints dispensed with a sufficient ownership by the host countries for the reforms, since those constraints were specified from outside. Sufficient ownership and commitment are especially essential, however, for the success of reforms. Ordered measures that were not jointly endorsed by the national stakeholders have not been able to influence national policies on a permanent basis.

As a response to the criticism of structural adjustment, the International Financial Institutions (IFIs) resolved at their annual meeting in 1999 to implement a clearer poverty-orientation of their services, which in future should rely on the national PRS. The previous structural adjustment credits of the World Bank were replaced by the Poverty Reduction Support Credit (PRSC). The IMF replaced its previous Enhanced Structural Adjustment Facility (ESAF) by the Poverty Reduction and Growth Facility (PRGF). Through their clear commitment to combating poverty, the IFIs have set an important example. However, the conditions of PRGF and PRSC are still very similar to traditional structural adjustment, "*garnished with some measures, which benefit poor people or are intended to spare these*" (Eberlei / Siebert 2002, 51). In addition, the quality of the public financial management has become a central concern of the donors and is continuously demanded. Without doubt, poverty-oriented and efficient budget management is essential for the implementation of the PRSPs. Concrete specifications in relation to budget planning and execution etc., however, always also signify a significant encroachment upon the sovereignty of the partners, which could have a negative impact on the host countries' own responsibility for the reform programmes.

To promote the ownership of the partners in PBAs and overcome the shortcomings of traditional conditionality, besides (re)-orientation to the contents of PRS, there are other reform proposals that in part signify considerable changes in the financing modalities.

A first reform proposal wishes to link the aid to results and not as previously to political measures. The traditional ex-ante conditionality is to be replaced by a performance-based ex-post conditionality. Such a refashioning of conditionality is in tune with the basic efforts for a greater result-orientation of the development cooperation. The precursor of this approach is the European Commission, which first implemented performance-based tranches in its budget support programmes in 1999 and since then has successively reformed the granting of budget support. Disbursements now depend on a limited number of outcome indicators, through which the outcomes of the policy are recorded and evaluated at the level of the user (European Commission 2002). Outcome indicators used most frequently are e.g. school enrolment rates or the number of births accompanied by medical personnel. The indicators and target values steered for are selected in the dialogue with the partner government and in a typical ideal case this is derived from the PRSP or comparable strategies. How the defined goals and objectives may best be achieved i.e. what policy measures are implemented for these is determined by the government independently. The intention here is to strengthen ownership and improve national accountability. If the outcomes steered for are not reached, this will entail a reduction in the performance-based tranche and not as previously a payment stop. The "all-or-nothing approach", which has led to strong fluctuations in the funding flows, thus yields to a gradual approach and the scope of the funding can be calculated better for the partner government. Up to the end of 2003, the European Commission approved about 30 budget support programmes in the ACP states (Africa, Caribbean, Pacific), which contain performance-based elements.

Other donors attempt to increase the ownership of the partners by structuring the tiering of the tranches and programme phases in such a way that the partner countries are given more scope in the implementation of the reforms. In the case of the floating tranche frequently used by the World Bank, the host countries decide independently about the time at which they introduce the reforms stipulated in advance and thus initiate a disbursement of the funds. In this way, the donors evade the dilemma either to interrupt the programmes entirely or tolerate unfulfilled conditionalities, thereby rendering doubtful their credibility. More recent World Bank approaches (programmatic adjustment lending), which aim at supporting the mid-term reform programmes of the partners, consist of several loans, which must be approved in advance by the Board of Executive Directors. Measures stipulated in advance, on whose implementation the continued existence of the programme depends, can be adjusted flexibly to the given circumstances and their contents can be modified in the event of a failure to achieve the defined goals and objectives (World Bank 2004, 23).

Besides a more performance-based conditionality or more flexible disbursement mechanisms, some authors prefer to restrict budget support to such countries able to produce evidence that they are pursuing "good" policies and which already show sufficient ownership for these policies before granting the budget support.[3] A far-reaching renunciation of conditionality would be associated with this. The evaluation of the country performance, however, contains subjective elements, unless it is based exclusively on quantitatively measurable criteria, such as e.g. data on budget allocation. If, on the other hand, the selection of the country (selectivity) is based on estimates about the relevance and effectiveness of policies, it reveals similar fields of tension to the stipulation of conditions. In addition, only few countries effect a uniformly good performance in all policy areas (Köberle 2003, 259). All in all, most countries show a mediocre political performance. A restriction to cooperation with countries that implement uniformly "good" policies would reduce the number of partners to a mere few and would not be justifiable as a development policy.

