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General Budget Support Evaluability Study

Country Case Studies: Mozambique & Andhra Pradesh

Volume II

GENERAL BUDGET SUPPORT EVALUABILITY STUDY

COUNTRY CASE STUDIES:

MOZAMBIQUE

AND

ANDHRA PRADESH

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ABBREVIATIONS

ADB	Asian Development Bank
AP	Andhra Pradesh
APERP	Andhra Pradesh Economic Reform Programme
APPSR	Andhra Pradesh Power Sector Reform Programme
BCM	Banco Comercial de Moçambique
BR	Boletim da Republica (official government bulletin)
CAPE	Centre for Aid and Public Expenditure, ODI
CFAA	Country Financial Accountability Assessment
CGE	Conta Geral do Estado (general government accounts)
CGG	Centre for Good Governance, Hyderabad
DAC	Development Assistance Committee (of OECD)
DFID	Department for International Development (UK)
DNPO	National Directorate of Planning and Budget (within MPF)
DNT	National Directorate of Treasury (within MPF)
EC	European Commission
EMRS	Expenditure Management Reform Strategy
EPSRP	Economic and Public Sector Reform Programme
ESIP	Economic Sector Investment Programme
FRP	Fiscal Reform Program
GBS	Global Budget Support (also direct budget support)
GDP	Gross Domestic Product
GoAP	Government of Andhra Pradesh
GoI	Government of India
GoM	Government of Mozambique
GoO	Government of Orissa
GSDP	Gross Sustainable Development Project
HIPC	Heavily-Indebted Poor Countries (debt relief initiative)
HRM	Human Resource Management
IFMIS	Integrated Financial Management Information System
IGF	General Financial Inspectorate (within MPF)
IMF	International Monetary Fund
ISP	International Sectoral Programme
JDP	Joint Donor Programme
MoU	Memorandum of Understanding
MPF	Ministry of Planning and Finance
MTBF	Medium-Term Budget Framework
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Fiscal Framework
O&M	Operations and Maintenance
ODA	Official Development Assistance
ODI	Overseas Development Institute, UK
OECD	Organisation of Economic Co-operation and Development
OPM	Oxford Policy Management Ltd, UK
PARPA	Action Plan for the Reduction of Absolute Poverty (Mozambique's poverty reduction strategy paper)

PEM	Public Expenditure Management
PEMR	Public Expenditure Management Review (conducted as part of PER)
PER	Public Expenditure Review
PRGF	Poverty Reduction and Growth Facility (of IMF)
PRFA	Poverty Reduction Framework Agreement (of DFID)
PRSP	Poverty Reduction Strategy Paper
RNE	Royal Netherlands Embassy, New Delhi
SFA	State Financial Accountability Assessment
SISTAFE	System for State Financial Administration Reform
SPA	Special Programme for Africa
TA	Administrative Tribunal
UTRAFE	Technical Unit for State Financial Administration Reform (within MPF)
WB	World Bank
WFP	World Food Programme

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This report looks at the GBS programmes of Mozambique and Andhra Pradesh and contributes case studies in the Synthesis Report (Vol 1) alongside Ugandan experience. We appreciate the support and time of the Government of Mozambique, Government of Andhra Pradesh, DFID Mozambique and DFID Andhra Pradesh.

PREFACE

Each year the Department for International Development (DFID) commissions, through its Evaluation Department, a number of independent evaluation studies. The purpose of DFID's evaluation programme is to examine rigorously the design, implementation and impact of selected policies, programmes and projects, and to record and share the lessons learned from them so that these can be applied to current and future policies and operations.

DFID's Evaluation Department (EvD) is independent of DFID's spending divisions and reports directly to DFID's Director General (Knowledge Sharing). This report represents the views of its authors, a joint team of consultants from Oxford Policy Management and the Overseas Development Institute.

This is an Evaluability Study which develops an Evaluation Framework for General Budget Support drawing on case study materials from Uganda, Mozambique and the Indian State of Andhra Pradesh. As such, it is not a rigorous evaluation and the case studies provide only early indications of lessons learned. The report has been widely discussed under the OECD DAC Evaluation Network and the framework itself has been further refined as a result of this. The final version is being used for a joint global formative evaluation of General Budget Support. DFID leads this process which is due to report in late 2005. The final version of the framework is being published by DFID on behalf of the 20 donors participating in the joint evaluation as DFID (2004) Joint Evaluation of General Budget Support: Evaluation Framework for country level case studies.

The valuable detail of the 3 case studies conducted during the Evaluability Study and the way this experience has influenced the design of the Evaluation Framework is captured in 2 volumes. The first is a syntheses pulling together the framework and including the detailed findings from Uganda. The second details the findings from Mozambique and Andhra Pradesh. We are very grateful to the participation of partner Governments in Uganda, Mozambique and Andhra Pradesh, without whose assistance these studies would not have been possible.

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PART 1

GENERAL BUDGET SUPPORT EVALUABILITY STUDY:

MOZAMBIQUE CASE STUDY

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1. BACKGROUND

1. This case study is one of three that has been commissioned by DFID's Evaluation Department in order to examine some early experiences in the provision of direct budget support as a means of delivering official development assistance (ODA) more effectively. The ultimate measure of the effectiveness of this and other methods of delivering aid is the contribution made to aid recipient governments' efforts to reduce poverty. The problems of measuring the impact of fiscal policy on poverty reduction have been widely discussed by both academic researchers and policy makers (see Inception Report and Literature Review for this project, also McKay 2002) and will not be reiterated here.

2. Mozambique is in theory an ideal country for aid donors – lots of poverty, relatively good policies, and recently, lots of growth. However, in practice there is a widespread public perception that much aid is wasted on poorly conceived projects, ineffective technical assistance, and expensive vehicles and luxury houses for the few[1]. This outcome is at least partly due to weak public sector institutions and inefficient administrative procedures for managing public finances. These factors have led some commentators to argue that aid effectiveness is constrained by and should take account of the 'absorptive' capacity of the government and economy concerned. However, it is also the case that such outcomes are at least partly a function of the way in which aid has traditionally been delivered in countries like Mozambique, through a multiplicity of individual donor projects with unclear objectives and little integration with government sectoral priorities and strategies. Aid donors have become increasingly aware that they need to be concerned with developing (rather than undermining) the institutions and human resources that would allow the overall capacity to manage and 'absorb' aid and other forms of public financing to be expanded.

3. Budget support is one mechanism which focuses upon building such capacity by channelling financial flows and other forms of assistance directly through the central government budget, where the allocation and use of these funds is determined by national institutions (Ministry of Planning and Finance (MPF), the Central Bank and Parliament) rather than by donors themselves. The ultimate objective of such budget support is to contribute, via the Government's public expenditure programme (particularly in social sectors) to poverty reduction. Several problems are immediately faced in attempting to design an effective evaluation methodology of budget support, in the context of the multitude of other explanatory factors which may affect poverty and, the frequent lack of good quality data, both quantitative and qualitative, which such an evaluation would require.

4. The objective of this case study is to review the experience to date of DFID and other bilateral donors in implementing a budget support programme in Mozambique. Several relevant distinctive features of Mozambique's situation and the Government's economic administrative reform programme are discussed. We then present a preliminary evaluation of the degree to which the posited benefits of budget support, over alternative aid modalities, have been realised. The report also attempts to summarise some of the views of local actors on the current budget support programme and how it could be enhanced. We wish

[1] A public opinion survey of attitudes to corruption in Mozambique found that 30.3% of people thought that consultants' were 'very' involved in corruption (Estudo sobre Corrupção em Moçambique, Ética Moçambique, July 2001, table 6.1, p.61).

to highlight here in particular the interesting views of the Mozambican Minister of Finance, Luisa Diogo, on this subject. We finally include some tentative recommendations on future design of budget support programme based upon lessons emerging from the Mozambique experience.

2. CASE STUDY METHODOLOGY

5. The overall objective of the case study is "to explore the processes established by DFID to deliver financing for poverty reduction through General Budget Support in Mozambique, with particular attention to the relevance of GBS to country circumstances, implementation structures and the approach adopted to risk management".

6. The main outputs of the individual case studies are envisioned to be:
- an assessment of DFID's objectives (in comparison to the log frame and to other parties) in pursuing GBS in each country
- an assessment of the procedures currently being implemented and how their success can be measured
- an assessment of DFID's human resource and organisational requirements in order to successfully implement GBS
- a summary of the key lessons to date on design and implementation of GBS.

7. The terms of reference additionally ask for an assessment of the following aspects of the Mozambique GBS programme:
- relevance – an assessment of the relevance of various aspects of the GBS programme to the institutional and policy environment in the country
- internal relevance and coherence – the nature of consultation and decision-making processes;
- monitoring – the framework for monitoring and evaluation, the extent to which evaluation criteria have been identified, and how these will be measured
- feasibility – the assessment of GBS in the light of potential developmental and fiduciary risks
- evidence and prospects – the sustainability of GBS in light of identified risks, and the likelihood that its objectives will be achieved
- DFID management – the impact of GBS on the operation and management of the DFID country office and any additional resource requirements.

8. Consideration will also be given to the particular environment in which the budget support programme is evolving in Mozambique and the extent to which the conditions necessary for successful implementation are present. The Literature Review for this project (Naschold and Booth, 2002) identified a number of possible preconditions for the successful implementation of such programmes. These include:
- the need for a formal agreement between donors and central budget authorities on policies and expenditure priorities
- adequate public expenditure management systems, including performance monitoring and auditing
- a unified reform programme owned by the country around which any donor conditions can be built
- a willingness of the part of the government to deal with so-called 'second generation' reform issues such as governance and institution-building, which are particularly important for ensuring effective use of public funds.

9. This case study is the result of a review of available documentation and also discussions with a number of people involved in the design of DFID's budget support programme for Mozambique. It was eventually not possible, due to logistical problems, to undertake a field trip to Maputo as originally envisaged in the terms of reference. We would particularly like to thank Nick Highton, DFID Economic Advisor in Maputo, for access to internal DFID documentation and Mick Foster, Consultant, who has recently undertaken a review of budget support in Mozambique for DFID in preparation for the submission of a new budget support programme proposal for 2003 – 2005.

10. It should be noted that implementation of coordinated budget support in Mozambique (as with most other countries in the region) is a relatively recent phenomenon – the joint donor programme commenced in 2000 – and hence our ability to assess the impact of this method of aid delivery will necessarily be limited to the more short-term or immediate identifiable effects. The objective here is hence to provide a "benchmark" for future more in-depth evaluations and to highlight some of the factors that such evaluations would need to consider.

3. POVERTY, AID AND POLICY IN MOZAMBIQUE 1992–2002

3.1 Poverty in Mozambique and the Poverty Reduction Strategy

11. The Government of Mozambique's (GoM) Action Plan for the Reduction of Absolute Poverty (PARPA), April 2001 sets out a clear commitment to the global objective of poverty reduction[2]. The key target for current government policy is the reduction of absolute poverty levels at a national level from 70% to 50% between 2000 and 2010, with the intermediate objective of attaining 60% by 2005. From these statistics alone, it can be understood that poverty in Mozambique is widespread. It is also intense – with an estimated 37.8% of the population living in ultra-poverty, defined as 60% of the total poverty line, and with a poverty gap index of 29.3% in 1997.

12. Recent empirical research on the determinants of poverty in Mozambique (Datt, et al. 2000) has identified a number of specific causal factors of such extensive absolute poverty that represent priority areas for intervention by government and other stakeholders in the national development process, namely:

1. slow economic growth in the early nineties
2. poor education levels of economically active household members, especially women
3. high dependency rates in households
4. low productivity of family agriculture
5. absence of employment opportunities in agriculture and elsewhere
6. weak development of infrastructure in rural areas.

13. One factor, which has the potential to contribute to the achievement of the government's poverty targets, is a significant reduction of existing regional asymmetries. The most recent evidence on the geographical distribution of poverty comes from the Mozambique National Household Survey on Living Conditions 1996/97 and is summarised in Table 1. This indicates that Sofala Province had the highest incidence of absolute poverty in Mozambique, with a headcount index of 87.9% of the provincial population of 1.3 million inhabitants (using 1997 census figures). Both Inhambane and Tete Provinces also had headcount poverty rates of over 80%. This compares with a headcount index of 47.8% for Maputo City, which is the only region in Mozambique where poverty rates in the 1996/97 period were below 50%.

14. There is still considerable controversy about what has happened to poverty levels in Mozambique since 1996/97. A second national household survey has recently been completed which will provide the first quantitative indication at a national level of the 'success' or otherwise of the government's poverty reduction strategy. Despite a strong growth record in the second half of the 1990's, there are several factors that may have affected poverty levels adversely since 1996/97. These include the severe flooding in southern and central regions of Mozambique in February and March 2000 and again in 2001, that affected both agricultural production and transport systems. This has been followed by drought in some parts of the country this year, with the latest WFP/Government estimate of the number of

[2] Mozambique's interim PARPA was reviewed in Robb and Scott (2001) and the full PARPA was the subject of a joint assessment by the World Bank and IMF (August 2001).

people in need of food aid in 2002/03 rising to 587,000 (3% of the total population). Concerns have also been expressed about the perceived concentration of economic growth in the southern provinces of Mozambique, particularly linked with significant new investments along the Maputo Development Corridor and the recent exploitation of on-shore gas reserves in Inhambane Province.

Table 1
Average consumption and estimates of poverty and destitution by province, 1997

Province	% of total population	Average monthly consumption (Mt/person/month)[a]	Head Count Index	Abject-poverty Head Count Index	Depth of Poverty (poverty gap %)
Niassa	4.85	147,841	70.64	40.48	30.1
Cabo Delgado	8.16	194,448	57.40	23.10	19.8
Nampula	19.47	161,668	68.92	37.11	28.6
Zambezia	20.34	154,832	68.10	34.35	26.0
Tete	7.30	117,049	82.27	53.60	39.0
Manica	6.19	191,608	62.60	26.96	24.2
Sofala	8.77	97,906	87.92	65.19	49.2
Inhambane	7.06	128,219	82.60	53.73	38.6
Gaza	6.57	183,233	64.66	26.54	23.0
Maputo Province	5.14	177,774	65.60	35.37	27.8
Maputo City	6.14	253,102	47.84	17.03	16.5

source: MPF 1998, PARPA 2001, Table 2.2
[a] *mean total consumption, temporally and spatially deflated, using national average prices as the base.*

15. There is relatively little evidence currently available regarding links between public expenditure programmes and poverty in Mozambique. However, a recent paper (Heltberg, Simler and Tarp, 2001) provides an interesting analysis of the progressivity of various types of expenditures in the education and health sectors, using data from the 1996/97 household survey on individual-level use of these facilities and data from the relevant ministries on average cost of provision. The authors conclude that regional and gender imbalances in access to education and health facilities (particularly in the post-primary education system) are probably more significant than income-based differences. Where these services do exist, they serve to reduce inequality relative to the measured distribution of consumption. The main caveat to this result is that it does not control for any unobserved variation in the quality of services received by families at different levels of the income distribution, which may be quite significant given that poverty is not evenly distributed throughout Mozambique. Nevertheless, the authors assert that alleviating budget constraints in Mozambique, where additional spending is channelled into priority sectors, will have "significant poverty reducing effects and help poor people access public services in one of the poorest countries in the world." From the point of view of donor support, there is also the possibility that the extra marginal expenditure made possible by these funds, if sufficiently well-targeted to areas of current imbalance, may be significantly more pro-poor than average expenditures in these two sectors.

Table 2
Mozambique: Expenditure on Social Sectors as defined in PARPA
(in % of total expenditure)

	1999	**2000**	**2001**
Total Expenditure (billions of Meticais)	**12,491**	**15,663**	**21,158**
Total actual expenditure in PARPA priority sectors [1]	55.2	68.9	66.2
Education	14.4	20.2	23.1
Primary	11.3	17.5	18.4
Post-primary	3.1	2.6	4.7
Health	12.0	13.0	10.6
HIV/AIDS	0.0	0.0	0.6
Infrastructure development	11.9	15.9	17.1
Roads	...	...	8.7
Sanitation and public works	...	...	8.4
Agriculture and rural development	4.7	6.3	3.5
Governance and judicial system	7.9	7.9	8.1
Security and public order	5.8	5.4	5.2
Governance	5.0	0.9	1.2
Judicial system	1.7	1.6	1.7
Other priority areas [2]	4.4	5.6	3.3
Social actions	0.6	1.1	0.8
Labour and employment	0.4	0.4	0.4
Mineral resources and energy	3.4	4.0	2.2
Memo: GDP (billions of Meticais)	**51,915**	**58,905**	**74,675**

source: Ministry of Planning and Finance and World Bank estimates; PARPA Table 18.

16. Since the introduction of the PARPA, both government and donors have sought to re-orientate their programmes to focus on achieving a more balanced geographical distribution of the provision of key social services, including education and health. Priority sectors identified in the PARPA have also received an increasing proportion of the government's budgetary allocations, representing 68.9% of total expenditure in 2000 and 66.2% in 2001. A breakdown of these expenditures by sector for 1999–2001 is shown in Table 2, with primary education and infrastructure development being the sectors that have increased their shares of total expenditure most rapidly. It is probably not possible at this stage to attribute a direct role to the budget support programme in achieving these results, although this is undoubtedly an important additional factor in generating government commitment to a rapid and sustained reorientation of its expenditure programme.

