

# Partnership General Budget Support in Nicaragua



## 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 Nicaragua

Nicaragua is one of the poorest countries in Latin America. It has a small, open and vulnerable economy. A series of structural adjustment programmes in the 1990s aimed at restoring macroeconomic stability. However, while still in a period of democratic transition following years of civil war, Nicaragua has endured a succession of crises. In 1998 Hurricane Mitch ravaged the country. More recently, the economy has been affected by a banking crisis (with the collapse of several commercial banks in 2000–2001) and also by a political crisis that culminated in the prosecution of former President Alemán and government officials on charges of corruption.

Nicaragua is heavily dependent on aid from a wide range of bilateral and multilateral aid partners. During 1994–2004, official aid flows averaged more than 20% of gross national income (see Table 1). During the period 1994–2004, the relationship between the government and donors was strongly influenced by political developments. Donors were keen to support President Bolaños after his election in 2001

because of his commitment to end corruption, his previous involvement in public sector reforms and his approach to partnership. At the same time, recent years have seen a progressive deterioration in the relationship between the Executive and the National Assembly, with the latter using its political power to slow down the pace of structural reforms.

### Origins and Design of PGBS

*Debt Relief and Poverty Reduction Strategy*

During the period 1994–2004, dialogue opened up from a mainly macroeconomic focus to include poverty reduction and governance issues. This change was influenced by the Heavily Indebted Poor Countries (HIPC) initiative and the Poverty Reduction Strategy Paper (PRSP) process. Nicaragua arrived at the decision point of the HIPC initiative in December 2001 and the completion point in January 2004. The size of debt forgiveness available was crucial in driving the pace of institutional reforms carried out by the government in a relatively short period.

The first PRSP (known by its Spanish

acronym ERCERP) was approved in 2001. With the arrival of the Bolaños administration there was a significant shift in the government's poverty reduction strategy, from the initial focus on social expenditure for poverty reduction to sustained economic growth through support to local development and productive clusters. This was reflected in the National Development Plan (PND) presented to donors in August 2003. In September 2004 the operational version (PND-O), covering 2005–2009, was launched.

*The Evolution of PGBS in Nicaragua*  
HIPC-inspired reforms and evolving national strategies were one crucial element in preparing the ground for PGBS. Another was the Bolaños administration's new approach to aid management and coordination. This was based on sector roundtables and the development of sector-wide approaches (SWAPs). A further element was the Poverty Reduction and Growth Facility (PRGF) agreement with the IMF. After PRGF2 was signed in 2002, the international aid coordination forum began discussing sector and general budget support in 2003. There was growing consensus that the highly earmarked,

### Box 1: Overview - PGBS under development in Nicaragua

PGBS in Nicaragua is still in a formative stage. There were very limited flows of PGBS finance during the evaluation period (see Box 2). A multi-donor approach to PGBS was under development but agreement was not reached until 2005. It was thus too early for a proper retrospective evaluation. The study therefore sought lessons from the design and preparatory stages of PGBS and considered its prospects in the specific circumstances of Nicaragua.

### 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.

fragmented and supply-driven character of aid in Nicaragua was hampering its effectiveness. A key initiative was the formation in 2003 of the Budget Support Group (BSG) – see Box 2.

PGBS design has been evolving throughout the evaluation period. Significant differences in approach among the potential PGBS donors and their concern to limit perceived

risks made agreement on a joint approach more difficult. The multi-donor Joint Financing Arrangement (JFA) provides a common approach for 2005 onwards.

#### The PGBS Design

Before the JFA was concluded, Sweden (in 2002) and the EC and WB (both 2004) had begun disbursing forms of PGBS. The WB instrument was a Poverty Reduction Support Credit (PRSC), while the EC provided unearmarked funding linked to education sector support. The JFA incorporates the existing Swedish, EC and WB programmes, and also includes two other EC programmes and other bilateral commitments. The JFA establishes mechanisms for dialogue, review, disbursement and reporting. The Performance Assessment Matrix (PAM) annexed to the JFA is a key instrument for reviewing performance and justifying disbursement. Differences in approach are still significant, particularly with regard to the link between conditionality and disbursement, the type of indicators, and the use of technical assistance.

### Box 2: The Budget Support Group and Participants in PGBS

The Budget Support Group (BSG), formed in 2003 with a rotating leadership, is the donor forum for discussing budget support. It has involved a wide group of bilateral and multilateral agencies, including the European Commission (EC), Finland, Germany, the Inter-American Development Bank (IADB), the Netherlands, Norway, Sweden, Switzerland, the United Kingdom (UK) and the World Bank.

The BSG developed a Joint Financing Arrangement (JFA) for budget support; this was eventually signed in mid-2005 by nine donors and the Nicaraguan government. However, a number of influential large donors (Japan, IADB, Spain and USAID) are operating outside the JFA. The IMF is not a JFA signatory nor a member of the BSG, but its PRGF plays a crucial role in setting the macro-economic framework for budget support.

