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A CASE STUDY OF AN ALTERNATIVE ASSISTANCE APPROACH

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Cover photo: World View Images
This young Nicaraguan girl is getting a drink from her community's new well, provided by the international relief effort after Hurricane Mitch.

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A CASE STUDY OF AN ALTERNATIVE ASSISTANCE APPROACH

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Abbreviations

CAFTA	Central American Free Trade Agreement
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Review
DFID	Department for International Development (UK)
EFA-FTI	Education for All–Fast Track Initiative
EC	European Commission
ESR	Economic Stabilization and Recovery
GBS	general budget support
GDP	gross domestic product
GTZ	German Technical Cooperation Agency
HIPC	heavily indebted poor country
IDB	Inter-American Development Bank
IMF	International Monetary Fund
JFA	joint financing arrangement
NDP	National Development Plan
NGO	nongovernmental organization
NPA	nonproject assistance
PER	Public Expenditure Review
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSAC	Programmatic Structural Adjustment Credit
SECEP	Presidential Secretariat for Strategy and Coordination
SIGFA	Integrated System for Financial and Administrative Management
SINASIP	National System for Monitoring Poverty Indicators
SWAp	sector-wide approach program
USAID	U.S. Agency for International Development
VAT	value-added tax

Executive Summary

Background

In the past, international donors to developing countries often saw the government as the problem rather than the solution. They preferred to give development aid in the form of projects, using a variety of workarounds—nongovernmental organizations (NGOs) or private contractors—as substitutes for an incompetent and intransigent government apparatus. Ultimately, these efforts proved counterproductive. The weak state got weaker, and projects that seemed successful at first failed after the donors left, in part because the government had never taken the projects as its own.

In the past, donors often saw host governments as the problem. Now, however, they seek to encourage government participation and ownership of the development process, and many are turning to general budget support as a result.

Donors now actively seek ways to encourage host government participation and ownership, and many are turning to general budget support (GBS) as a result. GBS is a form of nonproject assistance (program aid), a category that also includes food aid, balance of payments support, commodity import programs, sector assistance, and debt relief. While most of these rely on some degree of earmarking or **conditionality** (policy requirements for continued aid), GBS relies on broad agreements and a recognition that good development policies are already in place, along with adequate financial control and accountability mechanisms. Funds usually go directly to the finance ministry, which allocates them using its own procurement and accounting systems.

Nicaragua received large amounts of nonproject assistance in the 1990s, but late in the decade donors pulled back from this form of aid because of the government's poor macroeconomic policies and unchecked corruption. However, a new administration's prompt, decisive actions to restore macroeconomic stability, beginning in 2002, encouraged many donors to resume, or to begin planning, programs featuring nonproject assistance, including GBS.

The return to budget support was led by the World Bank, soon joined by the Inter-American Development Bank (IDB) and several bilateral donors, though by no means all of them. In addition, a number of donors have initiated sector-wide approaches (SWAps) and SWAp-like programs with the ministries of Health and Education, the strongest ministries within the Nicaraguan government. This paper examines the progress of this nonproject assistance trend, highlights problems and possible solutions, and assesses the chances that other donors—including USAID—will begin giving such aid to Nicaragua.

Early Results and Structural Issues Affecting GBS and SWAps

It is still very early to measure the impact of budget support in Nicaragua. However, experience has already highlighted institutional and structural problems that need to be solved for budget support to succeed:

- pervasive weaknesses in systems for financial control and accountability, transparency, and fair and effective procurement procedures throughout the government
- a generally weak budget process and poor budget and planning interactions with line ministries
- technical and managerial weaknesses within line ministries, aggravated by high turnover

It is likewise far too soon to gauge the impact of SWAps; in both education and health, they are still in their very early stages. However, the process of designing a SWAp has led donors to coordinate their efforts more, both among themselves and with the leaders in the two ministries. In both cases, the ministry leadership has been transformed from a relatively passive recipient of donor initiatives to the leader and organizer of donor activities—both project and nonproject—within the sector.

Fiduciary risk. The term "fiduciary risk" is often used as a synonym for corruption, yet simple incompetence can also keep government from using public funds efficiently and effectively. Measures to reduce fiduciary risk—via financial control, accountability, and transparency mechanisms—address both problems simultaneously, and they are central to the success of GBS or any development effort. In Nicaragua, both government and donors have taken major steps to reduce this risk, following the recommendations of the World Bank's assessment reports. However, only experience will tell whether these measures will prove adequate.

Donors differ enormously in their tolerance for fiduciary risk. It is this, rather than differing assessments of the facts, that has caused some to move ahead with budget support and others to hold back.

Government technical and managerial capacity. Whether the government has the capacity to carry out its responsibilities under GBS is perhaps the most worrisome aspect of the entire process. In the opinion of donors, the line ministries differ enormously in their capacity, with the ministries of Health and Education regarded as strong and two others—the Ministry of Agriculture and the Ministry of Transport and Infrastructure—as the weakest. The latter two cause particular misgivings, given the prominent role that the sectors overseen by these ministries play in the National Development Plan. Even in the strong health and education ministries, officials expressed concern about their staff's technical capacity. Bilateral donors have recognized the need to give line ministries technical assistance and training so they can carry out the design, implementation, monitoring, and evaluation functions often now performed by donors' project management units or outside contractors.

Donors differ enormously in their tolerance for fiduciary risk. It is this, rather than differing assessments of the facts, that has caused some to move ahead with budget support and others to hold back.

Host Country Ownership and Its Implications

Arguments for both GBS and sectoral assistance stress the idea that these will increase Nicaraguan ownership of the development process and therefore improve development outcomes. Improvements are, in fact, evident. In the strong line ministries, the effect of both sectoral program assistance and GBS has been better coordination, implementation, and alignment of donor-funded activities with the ministries' priorities. And for the national government, the process of GBS—even though its share of overall donor assistance is still very small—has also strengthened the budget and planning process and produced a national budget that better reflects the government's priorities.

Ownership also means donors must recognize that host governments are responsible for *all* public functions, not just those donors prefer. For instance, for Nicaragua's National Development Plan to succeed, bilateral donors must focus less on social service programs and more on the need to strengthen ministries responsible for infrastructure and the productive sector. USAID has done so in the case of the productive sectors (although not infrastructure); others have not. Bilateral donors still largely concentrate on working with the already strong ministries of Health and Education; the World Bank and IDB concentrate on fixing systemic problems related to fiduciary risk.

Donors take two very different approaches to monitoring and evaluation. The World Bank relies on government commitments to specific actions; other donors focus on progress toward broader development goals.

Workload and Transaction Cost Implications for Donors and Government

Workload implications. Donors who moved to GBS expecting it to reduce workload and staffing needs have found instead that their workloads have increased, in large part because donors still carry out a wide range of projects—often nearly as many as before—though with reduced budgets. According to the donors, pursuing a GBS program is invariably time-consuming, for senior staff in particular, even if its funding is modest. Similarly, the time required by donors' other projects does not decline proportionately with their size. Since few donors foresee shifting more than half their resources to GBS in the near future, this situation seems unlikely to change.

Government workload inevitably rises under GBS, as this mechanism implies a straightforward transfer of project design and implementation functions from donors to government. However, if the ministries involved are reasonably efficient and effective, and if the projects fit well with their existing functions, the increase in workload may be relatively small. In the case of Nicaragua, it is too early to judge. However, as with the donors, GBS negotiations are requiring extra time from senior government staff.

Transaction costs. Because budget support still coexists with a plethora of projects, it has not significantly lowered transaction costs for either donors or government. However, donors have placed a high priority on harmonizing their procedures for both project and nonproject assistance, which should substantially cut transaction costs, for the government at least. Donors would also like to time disbursements to synchronize better with the Nicaraguan budget cycle, but conflicts with donor governments' own budget cycles make this difficult. It would be very helpful for donors to be more transparent about the level and timing of their assistance.

Need for Donor and Host Government Consensus on a Basic Approach

Both SWAps and GBS are sometimes criticized as mechanisms for the donors to "gang up on" the host government. More accurately, they require the donors to work out their disagreements among themselves, rather than battling them out with the host government as battlefield. In health and education, the donors' unified approach has made the SWAps in those sectors possible. By contrast, in agriculture many donors want to focus only on smallholders, while others support the government's emphasis on larger-scale producers. Such debates must be resolved for non-project assistance to be possible.

Monitoring and Evaluation, Conditionality, and Additionality

So far, donors have taken two very different approaches to monitoring and evaluation. The World Bank is using a largely traditional method of monitoring conditionality in the form of a detailed 18-page matrix of government commitments to specific actions. Other donors favor an approach based on progress toward development goals, rather than specific achievement, set out in a much smaller matrix of about 10 indicators.