3.2 Aid to Mozambique 1996–2000: An Overview

17. Data on aid flows to Mozambique is available from the OECD's Development Assistance Committee (DAC) website. This is presented in Table 3 in comparison with similar data for the other case study countries (Uganda, India and Tanzania) and also for

several other countries in sub-Saharan Africa (Kenya, Botswana and Ghana) where DFID is an important bilateral donor.

18. This shows that Mozambique is by far the most ‘aid-dependent’ country in this sample, with net ODA representing nearly 22% of the country’s gross national income (GNI) in 2000 or the equivalent of US$ 50 per capita. Equivalent rates are 9.2% (or $37 per cap) in Uganda, 0.3% (or $1.50 per cap) in India and 11.4% (or $31 per cap) in Tanzania. The absolute levels of ODA to Mozambique appear to have fallen in recent years from US$ 1,080 million in 1998 to $876 million in 2000, which continues a steady downward trend on average since the early 1990’s[3]. Bilateral aid represented 73% of the total in the latest year, although this proportion has varied quite significantly in recent years.

Table 3
Aid Patterns to Mozambique in Comparison with Selected Other Countries

	Net ODA Receipts ($ million)					GNI/CAP (e)	Population	Current GNI	ODA/GNI
	1996	1997	1998	1999	2000	1999 *US$*	1999 *million*	1999 *$ million*	1999 *per cent*
Mozambique	888	948	1 040	804	876	220	17.30	3 657	21.99
Uganda	676	813	647	591	819	320	21.48	6 409	9.21
Tanzania	877	945	1 000	990	1 045	260	32.92	8 726	11.35
India	1 897	1 647	1 610	1 491	1 487	440	997.52	443 726	0.34
Ghana	651	494	702	609	609	400	18.78	7 638	7.98
Kenya	597	448	477	310	512	360	29.41	10 486	2.96
Botswana	75	122	106	61	31	3 040	1.59	4 671	1.30

Source: OECD/ DAC Tables 2002 (Table 25. ODA Receipts [a] and Selected Indicators for Developing Countries and Territories)

19. According to the OECD database, DFID’s contribution to total ODA to Mozambique averaged US$ 66 million per annum during 1999–2000, which is approximately 8% of the total, placing DFID in fifth place behind the World Bank (IDA), Portugal, USA and the European Commission in terms of net contributions over this period. Data from DFID Maputo shows that DFID’s aid programme to Mozambique has grown rapidly in recent years, doubling in value from 19 million pounds sterling in 1997/98 to 38 million pounds sterling in 2001/02. Table 4 shows a listing of major bilateral recipients of DFID aid 1999–2000, where Mozambique ranks in ninth place with 1.7% of the total.

[3] Comparable figures from UNDP Maputo show ODA of $858 million in 1998, $916.7 million in 1999 and $737.4 million in 2000 (all lower than DAC’s figures). Both sources confirm a decline in net transfers in recent years, even taking account of the additional resources from HIPC debt relief. Annual averages reported by UNDP Maputo for the following periods are: 1987–1990 $1,006 million, 1990–95 $990 million and 1995–2000 $906 million.

Table 4

Major Recipients of DFID Aid (per cent of total ODA)

1979-1980		1989-1990		1999-2000	
India	11.9	India	5.0	India	4.3
Bangladesh	5.1	Bangladesh	3.4	Uganda	3.9
Tanzania	2.8	Kenya	2.8	Tanzania	3.0
Pakistan	2.5	Nigeria	2.3	Bangladesh	2.6
Kenya	2.5	Malawi	2.0	Zambia	2.3
Sri Lanka	2.4	Pakistan	2.0	Malawi	2.2
Zambia	2.4	Ghana	1.9	Ghana	2.2
Zimbabwe	2.1	Tanzania	1.7	China	1.8
Sudan	1.8	Sudan	1.6	Mozambique	1.7
Malawi	1.5	Mozambique	1.5	Kenya	1.6
Egypt	1.5	Uganda	1.4	Ex-Yugoslavia. Unsp.	1.6
Ghana	1.4	Zambia	1.3	South Africa	1.4
Indonesia	1.0	St. Helena	1.3	Sierra Leone	1.1
Jordan	0.9	China	1.1	Indonesia	1.0
Nepal	0.9	Sri Lanka	1.0	Rwanda	1.0
Total above	**40.7**	**Total above**	**30.4**	**Total above**	**31.7**
Multilateral ODA	33.4	Multilateral ODA	41.6	Multilateral ODA	37.2
Unallocated	9.3	Unallocated	12.7	Unallocated	16.0
Total ODA $ million	**2 200**	**Total ODA $ million**	**2 755**	**Total ODA $ million**	**3 993**

Source: OECD/ DAC Aid Tables 2002

20. An increased DFID involvement in Mozambique can be linked to several factors including

- recent thinking on a redistribution of British aid resources to countries with high levels of absolute poverty and good governance records,
- Mozambique's entry into the Commonwealth in 1995,
- the crucial role that Mozambique plays as a transport corridor for several landlocked former British colonies in the interior, including Zimbabwe, Zambia, Botswana, Malawi and Swaziland
- a desire to see the gains from the end of the civil war in Mozambique in 1992 and subsequent transition to a pluralistic democratic system of government fully realised and regional stability maintained.

21. In terms of allocation of all bilateral ODA by sector, approximately 40% of aid to Mozambique in the 1999–2000 period falls under the twin headings of 'programme assistance' (which we interpret as being primarily budget support) and 'action related to debt relief' (which is indirectly part of the budget support programme). We do not have any data on trends in the breakdown of aid by sector, or on the makeup of specific donor programmes. However, the most recent IMF evaluation[4] shows that the proportion of non-project aid to total external assistance remained constant at between 40–44% of the total between 1999 and 2001. Hence, there is no evidence as yet at the aggregate level of a rapid shift away from aid delivery through projects, some of which are integrated into

[4] IMF Staff Report for 2002 Article 4 Consultation, June 2002.

sector-wide programmes in areas such as agricultural development, health and education. This contradicts one of the assumptions underlying the existing logical framework for GBS – at least for some of Mozambique's donors, there is not perceived to be a contradiction between providing budget support while continuing to finance stand-alone projects in sectors which would normally be considered to fall within the scope of the government's budget.

3.3 Public Expenditure Management

22. An efficient public expenditure management system is one of the key conditions required for the eventual success of budget support programmes in reducing poverty. As a part of the 2001 Public Expenditure Management Review (PEMR), a detailed analysis was undertaken of Mozambique's public expenditure management systems by a combined team from the Ministry of Planning and Finance, the World Bank, IMF and several bilateral donors, including DFID. The PEMR concluded that good fiscal management has played a central role in Mozambique's economic recovery since 1992, stating that "a prudent fiscal stance, accompanied by substantial, external assistance, contributed to relatively low deficits after grants, at least until 2000". With regard to poverty-related social expenditures, education, health and agriculture increased their combined share of budgetary allocations from 29 % in 1998 to 39 % in 2001.

23. However, the report warns that "fiscal imbalances remain and the fiscal position has deteriorated, particularly since 1996". This is primarily due to a significant increase in real expenditure over this most recent period, including a 16% increase in 2000 alone. This was only partly due to flood-related expenditures, which were mostly incurred in 2001. Other factors identified as contributing to the expansionary fiscal policy include recapitalisation of BCM (Banco Comercial de Moçambique), a significant increase in the civil service wage bill and higher social spending made possible by HIPC debt relief.[5] The report goes on to warn that "the current fiscal position is unsustainable and, if not corrected, may become a threat to macro-economic stability and growth".

24. An overview of Mozambique's current (2001) fiscal position is shown in Table 5, which is taken from the PEMR. This also shows a set of high-end or optimistic projections for 2002, 2005 and 2010 based upon a number of assumptions concerning levels of economic growth, tax revenue generation and levels of continued donor support to the budget. The overall balance after grants (in effect the government's borrowing requirement) is projected to deteriorate to –8.4% of GDP in 2002, compared to a target "sustainable" rate of –5.1% of GDP. This position already takes into account grants and HIPC-related assistance worth a total of 10.6% of GDP. Another interesting feature of the projected scenario for fiscal sustainability is that total expenditure under this "optimistic" programme is constrained to fall from the current level of 31.8% of GDP in 2001 to 24.3% in 2010.

[5] It should be noted that these factors have rather different budgetary and economic implications: the recapitalisation of BCM should in principle be a non-recurring budgetary liability. However, in 2002 the government is facing similar problems with regard to Banco Austral (the other previously state-owned commercial bank originally privatised in 1996/97). Higher civil service wages affect recurrent expenditures and could be due to extra recruitment or higher salaries and emoluments being considered as part of the government's public sector reform strategy; the use of HIPC debt relief to facilitate higher social sector spending is precisely the objective of the debt relief and restructuring programme.

Existing resource constraints thus allow little scope for sustained capital investment programmes in rural and urban infrastructure, unless these are undertaken at the expense of reduced current expenditure programmes[6].

Table 5
Mozambique: Government Finance - Scenarios for Fiscal Sustainability
As Percentage of GDP

	1998 actual	1999 actual	2000 actual	2001 estimate	2002 projection	2005 projection	2010 projection
Total Revenue	**11.4**	**12.0**	**12.7**	**12.5**	**12.8**	**15.0**	**17.2**
Tax Revenue	10.5	11.0	11.6	11.4	11.6	13.8	16.4
Non-tax Revenue	0.8	0.9	1.0	1.2	1.2	1.1	0.8
Total Expenditure and Net Lending	**21.6**	**24.7**	**28.4**	**31.8**	**31.4**	**27.4**	**24.3**
Current Expenditure	11.2	12.2	13.3	14.3	14.9	14.2	12.0
Capital Expenditure	9.8	11.6	13.3	14.5	13.2	12.8	12.3
Net Lending	0.6	0.9	1.8	3.0	3.2	0.4	0.0
Overall Balance before Grants	**-10.5**	**-13.2**	**-16.1**	**-19.3**	**-18.6**	**-12.5**	**-7.1**
Grants Received	**8.1**	**11.7**	**11.6**	**14.5**	**10.1**	**7.5**	**4.4**
Project	4.0	5.4	6.5	7.7	7.0	5.2	3.0
Non-project	4.1	6.3	5.2	6.8	3.1	2.3	1.4
Overall Balance after Grants	**-2.4**	**-1.5**	**-4.5**	**-4.9**	**-8.4**	**-5.0**	**-2.7**
Overall Primary Balance after Grants (exc. Interest payments)	**-1.4**	**-0.8**	**-4.3**	**-4.2**	**-7.1**	**-4.4**	**-2.3**
BM transfer of HIPC Assistance by IMF			**0.8**	**0.8**	**0.5**	**0.3**	**0.2**
Net External Borrowing	**4.6**	**1.8**	**2.8**	**4.0**	**5.3**	**4.5**	**2.4**
Net Domestic Financing	**-2.3**	**-0.3**	**0.8**	**0.1**	**2.6**	**0.1**	**0.1**
Memo items:							
Target: Sustainable Primary Deficit					-5.1	-3.2	-2.3
GDP Real Growth Rate	12.6	7.5	1.6	14.8	10.0	6.6	8.0
Nominal GDP (Mt billions)	46,908	51,915	58,896	72,684	87,308	126,245	215,620

source: Mozambique Public Expenditure Management Review, World Bank, December 2001, Annex 2, Table 1

notes: the projections are from the first scenario presented - based upon an 'optimistic' forecast of real GDP growth of average 8% per annum over period

25. The government's response to this situation has been to move swiftly to implement many of the recommendations of the PEMR. A new Public Finance Management Law was passed by the National Assembly in late 2001 and with the accompanying regulations, which are currently being finalised by MPF staff, will be introduced from January 2003. As can be seen in Box 1 below, the range of reforms currently being implemented is both complex and challenging. Amongst other reforms, the new law introduces an integrated financial management information system (IFMIS). This aims to provide more timely information on all aspects of budget formulation and execution. The PEMR report warns however that the introduction and effective implementation of such systems is a technically demanding exercise that should be undertaken carefully and in a phased manner, taking account of capacity constraints and seeking to avoid over-complex technological solutions. In the short term, there must be some degree of risk that problems with the implementation

[6] Given that the returns to such capital expenditure programmes (e.g. in rural infrastructure) are quite probably very high, both in economic and social cost-benefit terms, and exceed prevailing discount rates in financial markets, there is an argument that Mozambique should, with the help of donors, be following a more expansionary capital expenditure policy than currently projected.

of new systems will lead to a reduction, rather than immediate increase, in the efficiency of public expenditure management and hence in the transparency with which donor funds are being utilised. It is not clear whether this risk has been fully considered by the Joint Donor Group on macro-financial support.

Box 1. Summary of priority recommendations on public finance reform
Source: Public Expenditure Management Review, December 2001

Budget formulation
>new, more detailed budget functional classification from 2002
>budget formulated in current prices from 2002

Budget coverage
>take steps to ensure that a significant share of own source and earmarked revenues currently outside of the budget are included in 2003

Budget execution
>quarterly budget execution reports should present (a) initial budget allocation, (b) revised appropriation (if any), (c) all actual expenditures according to new classification
>include annex in budget execution report with information on donor-funded actual expenditures according to action plan prepared by MPF

Cash and asset management
>all bank accounts opened and managed by public institutions will require treasury (DNT) authorisation and DNT must be one of the co-holders; all accounts will be automatically closed by DNT on March 31st of following year
>finalise inventory of all bank accounts operated by public institutions both in Banco de Moçambique (BM) and commercial banks and close all bank accounts not related to the 2002 fiscal year
>create globalizing bank accounts for revenue and expenditure in BM
>create task force composed of MPF and BM staff to monitor the introduction of the treasury single account and the new payments system

Public accounting system
>ensure that the 2002 budget execution is consistent with the new budget functional classification
>launch a training programme on double-entry accounting and modified accrual accounting

Budget evaluation and auditing
>introduce specific budget lines for the internal audit department (IGF) in the 2003 budget and allocate an appropriate level of resources
>continue to implement reforms to raise IGF's capacity
>increase budgetary allocation in favour of the Administrative Tribunal (TA) and grant the TA the ability to set its own salary scale
>TA to establish partnership agreements with reputable private audit firms in Mozambique and a twinning arrangement with a foreign supreme audit institution to be sought.

26. A further issue discussed at some length in the PEMR is the need to undertake further decentralisation and deconcentration of fiscal management and public service delivery in Mozambique. The report correctly identifies that "finding the right balance of fiscal empowerment that maximises the effectiveness of public action and service delivery at each level of government, while minimizing the risks of fiscal instability and guaranteeing the degree of accountability that is required by democratic regimes" is the major challenge facing policy-makers in this area. We discuss below whether there is any inconsistency between moves to decentralise fiscal processes and the reorientation of donor support towards centralised direct budget support.

27. Finally, it is also worth noting that the results of an Expenditure Tracking and Service Delivery Survey in the health sector undertaken in mid-2002 are currently being analysed by an independent consultancy team in conjunction with the Ministry of Health[7]. This should provide detailed statistical information on various aspects of the current degree of execution of budget allocations in this sector. Amongst other uses, this data should enable further empirical analysis of the links between public expenditure on health service supply, demand for health care, and poverty. The findings of the survey will have important implications for the future targeting of donor support to this sector and, if successful, could be replicated for other high-priority social sectors, including education and rural infrastructure development.

[7] The consultancy team has been provided by Oxford Policy Management and Austral Consultoria under funding from the FoPOS project through which DFID have been supporting analytical and capacity building work in the National Directorate of Planning and Budget (DNPO). The survey is a component of the ongoing PER process jointly managed by the World Bank and DNPO.

4. DONOR VIEWS ON OBJECTIVES OF BUDGET SUPPORT: A SEAT AT THE POLICY TABLE

4.1 Current Donor Coordination on Budget Support in Mozambique

28. Earlier informal attempts to promote donor coordination in the provision of budget support and other forms of programme aid in Mozambique were formalised in 2000 with the establishment of the Joint Donor Programme (JDP) for Macro-Financial Support. The donors currently involved in this programme (the G10) are the UK, Belgium, Denmark, the European Commission, France, Ireland, the Netherlands, Norway, Sweden and Switzerland. Two bilateral donors participate in meetings as observers, namely Portugal and Germany. The IMF and the World Bank are also actively involved.[8] USAID are not involved due to strict domestic requirements over the transparency with which their funds must be utilised. The stated long-term objective of the programme is to contribute to poverty reduction. This objective is to be achieved by consolidation of high real economic growth by supporting economic reforms and sound economic policies and by providing a financial contribution for increased resource allocations to priority sectors for poverty reduction. The agreement setting up the JDP recognises that donors should attempt to reach multi-year agreements on macro-financial support and that this should be channelled through the state budget.