3 Challenge for developing countries: public expenditure management

However, the success of PBAs depends not only on a greater results-orientation of donor contributions and the harmonization and adjustment of their modes of delivery. Rather, the

3 The demand for a critical selection of the partner countries is based above all on the work of Burnside and Dollar (2000), who arrive at the conclusion that development cooperation is effective solely subject to the condition of "good" policy. An example of development cooperation based on a country selection evaluating the policy of the partner is the *Millennium Challenge Account* (MCA). 16 of 63 countries, which show a particularly good performance in the areas of legal certainty and economic freedom etc., qualified for this fund, which was set up by President Bush, for the budget year 2004 (MCA 2004).

new approach also makes considerable demands on systems and processes in developing countries. Therefore, public budgets have become a prominent topic in the international debate about programme-based development cooperation; for the awareness is growing that budgets, their preparation, implementation, and finally the monitoring and control are a central element in the political process and for the implementation of poverty reduction strategies (de Renzio 2004). In addition, transparency and possibilities to control public budgets are decisive for political participation and democratization in developing countries.

Through budgets, political priorities are set for the benefit or at the expense of basic social welfare services, military spending or of the machinery of public employees. For poverty-oriented financial management, however, not only the sectoral allocation of domestic and externally financed resources is important: as the World Development Report 2004 shows, services often fail to reach the poor because it's predominantly wealthier groups who benefit most from public spending. „*[…] while governments devote about a third of their budgets to health and education, they spend very little of it on poor people. Public spending on health and education is typically enjoyed by non-poor […]*" (World Bank 2003, 3).

An assessment carried out jointly by the IMF and World Bank in 2002 regarding the extent to which the public expenditure management systems in a total of 24 Highly Indebted Poor Countries (HIPC-Countries) allow a tracking of poverty-reducing spending demonstrates the enormous need for reform in these countries: out of 24 countries, for 15 countries, a need for "substantial upgrading" of the PEM system was established, the remaining nine required "some upgrading" (World Bank / IMF 2002).

Many of the weaknesses of PEM systems established in the course of such assessments are not necessarily specific to developing countries. Rather, they exist in the same or similar form in most industrialised countries, too. However, due to limited human and technical capacities, they are much more disruptive in poor countries and correspondingly more difficult to come to grips with.

3.1 The planning problem: from policy formulation to the budget

For a large number of administrations in developing countries, it is a nearly impossible task to translate the national PRS into comprehensive policy programmes and corresponding medium-term expenditure frameworks (MTEF) that could provide the basis for support through PBAs. In most countries, therefore, there is no or only a very limited direct relationship between the PRS and the public budget. A DFID study of the Ghanaian budget in 2003 comes to the conclusion that out of 30 projects and programmes stated in the Medium Term Priority MTP only 3 were consistent with entries in Ghanaian PRSP. On the other hand, 49 % of the spending estimated for the same year was attributable to programmes not mentioned in the PRSP (Levendo_lu 2003).

At the same time, the reason for this missing link between the PRS and the budget is not necessarily caused by a lack of political will, but rather in insufficient capacities and structures for public financial management, political planning and budgeting. Frequently, the reason for the lack of relationship between the public budget and the national PRS lies in unsuitable budget systems.[4] Significant problems in the preparation of the public budget in line with the political priorities formulated in the PRS also ensue for developing countries in connection with the wide-spread practice of dual budgeting, i.e. separate budgets for investment or development and recurrent expenditures. The main problem with dual budgeting does not consist in the separate presentation of different types of spending (for certain purposes of analysis and control, this is even necessary), but in the separate planning and budget formulation processes. Frequently, the separate budgets are based on different macroeconomic projections, budget classifications and accounting systems, which complicates the reconciliation of the overall budget as well as realistic estimation of the subsequent costs of investments (cf. Ramakrishnan 1998, 16). In addition, often there is an administrative separation of the respective responsibilities between the ministry of finance and a planning ministry, through which the mentioned planning problems become even more important.

3.2 Planning under uncertainty: the dependency of public budgets on external factors

A further considerable problem for PFM in developing countries is the great reliance of the public revenues on external conditions and on factors beyond the control of national governments. Due to the weak economic basis, the importance of the informal sector and the limited capacities of the tax administrations, many countries have to resort largely to the taxation of international trade to generate public revenues. Accordingly, the development of public revenues in most developing countries depends to a significant extent on factors that are difficult to predict, let alone influence by the national governments, particularly on the developments in the world markets and in other countries and regions. As a result, key tasks of PFM, such as the annual budgeting and the mid-and short-term balancing of public revenues and spending become significantly more difficult.