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

PGBS disbursements in Nicaragua have been very limited, and PGBS has been provided mainly as a substitute for, rather than additional to, project aid.

### Disbursements

Table 1 shows the limited PGBS disbursements that took place towards the end of the evaluation period. PGBS grew from USD 6m (1% of official aid) in 2001, to USD 63m (4% of official aid) by 2004. (The JFA anticipated a doubling of PGBS funding in 2005, but disbursements were delayed and then scaled back because Nicaragua had not remained on track with the IMF.)

### PGBS Effects on Public Expenditures and Services

The flow of PGBS funds is very recent, and requires caution in assessing its effects.

- PGBS is given in substitution rather than in addition to project aid.
- PGBS in 2004 only accounted for 10% of 'poverty-reducing public expenditures' (PRPE).
- Since 2002, PRPE as a share of percentage of public expenditure and GDP has risen; as that same period saw inflows of HIPC funds, the specific effect of PGBS is not clear.
- It is too early to tell whether PGBS is likely to lead to an increase in resources for service delivery.
- PGBS funds are on-budget but the specific contribution of PGBS to increasing discretion is still marginal and it is too early to observe any systemic effects.

### PGBS Effects on Poverty and Growth

- It is too early to assess the macro-economic impact of the recently begun PGBS financial flows. They have the potential to continue the stabilising effect of financial aid to the Bolaños government since late 2001, both in their direct financial effects and by supporting IMF conditions. However, positive effects may be offset by volatility in disbursement.
- No discernible poverty impacts could be expected in the very short time frame of PGBS so far.

### Potential Institutional Effects of PGBS

*Planning and Budgeting Systems*  
Since the 1990s donors have been supporting the improvement of planning and budgeting systems in Nicaragua.

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

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total ODA (actual) (USDm)	629	701	962	463	714	746	588	988	546	890	1,582
Total Partnership GBS disbursements (USDm)									6	8	63
PGBS as % total ODA (%)									1%	1%	4%
ODA as % GNI (%)	24%	23%	31%	13%	18%	19%	15%	24%	13%	21%	29%

- Technical systems underpinning planning and budgeting processes have been strengthened, with assistance from donors; however, there are underlying systemic weaknesses such as the fragmentation of responsibilities among government agencies.
- PGBS reinforces the trend towards using government accountability systems, but these systems are not themselves very strong.
- The proportion of external funds that are 'on-treasury' has increased following the 2001 establishment of a Single Treasury Account (CUT). However, this does not mean that all funds are fully 'on-budget' as the funds administered through the CUT include separate project funds.
- It is too early to judge the systemic effects of PGBS on the budget process.
- PGBS continues and reinforces a number of improvements motivated by the HIPC process, but its direct impact at this early stage is negligible.

#### *Policies and Policy Processes*

Since 2003 the BSG has been a counterpart to the government in the dialogue about pro-poor reform. This dialogue has played an important role in the evolution from the PND to the PND-O, by expanding consultation and including aspects that were originally under-developed. There have also been improvements in government sector planning and aid coordination. Progress is most noticeable in those sectors, such as education, where a SWAp exists and the corresponding sector roundtable has worked effectively. PGBS draws on and contributes to this overall coordination process. The JFA review mechanisms should enhance the effectiveness of sector working.

#### *Government Capacity and Capacity Building*

PGBS design has paid limited attention to plans for capacity building and human resources development. The Public Sector Technical Assistance Credit (PSTAC) –

the main TA support associated with PGBS – is used primarily to pay the salaries of key officials. This approach attracts well-qualified staff to implement reforms, but is highly detrimental to sustainable capacity development and institutional strengthening.

### **PGBS and Aid Effectiveness**

#### *Relevance*

PGBS design addresses well-documented weaknesses in previous aid operations, notably lack of country ownership and fragmentation associated with projects. Preparatory assessment for PGBS included an array of public finance management and risk analyses. Overall the minimum conditions for the development of PGBS were judged to be in place.

However, the Nicaraguan context poses severe difficulties: macroeconomic uncertainties which threaten the continuity of PGBS flows; the institutional fragmentation of the government; the rift between the executive and legislature; and the lack of a well structured civil service.

### **Harmonisation and Alignment of Aid**

PGBS development has provided impetus to harmonisation and alignment. However:

- Policy alignment is constrained by changes and weaknesses in the national policy documents with which donors align.
- The government's roundtable initiative is an important advance, but the extent of government leadership is limited and varies significantly between sectors.
- The single treasury account has boosted alignment with government financial systems for all forms of aid, but does not bring all funds fully on budget.
- PGBS itself is in principle aligned with the government planning and budget cycle, but delays to JFA disbursement have undermined alignment in practice, and PGBS donors still have a short planning horizon.

- Key government institutions outside of the new planning and budgeting systems are also funded by PGBS donors through other aid modalities, detracting from greater donor alignment with government efforts at improved financial management. (Some of the bilateral JFA signatories also provide support to poverty reducing public expenditure through the Supplementary Social Fund [FSS], which has been protected from constitutional earmarking but is not fully integrated with regular government planning and budget systems.)
- Collaboration among BSG participants has strengthened donor harmonisation, but as some large and influential donors are operating outside of the JFA, progress is limited.