29. The agreement sets up a range of implementation and monitoring systems in order to regulate the flow of funds and their uses. Ongoing dialogue on the JDP takes place in the quarterly Budget Working Group chaired by the Ministry of Planning and Finance. A joint donor–government review of the programme takes place annually at end of the first quarter. Following the review, donors make commitments in March/ April for the following year's programme and seek to agree a disbursement timetable. Given successful continuation of the programme in the current year, once the National Assembly (the parliament) approves the state budget for the following year, donors confirm in December the disbursement schedule. The announcement of pledges and disbursements is designed to be adjusted to GoM's budget cycle so that resources can be fully integrated into the budget for the next year. This has been implemented relatively successfully by all G10 members, although there were delays in the disbursement of one tranche by the EC in 2001, and Sweden has had difficulties in reconciling G10 procedures with their own internal aid programming and approval mechanisms.

30. The conclusions of the most recent JDP review, undertaken in May 2002, were broadly positive, with a recommendation being made to continue budget support in 2003. However, concerns were raised during the review, as well as separately, by donors about recent serious problems in the Mozambican banking sector and the implications that this might have for how effectively budgetary resources would be used. This issue is seen as being of particular concern, not just because of the negative impact that it may have on investor confidence and financial sector stability, but also, given government intentions to recapitalise two previously state-owned banks, due to the potential fungibility of budget support

[8] The World Bank's involvement is likely to be further enhanced in 2003/04 when it begins its own form of direct budget support linked to the implementation of a poverty reduction support credit that will support both cross-cutting reforms and sector spending. Closer involvement by the World Bank is regarded by other proponents of budget support as an important factor in gaining further leverage over the government's reform programme.

financing. It is not clear to what extent donor concerns have actually been addressed on this issue.

31. Areas identified by donors in the most recent joint review where further development of the JDP is required are:

- the need to increase the predictability of budget support, possibly through the development of three-year rolling agreements *(this is one of the main concerns expressed by MPF and at the moment is being most strongly supported by DFID and the European Commission);*
- the defining of arrangements to deal with potential non-compliance or issues in dispute *(this is also an issue for MPF – in what circumstances will budget support be withheld, either temporarily or permanently?);*

32. One of the weaknesses of the previous reviews seems to be that no attempt has yet been made to assess the quantitative or qualitative impact of the JDP on poverty reduction, or to evaluate whether the existing budget support programme is the most effective means of achieving this. It is stated that progress against the PARPA and PRGF implementation are the primary reference points for assessing the JDP, and that within PARPA implementation, issues of governance will have a strong weight. However the precise criteria by which this assessment will be made are not clearly defined and seem rather subjective, particularly when it comes to assessing the government's governance record.

33. From the government's point of view, it is unclear how it will know which of the many targets and conditions contained in the PARPA and PRGF have to be met in order to ensure continuance of the budget support programme or whether other, less quantifiable factors, are actually of more importance to particular donors. This is an area where further thought needs to be given. It would seem that clarification of the exact terms and conditions under which budget support is being given and could potentially be withdrawn would be beneficial for both government and donors, given that one of the claimed benefits of budget support is an increase in predictability. Some initial moves in this direction are currently being undertaken by DFID Maputo (see below).

4.2 DFID Objectives

34. The stated objective of the DFID budget support programme to Mozambique is to reduce poverty by providing financial support to the Government's poverty reduction strategy (the PARPA) while also using the opportunity of policy dialogue with Government that this provides to reinforce and develop policies and processes that support effective poverty reduction. Hence, one of the implicit objectives of budget support is to be able to influence Government policy through aid (or using GBS to 'gain a seat at the policy table'). Budget support is perceived as being a more effective means of achieving this than other forms of development assistance (e.g. project support, technical assistance, institutional capacity-building, balance of payments support) for a number of reasons: it is centralised; it is implemented in direct consultation with key officials in the Ministry of Planning and Finance and the Central Bank[9] and it provides scope for donor coordination in either implicit or explicit forms of conditionality.

[9] Foster (2002) makes the criticism that discussions on the budget support programme in the joint donor/ government working group have taken place at too low a political level to effectively influence policy.

35. Hence, the policy impact of the direct financial contributions of individual bilateral donors (which may be relatively small as a percentage of total budget resources) can be leveraged by a number of core donors acting in coordination, generating a critical mass for effective policy discussion. This appears to have been the main rationale for the coordination between the G10 group. By contrast, the desire to reduce transaction costs seems to have been, at least initially, a secondary consideration, but one that has increasingly been realised in practice and is appreciated by all parties to the JDP.

36. DFID's current country strategy for Mozambique, approved in 1998, defines four main impact areas:

- improving economic and financial management
- public service reform
- promoting sustainable livelihoods
- improving health and education.

The move towards budget support is certainly consistent with all of these objectives. DFID support to the Ministry of Planning and Finance and particularly the establishment of UTRAFE (the technical unit tasked with coordinating the implementation of the public expenditure management reforms) is judged to have been particularly valuable in influencing the direction of current reforms, in conjunction with the local IMF representative.

37. How can the design of DFID's budget support programme be improved? One of the main recommendations made by the recent review of Mozambique's budget support programme (Foster, November 2002) is the need for a policy matrix which sets out a limited number of clear and costed targets which the government aims to achieve in the next three years and which it is willing to be held to account over. Further disbursements under the budget support programme would be made conditional upon evidence of having successfully met these targets.

38. This already seems to have been taken on board by DFID. In its new Country Assistance Plan for 2003 – 2006 (draft, October 2002) it states that the future G10 programme "needs to be framed within a multi-year, multi-donor partnership agreement with GoM" which will be negotiated in the next 12 months. This is to be termed a Poverty Reduction Framework Agreement (PRFA) and is seen as a framework of shared conditionality for the G10 and possibly for other donors over time. One of the main principles that will underlie the development of the PRFA is that it should focus on a relatively limited number of core indicators of progress in key areas. These are intended to provide clear milestones of progress against the implementation of the PARPA programme and are conceived as a subset of this wider policy matrix. Once this PRFA has been negotiated and agreed with Government, it is anticipated that donors will seek to reach a common position on whether the direction of change, compared to the targets set, is sufficiently positive to merit continued budget support in subsequent periods. It would be highly desirable if the PRFA and the subsequent assessments of its implementation were made publicly available, in order to encourage transparency and public accountability, both on the side of government and donors.

4.3 Other Bilateral Donor Objectives

39. It is undoubtedly the case that some of Mozambique's other bilateral donors are less enthusiastic about the budget support programme than DFID, who is perceived as playing an "evangelical" role in this area. Reasons given by other bilateral partners for their reluctance to commit themselves fully to budget support were:

- the fiduciary risk involved in relying upon unproven government financial systems to manage these funds,
- the risks entailed in "putting all your eggs in one basket"
- their commitment to the implementation of existing sector-wide programmes through established budget management and implementation systems.

40. In their overall aid strategies some bilateral donors, including the Nordics and Switzerland, also particularly highlight the need to ensure that the allocation of their aid resources serves to compensate for perceived inequalities in the current geographical allocation of social expenditures. In the health sector, Switzerland's programme for Mozambique focuses on the need for "integrated provincial planning" and the need to ensure that the allocation of resources supports efforts to achieve decentralisation[10]. Donors wish to retain a direct control over the reorientation of health expenditures towards provinces which effectively implement such integrated health plans.

41. One of the other organisations which has strongly supported direct budget support in Mozambique is the European Commission. Their new proposal (2002) for future direct budget support suggests a move towards a performance-based disbursement mechanism. Most of the EC funding will continue to be made available as fixed tranches related to the joint review process and macro-economic performance, although some additional discretionary funding will be made available on a variable basis and will depend upon indicators of government performance in implementing the overall budget and delivering specified outputs in health and education. The joint objectives of the programme are to minimise unexpected shocks to aid flows, so that the government can plan its resource allocations with some degree of certainty, while also providing incentives to the successful meeting of output-based targets in key sectors of social expenditure. There is some concern about the most appropriate choice of targets (given that it is not possible to make such funding conditional upon achievement of all of the possible objectives of good government policy in these areas) but this may be one way of reconciling the potentially conflicting objectives of predictability, with continuing incentives for Government effort to achieve targets. Their formulation also explicitly acknowledges the possibility of exogenous shocks to future Government fiscal performance and provides some insurance against changes in external funding as a result of such downside shocks.

4.4 World Bank

42. The World Bank is currently in the process of designing a poverty reduction support credit for 2003 which will aim to support both cross-cutting reforms and sectoral spending. It is envisaged that a substantial proportion of these funds will be disbursed as direct

[10] Cooperation Mozambique-Switzerland: Country Programme 2002 – 2006, Berne, Switzerland.

budget support. One of the preconditions for such a credit is likely to be agreement with the Government of a detailed policy matrix setting out the actions that the Government proposes to undertake in return for access to these resources. This will probably also be linked to further development and refinement of the PARPA policy framework, focusing particularly on costed measures which are required in order to meet the established poverty reduction targets. There thus seems to be an opportunity for further integration of World Bank/IMF strategies with those of the G10 donor group in this area.

5. GOVERNMENT VIEWS ON OBJECTIVES OF BUDGET SUPPORT: GENUINE PARTNERSHIP OR ADDITIONAL CONDITIONALITY?

5.1 Ministry of Planning and Finance

43. As might be expected, the Ministry of Planning and Finance in Mozambique appears to be the strongest supporter of direct budget support within the central government administration. GBS effectively strengthens their negotiating position with regard to sectoral ministries, many of whom have previously benefited directly from donor support to projects or sector-wide programmes, and also lower levels of the administrative hierarchy who face stricter controls over their expenditure management as a result of current reforms. High-level support to the Mozambican programme is confirmed by the comments of Minister of Planning and Finance, Luisa Diogo, during a visit to London in September 2002 (Box 2). There are however some outstanding concerns from the Government's side about the terms and conditions under which donors will provide such support. The main issues raised and the potential for additional conditions to be attached to budget support which are not in the Government's poverty reduction strategy paper.

44. Compared to other countries, the Mozambican MPF is judged by several commentators to be in a relatively weak position with regard to effectively disciplining spending ministries. The view that budget ceilings are not a hard constraint over ministerial spending patterns is widespread, both among donors and among government officials. It is a matter of debate what impact current public finance reforms will have on this situation, given that these are still in the planning stage and will only be implemented for the 2003 budget cycle. There seems to have been considerable disagreement among the main MPF directorates over both the pace and direction of reforms. According to Fozzard (2002), the Expenditure Management Reform Strategy (EMRS) was originally designed and led by the Budget and Planning Directorate (DNPO), reporting to a technical committee comprising all Directorates and chaired by the Minister. Initial DNPO plans for budgetary reclassification were resisted by the Public Accounts Directorate, while proposals for centralised budgetary support mechanisms were resisted by the Treasury Directorate. Institutional rivalries can principally be attributed to the different perceptions of risks and benefits from reform among officials responsible for budget planning and monitoring, compared to those responsible for budget execution[11].

45. A further problem which has plagued MPF attempts to improve its control over budgetary processes has been reconciling the conflicting advice provided to it by advisors funded by alternative donor technical assistance programs. As part of the SISTAFE process, being led by the IMF, donors are beginning to streamline their technical support to MPF and focus on implementation of the provisions of the new legislation on public financial management recently approved by the National Assembly.

[11] It is also interesting to note that the budget projections for allocations of public expenditure to priority sectors given in the PARPA (representing almost 70% of total expenditure) are now not believed to be achievable or even desirable in practice by MPF officials.

Box 2
Briefing with Luisa Diogo, Mozambican Minister of Planning and Finance, Mozambican High Commission, London, 21 September 2002 (summary of her comments on budget support and governance)

Q. What are your views on budget support and does this new aid modality help you meet the objectives of the government's poverty reduction programme more effectively?

A. Budget support is very necessary in order to allow the government to meet its obligations under the PARPA and to effectively implement its expenditure programme. However there is a need to be clear about the objectives of budget support. It should allow both government and donors to spend more time looking at outputs from the government's programmes, rather than focusing upon implementation arrangements. There have been cases where we have received 30 missions per year from various donors wishing to evaluate and discuss their specific projects and programmes, which is a waste of resources and does not lead to better results.

Some bilateral donors are against the idea of budget support and I understand the reasons for this. They need to discuss and obtain approval from their national parliaments first; it is our responsibility to give them the instruments that they need in order to convince sceptics that Mozambique is fully prepared for budget support and will utilise these funds effectively and transparently. We have to modernise our financial management systems in order to achieve this. In Mozambique this is currently being implemented through a fundamental reform of the financial administration systems of the government – which will come into effect on 1 January 2003. This is the main transmission mechanism which will ensure that the objectives laid down in the PARPA can be effectively implemented and monitored. We will be able to track expenditure in, for example, the education sector: where the money is going – which province, which district, which school.

The main issue for me regarding budget support is the need for long-term commitment from donors. If donors promise funding and then change their minds, this is a big problem for us. Sometimes procedural problems arise and short-term targets are not achieved. The problem is that if one donor is not happy and decides to stop its programme, all of the others tend to follow. If there are persistent problems and it is clear that the government is not committed to its agreed reform strategy then of course donors should re-evaluate their strategy, but this should not be necessary in the case of short-term problems. Here, it is an issue of confidence and dialogue. Donors have to have confidence in the government and its commitment to reform, and the best way to establish this confidence is through dialogue with donors.

For example, last year we had a problem with Banco Austral [*a previously state-owned development bank which was originally privatised in 1996/97 but then ran into problems due to unrecoverable loans*]. We needed to identify funds to recapitalise this bank. I discussed this situation with the Bretton Woods organisations and we have now established a programme to resolve the problem. In the case of Mozambique, I believe that this is possible because a degree of confidence has been built with donors over time. But the issue of long-term commitment in the provision of budget support is an important issue if this form of support to the government's poverty reduction strategy is going to be effective.

Q. One of the arguments put forward in favour of budget support is that it leads to an increase in government "ownership" of the reform programme and budgetary process. What are your views on this and on the inter-related question of the conditions attached to this form of financing?

A. On the issue of "ownership", I do not think that there has ever been a doubt about our commitment to the reform programme. Regarding conditionality, in the case of budget support we feel the conditionality more than when donors were supporting their own projects. In fact, we are now having to face two sets of conditionality – one from the World Bank and IMF as part of the PRGF (Poverty Reduction and Growth Facility) process and one from the bilateral donors connected to budget support. In many cases these two sets of conditions overlap – it is possible to compare the two sets and say that this condition on, for example, outcomes in the education sector is the same as that one, just that the wording is different. But there are cases where the bilateral donors are asking for extra conditions. When my officials were negotiating with these donors, they came and said Madam Minister, the donors are asking for extra conditions which are not those contained in the Government's Plano Strategico [Master Plan]. I asked to see a list of these conditions and said OK we will accept these conditions. In the case of Mozambique, we receive approximately US$ 140 million per annum from bilateral donors and US$ 120 million from the World Bank and IMF, so obviously we have to pay careful attention to the needs of both sets of donors. But I believe that more effort needs to be made amongst Mozambique's various partners to integrate their requirements, so that we are clear on what we are trying to achieve and, again, so that we can focus more of our discussions on outcomes rather than procedures.

5.2 Line Ministries and other Levels of Administration

46. An area of continuing concern with line ministries in Mozambique is their reluctance to relinquish involvement in direct negotiations with donors over project support to their own areas of titular responsibility. The significant levels of off-budget expenditures and revenues show no signs of being systematically tackled, although this is one of the stated objectives of the financial management reforms. According to Fozzard (2002), several line ministries have recently launched their own reforms of their planning and financial management systems, without waiting for the MPF to take the lead. These have included sector-specific accounting systems and computerised financial management systems, which may or may not be compatible with the new systems being implemented as part of SISTAFE.

47. It was not possible on the basis of the information available to obtain any clear picture of the attitudes of other levels of state administration regarding the potential impact of centralised budget support on their operations. Fozzard (2002) discusses the relative position of the provincial administrations and concludes that their main role is to implement central government directives, with little scope to define and implement policies. Provincial government aggregate expenditure limits continue to be determined centrally and are financed by administrative transfers from the Treasury. Expenditure limits at provincial level were introduced as a means of capping resource flows in areas where there had been examples of poor expenditure management (particularly payrolls inflated by ‘ghost workers’) and were then reinforced with the introduction of Integrated Sectoral Programmes (ISPs), in areas such as agriculture and the judiciary. As a result, by 1999, provincial governments were free to allocate only 11% of their total recurrent budget amongst up to 20 provincial directorates. Hence, it could be argued that the move towards a more centralised system of budget support will have little incremental impact on the already limited financial autonomy of lower levels of the government administration. This however does not take into account the prevalence of off-budget revenues (through various forms of licence fees and service delivery fees) which are currently controlled more or less autonomously by provincial and district administrations – and which they are reluctant to relinquish control over despite MPF attempts to enforce greater transparency.

48. However, it is worth emphasising that the way in which budgetary resources (including external budget support funds) are eventually allocated is more a function of government policy than of the GBS mechanism, which is by itself allocation neutral. As a result of GBS, allocations of public resources (including inter-regional allocations) should become more closely related to decisions taken as part of the national budgetary process. To the extent that the Executive branch is centralist in its decision-making and there is little effective sanction over its decisions from the parliament or other countervailing forces within society, then the resulting allocation of resources may be both non-equitable and non-efficient. This potential risk must be weighed against the recognised costs of donors using project funding to by-pass national budgetary systems in order to correct what they perceive as allocative biases. The question is: are short-term misallocations a necessary price to pay for longer term improvements in government ownership of the budgetary process and hence higher levels of democratic accountability?