The same applies to the heavy reliance of most countries on bilateral and multilateral donors for the financing of government spending. The ratio of ODA funds to the gross national income in sub-Saharan Africa in 2002 was on average 6.3 %. Countries such as Malawi, Rwanda and Zambia even reached values of up to 20 %. Even more important for the management problem governments and administrations in developing countries face due to the great reliance on donor financing is the share of public expenditures funded by donors. This share is usually difficult to estimate, since, as a rule, corresponding data is only available for the budget of the central government. In most developing countries, however, a considerable share of both own and donor-financed funds is spent locally at the provincial, district and community level. For those countries in sub-Saharan Africa for

4 This is particularly true if a lack of technical and human capacities does not permit a classification of budget items by programmes and activities (cost units) and as a consequence the allocation of funds is carried out solely according to cost centres, eventually further disaggregated according to cost type. Such budgeting systems render both budget planning as well as the monitoring and evaluation of the budget execution in line with the PRS-virtually impossible. Some developing countries work themselves around this problem with so-called virtual poverty funds i.e. the indication of poverty-related expenditures– across sectors, administrative units and the type of costs. While such virtual funds can to a limited extent serve to inventarize the poverty-orientation of the public budget, they cannot provide for a systematic implementation and control of the PRS through coherent government programmes and projects.

which such data is available, the amount of ODA in proportion to central government expenditures fluctuated between 9.6 % in Côte d'Ivoire and 65.5 % in Uganda in the year 2002 (World Bank 2004, 335 f.).

Correspondingly, managing the various donor contributions is a central element of Public Financial Management in many developing countries. The particular challenges differ according to what form (projects, joint financing, general or sector budget support etc.) the donors deliver their contributions. In the case of project-based support, the institutions in the recipient countries concerned with PFM frequently find themselves confronted with the necessity to establish a large number of parallel structures and processes in order to comply with the respective administration and control requirements of the different donors. While joint financing and budget support disburden the scarce administration and control capacities of the partner country partly insofar as these parallel structures can be eliminated, conversely, however, the partner governments at the same time face a much more complex planning problem, which results from the amount of financing made available in the form of budget support being largely unknown when drawing up the national budget

On the one hand, this is due to the fact that donor contributions are in part linked to conditionalities and therefore, can be subject to reductions in the course of the financial year. The gradual approach of the EU described above represents an improvement in this respect. Moreover, the disbursement schedules of donors are usually not synchronized with the national budget calendars, with the result that the annual budget planning in the recipient countries often has to take place under conditions of considerable uncertainty about the funds actually available in the upcoming financial year.

Financial contributions of donors engaging in PBAs can therefore not be taken into consideration consistently when allocating expenditures to the individual sectors and programmes according to strategic priorities. Most notably the World Bank and the EU increasingly make efforts to synchronise their disbursements with the national calendars, in most cases, however, this adjustment has only just begun.

3.3 The problem of implementation: PFM in developing countries

Planning problems of the kind described above often result in significant deviations between the expenditures provided for in the budget and actual spending in the course budget execution, both in respect of the absolute amount and the allocation of funds between and within the individual sectors to individual government programmes and projects. Thus, for example, the difference between budgeted and actual expenditures in the 1990s averaged more than 50 % in Tanzania and more than 30 % in Uganda (Ramakrishnan 1998, 6). An analysis of Public Expenditure Reviews for countries in sub-Saharan Africa in 1999 came to the conclusion that in 22 % of the countries under investigation the deviation of actual from spent amounts government spending was more than 30 %, in 33 % differences between 10 and 30 % and in 44 % differences below 10 % were found.[5]

Besides a lack of planning capacities, it is especially the fiduciary risks inherent to the political and administrative system that lead to a misuse of public funds; for an effective control by government and administrative agencies, audit offices, parliaments and civil society hardly takes place at all in most developing countries and political or legal sanctions for non-compliance with the budget usually don't exist (Kristopoulos 1999, 21 f.). The case of public spending on education in Uganda in the 1990s is a regularly cited example of the lack of accountability resulting from the absence of sanction mechanisms in the public sector. A tracking survey in the year 1996 showed that between 1991 and 1995 only 13 % of government's non-wage expenditure for primary education actually reached primary schools, i.e. 87 % of the funds were either used by public officials for uses unrelated to education or captured for private gain. The relatively simple countermeasure to strengthen the accountability of district officials vis-à-vis the central government and above all the population through the publication of the resources designated for each school in local newspapers, through the announcement in radio and through printed notices at the local schools proved to be extremely effective: random tests showed that in the years 1999 and 2000 the proportion of money reaching the schools had increased to 80 to 90 % (Leiderer 2004, 21).