#### *Quality of Partnership*

**Ownership** – Despite the appearance of government ownership, there are reservations regarding its depth and effectiveness; strong conditionality on macroeconomic and finance management issues demonstrates the dominance of the donors within the relationship. This reinforces the government's perception that conditionality has not significantly changed. The fragmentation of Nicaraguan politics and administration, and the volatility reflected in the re-drafting of national strategies, inevitably limits the strength of national ownership.

**Interaction of aid modalities** – For PGBS donors, PGBS remains part of a broader portfolio. The sector roundtables are an important government initiative to coordinate the different aid modalities at sector level. However, there is a lack of clear strategies to determine the best deployment of different aid modalities.

**Transaction costs** – Government transaction costs in using PGBS will be lower than for project aid because of the reliance on its own systems. But the initial transaction costs of developing and introducing PGBS systems are high, and government ownership inevitably makes demands on high-level skills within the government.

### **Risks and Unintended Effects of PGBS**

#### *Unpredictability*

In principle PGBS should increase the predictability of aid flows channelled through the official public expenditure system. However, there is a significant danger of a perverse effect if government failure to meet conditions leads to suspensions or delays in disbursement. So far

### **Cross-cutting issues in the Joint Financing Arrangement**

- **Gender:** The JFA states as an aim the reduction of inequality between men and women, and has some specific gender-focused indicators, although this issue is unevenly covered.
- **HIV/AIDS:** Two HIV/AIDS indicators are included in the JFA, but little effort is made to ensure mainstreaming through policies and sufficient funding.
- **Environment:** The JFA includes support to sector plans and the plan for rural development and water and sanitation. However, there are concerns that the PND does not pay sufficient attention to urban pollution; neither does the JFA systematically relate environmental issues to the most vulnerable and poor groups.
- **Democracy and human rights:** The JFA includes a section on governance, focusing on justice, human rights and citizen security and participation. This indicates the importance that PGBS donors give these issues in their partnership with the government.

PGBS has not succeeded in increasing the predictability of aid.

#### *Public sector bias?*

The JFA embraces the overall approach of the PND, which includes a very strong private sector development policy as part of the new poverty reduction strategy, based on economic growth rather than social services.

#### *Fiduciary risks and corruption*

The fight against corruption is one of the JFA's fundamental principles and is very much on the political agenda. The JFA focuses on financial accountability and transparency and other aspects of fiduciary risks. PGBS donors have to balance immediate fiduciary risks against the

prospects of strengthening fiduciary standards through PGBS inputs.

### **Sustainability – Feedback and Learning**

National monitoring and evaluation systems are patchy, and systematic feedback to policy making is limited. The JFA represents progress in developing joint review mechanisms, but there is a danger that they become an additional and over-ambitious donor requirement, rather than being embedded in national systems. In its early versions, at least, the PAM primarily serves the interest of donors.

### **Overall Conclusions**

PGBS in Nicaragua is still in a

formative stage – so much so that it is still too early for a proper retrospective evaluation. It has made a promising start to tackling deep-seated problems of aid in a difficult political and institutional environment. The strongest PGBS effect so far is the boost it has given to harmonisation among donors, from a very low base.

### **Future Prospects**

PGBS will need to evolve further as the JFA is implemented, taking account of potential complementarities between different aid modalities. The evaluation's recommendations focus on critical issues for design and implementation.

## **Recommendations**

### **Design**

- Dialogue should involve a wider cross-section of the state and civil society.
- Ensure more inclusive involvement of donors, to attain a critical mass of PGBS funding.
- Put the coherent planning of public services, investments and revenues at the centre of PGBS, linked to a medium-term budgetary framework and a medium-term reform timetable.
- Government and donors should review the definition of pro-poor expenditure including discussion of constitutional earmarking.

### **Aid coordination**

- Donors and the government should treat sector budget support, project aid and PGBS approaches as complementary.
- Donors should forge clearer links to the IMF in relation to policy dialogue and performance assessment on structural and macroeconomic policies.
- IADB participation in the BSG should lead to its policy-based loans and relevant TA credits becoming part of the JFA.

### **Capacity building**

- Focus on the key institutional improvements for a stronger civil service.
- Government, supported by donors, should integrate funding for technical expertise into PGBS via human resources plans for departments.
- Paying government staff with targeted aid funds should be brought to an end.

### **Monitoring**

- Donors and the government should support national monitoring and evaluation of both the National Development Plan and Performance Assessment Matrix, spelling out results chains and increasing gender and regional disaggregation in indicators.
- Donors and government should seek convergence between PAM and PND targets.

### **Commitment and disbursement procedures**

- Donors should avoid all-or-nothing disbursement of PGBS and revise the system of conditionality accordingly.
- Donors should improve commitment procedures to allow better budget planning by the government.
- The fragmentation of funding via the Supplementary Social Fund should be reduced.

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