6. OBSERVED EFFECTS OF GBS IN MOZAMBIQUE: AN INITIAL ASSESSMENT

49. Based upon the experiences since 2000, this section makes an initial assessment of some of the possible identified effects of the move towards global budget support in Mozambique. We do this bearing in mind that, as we have seen, significant bilateral aid flows continue to be delivered through other mechanisms. The following discussion focuses upon levels two and three of the logical framework for budget support (see main synthesis report), which are concerned with the immediate results and more medium-term effects that might be anticipated as the result of a concerted move towards GBS by donors.

6.1 Level Two – Immediate Results

6.1.1. Increased government ownership of policy and budget process

50. The view of donors seems to be that government ownership of the economic and social reform programmes is relatively strong, whereas there are some doubts about government commitment to such "second generation" reforms as judicial sector reform and administrative decentralisation. The introduction of a comprehensive public finance reform programme, which has partly resulted from donor concerns about the effective use of their budget support funds, should eventually ensure greater Government control (and hence ownership) of its aggregate expenditure programme.

6.1.2 Strengthening of Ministry of Finance, Cabinet and Parliament as drivers of public resource allocation

51. This can be judged to have taken place in terms of the design and approval of the budget, but not yet in terms of budget implementation. The budget is widely believed not to be an accurate guide to actual resource allocations. This is currently the major risk to the potential success and sustainability of the budget support programme. The government is still attempting to gain control over the within-year budgeting process and has yet to move towards effective medium-term budget planning through the MTEF and other instruments. The resistance of some line ministries to GBS would seem to indicate that they perceive that this aid modality does indeed strengthen the relative position of MPF, particularly in comparison with decentralised project implementation and even the ISPs such as Proagri in the agriculture sector. The current levels of both legislative and judicial oversight of the budgetary process are also highly inadequate and do not serve to provide public confidence in the transparency of the current administrative systems. One of the objectives of the SISTAFE project is to provide more accurate and timely information on budget execution that can be used to hold the executive to account – however this assumes the requisite technical and human capacity in the designated oversight agencies, which are currently lacking.

6.1.3 Coordinated behaviour by donors around the PRSP/partnership agenda

52. This has probably been the most important effect of the move to budget support in Mozambique to date. The current coordination arrangements (around the Joint Donor

Programme) are regarded as successful by both Government and the donors. The Government has welcomed the ability to deal with bilateral donors as a group, with significant reductions in the number of meetings and donor-specific reporting requirements, simplified dialogue and greater predictability in the amount and timing of donor disbursements. However, some donors continue to wish to maintain an independent stance on key issues and also wish to develop their own capacity to effectively scrutinise and criticise the macro-economic reform programme. Some bilateral donors also do not perceive any inconsistency between a move towards budget support with the continuance of their own selective project-based assistance programmes – this seems to be more a response to the perceived risk of channelling a higher proportion of aid through a single unified mechanism

6.2 Level Three – Medium-Term Outputs

53. The medium-term effects of GBS are inherently more difficult to assess and there is particularly an attribution problem when the move to GBS effectively coincides with a number of other reforms which, it could be argued, may also be having either complementary or countervailing impacts. As we have seen, two particular examples are the implementation of the PARPA programme (including monitoring arrangements) since 2000 and the instigation of the public finance reform programme or SISTAFE in 2002. We discuss a range of possible effects below.

6.2.1 Reduced transaction costs

54. Anecdotal evidence would seem to indicate that transaction costs, particularly in terms of time taken up of key officials in MPF, have diminished as a result of the Joint Donor Programme on budget support. Given the scarcity of high-level civil servants in Mozambique, this is certainly an important advance. However, there are other types of transaction cost involved in the complex procedures needed to effectively implement and monitor the budget support programme which may well increase in the short term, particularly in the context of the current public finance reform programme.

6.2.2 Allocative efficiency of public spending

55. If we choose to define allocative efficiency in terms of the proportion of the government's budget allocated to identified high priority sectors, this has certainly been achieved since 1998/99. However, this seems to be more a direct effect of the PARPA agenda and only indirectly a result of GBS per se. Given the fungibility of donor resources and fact that these are not earmarked, it is of course not possible to compare realised budget allocations in both the presence and absence of the GBS programme. It is however quite unlikely that the additional expenditures in priority sectors such as health and education would have been possible in recent years without budget support: donors have effectively contributed to higher levels of expenditure in these key poverty-related areas.

56. By comparison, we do not have evidence to be able to judge whether the PARPA has yet led to a more efficient and equitable geographical targeting of poverty-related expenditures, but this should be an important criteria in any future evaluation of its success.

57. In seeking to assess the efficiency of public expenditure, a major weakness in Mozambique is the continuing lack of a clear linkage between sectoral planning mechanisms (such as the PARPA and MTEF) and the Government's ability to effectively channel Government expenditure to these sectors and regions. As we have seen, implementation of the budget is subject to many mid-year revisions and is largely undertaken on an incremental basis. Also there is currently little effective oversight of budget implementation, either by MPF or by the Administrative Tribunal, hence available evidence on how and whether resources are being used for their intended purposes relies exclusively on figures provided by the spending agencies themselves. Substantial off-budget expenditures, predominantly financed by external donors and non-budgeted revenues, means that it is impossible to estimate with any certainty how the aggregate pattern of public expenditure has really changed in recent years.

6.2.3 Predictability of budget funding

58. This seems to be the most contentious issue in all of the case study countries – donors remain unwilling to commit resources over multiple periods and wish to maintain notional conditionality over the use of their resources. The predictability of donor support has already been highlighted as a particular area of concern in Mozambique due to the relatively high proportion of total fiscal resources which are externally funded. This also raises doubts about the credibility of donor threats to cut off budget support in the future. This could have serious political, financial and economic consequences, for example if the government cannot afford to pay salaries of key public sector workers due to donor refusal to release promised funds[12].

59. This is a key area where DFID and other partners must more clearly define "the rules of the game". The potential for withdrawal of funds could seriously undermine government plans to implement its poverty reduction programme and particularly undermine the credibility of the MTEF. Government will be taking undue risk by expanding its service delivery programme in areas such as health and education if there is a risk that available resources will not be sufficient to cover even current expenditures and hence would rationally postpone decisions until there is greater certainty. This means that it would become rational to delay funding commitments until funds had actually been released, rather than when they are committed or programmed. This will serve to also further undermine the position of the MPF in relation to other ministries, which will undermine some of the other supposed benefits of GBS.

6.2.4 Effectiveness of Public Administration

60. In similarity to the discussion of the efficiency of resource allocation above, the effect of GBS in this area would seem to be more indirect than direct. As donors devote an increasing proportion of their aid budget to GBS, they have certainly become more concerned with systems of public financial management and with implementing reforms to

[12] However, Foster (2002) argues that the non-project support, which is most at risk of being interrupted, accounted for only 18% of total government expenditure in 2002. He also estimates that a combination of domestic revenues and foreign exchange reserves should be sufficient to meet over 90% of recurrent expenditures in the event of an aid crisis. It is not specified for how long they could be sustained, although probably only in the short-run.

strengthen these systems (which, in effect, they previously side-stepped by establishing their own project implementation mechanisms). It is too early to say whether the current programme of reforms will be successful in improving the effectiveness of public administration in Mozambique, but it is undoubtedly a step in the right direction and the fact that this issue is now nearer to the top of the agenda for discussions between government and donors is a breakthrough in its own right.

61. It should be recognised that the effectiveness of public expenditure is also limited by other factors such as a weak human resource base, low wages and an over-centralised public expenditure system in which provinces have lost most of their discretion over spending. To the extent that budget support increases the "resource envelope" which the Government has available to implement an effective civil service pay reform programme, this may be another mechanism by which budget support leads to enhanced public service delivery, by increasing the Government's ability to attract and retain skilled personnel in high priority occupational categories. It is more difficult to see how, at least in the short term, a move to budget support will support decentralisation of the administrative system, unless this becomes one of the agreed objectives of the public expenditure management reforms and donors continue to pressure the Government for greater commitment in this area. In the context of the current political situation and electoral cycle in Mozambique, with further municipal elections in 2003 and national elections in 2004, further progress on the decentralisation agenda is probably stalled for the time being.

6.2.5 Strengthening of democratic accountability

62. The main argument which underlies the potential link between budget support and democratic accountability is that, as a higher proportion of resources come on-budget, they should become more responsive and accountable to the standard legal and parliamentary checks which characterise systems of democratic government. These systems are, in theory, designed to reflect the interests of a wider range of groups within the domestic society and hence will result in greater levels of popular accountability in the budget planning and execution processes.

63. Does this characterise the experience in Mozambique to date? It is extremely difficult at this relatively early stage to make a meaningful assessment in this area, but there is a sense in which current institutional weaknesses may actually be serving to undermine accountability. Positive changes may eventually flow from the current budget reform processes, but there is certainly no evidence that this is an "automatic" consequence of the move to GBS. Attention needs to be given, possibly as part of the technical assistance which accompanies budget support, to identifying and strengthening the key institutions which will enforce such accountability. These include the Budget Committee of the National Assembly and the Administrative Tribunal, whose role is to legally certify the accuracy, regularity and financial correctness of the accounts and of the Government's fiscal management[13]. As pointed out clearly in the PEMR and also the most recent ROSC[14],

[13] The 1998 Government General Accounts (Conta Geral de Estado – CGE) were the first to be analysed in this way by the Administrative Tribunal, with their opinions and responses from the relevant state organs published in the Boletim da Republica (BR).

[14] Report on the Observance of Standards and Codes (ROSC) in the area of fiscal transparency by the Fiscal Affairs Department of the IMF, February 2001.

these systems of budgetary oversight are currently very weak in Mozambique, due mainly to lack of technical capacity and also poor information availability on actual budget outcomes. There are currently no other official structures, such as sector working groups or poverty working groups, which could serve to effectively engage a wider range of domestic stakeholders in the budget formation process. The strengthening of popular accountability in this way also does not appear to be a significant part of the debate.

64. By contrast, to the extent that GBS leads to a centralisation of decision-making over resource allocation, with respect to other levels of government and also non-governmental development agencies, it could be argued that (in the short-term) this may actually be serving to reduce local democratic accountability. This is a controversial claim, but one that needs to be carefully considered. If we examine some of the more traditional aid delivery mechanisms, including well-designed project interventions, the emphasis often placed by donors (in coordination with their national counterparts who were often national NGO's) on local consultation in project design (e.g. for rural water supply systems or de-mining programmes) means that they were arguably subject to a wider range of democratic influence and were probably more responsive to local needs. By comparison, current provisions for the ongoing involvement of non-governmental agencies in the PARPA, to which budget support resources are meant to be contributing, are less clearly articulated[15]. Given the history of central planning and top-down allocation of resources in Mozambique, the level of commitment by government agencies to participative budgeting processes must be doubted.

65. Lastly, there is a perception amongst opposition groups in Mozambique that there is a bias within the current Government towards the interests of regions of the country from which Frelimo draws its political support, essentially the three southern provinces of Maputo, Gaza and Inhambane, as well as the far northern provinces of Niassa and Cabo Delgado. There is little direct evidence from measured allocations of public expenditure to support such claims, although we do know that poverty incidence is highest in the central and northern provinces. However, in the light of the current stage of the electoral cycle, there is clearly a risk of manipulation of future resource distributions for political purposes. This is something that will need to be carefully monitored by the G10 group of donors, as well as by Mozambican civil society.

[15] There is no formal participation action plan in the Mozambican PARPA, although a wide range of groups were consulted in its formulation. See Robb and Scott (2001) for a comparative assessment.

7. ASSESSMENT OF DFID MAPUTO'S GBS CAPACITY

66. It has not been possible in a desk study to make an accurate or detailed assessment of the human resource capacity of DFID's local office. Much of the following draws upon comments by Mick Foster and a review of DFID planning documents received from Maputo.

67. There is obviously a clear appreciation amongst DFID staff in Mozambique of both the potential advantages of and risks to the budget support programme. These have been clearly articulated in the new Country Assistance Strategy for 2003–2006. A number of staff members, including those responsible for sectoral support programmes, have apparently been involved in the design of the current programme. DFID Maputo, through their Economic Advisor, is also playing a leading role in promoting the coordination of donor activities in providing budget support in Mozambique and is continuing to push for further improvement of the programme.

68. Having been previously located within the British High Commission in Maputo, DFID has recently moved to its own purpose-built office facilities. These are centrally located within easy reach of the Ministry of Planning and Finance, the Central Bank and other important government departments. Extensive use has also been made of external consultancy assistance by the DFID office both in evaluating different aspects of their existing budget support programme and also in seeking to improve its effectiveness in the future.

69. There is possibly the need for further analytical support to the DFID office on the likely future macro-economic impact of the budget support programme, particularly if any meaningful evaluation is going to be made of the poverty-related impacts of this programme. This would need to take the form of (a) some fiscal incidence studies in key poverty-related sectors, which sought to pick up the net effects of both tax and expenditure programmes on the distribution of income levels, and (b) possibly also some macro-modelling which would look at the effects of aid flows on exchange rates, money supply and government borrowing requirements.

8. KEY LESSONS TO DATE

70. In countries which are as aid-dependent as Mozambique, donors are reluctant to risk putting all of their financial resources into one aid modality but prefer to maintain a range of different options (including project forms of aid), some of which are more closely integrated into government priorities; donors wish to see clear evidence of the impact of their aid before moving further towards budget support – in light of the identified risks, this is probably a sensible strategy.

- The most obvious immediate impact of general budget support is the premium that this places upon effective donor coordination – this has been one of the successes of the Joint Donor Programme in Mozambique to date, but also presents a substantial challenge for the future, due to:
  - the need to now reach common agreement amongst disparate donors over the policy matrix which will be attached to future budget support disbursements;
  - how government success in meeting established policy targets will be measured and interpreted.

- From the point of view of the Ministry of Planning and Finance (but not necessarily of line ministries), it is important to enhance the predictability of financial flows in order to support a move towards medium-term fiscal planning through the MTEF. This is currently not perceived as being central to the budgetary process; there is no tradition of budget discipline in Mozambique and this is only now beginning to be challenged.

- Major risks to the success of the budget support programme are perceived to be:
  - concerns about a lack of government commitment to the general improvement of governance standards, despite statements of government intent in this area;
  - currently weak relationship between budget planning and budget execution – with the Ministry of Planning and Finance unable to impose budgetary discipline over spending ministries;
  - risk that the planned implementation of public finance reforms will not result in a more efficient and transparent allocation of public expenditures.

- This raises the question of the degree of sustainability of budget support programmes in countries where the absence of an effective public expenditure management system means that there are few guarantees that donor funds (irrespective of how these are delivered) will be used effectively and transparently? To what extent does further centralisation of the budget planning and execution systems actually create a situation in which the risks of bureaucratic malfeasance are actually increased? In Mozambique, it is unlikely that donors will continue to support a budget support programme in the medium term without clear evidence of improvements in public resource management.

- The proposals by the European Commission to move towards a mixture of fixed and variable tranches in their budget support programme deserves to be studied further by DFID. Given that there is a common desire by donors in Mozambique to move towards a much clearer articulation of the conditions which the Government must fulfil in order to gain access to additional budget support funds (through some kind of multi-year and multi-donor partnership agreement) this provides one method of combining a sufficient degree of predictability with the necessary incentives to achieve or exceed established performance-related targets in key poverty-related areas such as health and education.

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PART 2

GENERAL BUDGET SUPPORT EVALUABILITY STUDY:

ANDHRA PRADESH CASE STUDY

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1 INTRODUCTION

1. This case study is a contribution to Phase I of DFID's General Budget Support (GBS) Evaluability Study. It provides part of the evidence for the Synthesis Report of that study (published as Vol I).

1.1 Scope and purpose of this report

2. The overall objective of this report is to explore the processes being established by DFID and others in Andhra Pradesh (AP) to deliver GBS as a financing instrument for poverty reduction.

3. The AP case study contributes in two ways to the terms of reference of the wider exercise. First, it provides a body of findings to support the study's preliminary conclusions on the appropriateness, effectiveness and efficiency of GBS as an instrument for poverty reduction. These findings are not meant to be definitive, nor do they constitute an evaluation. Together with evidence from the other case studies (on Uganda and Mozambique) they provide elements that should enable DFID to make informed judgements about the *evaluability* of this form of poverty-oriented development cooperation. In turn, they may assist the design of a further programme of research and evaluation to be undertaken jointly by DFID and other donors as Phase II of the exercise.

4. This main part of the evaluability is based on two steps:

- The construction of a conceptual framework describing the expected results of providing GBS.
- The testing and refinement of this framework in the light of three contrasting types of country experience, in AP, Uganda and Mozambique.

5. A secondary objective of the evaluability study, including the AP case study, is to identify emerging lessons for DFID on the design, management and monitoring of GBS programmes. The study aims to provide feedback on early experiences with GBS and make proposals about ways of improving practice in the future, including organisational and human resource issues. The AP experience is an important source for both parts of the study because it involves the provision of relatively large amounts of GBS in a federal, low-aid dependency environment. It is also the first GBS programme that DFID have approved in Asia.