3.4 The role of the donors: diagnostics and PFM reform

In view of the many weaknesses of PFM-systems in developing countries and their key role for the implementation of poverty reduction strategies, the analysis and evaluation of the institutions and processes involved in the budget cycle, has become an important element of the PBAs. Both the decision regarding the scope and modes of delivery of donor support and the formulation of conditionalities depend crucially on the strengths and weaknesses of the PFM-system diagnosed in each case; for in particular for donors providing budget support there are significant risks that the funds made available by them will not be used, or not used efficiently for the intended purposes. In order to assess these risks realistically and manage them effectively through appropriate conditionalities and the support of necessary reforms, a systematic analysis of PFM and its deficiencies is key.

But a comprehensive analysis of the public financial management systems may also be required for tracking whether the funds made available were used by the partner government for the intended purposes; this applies above all – and this is usually the case – if performance indicators for subsequent disbursements or new financial resources are agreed. Besides the evaluation of the fiduciary risks, the systematic assessment of a country's PFM-system also serves to identify the concrete reform needs and thus as a basis for a comprehensive reform programme. Also, effective monitoring and evaluation of such reforms requires a systematic analysis of the institutional structures and the efficiency of

5 Deviations of sector allocation of more than 30 % were observed for 54 % of the sample in the education sector, for 57 % in the health sector, for 36 % in infrastructure and for 44 % in agriculture. Cf. World Bank (1999).

the PFM-system. In this regard, PFM diagnostics constitute an important element of the political dialogue between donors and partner governments in the context of PBAs.

To satisfy their information needs, various bi- and multinational donors – above all the IMF and the World Bank – as well as a number of international forums and networks are concerned with the development and use of analytical frameworks and diagnostic tools to assess PFM-systems in developing countries. By now, there is a whole bundle of analytical instruments, which each satisfy more or less clearly defined elements of PFM.[6] At the same time, however, the use of many different instruments causes serious co-ordination problems which leads to significant duplications for donors; Still worse, it tends to overstretch partner countries' scarce capacity through uncoordinated donor missions and assessments, which often results in a large number of frequently incompatible recommendations and reform proposals (Leiderer 2004, 52).

At the same time, however, donors also neglect important areas of PFM in their analyses. This applies in particular to the revenue side of the public budget, to politically sensitive areas such as defence and security budgets, and to PFM at the local level. The neglect of sub-national levels of government can be particularly problematic given the increasing importance of local authorities for the implementation of poverty reduction strategies not least due to donors' massive support of the decentralization processes in many developing countries.

Another problem is that most donors focus their analyses almost exclusively on the evaluation of fiduciary risks paying only limited attention to the partner perspective and the development of comprehensive reform strategies. Donors increasingly acknowledge these criticisms and there is widespread agreement that a pure risk assessment of donors providing budget support should no longer take centre stage in future diagnostic work, but more attention must be paid to the joint development of realistic reform strategies and action plans for the improvement of the budget management in the partner countries. As a consequence, several bilateral and multilateral donor agencies founded the Public Expenditure and Financial Accountability (PEFA) Programme, whose main goal consists in the development of a comprehensive approach to PFM analysis and reform. This approach is based on a Performance Measurement Framework, which consists in a set of PFM performance indicators and which is meant to satisfy the information needs of all donors involved in program-based approaches in a particular country. This way, capacities of the partner governments are meant to be freed up and a joint platform for PFM reform may be established.

6 Some of the most important diagnostic tools include the *Public Expenditure Reviews* (PER), *Country Financial Accountability Assessments* (CFAA) and *Country Procurement Assessment Reports* (CPAR) of the World Bank and the *Report on the Observance of Standards and Codes* (ROSC) of the IMF. Cf. Leiderer (2004).

