

Partnership General Budget Support in Malawi



The Joint Evaluation of General Budget Support 1994-2004

In 2004 a group of 17 donors and 7 partner governments commissioned a joint evaluation of General Budget Support (GBS). Its purpose was:

to assess to what extent and under what circumstances GBS is relevant, efficient and effective for achieving sustainable impacts on poverty reduction and growth.

The outputs of the study are a Synthesis Report, and seven country case studies, for Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda, and Vietnam.

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Background: Aid and Development in Malawi

Malawi ranks amongst the 10 poorest countries in the world, with a gross national income (GNI) per capita of approximately USD 160 (2003). The national household survey estimated that two-thirds the population were living in poverty in 1998. The economy is open and vulnerable to shocks; it has a narrow base and lacks key social services and infrastructure. The country is highly dependent on aid. External contributions to the total state budget have fluctuated between 33% and 57%, with project-tied aid as the main external source of funding.

Following Malawi's first multiparty elections, a new government took office in May 1994. This led to significant increases in commitments by bilateral donors and several of them established representative offices in the country in order to support expanded country programmes.

However, successive governments have had a poor record of fiscal discipline. In the run-up to the 1994 elections, the overall fiscal deficit almost tripled – to 15% of gross domestic product (GDP). In 1998/99, the deficit reached 5.1% of GDP. From 2001 until the current government took office in July 2004, fiscal expenditure overruns escalated. The fiscal deficit was 8% of GDP in 2001 and 12% of GDP in 2003.

Box 1

Overview – failure of PGBS to take root in Malawi

Because of frequent suspensions, there was not a steady flow of PGBS funds during the evaluation period. This meant PGBS could not be expected to have the long-term and institutional effects hypothesised in the evaluation framework. This country evaluation therefore focused more on the initial conditions for PGBS, drawing lessons from early experiences in a difficult context.

Origins and Design of PGBS

Debt Relief and the HIPC initiative

Malawi benefited from debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. Interim debt relief began in 2000, when Malawi prepared an interim Poverty Reduction Strategy Paper (PRSP). This was also the basis for the first Poverty Reduction and Growth Facility (PRGF) arrangement with the IMF. The full PRSP followed in 2002.

Pro-Poor Expenditures (PPEs) was a concept introduced as part of HIPC negotiations. The total level of annual funding for PPEs was expected to increase by at least as much as the HIPC debt relief provision. Since 2001/02, PPEs have become a standard feature of the budget, and are supposed to be protected in the event of shortfalls in revenues.

The Evolution of PGBS in Malawi

The donor approach to Malawi can be divided into three periods:

- In the period 1994 to 1999, dialogue was led by the International Monetary Fund (IMF) and the World Bank, which emphasised macro-stabilisation, trade liberalisation and structural reforms. In addition, the dialogue following public expenditure reviews (PERs) centred on allocation

of public resources for pro-poor expenditure (PPE).

- From 2000 to 2004, there was greater emphasis on public finance management and support for Malawi's poverty reduction strategy. In this period a group of donors established a joint working arrangement – the Common Approach to Budget Support (CABS), which, in the context of this study has been labelled PGBS. However, due to Malawi's failure to comply with PRGF conditions, budget support was frequently suspended.
- The final period began in July 2004, when a new government took office, and there were renewed efforts to establish PGBS.

Box 2

The CABS group of donors

The group was originally made up of the UK, Norway, Denmark and Sweden. The European Commission joined later, but Denmark withdrew from Malawi in 2002.

The World Bank, the IMF and Germany have attended as observers. Disbursements by the CABS group have in practice been closely linked to the IMF's Poverty Reduction and Growth Facility.

What is Partnership General Budget Support?

- General Budget Support (GBS) is aid funding to government that is not earmarked to specific projects or expenditure items. It is disbursed through the government's own financial management system. The finance is accompanied by other "inputs": conditions and procedures for dialogue, donor efforts to harmonise their aid and align it with national policies and procedures, and technical assistance and capacity building.
- In the late 1990s "new GBS" or "partnership GBS" (PGBS) emerged as a response to dissatisfaction with earlier aid instruments. "Partnership" is contrasted with the imposed conditionality of the structural adjustment era. PGBS is intended to support partner countries' poverty reduction strategies. By channelling funds through national systems, it also aims to strengthen national planning and implementation capacity, increasing the effectiveness of all public expenditure, including aid. .