6. It should be noted that the AP GBS programme is relatively young and that the case study therefore comments more on programme design and intent than on performance. The programme was agreed in early 2002 and the first tranche of GBS was disbursed in March 2002. At the time of the fieldwork for this study, in September 2002, DFID and the WB were about to embark on the first joint review of progress with the implementation of the programme with the Government of Andhra Pradesh (GoAP).

1.2 The conceptual framework

7. The conceptual framework that is being tested against programme realities in the three case studies is fully explained in Chapter 2 of the Synthesis Report. It is described here in abbreviated form, for those who may not have the Synthesis to hand.

8. Budget support refers to the channelling of donor funds to a partner government using its own allocation, procurement and accounting systems. Within this definition, GBS covers financial assistance as a contribution to the overall budget without formal limitation on where funds may actually be spent and any conditionality focused instead on policy measures related to overall budget priorities. Sector budget support covers financial aid earmarked to a discrete sector or sectors, with any conditionality relating to these sectors. Additional sector reporting may augment normal government accounting.

9. The conceptual framework consists of two elements:

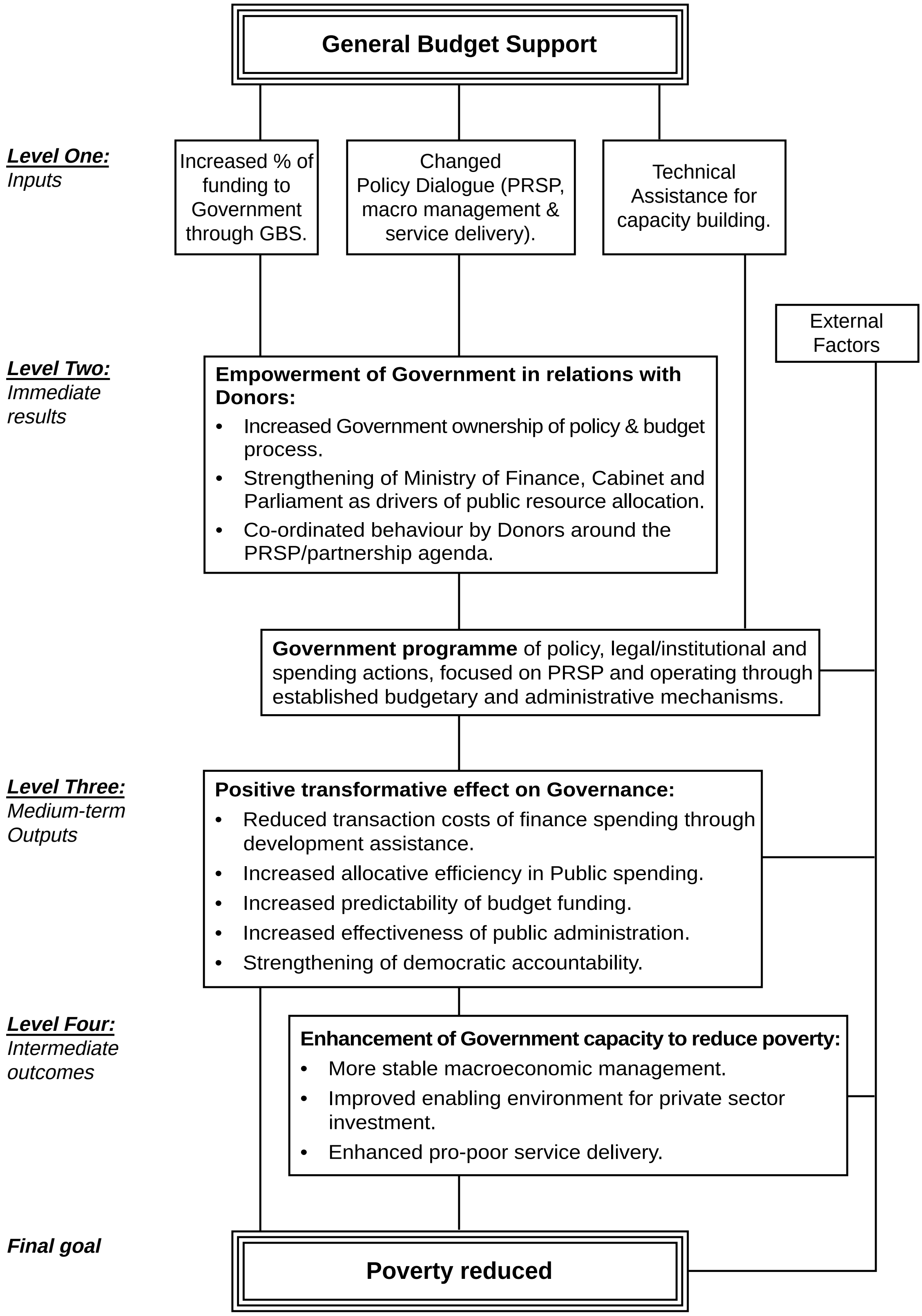
- an argument setting out the origins of the current approach to budget support in firstly, a critique of the project paradigm and secondly, disillusionment with the traditional form of programme aid, based on ex ante policy conditionality
- an effort to set out in diagrammatic form the principal claims made on behalf of “new” GBS as a modality of poverty-oriented aid, spelling out the implied causal links in logical-framework fashion. (Figure 1).

10. The characteristics of “new” budget support are identified in the following ways:

- It is partnership-based and provides untied budgetary resources in support of a nationally owned strategy.
- It is focused explicitly upon a Poverty Reduction Strategy Paper (PRSP) process and supports the government’s own poverty reduction strategy.
- It gives prominence to institutional development objectives, specifically to the requirements for creating accountable, capable governments.
- It utilises predictable, transparent methods for external budget finance which minimise transaction costs and work through government systems and processes.

11. Coordination of donor initiatives in support of the budget is a crucial component of the budget support process – the aim being to reduce transaction costs, improve predictability of funding, protect ownership and strengthen democratic accountability. Participation in policy and programme design by parliamentarians, local governments and civil society is also a prominent characteristic, supported by incorporating participation into the formulation of the government’s poverty reduction strategy. All these elements are captured in Figure 1, which is reproduced from the Synthesis Report.

Figure 1. Logical Framework Analysis of General Budget Support



12. As emphasised in the Synthesis Report, it is important to note that figure 1 is not based on any existing programme documents nor is it meant to describe either the current policy of any agency or the actual situation in any country. Instead, it aims to crystallise

the claims now being made about the superiority of new budget support as an aid modality. The implicit counterfactual is the provision of equivalent resources by means of an alternative aid modality or modalities – projects, traditional programme aid and/or direct sector budget support.

13. In response to the comments received on the Inception Report, the case studies have focused primarily on the "front-end" of the logframe, comprising levels one, two and three of the figure. The justification for this was that firstly some indication of impact at these levels would certainly be needed in order to provide any basis for further work in phase II and secondly, in so far as early lessons might be emerging from the experience of planning and managing budget support, it was most likely to be at these levels.

1.3 Background

14. The federal nature of India means that budgetary support cannot be provided to state governments without the acquiescence of the Government of India (GoI).[1] In part stemming from the lack of aid dependency and some equivocation about external assistance in general, donors operate in a much more uncertain environment in India than in most other countries. GoI's policy on GBS is not articulated and decisions seem to be made on a case-by-case basis and for only one year at a time.

15. In March 2002, DFID disbursed £65 million (US$100m) of financial aid to the Government of India, to be passed on in grant terms to the Government of Andhra Pradesh based on the completion of a set of agreed prior actions.[2] This financial assistance was not earmarked to specific expenditure items. An additional £0.5 million of DFID Technical Assistance (TA) was approved to support preliminary analysis, design work and one-off studies on key elements of the programme.

16. This complements a substantial portfolio of existing DFID TA in the state which includes support to power sector reform, public enterprise reform, revenue reforms, governance reforms and the strengthening of poverty analysis and monitoring. For DFID, this was and is the first instance of GBS in India, as well as the first instance in Asia. The AP GBS programme was designed and co-financed with the World Bank, who separately disbursed $250 million in GBS to the Government of Andhra Pradesh in March 2002.[3] The World Bank GBS is split equally between credit and loan.

17. It is anticipated that this will be the first of a series of annual tranches of GBS from DFID and the World Bank over the next three to four years in support of GoAP's fiscal and economic reform programme. A decision to provide assistance, and its level, will be taken each year by donors and GoAP on the basis of need and the performance achieved, and

[1] It should be noted that we did not meet with central government officials during the case study.
[2] Andhra Pradesh is the fifth largest state in India with a population of 76 million. Per capita income was US$380 in 1999 which is about 90% of the all-India average. Around one quarter of the population live in poverty, depend largely on agriculture, and are outside the reach of public services. The state fiscal year runs from April to March.
[3] AP is the third Indian state with which the World Bank has signed a Programmatic Structural Adjustment Loan (PSAL). Uttar Pradesh and Karnataka signed PSALs in 2000 and 2001 respectively.

will have to be approved by GoI. The main institutional and fiscal reforms supported by GBS operations in AP are expected to be completed by 2006/07.

18. The AP GBS programme aims to help the government achieve the goals of its fiscal and governance reform programme. The government's **fiscal reforms** are aimed at fiscal stabilisation, improved public resource mobilisation, and a restructuring of public expenditure towards priority development areas. This is accompanied by **public expenditure management reform** to strengthen financial management capacity and institutions, improve the realism of the budget, enhance fiscal transparency and accountability, and improve operational efficiency. It is also accompanied by **governance reforms** aimed at strengthening anti-corruption efforts, civil service reform, public enterprise reform and a programme of poverty monitoring and analysis. The specific measures in each of these three areas by which it has been agreed that progress in the reforms will be monitored are summarised in a GBS policy matrix. The reform measures are drawn from the government's existing strategies and reform programmes.

19. The programme of reforms supported by GBS aims to strengthen the efforts of AP to operationalise its *Vision 2020* document and is consistent with efforts by the Government of India to stimulate fiscal reform in the states, as explained below:

- Nationally, AP is seen as a pace setter for reform. Under the leadership of its Chief Minister, Mr Chandrababu Naidu, AP was the first Indian state to articulate a comprehensive vision when it released *Vision 2020* in 1999. *Vision 2020* is an ambitious statement of intent to pursue economic growth, social development and poverty reduction. Economic growth and a transparent and accountable government are seen as tools by which the state's objectives for human development and poverty reduction will be achieved. The government has set up a Poverty Eradication Mission with members from government, civil society and academic institutions. A key element of the government's reform programme is to develop and broaden the understanding of poverty and enable the government to sharpen the poverty focus of all its policies and programmes.
- There is increasing recognition of the importance of state reforms to solve India's national economic problems. The Government of India is a key player in the process of fiscal reform and must be a party to any agreement between donors and state governments on fiscal adjustment. The states derive a large proportion of their revenues (50–60% in some cases) through federal transfers. In addition, their ability to borrow is determined by the centre. Since GoI is in effect the lender of last resort to state governments it has an interest in the progress of fiscal adjustment reforms at state level, at a time when fiscal sustainability is by far the most serious macroeconomic issue facing the country (the states' share of the national fiscal deficit is now close to one half). The Tenth National Plan and mid-term appraisal of the Ninth Plan both argue that for the rates of economic growth required for poverty reduction (8% in the Tenth Plan) to be realised the issue of fiscal reforms at state level must be addressed as a necessary (though not a sufficient) condition.[4] Hence

[4] The links are (i) macroeconomic stability and hence sustainability of the growth process (ii) crowding out private sector investment by public sector borrowing (iii) the importance of public savings to raising overall savings and investment rates, and (iv) the link between the deteriorating fiscal position, particularly at state level, and shortfalls in public savings.

the establishment of the GoI Fiscal Reform Program (FRP) to strengthen the incentives facing states to undertake fiscal reforms. Under the FRP, a portion of central transfers is set aside to be allocated to states on the basis of performance in reducing revenue (recurrent) deficits on the basis of a Memorandum of Understanding between the state and the centre.

1.4 Methodology

20. This report is based on a review of documentation relating to the AP GBS programme and interviews with those involved in the design and management of the programme in Delhi and Hyderabad, conducted during the period 16–24 September, 2002.

21. It should be noted that the case studies are relatively short exercises. Contacts in several instances were limited to one meeting and a number of people with whom it would have been desirable to discuss the programme were not available at the time of the fieldwork. To minimise this constraint, care has been taken to check the interpretations and hypotheses expressed in this report with various stakeholders.

22. The case study was originally to have covered DFID's Orissa GBS programme as well. The context in Orissa is the same as in AP – DFID and the World Bank working jointly towards agreement with the state government on a medium-term adjustment programme and one or more tranches of GBS accompanied by complementary TA. However, at the time of the fieldwork agreement had not yet been reached with respect to the package of reform measures against which GBS could be delivered and further design work was required.

23. Indicatively, the Orissa GBS programme will comprise a first tranche of US$120 million from the World Bank and £40 million (US$60m) from DFID to be disbursed in 2002/03 (though of course these figures may change). Formal appraisal of the Orissa GBS programme is expected towards the end of 2002. While not formally including the Orissa programme in this case study, we make reference to it wherever possible.

24. Discussions were also held with the Royal Netherlands Embassy (RNE) Delhi. RNE has recently agreed a joint GBS arrangement with the Asian Development Bank (ADB) and the state government of Kerala. The ADB/RNE programme is for US$250m of GBS (of which US$50m is from RNE) to be disbursed in two equal tranches, indicatively in late 2002 and late 2003. RNE is considering further involvement in GBS arrangements in Kerala beyond this, as well as involvement in future tranches of the joint DFID/WB programme in AP.[5]

1.5 Organisation of the report

25. The report consists of six chapters. Following this introduction, chapters 2-5 are organised around the set of questions listed below.

[5] At the time of the fieldwork RNE had reached no decision with respect to its future GBS commitments.

- To what extent does the conceptual framework capture the intentions of the instigators and managers of budget support in AP?
- To what extent are the level one inputs and activities in place?
- How far are the immediate results at level two discernable and the medium-term institutional effects at level three objectives of the programme?
- To what extent is the programme likely to deliver the benefits identified in the conceptual framework. A number of issues are identified which, we suggest, will affect the success of the programme.

These chapters correspond to chapters 3, 4 and 5 of the Draft Synthesis Report.

26. In chapter 6 we summarise the observations of DFID staff on the design and implementation of the AP programme so far, as well as our overall conclusions arising from the comparison of the GBS evaluability framework with the AP programme.

2 WHAT BUDGET SUPPORT IS SUPPOSED TO ACHIEVE: ASSESSING PROGRAMME INTENT

27. This section looks at the relevance of GBS in AP. It looks at the extent to which the characteristics of 'new' general budget support are found in the AP GBS programme. It then looks at the logic of financial assistance to the GoAP reform agenda and the specific developmental benefits of GBS in this context compared to other aid financing modalities.

2.1 Introduction

28. As emphasised in chapter 1, our conceptual framework formalises the rationale for budget support as an aid modality. It is not an empirical description. It expresses what might be the objectives and intended outputs of a relative shift in funding towards budget support, combined with a structured shift in the nature of policy dialogue and a re-focusing of the use of technical assistance. It is nevertheless important to ask to what degree actual programme documentation, and the beliefs of programme staff with responsibility for budget support, correspond to this model.

29. In chapter 1 we noted that the characteristics of 'new' budget support were: [6]

- It should be partnership based, providing untied budgetary resources in support of a nationally owned strategy.
- It should be focused explicitly upon the government's own poverty reduction strategy.
- It should give prominence to institutional development objectives, specifically the requirement for accountable, capable governments.
- It should utilise predictable, transparent methods for external budget finance which minimise transactions costs and work through government systems and processes.
- It should include coordination of donor initiatives as an important theme.

30. These intentions are all apparent in the AP GBS programme, but are observable more in conversation with GoAP officials and DFID advisers based in Delhi rather than in programme documentation, which tends to focus on the expected impact of the reform programme being supported. Programme documentation relates mainly to the medium-term outputs (level three) and outcomes (level four) of the GBS programme. It does not set out immediate results (level two) as presented in figure 1 nor does it consider in any detail the particular choice of aid modality. Nonetheless, at a basic level, one can see consistency between structure of objectives in figure 1 and the AP GBS programme, as the following points illustrate:

- The AP GBS programme provides **untied budgetary resources** in support of the government's attempts to achieve the goals of its *Vision 2020* document. The great strength of *Vision 2020* is that it is home grown, ambitious, and has provided GoAP with direction and a set of high-level goals which set the agenda for development to

[6] "In a strict sense, such a model has not formally been adopted by any donor, however... it can be said to represent some sort of consensus on the direction for the future." pp5–6, GBS Evaluability Study Phase I, Inception Report, Report to DFID, OPM/ODI March 2002.

which its partners, including international development partners, are challenged to respond. There is recognition in government that *Vision 2020* needs to be complemented by operational strategies (in this sense it is currently less binding than a PRSP). The Policy Matrix around which GBS is provided responds directly to this requirement with a prioritised set of targets covering the government's fiscal and governance reforms. The matrix was developed in an iterative manner between GoAP, the World Bank and DFID and is essentially a summary of what are considered to be the key elements of the government's own reform agenda.