4 Conclusion: experience with PBAs

All in all, despite existing deficiencies in the collection of corresponding data, there is a trend that furnishes proof of the increase of PBAs in development cooperation.[7] In the 9th European Development Fund, the EU Commission has made available around 25 % of its cooperation with the ACP countries in the form of budget support. The World Bank states that programme financing of around 6 % of the total IBRD/IDA loans (financial year 2000) has in all likelihood risen to 19 % in the financial year 2004. Here, the poverty credits (Poverty Reduction Support Credits – PRSCs) play a significant role in supporting the Poverty Reduction Strategies. Moreover, the investment loans, which are increasingly associated with sector investment programmes, must be mentioned. The share of budget support and other PBAs in British bilateral development cooperation is around 15 %. In the context of German bilateral development cooperation, PBAs amounting to around EUR 100m are scheduled or have already been implemented. All in all, for most donors, the question whether PBAs make any sense is hardly ever raised any more, but they concern themselves rather with the matter of how PBAs can be implemented. For partner countries such as Tanzania, where already the largest part of the development cooperation (e.g. in the financial year 2002: 58 %) is made available as PBAs (cf. Frantz 2004, 1), this trend is of immense importance.

Against the background of these tendencies, the question arises how the concrete experience with PBAs has been. It is evident here that to date hardly any critically appraised empirical findings at all have been forthcoming. There is therefore no comprehensive proof that the advantages hoped for actually occur. Conversely, however, to date no empirical findings have come to light either, which would point to fundamental flaws in the approach.

The discussion currently taking place deals mainly with plausibility arguments and concrete, individual experience that was gained with programmes or countries over a shorter time period. Since the effects of PBAs hoped for are mainly of a long-term nature - for example increased ownership, stronger results-orientation in the case of the partners and donors, more effective accounting structures – an actual interim balance is not yet possible.

Despite these restrictions, there are, however, a few indications through forums such as the Learning Network on Program-Based Approaches (LENPA) or inquiries such as the evaluation (OPM/ODI 2003) of general budget support carried out for the DFID and the ongoing investigations by USAID (for example on Tanzania).

Against this background, the findings available can be summarised in six points:

– Sufficient commitment and ownership by the partner are essential. PBAs cannot be far-reaching and successful in the long-term if these preconditions are not satisfied by the partner. The most favourable preconditions, for example in Uganda and Ethiopia are not comparable to those in various countries in West Africa. On the other hand, however, it is also evident in difficult countries that, under rather unfavourable conditions, programme-orientation is perfectly possible, for example

7 The following data relates to the information made available by the LENPA forums (Learning Network on Program-Based Approaches).

through joint financing. The conditionalities for grants and credits must be adjusted accordingly so as not to undermine the ownership of the partners.

- The fiduciary risks of budget support are great even in the positive examples of countries such as Uganda. PBAs depend crucially on the partner side "going along with it". Should this not be the case, the question is raised how development cooperation can "bail out" again, for example in situations where a great responsibility was assumed through budget support. On the other hand, these considerations show that the usage of PBAs is very much more noticeable and visible and it is precisely here that the potential exists. In addition, even in the case of project-related procedures, the risks are partly considerable and the success depends quite significantly on the respective outline conditions.
- The partner side must establish sufficient capacities in order to be able to develop, implement and evaluate strategies. Most important here are the willingness and ability to improve public budget management and the accounting structures.
- PBAs can lead to visible results in the formulation of policies by the partners. Due to the co-ordinated procedure of the donor, the partly considerable volume of the funds and the discussions regarding central policies (see also poverty strategies and sectoral policies), as well as the integration of public budget management, the development cooperation interventions are calculated to exercise a noticeable and positive influence. Evidence of corresponding experience can be provided, for example for Uganda.
- A reduction in the transaction costs for the partner side and the donor is one of the best-known arguments of the advocates of PBAs (see Box 2). This means that due to a reduced number of intentions and common procedures of the donors, it is assumed that the costs might decrease recognizably, for example costs for the preparation of development cooperation negotiations, the large number of implementation activities and the monitoring. However, it has emerged that these costs cannot be reduced, at least in the short-term, since new communication mechanisms must be established, new analytical instruments are required and the entire projects are much more complex (Killick 2003; Killick 2004; GTZ 2004). There is, however, a certain plausibility that (a) lower transaction costs are expected in the mid to long-term and (b) higher transaction costs for PBAs at the same time also produce an improvement in quality.
- Donors must adjust themselves to the new procedure. Necessary above all here is know-how that covers budget questions as well as a presence on site in order to be able to accompany sectoral strategies, budget questions etc. continuously and adequately. Also, for the analysis and evaluation of the budget management and capacity building in this area, ownership by the partners and co-ordination of the donor activities are central.