Approach to the Evaluation

- The evaluation was not intended to compare budget support with sector support or project aid. However, the evaluators found that there is not a sharp distinction between general and sector budget support, that many of the non-financial inputs to PGBS are shared across aid modalities, and that interactions between PGBS and other modalities are important in explaining its effects.
- The evaluation was based on a logical framework: this identified the inputs of PGBS and then traced its various possible effects from inputs to activities to outputs, outcomes and impacts.
- PGBS has been operating for only a few years, and it is often just one among a number of influences on outcomes and impacts. This makes it difficult to be certain about its long-term effects, but medium-term effects are clearer. The study set unusually rigorous standards for an aid evaluation, and applied the same methodology consistently across the seven countries.
- This was an independent evaluation. Its findings and recommendations are those of the evaluation team.

Box 3: Did PGBS change the level or composition of aid to Malawi?

The volume of PGBS has varied significantly due to suspensions. The combined volume of PGBS and other unearmarked programme aid, even when PGBS has been disbursed, has been less than the annual flows of unearmarked programme aid prior to PGBS. The team concluded that PGBS in Malawi was essentially a new label for GBS (albeit with an added emphasis during the 2001–2004 period on alignment and harmonisation) following a long history of previous GBS operations.

Design

The rationale for adopting a joint approach in Malawi was to harmonise donor efforts, improve donor–government and donor–donor dialogue and reduce transaction costs. From the outset, each CABS member had a separate agreement and conditions with the government. All except Norway made IMF on-track status an explicit condition. Initially, the CABS conditions were focused on macroeconomic and public finance management, but they subsequently became more focused on conditions drawn from the PRSP documentation. General poverty indicators were replaced with a concern with the PRSP monitoring framework itself. The EC system linked some of its disbursement to outcome indicators. In 2005, a Performance Assessment Framework (PAF) was being developed. This aggregated the CABS indicators into a single matrix, but each participant would still make a separate disbursement decision.

Disbursements

Disbursements of PGBS-type budget support began in 2000/01, but were suspended in 2002/03. In the first two years, PGBS was equivalent to between 5% and 10% of government expenditure. In 2003/04, PGBS restarted with flows equivalent to 2% of government expenditure, rising to 4% in 2004/05. At its peak in 2001/02, PGBS still represented only 12% of total official development assistance (see Table 1).

PGBS effects on public expenditures and service delivery

Public expenditures

During the period under review, committed PGBS was suspended because of poor fiscal performance by the government. This did not curtail government expenditure, which continued unabated, resulting in increased domestic debt and service costs, low growth and poor macroeconomic performance. There was no improvement in fiscal discipline, nor was there any tailoring of expenditure as a result of the suspension in funding. Nor was there a

shift towards pro-poor expenditures, despite efforts by donors to promote such a shift. Predictability of funding was weakened by the interaction of donor conditionality and government fiscal indiscipline (see Box 4). Donors were concerned to protect pro-poor expenditures (PPEs), and this concern probably contributed to keeping a floor on such expenditures despite macroeconomic instability, but there was no shift towards PPEs away from non-PPE spending. PGBS donors contributed to an overall effect driven as much, if not more, by considerations for IMF PRGF conditionality and for HIPC as well as by non-PGBS donors.

Box 4: Was the Suspension of GBS in Malawi a Surprise?

The macroeconomic problems that followed suspension of GBS in Malawi from 2002 were severe. Within Malawi, there is sometimes a causal linking of the suspension to these problems as if the fault were the donors'. Donors point to the breach of conditionality by the government, most notably being off-track with the PRGF. They argue that the government should have anticipated suspension.

The team discussed this with a number of those involved, both politicians and civil servants. Civil servants, particularly those at the heart of the policy dialogue in the Ministry of Finance, saw that suspension was inevitable if weak fiscal discipline continued. They may have been uncertain of the precise timing of suspension, but regarded it as bound to happen. They argued that they had sought better financial controls because of their concern about the likely consequences of suspension, but were not adequately supported by key politicians.