- The AP GBS programme **does not contain explicit ex ante conditionalities.** This was mentioned to us on several occasions by GoAP as the key design feature of the programme as far as it was concerned – tranche release is based on an assessment of reforms actually completed rather than 'promises' to implement specific reforms in the future.[7] However, while espousing the principle of partnership, DFID and the World Bank regard the policy matrix as an important mechanism by which 'difficult' reform issues (for example, anti-corruption) can be 'put on the table'. Several donor commentators expressed the view that the threat of stopping budget support in this regard was important. Thus, while the need to work in partnership with GoAP appears to be well understood it is noticeable that in practice the language of conditionality has not been entirely left behind by donors and that the threat of 'exit' from GBS arrangements is seen as important to retain.
- Interestingly, there was explicit **consideration of alternative aid modalities** before GBS was chosen. In AP, both DFID and the World Bank have been involved in supporting the state government through three major initiatives all of which had fiscal stabilisation as the key objective – the Economic Reform Programme (APERP), the power sector reform programme, and the public enterprise reform programme. These were all earmarked investment programmes with donor funds tied to specific purposes and complementary TA. It became evident over time that these instruments were not meeting the stabilisation objective: on the contrary, they put further pressure on the state budget because of the need to allocate counterpart financing and to finance the recurrent operational costs of the investment programmes. Both donors therefore began to consider untied general budgetary support as an alternative aid modality. DFID in particular have noted that this is not to make the case against investment programmes (which GoAP needs to meet its restructuring objectives) but to point out that these programmes were detrimental to the fiscal stabilisation objective.
- At the heart of the GBS programme are an agreed set of **fiscal and institutional reforms** aimed at improving budget implementation and monitoring. The programme is based on an explicit Medium-Term Fiscal Framework (MTFF) which includes the fiscal cost of power sector restructuring and liabilities arising from public enterprise restructuring. Discussions have been held with the GoI Ministry of Finance to ensure that the GoAP MTFF is consistent with GoI's fiscal reform agenda for GoAP.[8] Unlike previous DFID programmes, the GBS programme targets cross-cutting institutional

[7] The prior establishment of a track record in reform was therefore important in order to commence with the programme. Hence, the identification of specific prior actions in the Programme Policy Matrix.
[8] The MTFF targets a consolidated budget deficit of 5.6% of GSDP in 2001/02 (compared to 6.2% GSDP in 2000/01), a consolidated budget deficit of 4.6% GSDP in 2002/03, and a gradual move into fiscal surplus over the medium term.

areas such as fiscal reform, governance and poverty. Moreover, engagement and dialogue are more ‘upstream’ compared with other aid-supported projects and programmes which tend to be confined to one or two departments.

- The AP GBS Programme diverges from figure 1 on the issue of **predictability.** While the programme is explicitly designed around an MTFF and aims to provide medium-term budget support, the decision on whether to provide assistance is taken annually. This annual tranching of budget support is partly a risk mitigation strategy. However, it is more significantly dictated by GoI who has not yet permitted donors to make multi-year GBS commitments. For GoAP, the predictability of budget support in these circumstances depends on:
  - GoI policy stance on GBS.
  - The content of the forward years of the policy matrix
  - The process of assessment by all stakeholders of progress against the matrix.

  A related issue is the lack of intra-year predictability of GBS. The first tranche of budget support was released at the end of the fiscal year that it was intended to support. To meet its cashflow requirements during the 2001/02 fiscal year, GoAP therefore borrowed an amount equivalent to US$250m from GoI which was repaid with the first tranche of GBS. Delays in the disbursement of GBS seem to have been caused by the approval process within both donor organisations taking much longer than had been anticipated.

31. For the purposes of evaluability the points above demonstrate some compatibility between the AP programme and the conceptual framework described earlier in this report. But it does not tell us enough about the choice of GBS over aid modalities (projects and programmes) as a means to achieve medium-term outputs and goals. The questions are: why is GBS an appropriate aid modality in AP and what are its specific benefits? Or put another way, if GoAP would have undertaken these reforms anyway, why is GBS still relevant and is there is some additional value in the extra resources at the margin which DFID has provided? This is the subject of the next section.

2.2 Relevance and benefits

2.2.1 The AP reform programme

32. In order to understand the logic of GBS in AP it is necessary to first outline the state’s economic and public sector reform programme.

- Major **fiscal reform** has been launched in AP, with the aim of significant increases in own-tax revenues, a reduction in food subsidies, and a freeze on civil service hiring.[9] However, these measures have been prevented from achieving fiscal stabilisation to date because of a rising power sector subsidy burden. The expanding power sector financing requirement and the related off-budget financing of that deficit has been the main cause underlying the deterioration of the fiscal position in AP. Reforming

[9] GoAP have had a freeze on civil service hiring for some time. Downsizing the public sector in AP is about public enterprise reform and not large scale retrentchment of civil servants.

the power sector is therefore a key component of the overall fiscal reform programme. A medium-term agenda for power sector reform has been developed (supported by DFID and WB) leading to privatisation in 2003/04. In the meantime, declining power sector subsidies are incorporated directly into the budget and use of supplementary budgets has stopped. The MTFF which has been developed incorporates the power sector resource requirements that are needed until the sector returns to profitability.

- The key to delivering the *Vision 2020* agenda is rapid growth, fiscal stabilisation, improved and explicit pro-poor policies, and governance reforms. A second pillar of the reform programme therefore comprises **public expenditure management reforms.** In the past, unrealistic budgets have made the achievement of fiscal targets difficult, with expenditure outcomes consistently deviating from budget, the emergence of significant payments arrears, few incentives for efficiency, and limited accountability along the line. Reforms in public expenditure began with a review of expenditure programmes for the 2000/01 budget with a view to containing and improving expenditure allocations and utilisation. Hard budget constraints are now set at the beginning of the budget cycle consistent with the MTFF which aims to protect key development expenditures and increase allocations to primary health and education, operations and maintenance, and priority public investment in essential infrastructure. A system of mid-year reviews of budgetary performance in line departments has been established, in part to establish a qualitative link to the next year's budget. Within the hard budget constraint, the government has extended budget flexibility through bundling heads of account, authorising six-month advance budget releases (the first state in India to do so), and has granted greater responsibility along with accountability to line departments. The government has identified an agenda for further strengthening expenditure programming and financing management.
- The third pillar of the government's reform programme is **improved governance and public management.** Overall, the aims of the governance reforms are to reform core systems, realign incentives, and gain some 'quick wins' to sustain the political support needed to carry the reforms forward. AP has enacted a variety of measures under the rubric 'SMART' – Simple, Moral, Accountable, Responsive and Transparent – to enhance service delivery and turn the public sector into an enabling agent for private sector growth. The government has produced a draft strategy on governance reform and, in collaboration with DFID, established a Centre for Good Governance (CGG) to undertake the requisite analytical work in support of reforms and facilitate their implementation.[10] The CGG was inaugurated by Prime Minister Tony Blair in January 2002. Realisation of the governance and public management reform agenda will require progress in several areas, including civil service reform (reduction in numbers and improved efficiency), deregulation, e-Government, anti-corruption, and transparency.
- An important part of the governance and public management reform agenda are the activities GoAP has undertaken to broaden the understanding of poverty and ensure that all government policies and programmes make a greater contribution towards **poverty reduction.** There is potential to make greater progress on eradicating poverty

[10] Both *Vision 2020* and the Government's *Strategy Paper* emphasise the need to refocus government priorities from being a direct provider in many sectors of the economy to a facilitator of private sector activity. This will involve reorienting the civil service to focus on the delivery of core goods and services.

by ensuring that all decision making across government is informed by poverty analysis. To this effect GoAP has established a Poverty Eradication Mission under the Chief Minister. A unit within the mission will carry forward analytical and poverty monitoring work. This unit aims to provide policy guidance and inputs to planning and budget processes in government, and play a coordinating role in developing poverty reduction strategies and pro-poor growth policies.

- Although the core issues concern fiscal reform, public expenditure management and governance/public administrative reform, there has been explicit recognition that there is a need, through the reforms, to address economic growth. This is recognised as a critical constraint to poverty reduction in general, and as a particular concern at a time when public sector downsizing is being contemplated.

2.2.2 The Rationale for Development Financing

33. The rationale for development assistance therefore derives from:

- The need to protect priority development expenditures through the period of reform. These expenditures (non-wage O&M, capital outlay, primary health, primary education) would otherwise face substantial forced cuts if the power sector is to be restructured within the constraints of the MTFF (as mentioned above, power sector restructuring involves significant short-term costs).
- Budgetary support to the power sector while the sector reforms take place. The experience of other states is that if support is not provided, reforming power utilities are forced to run large arrears and enter into expensive short-term borrowing arrangements detrimental to the long-term health of the sector. The power sector financing requirement is projected to decline only over the medium term – there is a limit to the rate at which tariffs can be increased and efficiency improved without provoking a backlash.
- Voluntary retirement payments related to privatisation, closure or restructuring of public enterprises, which also place a demand on the budget.

34. The first of these items has not been quantified. The second and third are estimated at US$670m in 2001/02. The combined DFID/WB assistance through GBS of US$350m amounts to less than 5% of the government budget and less than 1% of Gross Sustainable Development Product (GSDP) in 2001/02.

35. The rationale for *significant* levels of financial assistance is that such amounts allow the pace of implementation of the government's reforms to be increased over and above what would otherwise have been the case while protecting priority development expenditures. The main institutional and fiscal objectives supported by the programme are expected to have been achieved by the end of 2005/06. At this point the GBS programme is expected to cease and GBS funds will be replaced by those domestic fiscal resources that have been released as a result of the reform programme (i.e. the resources presently allocated to power sector subsidies will become available for developmental purposes).

2.2.3 The Rationale for General Budget Support

36. The rationale for GBS as a means of disbursing funds and achieving specific development goals therefore rests on three arguments.

'Flexibility' and support for the fiscal stabilisation objective

37. GBS allows for flexibility in allocating resources between and within the three main areas of reform which are generating transitional costs – power sector restructuring, allocations to priority social sectors, and public enterprise restructuring. As long as the aggregate annual cost of reform in these areas has not been significantly underestimated, GBS avoids the need to resort to unplanned borrowing or build-up of arrears in any one area of reform if the costs of reform deviate from plan. Unlike previous financing modalities, GBS has no counterpart financing requirement or O&M implications.

38. To this extent, GBS is supportive of the fiscal stabilisation objective. The World Bank refers to 'the flexibility [of programmatic budgetary support] required in the Indian political environment' (World Bank 2002, p9). We take this to mean that if the projected level of power sector restructuring in 2001/02 proves politically impossible to achieve, GBS funds can be used to fund the higher level of power sector subsidy that would be required in that year, thereby supporting the fiscal stabilisation objective. This possibly reflects the difficulty in making an ex ante assessment of the rate at which power sector restructuring in AP becomes politically unsustainable. A key reason for using GBS as an instrument for fiscal stabilisation therefore rests on the political economy of reforms.[11]

'Gap filling' and support for the Public Expenditure Management (PEM) reform objective.

39. GBS provides the GoAP Finance Department with additional discretionary funds, thereby enhancing its ability use the budget as a tool for resource allocation and performance improvement.[12] A rough calculation suggests that in the short term the Finance Department has full discretion over only about 10% of its annual budget, of which about half has to go to power sector subsidies. The 90% of the budget that is in effect 'non-discretionary' expenditure is allocated to salaries, wages, pensions, debt interest, and counterpart funding for centrally sponsored schemes and donor projects. This 90% of the budget is relatively fixed **in the short term** and therefore not available in any significant amount for reallocation within or between sectors.[13]

[11] DFID advisers agree with us on this last point but they have argued that the particular WB statement referred to is a reference to the programmatic nature of support (i.e. annual approvals within a multi-year framework) and is in fact a reference to a risk mitigation strategy for donors, whereby if reforms become stalled for political reasons, donors can withdraw support. The two interpretations raise important issues about the true nature of the partnership with government. These issues are discussed later in this report.
[12] This hypothesis was confirmed by the Finance Department, GoAP. The percentages discussed here are Finance Department estimates.
[13] This argument only makes sense as long as the focus is short term (say, 2-3 years). In the medium to long term all budget resources are available for reallocation within or between sectors.

40. At US$ 350m in one year, GBS represents about 5% of the AP budget and according to the above argument doubles the amount of discretionary resources available to the Finance Department. In the context of a reforming government that is trying to maximise the benefits of additional expenditure at the margin, this amount and the flexibility associated with it is significant. While it is difficult in the short term to reduce expenditure to non-performing departments, GBS at least allows the Finance Department to refuse to increase expenditure in non-performing departments until they improve their efficiency and/or can demonstrate the effectiveness of their existing and planned expenditures. In this scenario, the Finance Department can give the resources instead to performing sectors and begin to demonstrate the quasi-contract that is the budget (i.e. funds are provided through the budget in return for specific outputs and not as of right).

41. This gets to the heart of what a department or ministry of finance is supposed to do when moving towards a Medium-Term Budget Framework (MTBF) as in AP. The logic of the AP GBS programme is that it brings forward this role by about three or four years, after which time the power sector will have been restructured and an additional 5% of discretionary resources (currently used as power subsidy) will become available to replace the financing currently provided by GBS. [14]

'Dialogue' and support for the governance reform objective.

42. GBS is an instrument which enables donors to engage in dialogue with GoAP on core functions and the governance reform agenda (i.e. expenditure programming, budget execution, financial management and accountability, public management and administrative reform). It has enabled DFID to 'get a seat at the table'. DFID programmes have looked at these issues in the sectors in which they operated but they have not been able to address them systemically.

43. There is general agreement that the governance reform agenda is difficult to 'projectise' and that, in AP at least, it is only through GBS and the dialogue that goes with it that donors have been able to influence GoAP's public administrative reforms and encourage difficult issues (such as corruption) to be confronted. A related point is that GBS allows some funding of the governance reform agenda. These benefits were acknowledged by both the WB and the RNE (interestingly, the Dutch do not see GBS as necessary to gain influence on the governance reform agenda in Kerala, but they agreed that 'Andhra Pradesh is different').

44. In a low aid-dependency environment, this type of policy influence is important for DFID. Influence over governance reforms at state level will improve the enabling

[14] A Medium-Term **Fiscal** Framework is the first, necessary step towards a Medium-Term **Expenditure** Framework. It typically contains a statement of fiscal policy objectives and a set of integrated medium-term macroeconomic and fiscal targets. A Medium-Term **Budget** Framework builds on this first step by developing medium-term budget estimates for individual spending agencies. The objective of an MTBF is to allocate resources to the nation's strategic priorities while ensuring that these allocations are consistent with overall fiscal objectives. In fact, an MTBF is the most basic type of MTEF. An MTEF develops the approach further by adding elements of activity-based and output-based budgeting to the MTBF. These methods seek to improve the efficiency and effectiveness of public spending, in addition to enforcing fiscal discipline and strategic prioritisation. *OPM Review, May 2000.*

environment for other DFID interventions in the state. But of much more significance, it may influence the effectiveness of that portion of the state budget which is not financed by external donors (in AP, some 95%).[15] In AP this objective is a shared one with government, which looks to DFID and other donors for strategic advice on what has worked elsewhere in governance and public administrative reform. Implicitly, the financial penalty for not confronting these governance issues is much more significant with GBS.

2.3 Assessing programme intent

45. It is clear that the "projects or GBS" debate does not apply in the AP context. Indeed, it is considered somewhat irrelevant by DFID who, with the WB, have developed the AP GBS programme to meet specific development goals which are not easily met by other forms of programme or project assistance. These intentions are well understood by the DFID office, which has a clear sense of the underlying institutional processes being promoted in the shift to budget support. We were also struck by the extent to which these objectives were shared by GoAP, in particular the Finance Department. This broad understanding has been promoted by internal debate and semi-formal seminars and training activities, and appears to have developed since approval of the programme. This may explain why the GBS programme document does not go into very much detail on the underlying argument concerning choice of aid modality.

2.3.1 The significance of low aid-dependency

46. Compared to other countries in which DFID works, especially those which are highly aid-dependent, it is noticeable how until the advent of GBS DFID did not see itself as having an effective voice on cross-cutting issues of institutional and administrative reform in AP which are at the heart of the state government's reform agenda. In this respect, GBS has 'fast-tracked' DFID entry into these debates. Several observers have commented that this has only been possible because of the particular openness of GoAP to external advice.

2.3.2 The significance of the federal context

47. The big area of uncertainty in all of this is the GoI policy stance on GBS. As one observer put it "if GBS unravels next year (because GoI does not approve further tranches) will DFID lose its seat at the policy table?" Dialogue is proceeding with GoI on the whole issue of GBS but discussions appear to be at a much earlier stage than at state level. We also understand that GoI is concerned about the overall level of aid being disbursed to particular states, irrespective of modality. These concerns become much more significant if the main choice of modality is GBS, which allows relatively large amounts of financial assistance to be turned on and off relatively quickly. At the time of the fieldwork we understand DFID had suggested to GoI that guidelines or a cap be placed on the overall level of aid financing to each state.