One question that neither group has addressed is "additionality"—i.e., are donor funds added to those of the host government to raise total spending in a target area, or are they merely displacing the government's resources to other areas? Donors have chosen not to negotiate specific levels of budget categories in the budget support process. Rather, as noted above, they will focus on additionality of results via a series of specific indicators agreed on with the government. Nonetheless, given that such results can be measured only after a substantial time lag, donors may wish to monitor budget allocations as well.

Can SWAps Be a Transition to GBS?

To date, donors have seen sectoral assistance as an alternative to project-based aid in an already strong ministry, rather than a transitional step toward budget support. Where a ministry has the needed capacity and the donor shares the ministry's vision and approach, a SWAp has many obvious advantages in terms of effectiveness and efficiency. However, sector assistance also has most of the disadvantages of project assistance, as it still transfers overall development strategy decisions from the host government to the donors.

Restoring the Role of the Budget Process in Government Investment

In a country like Nicaragua, where donor funding has tended to dominate public sector investment decisions, the government's own budget processes are inevitably weakened. One of GBS's greatest potential contributions is restoring the government to its central role in budgeting. At present, even though GBS is still a relatively small part of total donor resource flow, Nicaragua's budget process is clearly growing more important.

Ironically, one symptom of this is rising contention within the government as the institutional actors there sort out their respective roles. The higher stakes now at play in the budget process inevitably trigger conflicts pitting the finance ministry and the presidency, which are responsible for the budget, against the line ministries—especially those favored by donors—and against each other. Donors may find this frustrating, but it is basically a healthy process, and one made necessary, at least in part, by the donors' own past actions.

The Future of GBS

Given the concerns about the capacity of the Nicaraguan government, no donor expects to shift its programs to 100 percent budget support; however, several do see that as a long-term goal. A number of bilateral donors remain interested but skeptical, and prepared, in principle, to participate in GBS if the problems discussed above can be resolved. Project aid to increase government capacity will continue to be essential for the foreseeable future. Nevertheless, there is almost complete consensus, even among donors that do not provide nonproject assistance, that the effort is worthwhile and will restore Nicaragua's government to its proper leadership role in its own development.

Introduction

The Debate on Appropriate Types of Assistance

In the last few years donors have placed new emphasis on the central role of government in the development process. In the past, donors often saw the government as the problem rather than the solution. They used a variety of workarounds—nongovernmental organizations (NGOs) or private contractors—not as deliverers of services on behalf of the government but as substitutes for an incompetent and intransigent government apparatus. Ultimately, these efforts proved counterproductive. The weak state got weaker, essential functions of the state continued to be carried out poorly or not at all, and projects that seemed successful at first failed after the donors left, in part because the government had never taken the projects as its own.

In 2002, the improved economic policies of the new Bolaños government encouraged many donors to move from projects toward nonproject aid—in particular, general budget support.

Donors have become increasingly aware of the critical role of government in assuring security, macroeconomic stability, property rights, the rule of law, and adequate prudential regulation of the financial system, as well as regulating natural and other monopolies. In addition, in all countries, governments play a key role in the critically important areas of health and education. In these sectors, the essential role of government in funding and regulating—if not necessarily directly providing—public goods and essential social services is also being recognized. As a result, donors now encourage host governments to take ownership of development efforts in their countries as far as possible.

In Nicaragua, the inauguration of the Bolaños administration in early 2002 presented an opportunity for multilateral and bilateral donors to work toward shared development goals with what they perceived to be a more honest and capable government. The new administration found Nicaragua's macroeconomic policy in disarray and promptly took decisive action to restore stability. Encouraged by these developments, a large group of donors, led by the World Bank, decided to move away from donor-managed projects in favor of nonproject assistance, in particular general budget support (GBS)—a type of aid that will be described in more detail in the next section.

A USAID evaluation team had the opportunity to discuss the progress of GBS and related types of aid with a large number of donor and government officials in July 2004. Since GBS is relatively new, the experience in Nicaragua permits an early-stage case study allowing interested donors, host governments, and others to gain a clearer idea of the conditions needed for it to succeed.

Donors in Nicaragua vary in their views of GBS. While GBS may contribute to sustainable development, there are a number of risks inherent in it, and some donors, including USAID, prefer to wait until more experience is gained in its use. For donors who have adopted GBS, the proportion of aid they provide using this approach varies widely, though no donor gives, or expects to give, more than half its total funding in this form. Donors also support development through traditional projects, technical assistance, and different forms of sector aid.

In the case of Nicaragua, it is too soon to know whether GBS has improved government performance. This report will therefore briefly describe the main types of aid currently at work in Nicaragua, summarize the history of nonproject assistance there, and examine the impact so far of the latter type, in particular GBS. It will discuss the main issues that have arisen in the process, with special attention to fiduciary risk and the diverse effects of different aid modalities on both the donors and the government. The conclusion will sum up the present state of nonproject assistance in the country and discuss how far donors are likely to go with this form of aid—especially GBS—in the near future.

Project versus Nonproject Assistance[1]

Project Assistance

Globally, foreign aid is largely provided through project assistance, or donor-managed projects, as opposed to aid given directly to the host government. There are a number of reasons project assistance is so widespread:

- Donors retain control of the money spent on projects. Donors fear that money given directly to the government may be misspent, stolen outright, or siphoned off for other outlays (e.g., military spending) for which it was not intended.
- Projects will reflect donors' priorities and development philosophy. Host governments may be unwilling to allot resources to disfavored sectors, provinces, ethnic groups, genders, occupations, or even diseases it finds inconvenient to acknowledge; project assistance allows donors to move into these gaps.
- Donors can ensure that projects are operated by personnel with training and experience in management and relevant technical areas.
- Donors can draw on their experience running similar projects in other countries with comparable problems.
- Projects may be designed to empower civil society, the private sector, or the grassroots as opposed to the center—goals that may not figure in national government plans.
- Donors can arrange for strong auditing, monitoring, and evaluation of their projects, both for their internal needs and to satisfy taxpayers, boards, and charitable givers back home. In addition, when donors manage their own projects they often find it easier to tie expenditures to results, which is useful for the same reasons.
- Projects may give donors leverage in pressing for policy reforms directly with a line ministry (such as agriculture or health).
- Projects may be cross-border or regional in scope (e.g., polio eradication).

Given these advantages, donor-managed aid projects have a good chance of succeeding—at least during their lifetimes. But once they end and their personnel leave, many tend to fail, for any of a number of reasons:

- Projects can be "islands of development" that only reach a small group of people.
- Projects may not strengthen local institutions or change institutional relationships. They may even damage local institutions by drawing off skilled staff.
- Projects may be difficult to replicate; for example, they may call for special skills or for intensive efforts that are hard to scale up.

1 Much of this discussion is adapted from USAID 2004, 3–5, 33–34. For balance of payments and sector support, see also USAID, *Policy Paper on Program Assistance* (Washington, D.C., Feb. 1996), PN-ACD-317.

- Projects' benefits may not be sustainable, as when no one has assumed responsibility for assuring the maintenance, staffing, or other resources needed to continue the work.
- If projects are out of synch with local customs and priorities, the intended beneficiaries may acquiesce with them for the time being but let the projects drop after donor staff leave.
- If the central government sees projects as conflicting with its interests or aims, it may allow any changes they have introduced to unravel after they conclude, or even actively seek to undo their effects.

Donors trace many of these problems to a lack of host country ownership of these efforts. Without a coherent national vision of development that sets overall priorities and takes competing stakeholders' interests into account, development efforts tend to be piecemeal, even conflicting at times. And if the national government remains a spectator rather than a leader in the process, it will not grow the skills in management, finance, and technical matters needed to take charge in the future—whenever that arrives. Instead, its staff must spend their time courting donors, trying to keep track of what the donors are doing, and dealing with a multitude of donor proposal, implementation, and reporting requirements.

In addition, when a donor provides project assistance, it is not part of the host government's broader program decisions or budget processes. For this and other reasons, many donors also supply nonproject assistance

Types of Nonproject Assistance

Balance of Payment Support

The donor provides a resource transfer, in the form of foreign exchange (cash transfer) or a commodity import program, to address immediate gaps in the country's balance of payments or budget. This works best when it helps to support short- and medium-term economic or political stabilization. It must be linked to policy reforms that will close the gap by restructuring the national economy. The infusion of resources mitigates the short-term drops in consumption and production that sometimes occur as policy reforms are adopted.

Sector Program Assistance

These programs target either a complete sector (e.g., agriculture, industry, education, health, exports) or a subsector (e.g., agricultural marketing, healthcare financing, child survival). Sector assistance supports reforms and other actions to break down sector-wide obstacles to sustainable growth, enabling the government to offset the short-term costs of making these changes. USAID always links disbursement of sector assistance funds to the host government's fulfillment of specific requirements **(conditionality)** it has agreed to beforehand with USAID.