Box 2:	**Transaction costs**

Transaction costs are costs that arise in order to enable the carrying out of market transactions. These costs do not depend on the production of goods, but on the transfer from one economic subject to another. Typical transactions arise through the search for current products and suppliers, the procurement of information about product qualities, costs of concluding contracts etc. If the number of transactions can be reduced, by individual transactions being consolidated into one transaction, naturally the transaction costs are also reduced.

Transaction costs in the context of development cooperation relate to the preparation, the negotiation mechanisms, the implementation and the monitoring. In principle, in this, three categories of transaction costs may be distinguished (cf. Brown et al. 2000, 7 f.):

Administration costs: These include primarily general administration costs for development cooperation, which in particular comprise wage costs.

Indirect costs: These arise through the provision mechanisms of development cooperation. Examples of the coming into *existence* of indirect costs are: inconsistencies between development cooperation and other public expenditures, undermining of ownership in the case of the partner, delays in payment.

Opportunity costs: These relate to the possible losses of the resources used in comparison with an alternative use of resources (for example: use of working capacities of a government administration for development cooperation in comparison with other responsibilities).

The only study[a] to date that attempts to obtain a quantitative overview of transaction costs is by Brown et al. (2000), carried out for Vietnam. In view of the enormous difficulties and often no longer available data on the recording of transaction costs it is evident, however, that a quantitative monitoring is not practicable.

a Cf. Oxford Policy Management / ODI 2002, 36 f.

Source: Klingebiel 2003, 3

Overall, no clear picture has emerged whether programme-oriented development cooperation is “better” or “worse” than any other form of development cooperation. Last but not least, the initial and outline conditions of the partner countries and the partly very different procedures of the donors, which range from a gradual approach (for example Senegal) to a rapid reorientation of central donors (for example Uganda, Tanzania), makes the variety of influencing factors clear.

In view of the well-known flaws in project-related approaches, the plausible long-term effects and the fundamentally more significant contribution of programme-oriented development cooperation, in principle the approach offers development policy advantages. The concrete procedure and the possibilities of success naturally depend on the respective individual case. Budget support makes no sense, for example in countries without a corresponding commitment and sufficient ownership. However, even in countries with difficult initial conditions, in principle, no good reason has been stated against joint financing for example – i.e. with very wide-reaching control mechanisms – by the donors. The initial conditions and goals for programme-oriented development cooperation should not be confused with one another. This means fully functioning general accounting offices, sufficient planning capacities etc. cannot be made a precondition of programme-oriented development cooperation, but are rather the result of the efforts.

Bibliography

Adam, C. et al. (2004): Performance-Based Conditionality: A European Perspective, in : *World Development*, 32, (6), 1059-1070

Asche, H. / K. Lauckner (2002): Die deutsche Technische Zusammenarbeit in Internationalen Programmen, Handreichung, GTZ, Eschborn

BMZ (Bundesministerium für wirtschaftliche Zusammenarbeit and Entwicklung) (2004): Neue politische Dynamik mit Afrika, Positionspapier zur Entwicklungszusammenarbeit mit Subsahara-Afrika, BMZ-Spezial, Bonn

Bouley, D. / J. Fournel / L. Leruth (2002).: How Do Treasury Systems Operate in Sub-Saharan Francophone Africa?, IMF Working Paper 02/58, Washington, D.C.

Brown, A. et al. (2001): The Status of Sector Wide Approaches, ODI, Working Paper 142, London

Burnside, C. / D. Dollar (2000): Aid, Policies and Growth, in: *American Economic Review*, 90 (4), 847–68.

CIDA (Canadian International Development Agency) (2003): CIDA Primer on Program-Based Approaches, no place

Club du Sahel (2000): Aid Reform, A Review of Aid: Co-ordination Mechanisms, SAH / REFA(2000)3, Paris

Devarajan, S. / D.R. Dollar / T. Holmgren (Hrsg.) (2001): Aid and Reform in Africa. Lessons from Ten Case Studies, The World Bank, Washington, D.C.