[15] There may not be much impact on centrally funded programmes. Here interaction with GoI may be more relevant.

48. In the longer run, the scope for effective delivery of development assistance through GBS is constrained by a fragmented budget process, much of which is not under state control. Both State and GoI reportedly bypass treasury systems in order to achieve more flexibility than the budget system would otherwise allow. Previous studies have indicated that, in GoAP at least, government sees project aid as having a number of significant advantages in this regard. The normal arguments for budget support do not therefore apply and, in the short to medium term at least, it would appear to make sense for DFID to plan (as it has done) to retain both earmarked programmes and projects within its portfolio.[16]

Box 1: Extract from DFID GBS Project Concept Note, January 2001.

> "DFID has projects in Andhra Pradesh in several sectors, including education, health, rural and urban development, and power. Whilst being successful in delivering results, these have had limited impact on the broader reform agenda. Budget support should help bring about a qualitative improvement in the enabling environment (e.g. a fiscally sustainable framework, and an effective pro-poor policy agenda) for taking forward DFID state strategy priorities. It will strengthen the prospects for the success of ongoing projects for which DFID already has committed resources (e.g. power sector, and public enterprise reform). It should also improve the environment for proposed DFID sector aid."

[16] Source: CAPE, September 2000. DFID currently does not have sector programmes in AP. This would require clearer sector policies, expenditure programmes, management and review arrangements.

3 ARE GBS INPUTS AND ACTIVITIES IN PLACE?

49. This chapter documents the processes used in the development and implementation of the AP GBS programme. A similar set of processes is underway in Orissa. As indicated in figure 1 above, the inputs and activities associated with 'new' GBS are:

- Direction of substantial financial flows through the budget.
- A new form of policy dialogue.
- A refocusing of technical assistance on institutional capacity building within government.

3.1 The nature of the partnership

50. The great strength of *Vision 2020* is that it is home grown, ambitious, and has provided GoAP with direction and a set of high level goals which sets the agenda for development in the state. *Vision 2020* has been utilised to derive a Policy Matrix which all parties regard as a tool to enable discussion of reforms to stay focused, priorities to be discussed, and progress to be monitored.

51. DFID has had a history of engagement with GoAP in several sectors over a number of years and believes that there is a fairly high level of understanding on both sides as to 'what the nature of engagement is all about'.[17] Some observers have noted that this past history of engagement, especially in a low aid environment, has made it easier for DFID to contemplate GBS in AP. To some extent it has enabled DFID advisers to recognise those policy issues which are less easily addressed through projects and programmes but which might be addressed by GBS. Equally, there is still some learning going on within DFID, where the cross-sectoral advisers (governance, social development, and economists) are more likely to be familiar in the first place with central level policy processes where these debates take place.

52. The Policy Matrix associated with the AP GBS Programme is not regarded by stakeholders (and certainly not by government) as a summary of conditionalities. Indeed, the term 'conditionality' in relation to GBS is unacceptable to GoAP, reflecting the very strong domestic ownership of the reform agenda from which the matrix is drawn. The reform actions against which progress is monitored and GBS tranches are released needs to be seen in this light. All stakeholders refer to the matrix as a means of focusing on the key reforms which need to be undertaken. In practice, this dialogue has revolved around five or six key figures in the state administration and is centred on the Department of Finance. Nonetheless, GoAP told us that the absence of conditionality "shows that donors are convinced in the reform agenda and the people managing it".

53. However, in both AP and Orissa the political difficulty of many of the reform measures being considered in each state indicates the extent to which the reforms, and the decision to enter into discussions about GBS-type financing, have been crisis driven. In both AP and Orissa (but more so in Orissa, where the budget crisis is more severe) the main

[17] Comments made to us by by GoAP support this view.

incentives to engage with the WB and DFID in GBS discussions are clearly the fiscal crisis and the increasing difficulty of meeting debt service and (in Orissa) salary commitments. Contributing to this, the harder line now being taken by GoI on state finances has reduced the prospects of unconditional bailout by the Centre. In relation to the cashflow difficulties being faced by each state the financing now on offer by DFID and WB through GBS is significant. For both DFID and the WB, there is recognition that resolving the fiscal crisis in each state, and the associated governance problems, are a prerequisite for sustainable poverty reduction. An additional attraction is the possibility of creating positive demonstration effects, promoting state-level reforms more widely, and thereby helping to address the problem of the fiscal deficit at national level.

3.2 Redirection of funding

54. It seems unlikely that all DFID's financial assistance in AP will move quickly towards GBS. However, GBS represents a significant shift between alternative aid financing modalities over a relatively short time frame. The shift in DFID's AP portfolio is shown in Table 1.

Table 1: DFID India Programme: Current Spending 1999/2000 – 2001/02 (UK£million)

	1999/2000	2000/2001	2001/2002
Project/ programme			
Sub Total Project Spending (AP)	12.80	19.60	26.50
Sub Total Budget Support Spending (AP)	-	-	65.00
Total DFID Andhra Pradesh	12.80	19.60	91.50
Total DFID India	96.00	105.00	180.00

3.3 Additional technical assistance

55. The level of TA provided by DFID to AP has probably not changed significantly as a result of GBS. The additional £0.5 million of DFID TA - approved to support preliminary analysis, design work and one-off studies - complement an already substantial portfolio of existing TA in AP (e.g. power sector reform, public enterprise reform, revenue reforms, governance reforms and the strengthening of poverty analysis and monitoring). The existing TA portfolio is seen as being largely complementary to the objectives of GBS programme (in particular, the CGG in Hyderabad) and the main reason why the additional amount of TA approved with the GBS programme is relatively small.

3.4 The process of programme development

3.4.1 Timing

56. In mid-2000, DFID and the World Bank concluded that the two key investment programmes on which they were collaborating in AP, the AP Economic Restructuring Programme (APERP) and the AP Power Sector Reform Programme (APPSR), were not supportive of the wider objective of fiscal stabilisation. The programmes had succeeded

in meeting some targets, such as increased social sector spending, but these achievements were overshadowed by problems with the fiscal framework, which went seriously off-track as a result of rising power sector subsidies, food subsidies, and a 25% increase in civil service salaries. While the pay increase was larger than had been assumed, reductions in subsidies on power and food were delayed. Neither APERP nor APPSR provided budgetary support to meet short-term fiscal pressures. Moreover, APERP skewed GoAP finances because of the recurrent and counterpart financing implied in the investments provided by the programme (i.e. roads, hospitals, schools, irrigation).

57. Through the remainder of 2000/01 DFID and the World Bank undertook three or four preparatory missions to AP to explore and develop an alternative means of supporting the GoAP reforms. The missions focused on firming up the MTFF which GBS would support and developing the policy matrix of reforms, progress against which would be the basis for successive tranches of GBS over a three to four year period.

3.4.2 Content

58. The matrix is based around those elements of the GoAP reform agenda that are under the direct influence of the Department of Finance, which is one of the key drivers of the reform process. Appraisal of the programme took place in December 2001–January 2002, sign-off by the World Bank and DFID in February, and disbursement of the first tranche of US$ 350m took place in March 2002.

59. There has been close collaboration between DFID and the World Bank on the design and implementation of the AP GBS programme. This in itself has been a new development. Planning, dialogue and review procedures are jointly conducted. Programme documentation is jointly produced although formal approval and tranche release from each organisation is separate.

3.4.3 Monitoring

60. The design and review process is a single one in which all donors participate. Both the AP and Orissa GBS programmes have involved multi-disciplinary teams of DFID Advisers in joint design and appraisal missions with World Bank teams. While the requirement falls most heavily on the cross-cutting advisers (governance, social development, and economists) to be involved in the process, it requires all advisers to become much more conversant with state government public expenditure management systems and processes (e.g. centre–state relations and issues, state-level policy making, planning and budgeting) than is the case with project or sector-level support.

61. There is an indication that some functions are being delegated within the design and review missions to a single donor – for example, the World Bank may be taking the lead on monitoring the overall programme. The Netherlands have indicated that if they join the AP programme in the future they may consider delegating some of their dialogue and review requirements to DFID.

62. Another feature of the process is the perception amongst bilateral donors (DFID and

RNE) that the joint negotiation and review with the multilateral agencies that comes with GBS enables them to increase their influence within the donor community and consequentially with partner governments.

63. A similar sequence of events around GBS to those which have taken place in AP are unfolding in Orissa, as shown in box 2.

Box 2: The Process of Development of the Orissa GBS Programme

- A growing fiscal crisis, particularly after 1998 when the implementation of a large civil service salary increase led to a step jump in the salary bill and rising debt burden.
- Approval of a large DFID technical assistance programme in 1999 aimed at addressing fiscal problems, wider public sector reforms, and development of a poverty reduction strategy. World Bank focusing on fiscal crisis and economic growth issues.
- Initiation of discussions in 2000 between Government of Orissa (GoO), WB and DFID over possible budget support. Slow progress. GoO takes steps to increase revenues and contain growth in salaries, with some success.
- In 2001, Memorandum of Understanding signed between GoO and GoI within the framework of GoI's Fiscal Reforms Facility designed to incentivise fiscal reform at state level.
- During 2002, DFID/WB discussions continue on budget support designed as a transitional mechanism to meet public sector reform costs and help ease the adjustment process.
- Formal appraisal of the Orissa GBS programme is expected towards the end of 2002.

4 WHAT ARE THE IMMEDIATE RESULTS AND MEDIUM-TERM EFFECTS OF GBS ?

64. This chapter covers the remaining levels of the GBS logframe (levels two–four) presented in figure 1 and compares them with ‘programme reality’ in AP. We start below with the short-term objectives and then move down each level of the conceptual framework and compare it with the AP programme.

4.1 Comparison with the conceptual framework

4.1.1 Assessment of basic requirements for GBS

65. The basic requirements for GBS were assessed prior to agreement of the programme. These are:

- A credible commitment to poverty reduction (Vision 2020). The concern within DFID over the government’s overall approach to poverty mainstreaming is being addressed through policy dialogue and separate TA/projects.
- Sound macro-management and enabling environment for private sector activity (see IMF perspective below).
- A sound public finance system. DFID is already using government systems to account for development assistance. A preliminary State Financial Accountability Assessment was also conducted prior to the release of the first tranche of GBS. A full SFAA is to be undertaken prior to release of second tranche.

66. In May 2001, the IMF Article IV consultation noted that notwithstanding India’s relatively strong growth performance there remain important impediments to achieving the authorities’ objectives of higher growth and faster poverty reduction. The IMF cited fiscal consolidation (i.e. deficit reduction) and implementation of Central Government’s agenda for structural reform (i.e. deregulation of power, industrial and labour markets) as two critical prerequisites for achieving these objectives.

4.1.2 Level two – immediate results

67. The short-term objectives of the AP GBS programme are partly consistent with the evaluability framework. The main short-term benefits of GBS in AP are:

- Strengthening of the Department of Finance as a driver of the reform process, by increasing the discretionary resources available to it.
- Coordinated behaviour by donors around the poverty/partnership agenda.

68. GBS does not increase government ownership of the budget and policy process compared to the non-GBS scenario as proposed by the evaluability framework. Ownership was already strong in AP. There is recognition, however, that GBS shifts the balance of power towards the Department of Finance, which is one of the main drivers of the reform process. There is recognition among observers that by empowering the Department of Finance GBS could disempower line departments, but DFID TA and ongoing projects can

help address this issue (e.g. the Centre for Good Governance, which is currently supporting a functional review and Medium-Term Expenditure Framework for the Department of Education). More importantly, it needs to be recognised that in AP, GBS is enabling the restoration to the Department of Finance of its rightful 'challenge' role in relation to policy making and resource allocation.

69. GBS promotes coordinated behaviour around Vision 2020. However, there are fewer donors active in each state in India compared to other countries where DFID operates so the benefits of cooperation may not be significant. Nonetheless, through GBS DFID sees the possibility of increasing its policy influence through association with larger World Bank financing (as does the Netherlands through collaboration with the Asian Development Bank in Kerala). The extent to which this benefit will actually materialise is difficult to say. Attribution is generally recognised as a difficult issue – 'some advice may rub off' is how one observer put it. Moreover, both DFID and the RNE noted the difficulties in establishing effective coordination between donors (this issue is discussed in more detail below).

70. A second point to recognise is that there is still a strong element of de facto conditionality around GBS in AP. As one observer put it 'DFID does not set conditions but supports the delivery of those conditions set by the World Bank' These are seen as 'enhancing the partnership by keeping it more focused on joint reform criteria and enabling difficult issues to be confronted'. It is difficult to comment, on the basis of the fieldwork alone, on the extent to which this describes a relationship with government that is primarily one of partnership or one more reflective of old-style conditionality. Our judgement would be that there is still a degree of self-delusion amongst donors about the significance of 'exit threats' as a lever of policy reform. The consistent message from GoAP was that GBS was 'money for what the government has already done' and that the future pace and scope of implementation of reforms was an issue for domestic consideration alone.

4.1.3 Level three – medium-term outputs

71. The medium-term outputs of the AP GBS programme are partly consistent with the outputs collectively labelled in figure 1 as 'positive transformative effects on governance'. According to the conceptual framework, the following benefits are expected to flow from GBS in the medium term:

- Increased effectiveness of public administration.
- Increased allocative efficiency in public spending.
- Strengthened democratic accountability.
- Reduced transactions costs of financing spending through development assistance.
- Increased predictability of budget funding.

72. It is too early to make any judgements on whether GBS has led to improvements in **public administration** in AP. However, there is some evidence that the Department of Finance is starting to implement the type of process improvements which are the necessary precursors of improvements to the efficiency of resource allocation. In the education and health sectors, as part of the budget process the MoF is demanding evidence of the

efficiency and effectiveness of existing programmes before approving increases in budget allocations which are now possible as a result of the increase in discretionary resources. This would not have been possible without flexible GBS financing.

73. In relation to **allocative efficiency,** it is important to recognise that GBS will not have an effect on that portion of the GoAP budget whose content is determined by GoI. Some 40 % of the GoAP development (capital) budget is accounted for by 'State Plan Schemes' – i.e. vertical programmes run by the centre.[18] In the low aid-dependency and federal environment of India, DFID needs to interact simultaneously at state and central level if it is to influence the overall composition of the GoAP budget. This issue is not discussed at all in the AP programme document. However, there is evidence that the processes associated with GBS may be able to help in this regard. DFID staff have pointed out that GBS negotiations with GoI (on the consistency between the Policy Matrix supported by GBS and the FRP) have, for the first time, given them significant access to those GoI officials involved with the GoI-funded portion of the GoAP budget. This has reportedly permitted some entry to discussions around the effectiveness of central resource allocation and monitoring.

74. In AP, GBS has not led to any significant strengthening of **democratic accountability** as proposed in the evaluability framework. Unlike many countries in which DFID works, the problems of accountability do not derive primarily from excessive off-budget donor support.

75. For reasons explored in the literature review of this study, **transactions costs** are difficult to measure. Essentially, the concept aims to capture the aggregate cost of the administrative activities involved in providing development assistance, which has no value either to the recipient government or to the donor other than to permit an aid transaction to take place. In the course of a brief field visit it was of course not possible to make any measurement of the change in transactions costs. It was generally the view of DFID that the new structure of working with the World Bank which now involved a much wider group of DFID advisers was generating transactions costs of its own which in the early years of GBS were likely to be high. However, these learning effects aside, it was generally perceived that the transactions costs in relation to the level of financing provided through GBS was likely to be much lower in the long run compared to the same amount of funding provided through projects.

76. Transactions costs do not fall automatically. Deliberate attention is needed to work out how consultation and coordination mechanisms will work. In Kerala, RNE has invested management time in the agreement of a Memorandum of Understanding (MoU) which specifies how the cooperation arrangement between donors will operate. No such process has taken place yet in AP, where coordination between DFID and the World Bank appears to be much more ad hoc, not subject to basic agreements on operating rules, and therefore more problematic.

[18] 2001/02 Budget Estimates.

77. In AP, channelling donor funds through the state treasury system does not address any significant issue of transactions costs associated with donor financing. This argument applies more in countries with large numbers of aid projects and a multitude of donors, each with their own reporting schedules and accounting requirements, leading to excessive transactions costs. As mentioned above, project and sector aid is seen as having a number of advantages which may help counter some of the problems of the AP budget system.

78. GBS has not increased the **predictability** of budget funding in AP. While the programme has been designed within the context of a medium-term adjustment programme, approval of tranche release is annual. GoI has only given approval for one year's release of GBS to AP. Given GoI's concern about the allocation of aid at the national level to a few 'partnership' states, delivering predictability is likely to be more of a challenge with GBS compared to other aid modalities, at least in the present climate. GoAP is therefore vulnerable to adverse GoI or donor assessments of GBS and subsequent decisions to reduce or cease this type of funding from one year to the next.

79. At one level, the predictability issue points to an unfinished advocacy agenda between donors and GoI on GBS. But more fundamentally, this situation is completely at odds with the focus in the policy matrix on a realistic medium-term reform agenda and fiscal framework (incorporating projected levels of GBS). Public finance theory is unanimous on the need for 'predictability in funding' as a necessary (but not sufficient) element of a sound public finance system. In the absence of such medium-term commitments in GBS operations it is difficult to see how the medium-term outputs and longer-term objectives and the goal of GBS can be achieved.