Sector-Wide Approach (SWAp)

Under sector program assistance, an individual donor usually negotiates its own sector agreement with a government. In contrast, a SWAp aims to coordinate *all* donor assistance in support of a single program covering sectoral policy and expenditures. The government provides the leadership, and donors adopt a common approach to support the government's effort. SWAp financing typically includes a range of donor budget support, project aid, and technical assistance, which may or may not be earmarked to specific expenditures or disbursed through the government's own budget process.

General Budget Support (GBS)

In this form of assistance, conditionality focuses on development-oriented policy measures the government has agreed to implement. They typically include overall budget priorities set out in a medium-term budget and expenditure framework. With agreement on the budget as a whole, there is no need to earmark specific aid flows to specific country expenditures. Funds are disbursed to the host government's national budget, and accountability is based on government-audited accounts of its total revenues and spending.

(also called program aid), which may include food aid, balance of payments support, commodity import programs, sector assistance, and debt relief. With nonproject assistance, donors gain a seat at the policy table and can work with the government on the many interrelated problems that harm development.

Many donors feel that a switch to GBS will help host governments perform more effectively in reducing poverty: since the government is responsible for the program, it will identify the most critical development problems and focus on solving them. They also expect that GBS will

- improve coordination among donors
- harmonize and align aid with the government's budget and policy system
- use policy dialogue to reform overall government policies and budget priorities, rather than narrowly concentrating on individual projects or sectors
- increase efficiency in public spending, because the government directs its own budget allocations instead of dealing with a large number of often disparate donor projects (which tend to reflect donor rather than government priorities)
- make the government accountable to its own people, not just to donors
- reduce transaction costs for donors in the long term, since donors will not have to manage a large number of projects
- reduce transaction costs to the recipient, since it does not have to deal with a multitude of donor projects and reporting requirements

GBS makes sense in places with good governance and capable institutions. Concerns about GBS center on the fact that these qualities are lacking or intermittent in many host countries. Host country governments may have weak managerial, financial, monitoring, and evaluation systems; opaque budgeting processes; a lack of budget discipline; too few skilled technicians; and too much focus on the central government to the neglect of the periphery, where much sustainable development must occur. Opportunity for corruption and misuse of funds is high in these conditions. Moreover, while GBS lowers some transaction costs, it raises others, placing new and heavy demands on the time of senior officials (both donor and host country) who must negotiate and follow up on conditionalities. A careful assessment of risks and benefits is therefore essential before a GBS program is launched.

History of Nonproject Assistance in Nicaragua

USAID Balance of Payments Support in the Early 1990s

In 1990, the Chamorro administration inherited a country with dire social, legal, and economic problems caused by the legacy of the prior regime. Over the previous 12 years, per capita output had fallen 60 percent, and export earnings had fallen by 50 percent. Infrastructure was deteriorating, politicized health and educational services were functioning poorly, and private property had been taken without compensation under various pretexts. Mismanagement of monetary and fiscal policy had produced hyperinflation. The government owed vast amounts to external creditors, and the Central Bank faced a severe foreign exchange shortfall. Banking and foreign trade had been made state monopolies, while the politically determined and grossly overvalued exchange rate had crippled what viable export industries remained. The state banking system was dysfunctional, with politically directed lending and loan rates actually set below deposit rates and the rate of inflation. The function of the state banks had essentially become one of taking money from the Central Bank and giving it away to the politically favored. Finally, the previous administration held a portfolio of 351 badly (and politically) managed productive enterprises, many expropriated from prior owners without compensation.

In 1990, the Chamorro administration inherited a country with dire social, legal, and economic problems. International donors launched assistance flows that would total over $7 billion by 2002.

Upon the installation of the new, democratically elected Chamorro government, the international community provided project and nonproject assistance flows that would amount to over $7 billion by 2002. A large portion of the initial aid was a four-part Economic Stabilization and Recovery (ESR) program from the United States, which marked the start of U.S. nonproject assistance in Nicaragua. A large-scale balance of payments support program, ESR was intended to help the government reestablish monetary and fiscal stability, restructure the financial system, begin the process of privatization of state enterprises, eliminate the state monopoly on foreign trade, and establish free access to foreign exchange for current transactions at a competitive exchange rate. The single disbursement of ESR I was used to clear arrearages to the World Bank and International Monetary Fund (IMF), enabling those institutions to resume their own lending programs to Nicaragua.

The ESR program started with a $60 million grant (ESR I) in May 1990, and with subsequent grants (ESR II and III) ultimately amounted to over $300 million in foreign exchange disbursements by the end of 1992. Disbursements occurred through a series of fixed tranches, or installments, that were released upon the fulfillment of agreed-on conditions. This was traditional, policy-based assistance in which disbursements were based on the prior fulfillment of agreed policy reform measures. The United States carefully coordinated conditionality regarding future disbursements with the IMF and the World Bank. In every case, the conditions in the agreement represented established Nicaraguan government policy and had been established through policy dialogue.

Despite conscientious coordination between USAID, the World Bank, and the IMF, occasional instances of conflicting conditionality arose. The most serious was a condition of ESR III that required the government to begin licensing private banks prior to the release of a particular tranche. Unfortunately, a World Bank condition required the government to establish a functioning banking superintendency before licensing private banks. The superintendency, in turn, awaited the approval and implementation of an Inter-American Development Bank (IDB) technical assistance loan. These clashing conditionalities represented a serious difference of views between USAID and the World Bank over the relative importance of an early reestablishment of a functioning banking system versus the early establishment of an adequate system of prudential supervision. The conflict was ultimately resolved with an agreement by USAID to provide significant technical assistance to the superintendency ahead of the IDB loan. It illustrates, however, the type of problem that can arise even among like-minded donors when they are negotiating separate conditionality packages with the government.

Economic recovery began in the second half of 1991. The hyperinflation of the prior years was eliminated through sound fiscal and monetary policies and exchange rate reform. Private banks were reestablished and quickly captured a significant share of total deposits. Government intervention in price formation was eliminated, as was its monopoly on international trade. The state's role in the productive sectors was quickly reduced as state-owned businesses were sold, returned to prior owners, or closed. By the end of 1992, recovery had proceeded far enough that the need for policy-conditioned balance of payments support essentially ceased.

Resumption of Nonproject Assistance in Nicaragua, 2002 to Present

Recovery and the HIPC Process

By early 1998, Nicaragua had achieved significant economic growth and macroeconomic stability. The process suffered a setback from the damage caused by Hurricane Mitch in late 1998, which required a huge increase in government spending. Partly due to a massive inflow of disaster assistance, however, the economy bounced back, with real GDP growth accelerating to 6 percent in 1999.

It was at this point that the country was held to have reached its "decision point" under the Heavily Indebted Poor Country (HIPC) initiative in late 2000. This new kind of nonproject assistance gave the country interim relief from its crushing external debt burden, carried over from the civil war of the 1980s. The HIPC process required the government to initiate the broad consultations needed to prepare a Poverty Reduction Strategy Paper (PRSP) and led to the reengagement with donors that ultimately produced the current GBS process.

During the three-year period 2001–03, between Nicaragua's decision point and its completion point, Nicaragua received interim debt relief equal to $253.1 million. When Nicaragua reached its HIPC completion point at the end of 2003, its multilateral and bilateral creditors reduced its stock of debt by $3.341 billion in net present-value terms (IMF 2004, 7). Part of the conditionality for this relief required the government to maintain the policies needed to sustain macroeconomic stability. Another condition was the government's commitment to calculate the budgetary savings from debt relief each year and to use a substantial part of these savings to increase spending on poverty-related items (as specified in the PRSP). During 2001–03 Nicaragua increased such spending by $165 million, while reducing nonpoverty-related spending by $49.5 million (IMF 2004, 10).[2]

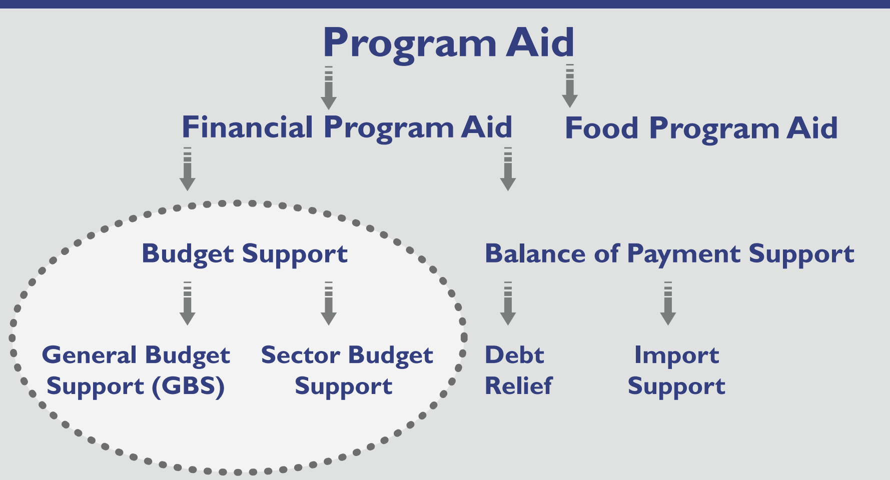
2 The rest of the HIPC debt relief funds were used to service the increased domestic debt acquired during the 2000–01 financial crisis and to strengthen the foreign exchange position of the Central Bank.