Eberlei, W. / T. Siebold (2002): Armutsbekämpfung in Afrika. Neue Ansätze oder alte Konzepte?, INEF Report 64, Duisburg

European Commission (2002): Guidelines for the Use of Indicators in Country Performance Assessment, Brussels

Foster, M. / J. Leavy (2001): The Choice of Financial Aid Instruments, ODI, Working Paper 158, London

Frantz, B. (2004): General Budget Support in Tanzania. A Snapshot of Its Effectiveness, Paper prepared for USAID, no place

GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit) (2004): Synthesis Report, Forum on A-lignment Challenges in Programme-Based Approaches, LENPA-Forum 17 to 19 November 2003, Eschborn

Killick, T. (2003): Macro-Level Evaluations and the Choice of Aid Modalities, Paper prepared for the World Bank Conference on Evaluation and Development, Washington, D.C.

– (2003): Politics, Evidence and the New Aid Agenda, in: *Development Policy Review* 22 (1), 5–29

Klingebiel, S. (2003): Der internationale Diskussionstand über Programmorientierung. Schlussfolgerungen für die deutsche Entwicklungszusammenarbeit, Deutsches Institut für Entwicklungspolitik (DIE), Bonn

Köberle, S. G. (2003): Should Policy-Based Lending Still Involve Conditionality? in: *The World Bank Research Observer* 18 (2), 249–273

Kostopoulos, C. (1998): Progress in Public Expenditure Management in Africa. Evidence from World Bank Surveys, Washington, D.C.

Leiderer, S. (2004): Öffentliches Budgetmanagement in Entwicklungsländern. Analyseinstrumente und Ansatzpunkte der programmorientierten Entwicklungszusammenarbeit, Deutsches Institut für Entwicklungspolitik (DIE), Bonn

LENPA (Learning Network on Program-Based Approaches) (2002): Forum on Accountability and Risk Management under Program-Based Approaches, Synthesis Report, Ottawa

Levendo_lu, E. (2003): DFID Budget Analysis Project, Final Report 29 May 2003

Lienert, I. (2003): A Comparison Between Two Public Expenditure Management Systems in Africa, Africa Region Working Paper Series 28, Washington, D.C.

MCA (Millennium Challenge Account) (2004): http://www.mca.gov/countries_overview.htm

Niederländisches Außenministerium (2001): Memorandum on the Relationship Between Macro-oriented and Sectoral Programme Aid, Den Haag

OECD / DAC (Organization for Economic Co-operation and Development / Development Assistance Committee) (2003): Harmonizing Donor Practices for Effective Aid Delivery, Paris

OPM (Oxford Policy Management) / ODI (Overseas Development Institute) (2003): General Budget Support Evaluability Study, Final Synthesis Report, Oxford

– (2002): General Budget Support Evaluability Study, Phase I, Final Synthesis Report, Report to UK Department for International Development (DFID), (30. Dezember 2002), Oxford

Ramakrishnan, S. (1998): Budgeting and Financial Management in Sub-Saharan Africa. Key Policy and Institutional Issues, HIID Development Discussion Paper, No. 622, Harvard University

Renzio, P. de (2004): Why Budget's Matter. The New Agenda of Public Expenditure Management, Briefing Paper, Overseas Development Institute (ODI), London

Wood, A. / M. Lockwood (1999): The Perestroika of Aid? New Perspectives on Conditionality. Bretton Woods Project, Washington, D.C., http://www.brettonwoodsproject.org/topic/governance/poa2.pdf

World Bank (2004): World Development Indicators 2004, Washington, D.C.

– (2004): Programmatic Adjustment Lending Retrospective, Washington, D.C.

– (2003): World Development Report 2004, Making services work for poor people, Washington, D.C.

– (1999): Public Expenditure Reviews. Progress and Potential, PREMnotes Number 20, http://www1.world-bank.org/prem/PREMNotes/premnote20.pdf

– (1998): Assessing Aid – What Works, What Doesn't and Why?, Washington, D.C.

World Bank / IMF (International Monetary Fund) (2002): Actions to Strengthen the Tracking of Poverty-Reducing Spending in Heavily Indebted Poor Countries, Revision 2, Washington, D.C.