Some ministers and parliamentarians shared this view and argued that the problem lay at the very top of the political executive, where there was a failure to understand that donors would indeed suspend. This may have been exacerbated by donors initially exercising their discretion not to suspend immediately.

When suspension did happen, civil servants involved said that it did surprise those at the top of the political ladder, who thought perhaps that they had done enough to comply with donor conditions despite being in breach of formal conditionality. This may suggest that policy dialogue had not been sufficient to reach the top of the political ladder.

Table 1: Partnership General Budget Support and Total Aid in Malawi

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total ODA (actual) (USDm)	488	464	530	375	477	489	489	455	423	571	555
Total Partnership GBS disbursements (USDm)							58	48	0	14	28
PGBS as % total ODA (%)							12%	11%	0%	3%	5%
ODA as % GNI (%)	41%	32%	22%	13%	25%	26%	26%	24%	21%	31%	27%

PGBS did not in practice provide steady funding for PPEs, and predictability of funding was weakened by the interaction of donor conditionality and government fiscal indiscipline.

Delivery of Public Services

In the absence of a steady flow of funds, no significant PGBS effects on service delivery could have been expected.

PGBS Effects on Poverty and Growth

Malawi lacks good time-series data from which trends in poverty could be established. In any case, a significant impact on poverty could not be expected from the intermittent flow of PGBS funds. Nor was PGBS successful in stabilising macroeconomic performance.

Institutional Effects of PGBS

Donor efforts to improve planning and budgeting systems have a long history in Malawi, but with only limited results. However, some progress was made (2000 to 2004) in improving the legal basis for public finance management. Since 2004, there have been improvements in planning and budgeting systems, though support for these came chiefly from non-PGBS funding. The PGBS donors did play a significant role in the development of domestic accountability and transparency systems – particularly anti-corruption, where PGBS donors were the main financial supporters of the Anti-Corruption Bureau. The hypothesis that reliable on-budget discretionary finance might systemically strengthen budget and policy processes was not really tested in Malawi during the evaluation period.

PGBS and Aid Effectiveness

Relevance

The design of PGBS in Malawi responded to the local context but was inevitably **risky**. It placed considerable weight on the PRSP, but this involved definite risks given the government's record on policy implementation and fiscal discipline. The donors' underlying analysis recognised risks mainly in terms of the financial, political and economic circumstances and their likely developments. Efforts to mitigate risk focused primarily on fiscal management rather than on political risks. In the risk analysis, political risks in terms of commitment and policy priorities were relatively understated, while positive signs of progress were often overstated. Since the 2004 election, the design has been adjusted to respond to the evolving context.

There have been relatively **low levels of government ownership** in the PGBS process. Conditionalities reflected donor rather than government concerns. Stakeholders came up with different explanations for suspensions (see Box 4).

Since 2004 there have been some signs of stronger government commitment, most notably in the increased role of parliament in scrutinising the budget.

Harmonisation and alignment

The 2001–2004 PGBS represented a more closely coordinated effort among the donors. It served as a joint working arrangement to harmonise reviews and provide one, rather than several, avenues for government–donor dialogue. CABS was thus seen as a vehicle for improved dialogue and coordination.

There were some improvements in alignment with Malawi government policy instruments – including the Malawi poverty reduction strategy – although these instruments were at an early stage of development. The real question is how far it is possible to align meaningfully with weak policies and systems.

While the CABS PGBS has led to one coordinated dialogue with respective donors, the funding from each of the donors has been guided by separate bilateral agreements. These reveal that the donors have maintained different emphases, conditions and triggers for the release of funding (e.g. not all donors required the government to have a PRGF programme with the IMF). The CABS group thus created a joint working relationship for improved coordination of the donor/government dialogue, but did not fully harmonise conditions linked to the support.

Interaction of aid modalities

PGBS has been one aid modality among others and the limited impact of PGBS has meant that the indirect effect on other aid modalities has been muted.