However, the HIPC process, which was launched in the last days of the Alemán administration, had a rocky start. The winding down of donor disaster assistance in 2001 failed to trigger a corresponding reduction in government spending, resulting in a ballooning public sector deficit. World coffee prices collapsed in 2000. Four large commercial banks failed in late 2000 and 2001, which required government intervention and enormously expanded the government's domestic debt. These factors combined to produce a totally unsustainable macroeconomic situation. It was also at this time that the scope of corruption in the Alemán administration, especially in the area of government procurement, began to come to light. The donors' emerging reengagement in the form of nonproject assistance was therefore suspended.

When the Bolaños Administration came to power early in 2002, the country's macroeconomic policy was in disarray. The consolidated public sector deficit had reached 8.4 percent of GDP in 2001. The failure of the four commercial banks added an amount equal to 14 percent of GDP to the Central Bank's already large domestic debt. The combination of tight monetary policy to combat inflation (which had reached almost 10 percent in 2000), displacement of domestic private sector lending by government debt, recession in the United States, and collapsing world coffee prices caused the Nicaraguan economy to stagnate and real GDP to decline by 1 percent in 2002.

The new Bolaños government took vigorous steps to reverse this deteriorating situation. It enacted two revenue packages that reduced exonerations from the value-added tax (VAT) and raised central government revenues by an amount equal to 2 percent of GDP. These revenue measures, along with spending restraint, reduced the consolidated public sector deficit (after grants) to 5.5 percent of GDP in 2002 and 3.8 percent in 2003. However, GDP growth—2.3 percent in 2003—stayed well below the levels of the late 1990s.

Figure 1. Nonproject Assistance in Nicaragua, 2002 to Present



With the exception of the balance of payments support of the early1990s and the HIPC process several years later, this study examines the forms of budget support shown here: general budget support and sector budget support.

By August 2003, the government was broadly in compliance with the targets of its IMF program. At that point, the Bolaños administration asked the IDB to convene a consultative group at which it proposed a bold—and somewhat risky—program to jumpstart the economy. The plan was to restrain the growth in current spending while continuing to meet the targets for social spending contained in the HIPC and the IMF's Poverty Reduction and Growth Facility. At the same time, the government would increase public sector investment in support of productive activities. This proposal, embodied in the National Development Plan (NDP), would raise the consolidated deficit in 2004 to 4.4 percent of GDP. However, it would increase public sector saving from 0.2 percent to 2.1 percent of GDP; it would also accelerate growth to 3.7 percent in 2004 and to over 5 percent in subsequent years. With some misgivings, the donors generally endorsed the proposal. They requested, however, that the Nicaraguan government reconcile the new strategy with the commitments embodied in the PRSP, generating a revised PRSP (PRSP II).

World Bank Budget Support

In response to an improved assessment of the integrity and implementation capacity of the Bolaños administration, in 2002 the World Bank had already begun to prepare a $15 million, single-disbursement Programmatic Structural Adjustment Credit (PSAC) as part of a renewed budget support program. The PSAC was intended to support the implementation of Nicaragua's PRSP and laid the groundwork for a renewed multiyear program of budget support by the Bank and other donors. Much of the conditionality for this relatively modest program consisted of measures to strengthen financial control, accountability, procurement integrity, and budget transparency. It was approved in March 2003, and the government successfully carried out the conditionality measures.

The encouraging outcome of the PSAC led the Bank to begin preparing a much larger and more ambitious $70 million Poverty Reduction Support Credit (PRSC I) during 2003, to be disbursed in two tranches of $35 million. The conditionality for this credit, which continued the conditionality matrix developed under PSAC, called for a large number of very specific measures aimed at reducing fiduciary risk as well as meeting more general conditions regarding delivery of social services.

Inter-American Development Bank Nonproject Assistance

Beginning early in the Bolaños administration, the IDB initiated a series of relatively small, targeted, policy-based loans. Though characterized by the IDB as sector loans, they actually give support to the central government budget through the Treasury's Single Account *(Cuenta Única)* upon the fulfillment of sectoral conditionality. In some cases (e.g., its upcoming health sector loan), the IDB expects that to meet program targets, the government will need to spend more in the sector. However, the success of the program will be judged on the government's achievement of PRSP-related targets, not on its level of spending.

Since the resumption of nonproject lending to Nicaragua in 2002, the IDB has completed two such loans, and two more are in preparation. The first program loan, the $30 million Program to Support the Poverty Reduction Strategy, was approved in November 2002 and disbursed in two $15 million tranches based on the fulfillment of conditions in education, health, and family planning. A second $25 million loan for Modernization of the State and Fiscal Reform was approved in 2003 and conditioned on reforms of the tax system and other public administration reforms. At the time of the evaluation team's visit, a $30 million Health Program Loan was in preparation, and a Social Reform Program Loan for $15 million was also being planned.

Policy-based assistance is disbursed based on the fulfillment of specified policy conditions. But fulfilling some conditions may be outside the government's control.

Although the IDB program loans are disbursed to the Treasury's Single Account, they are perhaps more properly characterized as policy-based assistance of the type carried out by USAID throughout Central America in the late 1980s and early 1990s. They are disbursed based on the fulfillment of specified policy conditions rather than to meet the government's budget requirements. Since fulfillment of some conditions may be outside the government's control, such loans may not be a reliable source of budget financing.

In contrast to this disburse-on-meeting-conditions approach, many bilateral donors have embraced a program-based approach (PBA), which encompasses both GBS and SWAps. The key characteristic of PBAs is not the disbursement mechanism used (cash transfer versus project disbursement). Rather, it is an acceptance of the central role of the host government in establishing a single comprehensive development program and budget framework, along with a reliance on host government systems for design, implementation, financial management, monitoring, and evaluation (Lavergne 2003, 4). Typically the host government unit is a ministry (SWAps) or the government itself (GBS).

PBAs take the position that what is important is the success of the overall development effort, either in a particular sector or in the country as a whole. If the overall effort fails, the narrow success of a particular donor project is cold comfort. PBAs, particularly when they come in the form of GBS, also implicitly recognize the fungibility of resources. Individual donor projects—

For program-based approaches, what counts is the success of the overall development effort, either in a sector or in the country as a whole. If the overall effort fails, the narrow success of a particular project is cold comfort.

particularly single-purpose projects involving commodities, technical assistance, or institution-strengthening training—are not inconsistent with a PBA approach, provided the donors involved coordinate their procedures for reporting, financial management, and procurement.

Bilateral Donors and the Budget Support Group

Since the beginning of the Bolaños administration, a number of bilateral donors have begun moving a portion of their programs from a project to a sectoral or GBS basis; others are considering doing so. Under the leadership of the Dutch and Finnish assistance agencies, the bilateral donors have organized the Budget Support Group. Organized on a somewhat informal basis, this group includes both donors actually providing budget support (the EC, the Netherlands, Switzerland, Finland, and the United Kingdom) and donors who provide technical assistance aimed at increasing the government's institutional capacity to manage GBS (these include USAID, Japan, and Germany). The latter donors participate in discussions of the conditionality of future funding on an equal basis.

A key accomplishment of the Budget Support Group has been the preparation of a Joint Financing Arrangement (JFA). This agreement responds to a number of issues of concern to the bilateral donors, including the need to simplify the World Bank's policy reform matrix.[3] The bilateral donors in the Budget Support Group are presently negotiating, both among themselves and with the government, to produce a set of no more than 10 indicators that will constitute the conditionality for bilateral budget support under the JFA.

The JFA also addresses two other important areas: aligning negotiations and disbursement schedules with the government's budget cycle; and harmonizing procedures in a wide variety of areas, including auditing and performance monitoring, to reduce unnecessary burdens on the Nicaraguan government. Once the government completes the Operational National Development Plan *(Plan Nacional de Desarrollo Operativo)* 2005–09 (PRSP II), the JFA will be ready for signing.