4.1.4 Level four – intermediate outcomes

80. The long-term objectives of GBS in AP are set out in the Policy Matrix. They are:

- Fiscal reform – create fiscal space to maintain financing of priority social services through eliminating the revenue deficit, improving expenditure efficiency, and restructuring expenditures within a sustainable fiscal framework. Improve the development effectiveness of state expenditures. Improve revenue buoyancy, administration and efficiency.
- Public Expenditure Management reform – frame the annual budget in a medium-term perspective, strengthen the link between policy, planning and the budget, assure compliance with the approved budget, and strengthen financial accountability
- Governance reform – create a framework and institutional infrastructure for realising the goals of 'SMART' (Simple, Moral, Accountable, Responsive and Transparent) government and, inter alia, performance indicators to demonstrate monitorable improvements in service delivery in critical areas, strengthen accountability, strengthen HRM, inform policy formulation by poverty eradication objectives, reduce corruption in government, legal and institutional framework to increase transparency and public access to information, reorient government away from direct provision of goods and services, etc.

81. These objectives are consistent with the "intermediate outcomes" identified in figure 1. In the federal context some aspects of 'macroeconomic management' specified in the evaluability framework are not state-level responsibilities (e.g. monetary policy) while others such as fiscal policy are partly shared with the national government (e.g. the composition of centrally sponsored schemes).

4.2 Summary

82. From the above section, the evaluability framework (chain of causality) for the GBS programme in AP may be summarised as follows:

Table 2: Logical Framework Analysis Of General Budget Support

Inputs	• Increased funding of Government through GBS • Changed Policy Dialogue (governance, poverty strategy, fiscal management) • Technical assistance for capacity building
Activities	**Empowerment of Government** • Strengthened Department of Finance as driver of resource allocation • Coordinated behaviour by donors around Government Programme
Short/Medium-Term Outputs	**Positive transformative effect on governance** • Increased effectiveness of public administration *(in theory - too early to tell)* • Increased allocative efficiency of spending *(some positive signs)* • Increased democratic accountability *(no, not relevant)* • Reduced transactions costs *(perhaps – difficult to quantify)* • Increased predictability *(should be, but is not at the moment)*
Intermediate Outcomes	**Enhancement of Government capacity to reduce poverty** • More sustainable fiscal management • Improved enabling environment for private sector investment • Enhanced pro-poor service delivery
Final Goal	**Poverty Reduction**

5 RISKS AND EXTERNAL FACTORS

5.1 Introduction

83. The AP GBS programme was approved less than a year ago. In many respects it is too early to assess whether the programme will achieve its objectives. However, the above analysis demonstrates that at different levels the AP programme is consistent with the conceptual framework set out in chapter 1. In particular the following comments can be made about the programme:

- It is consistent with DFID's 1997 policy decision to support development as far as possible through government actions and institutions
- It is consistent with the Central Government's agenda for fiscal consolidation and structural reform, as the prerequisites for higher economic growth and faster poverty reduction
- It is partnership-based and is focused on the government's own poverty reduction strategy
- It gives prominence to institutional development objectives, in particular open, accountable and capable government
- It provides significant financing which enables Government to increase the pace of its reform programme and bring forward the benefits of reform

84. There are, however, a number of issues which could affect the longer-term success of the programme. The section below discusses those which have become apparent during this case study. Given the stage of implementation of the programme, it would be appropriate to consider this as a preliminary list. Other issues may become apparent or more significant as the programme develops.

5.2 Predictability

85. GBS funds over the medium term are predictable only to the extent that performance and reforms at state level are assessed as being 'on-track' (see below on monitoring). More importantly, no such 'in principle' agreement over levels of medium-term funding has been reached with GoI. GBS effectively has a one year time horizon and has to be negotiated with GoI each year.

86. It needs to recognised that the absolute amount of resources on offer through GBS is quite small compared to the overall GoAP budget. Nonetheless, we would contend that GBS could have a destabilising effect on the fiscal position of GoAP. A prudent government should not programme GBS resources into the MTFF until they have actually been received. Otherwise, the MTFF is vulnerable to failure by donors to deliver on promises about GBS or GoI decisions not to allow GBS in a particular year. This points to an unfinished advocacy agenda between donors and GoI based on an understanding that the benefits of GBS are dependent in significant part on the predictability of medium-term funding.

87. In the absence of an explicit medium-term commitment it is difficult to see how GBS can claim to contribute towards medium-term governance objectives.

88. Regarding intra-year predictability, the fact that the first tranche of GBS was only received relatively late in the fiscal year and that it was spent by GoAP before it was received appears to be largely due to unexpected internal delays within DFID in approving and releasing the funds. This appears to be the partly the result of unrealistic sequencing of the GBS review/monitoring process, which is the subject of the section below

5.3 Sequencing

89. Insufficient thought has been given to the sequencing of review, tranche processing and dialogue. In AP the current process involves;

(i) reviewing progress on policy matrix targets for year one about six months into that year

(ii) making an assessment about whether or not to release GBS and processing that tranche during the remainder of year one.

This is an extremely tight timetable and probably one which is unsustainable – both in terms of what it is possible to review at the six-month point and the time it allows for dialogue with Government during what remains of the fiscal year. The process needs stretching out.

90. The review of progress should be of the most recently completed fiscal year, and tranche release should be for the forthcoming (or forthcoming +1) fiscal year. A more stretched out process would allow for greater alignment between donor and government processes. Current thinking in the DFID India office is that it would be better to move to an assessment of actual fiscal outturns, especially since forecasting power sector outturns has proved problematic (power is the key variable in the fiscal framework). One of the reasons the Netherlands did not enter into the first tranche of GBS in AP was related to the very short time span between approval and release of the first tranche in March 2002.

5.4 Monitoring

91. The main monitoring tool of the programme is the Programme Policy Matrix. However, it is not clear how DFID or the WB will use the matrix to monitor GoAP reforms. Detailed monitoring indicators are not apparent, criteria for cessation are not completely clear, and it is not clear how an overall judgement about progress should be made.

92. DFID India disagrees with this assessment, and points to the fact that it has discussed a core set of targets and risks with the government which would provide the basis for approving future GBS support to AP. If so, this is not reflected in any programme documentation. Given that performance across the policy matrix is likely to be asymmetric and some targets are likely to be more significant than others, we would argue that there is need for greater clarity around GBS monitoring if the ‘partnership’ between donors and government is to work. At present there is too much room for differences of opinion over reform progress. During the fieldwork for this study, for example, it was apparent that donors and the government were beginning to make different assessments of progress on the reform programme between March and September 2002. On this basis DFID and GoAP appeared to be diverging in their assessment as to whether a second tranche of GBS should be approved, with GoAP being fairly upbeat and DFID more pessimistic.

93. DFID has recognised that the approach to monitoring the programme has yet to be fully developed. An important area in this regard is the monitoring of performance against the medium-term institutional effects and longer-term intermediate outcome goals of GBS as identified in the Evaluability Framework. Some of DFID's TA support is starting to focus on this area of the programme.

94. The difficulty of programme monitoring is an issue which has also been encountered in the Kerala GBS programme being jointly financed by the ADB/Netherlands. Here a detailed monitoring framework is being developed by ADB, based on the equivalent policy matrix for Kerala.

5.5 How much to give?

95. The amount of GBS allocated each year in both AP (and in Kerala with ADB/RNE) appears to be a relatively arbitrary figure. In the case of AP, to realise the specific benefits which have been identified (in particular in relation to the fiscal stabilisation and PEM benefits) GBS needs to represent a significant amount of budgetary financing. In some sense it also needs to represent a sustainable level of financing.

96. The difficult judgement which has to be made is whether GBS resources are sufficient to compensate for the short-term political costs incurred through implementing power sector reforms. Another difficult aspect, if one assumes that the first can be addressed, is how to identify the point at which GBS resources begin to *reduce* the incentive on government to reform because it reduces the immediate fiscal pressure to implement politically difficult reforms (moral hazard).

97. There are no easy answers to this issue, but it is worth noting that moral hazard arguments were one reason why the Netherlands did not contribute to the 2001/02 GBS tranche for AP.

5.6 Donor coordination

98. The AP programme demonstrates that it is overly optimistic to assume that donor coordination will happen automatically. The development of the AP GBS programme has involved DFID and the World Bank working closely together over many months. Even so, difficulties around coordination and collaboration and even information sharing persist. The Washington base of much of the WB team appears to exacerbate the situation. Our main observation here is that no time appears to have been dedicated to developing a process of joint working practices. Dialogue is reportedly only carried forward when the Washington-based team members are in India. Moreover, in the absence of agreement on joint working practices the demands of the WB's internal systems appear to bear heavily on the actual nature of working arrangements. DFID has observed that this has had an adverse effect on the quality of dialogue with GoAP.

99. Coordination has also been an issue for the ADB/RNE GBS Programme where, because of concern within the RNE that its views will be ignored by the larger financier, RNE/ADB are moving towards an MoU arrangement which formally specifies coordination and cooperation arrangements, especially in relation to programme monitoring procedures.

6 LESSONS LEARNED

6.1 Observations made by DFID

100. In the course of the country case studies, the evaluability team was asked to identify the key lessons learnt so far by DFID advisers with a view to wider dissemination so that DFID might better prepare itself for the challenge of delivering GBS. Our observations are of a very preliminary nature and are presented here with a view to facilitating this discussion within DFID. The aim is to identify those issues which a wider set of staff in DFID experienced in designing and managing GBS could begin to address.

6.1.1 GBS is succeeding

101. Budget support has enabled DFID to begin discussions with GoAP on a range of governance reform issues for which it previously had no effective platform. In the opinion of many close observers it has given DFID 'a seat at the policy table'. This finding is likely be different to the findings of budget support operations in Africa, where donors are already at every significant policy table by virtue of their overall financial contribution to the budget.

102. Moreover, GoAP sees partnership as the key element of GBS, the nature of which appears to have allowed for the possibility of gradual expansion by donors of the concept of governance – in effect it enables them to 'put difficult issues on the table'. Or as one observer put it, 'deal with many of the issues that were traditionally considered external to project world'. Here, the longstanding bilateral relationship between DFID and GoAP is an important factor. GBS is therefore succeeding in having a positive impact in terms of facilitating dialogue on the government's reform agenda.

6.1.2 Gearing up for working with GBS stakeholders

103. A significant lesson of the AP experience is that GBS takes a long time to organise. This is because it takes a long time to engage effectively with other donors and governments (where lack of aid dependency may be partly to blame). Moreover, it cannot be assumed either that difficulties of working with other donors will be easily overcome or that state or federal governments will necessarily move at the same time as donors. Despite the joint working arrangements agreed between the World Bank and DFID in AP, there is a strong impression that the focused thinking around the objectives of budget support has really been much more around the development of organisational positions rather than a shared multi-donor position. Unless effort is put into resolving this problem, the overall objectives of GBS are only likely to be partly achieved. This points to the need for advocacy work between donors, and then the discussion of the common donor position with *both state and central governments* at the early stages of (and then throughout) the GBS arrangement.

6.1.3 Developing skills at country office level

104. The jump from 'project land' to GBS is not easily made immediately. GBS requires DFID to have an understanding of the broad policy issues which need to be addressed to reduce poverty before entering into negotiations with government. This includes detailed

work on sectoral policy, budget issues, cross-cutting issues of public administration and on service delivery questions. In each of these areas, there is a requirement to work with other donors as well as with government. DFID advisers therefore need to know more in general about the government planning and policy making procedures within which these decisions are made to be able to influence GBS discussions. These are likely to be new skills for at least some advisers. As one close observer commented – 'if we knew then what we know now [about the process of budget support negotiation] we would have given our advice differently'. The DFID India office is addressing this issue through formal and semi-formal training activities.

6.1.4 Supporting actions at HQ level

105. Our general perception is that central support of country offices on issues related to GBS needs to be strengthened if effective lesson learning – in particular the practicalities of assessment and design – is to take place across the organisation.

106. Based on the experience of DFID India, information on other GBS operations (what works, what does not, and why) is hard to come by at country-level. In some respects, DFID HQ appears to be behind the country offices (for example, recognising that Indian states do not have PRSPs) and in others there is a need to update guidelines and procedures to reflect the nature of budget support. Examples of procedures which may need reviewing include the requirement to:

- 'attach' aid to specific budget expenditures (for UK National Audit Office reporting requirements?).
- submit a 'project completion review' for each tranche (this is inconsistent with an aid modality that is disbursed on the basis of actions already completed).

6.2 Our own observations

107. The institutional challenge implicit in the GBS process – that of creating capable, effective and accountable states – is a very difficult one. Realising the benefits of budget support requires focused and coordinated action from both government and donors in pursuit of a clear and agreed set of objectives, and a close attention to the detail of actions necessary to install or renew institutional structures and procedures. In the Synthesis Report of this study, we contend that this joint venture between government and donors – which we have described as a 'club' – needs to be very clearly specified if the medium-term institutional benefits implicit in the GBS paradigm are to be realised. There needs to be a minimum of loyalty to a shared agenda, voice over that agenda, and some restrictions over the potential for exit.

108. One issue in particular is worth repeating – our judgement is that the threat of withholding budget support (or actually withholding it) will not force GoAP to undertake policy reforms which it would not otherwise have taken. However, what is almost certain is that this type of short-termism, if implemented, will seriously undermine or destroy any claims that can be made about the institutional benefits of GBS. In short, medium-term commitment is needed for medium-term benefits to be realised. If there is one thing almost all public expenditure specialists are united on it is that *predictability of funding* is a

necessary and early prerequisite for more fundamental public expenditure management reform. In brief, therefore, our overall conclusions are as follows:

6.2.1 GBS objectives need to be clarified and bought into by all stakeholders

109. Although the GBS process in AP is relatively new, it was noticeable how differing views of performance were starting to emerge. In our view, the process is underway in the absence of clear enough understanding and agreement (amongst donors, and between donors and GoAP) on what combination of actions and objectives constitutes performance, and, equally what combination should lead to concern about the likelihood of GoAP meeting GBS objectives. It is noticeable that the institutional development impacts of budget support are at present poorly captured in the DFID/WB project documentation for budget support in AP.

110. The objectives of GBS need to be discussed more deeply along three paths – between participating (and potential) donors, between the donor group and GoAP, and between the donor group and GoI. A particular risk at present appears to be the pursuit of GBS at state level in the absence of sufficient agreement and understanding with the national government with regard to GBS objectives. This runs the risk of state level achievements in dialogue, financing and TA being upset by a much slower approval process or outright rejection at the centre. The immediate casualty of this situation would be predictability of funding, which needs to be fully 'internalised' into the design of GBS if it is to achieve its objectives.

6.2.2 Structures for coordination need to be clarified and formalised

111. Another conclusion is that DFID and other donors involved in GBS need to give more attention to making clear the indicative targets where change is being pursued and, equally importantly, defining the process by which these targets will be monitored in the context of the donor–government partnership. We noted that the present highly compressed monitoring arrangements were probably unsustainable. We also noted that other GBS operations (e.g. ADB/RNE in Kerala, and Uganda) were addressing this issue more directly with Memoranda of Understanding governing collaboration and cooperation arrangements and specific attention to programme monitoring issues. This may represent an area where lessons could be learnt by the AP programme.

112. More generally, GBS *operating rules* between donors and government need to be clearer. At the moment they seem to be highly problematic. It takes time to make donor coordination work, especially at the start of GBS processes – 'the rules of the game' need to be established. Once these rules have been clarified it is necessary to respect them in order to protect the partnership arrangement and give greater predictability in the provision of funding.

6.2.3 Operating rules need to be clarified and formalised

113. Another finding is that at the operational level concepts of 'conditionality' are still being used to describe the donor–government relationship. Although this is probably over-simplification of a complex set of relationships, the end result is hampering the

development of ‘partnership’ at least as it is espoused by those involved in the GBS and reducing the likelihood that the medium-term institutional development objectives of budget support will be met.

114. Reliance on threat of exit may also be leading to a false sense of security over the risks inherent in moving towards GBS. It is noticeable, for example, that the exit option is still being considered as an effective risk containment strategy. We would contend that it is not, but instead increases the risk that medium-term objectives of budget support will not be met, alongside a less than complete analysis of the public finance system in AP – undertaken by and largely restricted in its circulation to the World Bank.

6.2.4 Understanding of the operating context needs to be continuously developed

115. Our final observation is that a lot more information about the government’s budget is required with GBS than may be available at the start of the process, to identify those budget items relevant to particular policy issues and how they are performing. In particular, detailed work on sectoral policy options and budget issues need to be known, on service delivery, and on related cross-cutting administrative issues such as civil service salaries and operational issues. DFID is generally well placed to draw on good analytical skills in these areas but the necessary process skills and familiarity with the decision-making environment at state and national level may be new for some.

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DEPARTMENT FOR INTERNATIONAL DEVELOPMENT

The Department for International Development (DFID) is the UK Government department responsible for promoting sustainable development and reducing poverty. The central focus of the Government's policy, based on the 1997 and 2000 White Papers on International Development, is a commitment to the internationally agreed Millennium Development Goals, to be achieved by 2015. These seek to:

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