Publications of the German Development Institute

Book Series with Nomos Verlagsgesellschaft

Neubert, Susanne / Waltina Scheumann / Annette van Edig, / Walter Huppert (eds.): Integriertes Wasserressourcen-Management (IWRM): Ein Konzept in die Praxis überführen, 314 p., Nomos, Baden-Baden 2004, ISBN 3-8329-1111-1

Messner, Dirk / Imme Scholz (eds.): Aktuelle Herausforderungen für die Entwicklungspolitik, 410 p., Nomos, Baden-Baden 2004, ISBN 3-8329-1005-0

Brandt, Hartmut / Uwe Otzen: Armutsorientierte landwirtschaftliche und ländliche Entwicklung, 342 p., Nomos, Baden-Baden 2004, ISBN 3-8329-0555-3

[Books may be ordered through bookshops]

Book Series with Weltforum Verlag

118 *Ashoff, Guido*: Der Entwicklungshilfeausschuss der OECD und die deutsche Entwicklungszusammenarbeit: ein Verhältnis auf dem Prüfstand, 182 p., Bonn 2000, ISBN 3-8039-0497-8

117 *Scholz, Imme*: Nutzung natürlicher Ressourcen zwischen Raubbau und Nachhaltigkeit: Sozioökonomische Bedingungen und unternehmerische Handlungsmuster, 446 p., Bonn 1999, ISBN 3-8039-0492-7

116 *Neubert, Susanne*: Die soziale Wirkungsanalyse in armutsorientierten Projekten. Ein Beitrag zur Methodendiskussion in der Evaluationspraxis der Entwicklungszusammenarbeit, 139 p., Köln 1999, ISBN 3-8039-0487-0

[Books may be ordered through bookshops]

Reports and Working Papers

11/04 *Scholz, Imme et al.*: Sociedade civil e política ambiental na Amazônia. Os casos da berragem de Belo Monte e da rodovia federal BR-163, 85 p., Bonn 2004, ISBN 3-88985-272-6, **D:** ISBN 3-88985-260-2

10/04 *Qualmann, Regine et al.:* Negotiating Economic Partnership Agreements with the EU. Opportunities, Risks, and Negotiation Options for Tanzania, 70 p., Bonn 2004, ISBN 3-88985-270-X

[Price: 9.63 Euro; may be ordered directly from the Institute or through bookshops. This publication series was terminated and superseded by the new publication series “Studies” starting November 2004]

New publication series from November 2004

Studies

3 *Brüntrup, Michael:* Agrarwirtschaftliche Interessenlage und agrarpolitischer Handlungsbedarf subsaharischer Länder aufgrund der Agrarverhandlungen in der Doha-Runde am Beispiel Tansanias und Senegals, 187. p., Bonn 2005, ISBN 3-88985-279-3

2 *Herrfahrdt, Elke:* Landwirtschaftliche Transformation, Desertifikation und nachhaltige Ressourcennutzung. Fallbeispiel Usbekistan, 134 p., Bonn 2004, ISBN 3-88985-274-2

1 *Grävingholt, Jörn*: Crisis Potentials and Crisis Prevention in Central Asia. Entry Points for German Development Cooperation, 114 p., Bonn 2004, ISBN 3-88985-273-4, **D:** ISBN 3-88985-266-1 (Reports and Working Paper 6/04)

[Price: 10.00 Euro; may be ordered directly from the Institute or through bookshops]

Discussion Paper

2/2005 *Klingebiel, Stephan:* How much Weight for Militäry Capabilities? Africa's New Peace and Security Architecture and the Role of External Actors, 34 p., Bonn 2005, ISBN 3-88985-282-3

1/2005 *Klingebiel, Stephan:* Wie viel Gewicht für militärische Fähigkeit? Die neue Friedens- und Sicherheitsarchitektur Afrikas und die Rolle externer Akteure, 32 p., Bonn 2005, ISBN 3-88985-281-5

6/2004 *Scholz, Imme:* A Forest Convention – Yes or No? Position paper for the BMZ on the state and the perspectives for creating a legally binding instrument for international forest policy, 30 p., Bonn 2004, ISBN 3-88985-280-7, **D:** ISBN 3-88985-275-0

5/2004 *Roheder, Katja:* Entwicklungspolitische Handlungsfelder im Kontext erodierender Staatlichkeit in Subsahara-Afrika, 40 p., Bonn 2004, ISBN 3-88985-278-5

4/2004 *Altenburg, Tilmann / Andreas Stamm:* Towards a More Effektive Provision of Buisness Services. Conceptual Considerations and Practical Examples from Thai-German Development Cooperation, 25 p., Bonn 2004, ISBN 3-88985-277-7

3/2004 *Faust, Jörg / Dirk Messner:* Europe's New Security Strategy – Challenges for Development Policy, 23 p., Bonn 2004, ISBN 3-88985-276-9

[Price: 10.00 Euro; may be ordered directly from the Institute or through bookshops]

D: = German **E:** = English

A complete list of publications available from DIE can be found at:

http://www.die-gdi.de