The Budget Support Group helps donors to ensure that the government's budget and strategy address what they believe to be critical development issues. The group does not, however, negotiate the details of the budget itself. The team encountered a strong consensus among both bilateral and multilateral donors that the detailed composition of the budget, apart from the poverty-related spending commitment embodied in the PRSP and the HIPC agreements, is not an appropriate subject for donor negotiations. Rather, the donors intend to discuss government policy and to judge government performance in meeting an agreed-on set of performance indicators.

Health and Education SWAps

In parallel with these efforts in GBS, a number of donors have initiated discussions with two ministries—health and education—on SWAp programs in their respective sectors. These two ministries are universally acknowledged by donors to be the strongest within the Nicaraguan government.

The case of the Ministry of Education is instructive. Donors' shift to a SWAp began in the early days of the Bolaños administration, when the new minister found the ministry hosting no less than 45 donor projects. Although good activities in themselves, the projects lacked policy coherence or focus and were having limited impact on the sector as a whole. Moreover, they distracted ministry staffers with a wide variety of special and unique requirements, imposing very burdensome transaction costs. A particular problem for the ministry was that the donor projects, though ostensibly public investment, often entailed large recurrent costs. When the projects

3 A number of bilateral donors told the evaluation team they were dissatisfied with the Bank's 18-page conditionality matrix; one stated that a major accomplishment of the BSG to date had been to "make the World Bank accountable." However, as discussed more fully elsewhere, much of the detailed conditionality in the Bank's matrix reflects measures needed to address fiduciary risk issues; in this area, the need for highly specific conditionality is probably unavoidable.

ended, the ministry found it had to either absorb unplanned-for recurrent expenses or see the results collapse.

With the arrival of the new minister, the ministry began to articulate its own priorities, which involved lines of action to improve governance and administrative systems. At the same time, Nicaragua was selected to be one of seven countries to participate in an OECD program, the Education for All–Fast Track Initiative (EFA-FTI), implemented by the World Bank. Although a project, the EFA-FTI had many of the characteristics of a SWAp, with primary attention on indicators, all linked to long-term goals incorporated in the ministry's own strategy and developed and elaborated with the assistance of the World Bank, USAID, and other donors.

Based on the experience of developing the EFA-FTI, the ministry met with donors to discuss the development of a SWAp. As part of its preparations, the ministry analyzed funding requirements over a 15-year period, prioritized uses of funds, and developed a common work plan for 2004. The work plan was coordinated through a steering committee of donors. Four donors have committed resources to the SWAp: Canada ($15 million over four years), Denmark ($25 million over five years), the EC ($15 million over three years), and the World Bank ($15 million over four years). Other donors are providing, or expect to provide, technical assistance within the overall SWAp.

Although USAID is a major donor in both education and health, its participation in the SWAps in these two areas has been restricted by the Agency's implicit policy against cash transfers and by USAID missions' limited abilities, in practice, to take part in harmonizing rules for procurement, financial control, and accountability. USAID has, however, had some involvement with these SWAps, primarily as a provider of training and technical assistance.

Summary and Expectations of Nonproject Assistance

As shown in table 1, USAID's ESR program of the early 1990s occurred in parallel with numerous other donors' related and coordinated assistance. A terminological distinction is made here between budget support (conditional) and GBS (performance-based but unconditional) to reflect differences in approaches that donors have taken in Nicaragua. The process of preparing to implement SWAps in Nicaragua (2002–present) includes various project and program activities predominantly in the health and education sectors. These SWAps were not yet being implemented at the time of this study.

Levels of assistance provided by donors in 2003 are detailed in table 2. These data include all assistance, whether disbursed through the public sector or not, as reported by donors to the Ministry of Foreign Affairs. Donor disbursements for 2004 are expected to equal 90 percent of public sector investment expenditures. (As noted above, donors finance 80 percent of this spending; they also

Table 1. Summary of Nonproject Assistance in Nicaragua, 1990 to Present

Donor	Year	Program	Assistance Type
USAID	1990–93	ESR I–IV	Balance of payments support
World Bank, IMF, various bilateral	2000–04	HIPC	Debt relief
World Bank	2002	PSAC	Budget support
IDB	2002–present	Sectoral loans	Sector budget support
Various bilateral and World Bank	2002–present	BSG	GBS
Various	2002–present	Various sectoral programs	Various project and program activities
World Bank	2003	PRSC I	Budget support
World Bank	2004	PRSC II	Budget support

Source: Donor and government interviews
Note: Dates indicate when efforts began, such as the beginning of the HIPC process, and do not necessarily indicate the date of implementation.

Table 2. Total Foreign Assistance Disbursed to Nicaragua in 2003, Selected Donors

Donor	Percent of Nicaragua's GDP
World Bank	2.74
IDB	2.48
USA	1.11
EC	0.89
Sweden	0.82
Denmark	0.66
Japan	0.47
Spain	0.40
Netherlands	0.38
Switzerland	0.37
Italy	0.29
OPEC	0.27
Finland	0.19
Taiwan	0.19
World Food Program	0.17
Norway	0.12
Luxemburg	0.12
South Korea	0.11
Total	11.77

Source: MINREX (Ministry of Foreign Affairs), Government of Nicaragua, and World Development Indicators, World Bank
Note: Detail may not add to total due to rounding.

contribute a much smaller amount for recurrent expenditures.)

The dominant provider of budget support to the government of Nicaragua is the World Bank, both because it is the largest donor—as shown in table 2—and because it has been the leader in committing to provide assistance over the period of the National Development Plan (2003–08). Among the top donors, and second in importance in terms of nonproject assistance, is the EC, which has a large assistance program and has stated its intention to provide roughly 20–30 percent of this aid in program-based assistance. Of the other bilateral donors, the Netherlands, Switzerland, Finland, and the United Kingdom are committed to the mechanism of GBS, but absolute levels of their assistance are somewhat smaller.

Impact of Nonproject Assistance in Nicaragua

Impact of Early 1990s Balance of Payments Support

The policy-conditioned programs of balance of payments support funded by USAID, the World Bank, and other donors in the early 1990s enabled the Nicaraguan government to carry out a difficult and profound transformation of the economy. In a short time, the government eliminated macroeconomic imbalances, reduced the size of the public bureaucracy, eliminated the state monopoly on foreign trade, transferred a substantial portion of the 351 state enterprises to private ownership, licensed private banks, and created a mechanism for the banks' prudential supervision.

Policy-conditioned balance of payments support in the early 1990s enabled the government to transform Nicaragua's battered economy. As market-economy institutions were rebuilt, economic activity began to accelerate.

This transformation was not carried out without conflicts, backsliding, and less-than-perfect implementation. Despite close coordination among donors, occasional conflicts about priority arose because of the separate conditionality packages each donor had negotiated with the government. These factors increased the chances that any related reforms would not go far enough. For example, the banking system crisis of 2000–01 revealed serious shortcomings in the prudential regulation of banks, despite the extensive technical assistance that the IDB, USAID, and other donors gave the superintendency following their balance of payments support during the early 1990s.

On the whole, however, the transformation was carried out successfully. Balance of payments support dropped sharply after 1993 as the country's external balance became increasingly sustainable. As the institutions of a market economy were rebuilt, economic activity began to accelerate. Over the period 1994–2001 economic growth averaged 4.5 percent per year, despite a series of external shocks, including Hurricane Mitch. Moreover, the rebuilt market-economy institutions enabled the government to maintain moderate levels of inflation, which averaged 10.3 percent per year over the eight-year period. Regular, planned depreciations of the cordoba by the Central Bank maintained the country's external competitiveness.

As a result of steady economic growth, Nicaragua made significant progress in reducing poverty in general and extreme poverty in particular. The proportion of Nicaraguans living in extreme poverty declined by 22 percent, falling from 19.4 percent of the population in 1993 to 15.1 percent in 2001 (World Bank 2003b, 1). Broader poverty indicators improved by lesser amounts but still improved significantly. The greatest reductions in poverty took place in rural areas.

Impact of GBS

It is still very early to measure the impact of the recent inflows of GBS. However, a number of important outcomes are already evident. One of these has been to highlight a number of institutional and structural problems that need to be resolved by the government and donors.

Many of these structural problems have been created, or at least aggravated, by the actions of donors operating at a project or sectoral level. The difficulties will be summarized briefly in this section and explored in more detail in the following sections. They include

- pervasive weaknesses in systems for financial control and accountability, transparency, and fair and effective procurement procedures throughout the government
- technical and managerial weaknesses within line ministries, which have been bypassed—using a variety of mechanisms—by donors interested in quick project implementation
- lack of coordination among donors regarding policy, resulting in conflicting signals to the Nicaraguan government
- a generally weak budget process and poor budget and planning interactions with line ministries

The biggest factor aggravating these problems has been the sheer collective weight of donors in the activities of the Nicaraguan government. Taken together, donors finance 80 percent of Nicaragua's public investment budget. Even when donor resources are disbursed through government, their earmarking and conditioning have made the government's own decisionmaking processes less important.