Transaction costs

The transaction costs of PGBS itself have been low; but project funding has continued as the dominant donor approach. Thus the aggregate

transaction costs of aid have not declined.

Unintended Effects of PGBS

Application of PGBS conditionality in a difficult context led to increased **unpredictability** of aid. When PGBS was suspended due to non-compliance with conditions, there were no sustained measures by the government to control expenditure. Indeed, expenditure continued to far exceed budget ceilings, despite the shortfall in PGBS receipts. The result was an accumulation of increased domestic debt, increasing debt service costs and **adverse effects on private investment and prospects for growth**. The underlying cause of these perverse effects on macroeconomic performance was the government's poor fiscal performance, which led the CABS donors to suspend PGBS which, in turn, further worsened the situation.

Sustainability – Feedback and Learning

There was some learning from the PGBS experience. The government learned that the threat of suspension is real, where it fails in its commitments. Donors have learned that suspension needs to be managed to avoid fiscal shocks. Sustainability needs to be based on macroeconomic stability, in order to prevent the effects on poverty that result from economic crisis. A more stable PGBS contribution requires a focus on basic stabilisation measures and fiscal performance.

Overall Conclusions

The full logic of the framework for this evaluation could not be tested in Malawi, due to frequent suspensions of PGBS.

The Malawi case suggests that political governance is a key entry criterion for PGBS. Moreover, the intentions of the government with respect to sound financial management and poverty reduction need to be established rather than assumed.

It should also not be assumed that conditionality can substitute for, or promote, ownership. The assumed incentives associated with PGBS were not effective in Malawi.

In short, embarking on a PGBS process

Box 5: Cross-cutting issues

The evaluation found a limited relationship between the cross-cutting policy issues and PGBS. **Gender** and **HIV/AIDS** were included as indicators for performance assessment, and some donor decisions were influenced by **human rights** and **democracy** issues. **Environmental** issues, although important, were not addressed through PGBS.

– with multiple process, output and outcome targets in support of ambitious poverty reduction policies – is unlikely to achieve the intended results where weak political governance, lack of ownership and limited capacity are the binding constraints to policy implementation.

Future Prospects

The change of government in 2004 resulted in improved donor-government trust, and PGBS restarted. The CABS donors developed a performance assessment framework and introduced a joint framework agreement with the Malawi government. Some donors also

released previously suspended budget support as an incentive to improve fiscal management. (The PRGF also later resumed.)

PGBS prospects are now more promising, based on more limited objectives and signs of improved governance and fiscal discipline. While the focus of this “new” PGBS is on macroeconomic stability, the rationale is to prevent the potential poverty impacts of a severe economic crisis

Post-2004, the Malawi Government and politicians have learned that the donors’ sanction of suspension of PGBS is real, while the donors have appreciated that

a more limited objective is perhaps more appropriate for continued PGBS in the circumstances. And that suspension needs to be managed well, especially in the short term, to avoid fiscal shocks. They are now treating PGBS as a medium to long-term obligation. Thus the long-term view is an optimistic one in which PGBS can play a positive role.

This means that PGBS is being used in a similar way to the programme aid of the mid-1990s, where it focused on basic stabilisation measures and fiscal performance, rather than on the full range of issues addressed in the PRSP.

Recommendations

Political Governance and PGBS Design

- The decision as to whether to go ahead with PGBS should be based on an assessment of political governance, fiscal performance and public finance management capacity.
- Donors and the Malawi government need to focus on capacity development, as well as policy formulation and implementation.
- Moreover, when designing PGBS conditionalities and sanctions, donors need to consider carefully the potential impact of suspension of PGBS on macroeconomic stability.
- Where donors assist in difficult policy contexts (like Malawi), they should commit to the medium to long term.

Harmonisation

- Continued effort is required to make PGBS a vehicle to improve harmonisation among a wider group of donors.

Monitoring

- In order to monitor PGBS meaningfully, a baseline and effective monitoring system must be developed prior to, or in early stages of, the PGBS arrangement.

Feedback

- Donors and government need to strengthen feedback to all country stakeholders, including parliament and civil society.

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