This has led to a situation where donors are far more important to favored line ministries than either the Ministry of Finance or the Presidential Secretariat for Strategy and Coordination (SECEP), which is responsible for planning and for PRSP implementation. Ministries favored by donors (e.g., health and education) have been technically and managerially strengthened, while others (e.g., agriculture and, above all, public works) have remained weak and ineffective. The result has been poor budget and planning processes and an unhealthy imbalance of power between the finance ministry and SECEP, on the one hand, and the favored line ministries on the other.

These problems are far from resolved. However, the GBS process has highlighted the issues and is beginning to make donors aware of their own role in creating or worsening them. If GBS is to succeed, these issues must be solved—and, to a very considerable extent, that is what is happening.

Impact of SWAps

It is far too soon to gauge the effects of SWAps in Nicaragua. Both the education and health SWAps are still in the very early stages. However, the process of designing a SWAp—like that for designing a GBS program—has increased donors' coordination, both among themselves and with the ministry leadership. In both cases, the ministry leadership has been transformed from a relatively passive recipient of donor initiatives to the leader and organizer of donor activities within the sector.

Fiduciary Risk in the Nonproject Assistance Programs

The most often-voiced concern about nonproject assistance, particularly within USAID but by other donors as well, is fiduciary risk. In the context of foreign assistance, fiduciary risk is the probability that funds will be used for purposes other than those intended. It is not synonymous with corruption. For example, it includes the probability that funds will be intentionally or unintentionally diverted to other than those agreed upon. Conversely, there are many forms of official corruption (bribe taking, for example) that do not involve the misuse of government funds.

Procurement abuses gave the previous administration its reputation for extreme corruption. Only a few years later, the World Bank's assessment found substantial progress in both financial management and procurement in Nicaragua.

The approach to fiduciary risk adopted by members of the multidonor Budget Support Group has been heavily influenced by the World Bank. This reflects the fact that the World Bank was the first major donor to resume nonproject assistance after the long hiatus under the Alemán administration. The Bank continues to be the largest single provider of such assistance. Moreover, the Bank has a well-established and highly structured approach to the problem of fiduciary risk. Among other donors, only the UK's Department for International Development (DFID) appears to have a well-articulated policy in this area.

In preparing for its first $15 million budget support loan, the Programmatic Structural Adjustment Credit (PSAC), the Bank carried out three assessments of the fiduciary risk involved in its own lending operation. These three instruments are part of the Bank's standard country assessment process, especially in the case of nonproject assistance. However, they took on special significance in the case of Nicaragua, both because of the government's well-deserved reputation for corruption during the Alemán administration and because of the important role that multilateral and bilateral budget support were expected to play in implementing the PRSP. The first instrument was a Country Financial Accountability Assessment; the second, a Country Procurement Assessment Review; the third, a Public Expenditure Review.

The Country Financial Accountability Assessment (CFAA) is the Bank's main diagnostic tool for public financial management and accountability. The CFAA describes and analyzes expenditure monitoring and accounting, financial reporting, internal controls, and both internal and external auditing, with recommendations for improvements (Allen et al. 2003, 18).

The Country Procurement Assessment Report (CPAR) focuses much more narrowly on whether the procurement rules and practices of the borrowing government conform to World Bank requirements, since, of course, Bank projects are implemented through host-country procurement. As such, a CPAR carries out a comprehensive analysis of legislation, organizational responsibilities, oversight, practices, and procedures, as these relate to public sector procurement. Although normally focused specifically on Bank-funded procurement, the CPAR has broadened its reach in recent years to examine the adequacy of host-government systems for insuring fair and open competition in public sector procurement in general (ibid.). In Nicaragua's case this assessment was seen as particularly significant, since it was in the area of procurement that the previous administration gained its reputation as one of the most corrupt in the world.

The Bank's Public Expenditure Review (PER) is undoubtedly the best known of the three instruments for assessing fiduciary risk and focuses on the budget preparation process. Its emphasis is on the process of annual budget preparation, legislative review, priority setting, and—increasingly—on medium-term programming (ibid., 17). The CFAA, by contrast, focuses on the area of budget execution, although there is a certain degree of overlap.

The results of the Bank's three-part assessment were generally positive, and acknowledged the progress that the Nicaraguan government had made, particularly in its Integrated Financial Management System (SIGFA) and in procurement reform. The assessments found that the government does indeed have the minimum level of audit and financial controls needed to implement GBS and sectoral programs. Essentially, the requirements for financial control, audit, and procurement integrity are the same for both GBS and SWAps. The assessments also identified areas needing improvement to lessen fiduciary risk in the three major areas of budget, procurement, and financial management/accountability. What is different from earlier assessments carried out by the Bank is that these recommendations are now contained in the conditionality for the PSAC and PRSC I, and were to be incorporated into the conditionality for PRSC II. In fact, the bulk of the very detailed requirements in the 18-page conditionality matrix relate to these reform measures, required, in the Bank's view, to address fiduciary risk issues.

Both donors and government have complained about the level of detail in the World Bank's conditionality. But reforms in this area are all about details; an inadequate reform is simply a roadmap to corruption.

The principal measures fall into the following areas:

- budget preparation
  - implement SIGFA budget formulation and execution modules throughout the central government and eventually extend SIGFA to the departmental and local levels of government and autonomous agencies
  - prepare a medium-term expenditure framework, together with calculation of the recurrent-cost implications of the public investment program
  - establish a single, unified registry of public investment projects
- budget execution and financial management
  - enact law establishing a firm legal foundation for SIGFA
  - implement SIGFA budget execution modules throughout the public sector
  - establish Single Treasury Account system and shift all funds to it, including donor funds
  - implement action plan based on other findings of the CFAA
- procurement
  - make government procurement information available on the internet
  - ensure that the Ministry of Finance implements standard government-wide bidding documents

- enact legislation clarifying the role of the Office of Public Ethics
- enact legislation implementing other recommendations of the CPAR

- transparency
  - enact a law on access to government information
  - implement a national system making poverty monitoring indicators publicly available (SINASIP)

Both bilateral donors and Nicaraguan government officials have complained about the level of detail contained in the Bank's conditionality matrix. However, in the case of reform of financial control/accountability and procurement, it is difficult to see how this can be avoided. Reforms in this area are all about details, and an inadequate reform is simply a roadmap to corruption. Even with the detail already contained in the matrix, there are a number of points on which the parties only "agree to agree," including a catchall condition to implement an action plan based on the findings of the CFAA. It remains to be seen if this approach—addressing weaknesses in fiduciary risk while at the same time carrying out a coordinated multidonor GBS program—will succeed.

Among the bilateral donors, as noted earlier, only DFID has a well-articulated policy for addressing the problem of fiduciary risk. This policy sets out eight good-practice principles, as well as 16 benchmarks for assessing adherence to those principles. These are shown in the table at right, taken from DFID's own policy paper (DFID 2002). In practice,

Table 3. Managing Fiduciary Risk: Principles and Benchmarks

Good Practice Principles	Benchmarks for Assessment
A clear set of rules governs the budget process.	• A budget law specifying fiscal management responsibilities is in operation. • Accounting policies and account code classifications are published and applied.
The budget is comprehensive.	• All general government activities are included in the budget. • Extra budgetary expenditure is not material.
The budget supports pro-poor strategies.	• Budget allocations are broadly consistent with any medium-term expenditure plans for the sector or for the overall budget.
The budget is a reliable guide to actual expenditure.	• Budget outturn shows a high level of consistency with the budget
Expenditure within year is controlled.	• In-year reporting of actual expenditure. • Systems operate to control virement,[4] commitments, and arrears.
Government carries out procurement in line with principles of value for money and transparency.[5]	• Appropriate use of competitive tendering rules. • Decision making is recorded and auditable. • Effective action is taken to identify and eliminate corruption.
Reporting of expenditure is timely and accurate.	• Reconciliation of fiscal and bank records is carried out on a routine basis. • Audited annual accounts are submitted to parliament within the statutory period.
There is effective independent scrutiny of government expenditure.	• Government accounts are independently audited. • Government agencies are held to account for mismanagement. • Criticisms and recommendations made by the auditors are followed up.

Source: Department for International Development (UK) 2002, 10.

4 "Virement" is the movement of budget resources from one budget heading to another.

5 DFID's Procurement Department is preparing more detailed guidance on ways to assess procurement systems.

however, this approach is only a more general statement of the same principles that underlie the World Bank approach. In fact, the DFID policy paper makes several favorable references to the World Bank approach, including a recommendation that the three assessment instruments be combined in a single process. In the specific case of Nicaragua, DFID has accepted the World Bank's judgment that the level of fiduciary risk is acceptable both for the Bank and for the donors of the Budget Support Group operating through the Joint Financing Arrangement.

Both donors and government officials agree that the most important contribution to improving financial control, accountability, and transparency has been the implementation of SIGFA. This system enables government officials, members of the National Assembly, and donors to monitor and track government financial flows in nearly real time. It has vastly improved budget execution.

While the public at large do not have access to SIGFA, SECEP separately publishes on its website a wide variety of indicators established under the PRSP and National Development Plan. These indicators enable the public at large, the press, and local organizations to monitor government performance.

Other Key Issues in the Nonproject Assistance Programs

Design

The organization of the GBS program in Nicaragua under the Budget Support Group is unusual in a number of respects. Most important is the fact that all the donors recognize the critical importance of institution-strengthening technical assistance. As a result, donors who provide such assistance participate on an equal footing in negotiating GBS conditionality. All donors agreed that this arrangement has strengthened the overall process. Moreover, the stress laid on institutional strengthening reflects a realistic assessment of the current weaknesses of the Nicaraguan government.

All donors recognize the critical importance of institution-strengthening technical assistance. This attitude reflects a realistic assessment of the Nicaraguan government's current weaknesses.

Although a number of donors are also interested in undertaking SWAps, especially in the health and education sectors, the Budget Support Group's recent focus has been very much on GBS. In Nicaragua, both GBS and SWAps involve coordinated efforts by donors and government to support a locally designed development program that entails coordination and harmonization of donor activities and procedures; is led by the recipient country; has the host government's own budget priorities as its fundamental framework; and aims to increase the role of the host government over time. Thus, GBS in Nicaragua has a number of SWAp-like characteristics. An important trait is the lead role of the host government in all functions, including program design and implementation, financial management, and program-wide monitoring and evaluation. In addition, GBS in Nicaragua incorporates large amounts of technical assistance aimed at improving the government's capacity to increase the effectiveness of aid across the board.

While donors coordinate activities in part to decrease transaction costs for the government, the inclusion of large amounts of project aid under both the GBS and the SWAp frameworks means that local officials must still cope with a wide range of donor requirements, procedures, and mechanisms. Some local donors have also noted that the government is concerned about transparency on the donors' side of the GBS process. The Budget Support Group has thus given high priority to harmonizing these elements of project aid.

The Budget Support Group framework and donors' plans to increase GBS and supporting technical assistance has important implications for donor program design as well. When most assistance is provided in the form of projects, the donors' diverse policies, philosophies, and methods do not have to be reconciled unless they radically conflict. Each donor can simply carry out its own projects, using its own approaches and reflecting its own development philosophy. For both SWAps and GBS, this is simply not possible. Neither an implementing ministry under a SWAp, nor the government as a whole under GBS, can accommodate fundamentally differing donor approaches in a coherent program. Both SWAps and GBS are sometimes criticized as mechanisms for the donors to "gang up on" the host government. It is more accurate to say that these mechanisms require the donors to work out the differences among themselves, rather than battling them out with the host government as the battlefield.

This phenomenon is already clearly evident in Nicaragua. In the health and education sectors, donors have adopted a unified approach, and this has made SWAps possible. In the productive sectors, however, there are fundamentally different approaches. The contrast is especially marked in agriculture, where a number of European donors, joined by the UN Development Program, favor an exclusive focus on smallholder farmers, whereas USAID and a number of other donors support the government's preference for assisting larger-scale producers with better commercial and export potential. This particular disagreement has not been resolved, and it may not be resolvable. But such differences must be reconciled for nonproject assistance to be practicable.

While the role of GBS is clear in Nicaragua, the role of SWAps is not. At the moment, donors seem to see SWAps as a substitute for project assistance in the stronger ministries, rather than as a transitional stage to GBS. SWAps, in the view of donors, offer many of the advantages of project assistance in a strong ministry, as well as other advantages characteristic of program assistance: they allow the ministry itself to better coordinate programs while streamlining the development process by using one set of government procedures rather than a plethora of donor procedures and requirements. However, SWAps share many of the disadvantages of project assistance in a country like Nicaragua that is heavily dependent on donor assistance overall. Like projects, SWAps tend to undermine the budgetary process and impinge on the ability of the host government to set its own priorities and strategy.

If donors accept the principle that the host country government should establish the development strategy, they must also accept that the government's priorities may differ somewhat from their own. In Nicaragua, the National Development Plan places more stress on the development of the productive sectors and less on the delivery of social services than some donors are comfortable with. However, most of those donors acknowledge the government's right to set its own agenda for progress, and they are therefore moving ahead with GBS. What will likely continue to be seen in Nicaragua are programs of targeted technical assistance to line ministries, combined with general resource support provided to the Treasury's Single Account.

Implementation

Management Capacity of the Government of Nicaragua

Both donors and Nicaraguan government officials agree that while the administrative, technical, financial, and monitoring capacity of the government varies enormously among ministries, in many cases it is seriously deficient in important respects. For most donors, the lack of capacity to implement projects is probably the single greatest obstacle to a more rapid transfer from project to nonproject assistance. Where donors differ, however, is in their willingness to risk implementation failure by relying, perhaps prematurely, on government capacity that may not yet be adequate. A case in point is the issue of fiduciary risk discussed earlier. All donors agree that substantial amounts of technical assistance will continue to be required for many years to come before the government can fully replace the donors who now carry the burden of project implementation and management.

Furthermore, nonproject assistance, whether sectoral aid or GBS, imposes an additional set of management and technical demands that strain the capacity of all ministries and that some are simply not in a position to meet. These demands include the large amounts of staff time, particularly senior staff time, that the move toward GBS and SWAps requires.

GBS is premised on the recipient government's taking control of the GBS process, setting priorities, and allocating resources in accordance with those priorities in the face of competing demands from line ministries. At the line ministry level, for both GBS and SWAps, a similar allocation of resources needs to take place, followed by the design, implementation, monitoring, and evaluation of activities.

GBS is premised on the recipient government's taking control of the GBS process, setting priorities, and allocating resources in accordance with those priorities. The results create winners and losers—and conflict.

Donors in the Budget Support Group complain about the government's passive approach to the group itself. In principle, Budget Support Group meetings should be convened by the government through a senior official designated by the president of Nicaragua to speak for the government as a whole. However, donors note that meetings are convened by donors' representatives, not by the government. In addition, the government's representative is the vice minister of foreign affairs for economic cooperation, not an obvious official to represent the government in discussions of budget matters.[6]

Perhaps more important, the donors see serious disconnects between the line ministries and the Ministry of Finance, as well as between the Ministry of Finance and the Technical Secretariat of the Presidency (SECEP). SECEP is an important player because it is responsible for public investment planning, including the public investment portion of the budget, the PRSP, the National Development Plan, and, in general, the setting of development priorities. Donors suggest that there are further disconnects among the various functions of SECEP itself. These weaknesses may be understandable; in fact, this report suggests elsewhere that the donors may themselves bear a good deal of the responsibility for them. The fact remains that a quick resolution of these shortcomings in budget preparation and strategic planning is absolutely essential if GBS is succeed in Nicaragua.

Within the line ministries, donors report that the level of capacity to implement projects is highly uneven. While donors note that capacity has improved over recent years, especially the last two years, there is a general feeling that management capacity does not extend below the highest levels of the ministry. In fact, the managerial weaknesses of the line ministries are far more worrisome than their lack of technical capacity, although that is also of concern. Ministries, up to a point, can hire technical experts to fill specific needs—the same technical experts now hired by the donors. The problem is who will write the scopes of work, judge the technical qualifications of competing contractors, and then make sure the work conforms with the terms of the contract. For this, the line ministries need managerial depth, and such depth is currently lacking in many cases. Management capacity is also said to be undermined by high turnover rates and, in some instances, political favoritism in appointments.

Though secondary to the management gap, lack of technical capacity is also a serious issue, even in the strongest ministries. The Ministry of Education has identified important technical training needs in all aspects of education, both within the ministry itself and at the municipal level, if the current educational reforms are to succeed.

The weakness of the economic ministries is a particular concern, given their central role in the National Development Plan. One problem is that the central government's effort in promoting private sector development—including investment and trade—is spread among a number of ministries, including the ministries of Agriculture, Public Works, and Industry and Commerce, as well as SECEP. Although the experience of the CAFTA negotiations suggests that the government has at least the minimum capacity required to carry out these functions, these ministries clearly need strengthening.

Though the lack of managerial capacity appears daunting, there is no reason the Nicaraguan line ministries should not be able, with considerable donor help, to assume the implementation functions currently being performed by donors. Recent history offers a basis for cautious optimism. While the ministries of Health and Education are now considered to be reasonably efficient, effective, and well managed, 14 years earlier they were in as poor a state as the Ministry of Public Works is today. What has

6 That the Ministry of Foreign Affairs represents the government is due to historic circumstance, as the Budget Support Group grew out of a subgroup of the Good Governance Group, to which the Ministry of Foreign Affairs and Cooperation was the official liaison.

Donors who moved to GBS expecting it to reduce workload and staffing needs have found instead that their workloads have increased, in large part because donors still carry out a wide range of projects—often nearly as many as before—though with reduced budgets.

changed is a decade and a half of intensive donor-assisted institution building. Donors need to give the same kind of intensive institutional support to the ministries of Agriculture, Public Works, and Industry and Commerce, all of which play critical roles in the National Development Plan. For the government to take over the donors' implementation functions, however, the donors need to relax their focus on "poverty" programs (i.e., social service delivery) and acknowledge the critical importance of the infrastructure and productive sector ministries. USAID has recognized this for the productive sectors (although not for infrastructure); other donors need to do so as well.

In principle, donors realize that institutional strengthening is essential for GBS and SWAps to succeed, and they are prepared to provide large amounts of technical assistance to address it. In practice, however, the team did not detect either a comprehensive view of the problem on the donors' part or—especially in the case of the bilateral donors—a willingness to broaden their sectoral focus to encompass the weaker ministries. The World Bank and IDB are still largely concerned with fixing systemic problems related to fiduciary risk. The IDB is also working on the procurement system, and the World Bank on other financial management issues. The bilateral donors (again, USAID excepted) are still largely focused on working with the already strong ministries of Health and Education.

Donors intend that as the Nicaraguan government's capacity improves, the share of total aid represented by nonproject assistance in general and GBS in particular will grow. Even with the government's current capacity shortfalls, a number of donors remain determined to maintain and even increase the proportion of GBS in their assistance. These donors are prepared to accept the resultant risks. Others are not.

Staff Workload

One of the motivations for donors in moving from project to nonproject assistance has been the belief that the latter would be less staff-intensive for both donors and recipients. To donors, it seemed obvious that shifting the project design, implementation, monitoring, and evaluation functions from donors to the host government would reduce demands on staff time. At a time when many bilateral donors have been under pressure to reduce staffing, this is no small consideration. The question of such a shift's effects on the host government's workload is more complicated, but the general expectation was that gains from streamlining procedures would help to offset the added burden of project design and implementation. In practice, the results are proving far more complex.

For Donors

It is the universal view of the donors involved in the Budget Support Group that the process of providing GBS has *increased* demands on their staff time thus far. Although there is hope that these demands may decrease as processes and procedures become better established, the team encountered no donor who expressed confidence that there would be a net reduction in staffing demands in the foreseeable future.

The reason for this somewhat surprising result is that donors are continuing to provide project assistance along with budget support. From a donor point of view, both activities lose important economies of scale when both are part of a donor program. One donor stated that developing and implementing a budget support program is essentially a fixed cost, regardless of the level of support being provided. The program parameters have to be discussed with the government and with the other donors, and performance indicators agreed on and monitored. Another donor noted that it recently had to engage a local-hire economist to monitor GBS performance targets and evaluate government performance. This was in addition to its small project implementation staff.

The question of staffing requirements for implementing a reduced portfolio of projects is more complicated. It depends on the nature of the projects and, in particular, on whether the sectoral focus of the project portfolio is narrowed at the same time or remains the same. In the case of Nicaragua, the donors' shift from projects to budget support has not led to any narrowing of sectoral focus, and the remaining technical assistance projects are technically and managerially complex. In fact, it is precisely because of this complexity that donors are continuing to administer them directly rather than turn them over to government line ministries as part of a GBS or SWAp package. The result is that donors have not experienced anything like a proportionate reduction in staffing demands from their project portfolios, even as they have added significant staffing demands for their nonproject assistance.

Finally, donors almost universally reported that GBS places very heavy demands on their senior staff. It is the senior donor representatives who meet with the government and negotiate the terms of the budget support, including the conditionality matrix. This senior staff is not easily augmented, and the added burden on senior staff members, while hard to measure, is certainly considerable.

Many donors expressed the hope that demands on staff time would drop as procedures and policies become better established. However, as long as donors continue to conduct substantial technical assistance programs as well as GBS, it is difficult to see how this burden can decline significantly.

For Government

Any judgment about the staffing demands of nonproject assistance on government in Nicaragua must begin with the strong caveat that the process is still in its early stages: any conclusions must be regarded as preliminary. As with the donors, there has been an increased demand on the time of senior officials to establish policies and priorities and negotiate with donors. Unfortunately, this extra burden seems both unavoidable and difficult to accommodate.

To some extent, this is simply a consequence of the shift to the government of responsibility for decisions about policy, priorities, and budget allocation that have previously been taken by donors. Making such decisions obviously takes time and effort. Moreover, the results inevitably create winners and losers—and conflict. The task of making the decisions and resolving the conflicts, including deciding whether and how to compensate losers, has simply been transferred back where it belongs—to the democratically elected government of Nicaragua.

Both donors and Nicaraguan government officials report that budget support places very heavy demands on their senior staff.

The same is true within individual sectors. In the case of education, key policy reforms have included decentralization, curriculum changes that encourage active student involvement, and parental participation. Responsibility for implementing these reforms rests squarely with the minister of education. The costs have to be accommodated within the domestic political process, as they are in any democratic society. In some cases, as a practical matter, there may have to be compensation for those who lose out in the reform processes, such as central ministry functionaries and teachers unable to adjust to the new curriculum approaches. This again is a political judgment best made by the Nicaraguan government. Since the minister of education has made it quite clear that the reforms being implemented represent government, not donor, policy, the ministry is very comfortable taking the lead in this area.

At the line ministry level, there is a clear increase in staffing requirements as the ministries absorb project design, implementation, and evaluation functions previously carried out by donors. The ministries may well be able to carry out these functions more efficiently than the donors as a result of donors' harmonization of procedures, but they must absorb the additional workload nonetheless. In the past, the line ministries often had to set up separate "project implementation units" to deal with each donor's particular requirements. To this extent, at least, such streamlining should involve clear efficiency gains. How these conflicting tendencies will work out on balance remains to be seen.

The Budget Support Group's proposed indicators are implicitly measures of output and effectiveness; links to actual reductions in poverty or increases in citizen welfare will have to be judged by each donor for itself.

Effect of Nonproject Assistance on Donor and Government Transaction Costs

Beyond the question of staffing, nonproject assistance—especially GBS—may provide an opportunity to reduce other transaction costs for both donors and recipients. Given that significant technical assistance programs are certain to continue for some time, the Budget Support Group has placed a high priority on harmonizing procedures for both project and nonproject assistance.

One challenging priority in this area is budget cycle harmonization. Donors would like to be able to time their disbursements to coincide with the needs of the Nicaraguan budget cycle, which begins in October. However, donors' own budget cycles make this difficult. Nevertheless, at the very least it should be possible for donors to be more forthcoming about the level and timing of their assistance.

Monitoring and Evaluation

The Donors' Divergent Approaches to Conditionality

In the shift from project to nonproject assistance, no element is more critical to success than donors' monitoring and evaluation of results. To date, donors have taken two very different approaches to monitoring and evaluation. The World Bank, first in the PSAC and then in PRSC I, has taken a largely traditional approach, in the form of a detailed 18-page matrix of government commitments to specific actions. Other donors, as discussed below, favor an approach based on the country's progress toward development goals rather than specific achievements, as laid out in a much smaller matrix expected to contain about 10 indicators.

These approaches converge inasmuch as the World Bank's matrix provides detail that feeds into the broader indicators currently being discussed by other donors. Moreover, even the World Bank's budget support programs differ somewhat from its traditional program lending. In any GBS program, there is an inherent conflict between a donor's assurance it will provide funding to the budget and its need to be clear about the programmatic terms under which the assistance is being provided, as well as those under which it will be continued. The Bank appears to be resolving this problem, in general, by basing its budget support disbursements on the Nicaraguan government's prior actions (the second tranche of PRSC I is an exception). Therefore, what is under discussion in the conditionality matrix is not the current year's budget support, which is assured, but funding for the next year and the years that follow. In this respect, the Bank's conditionality somewhat resembles the budget support provided by bilateral donors.

As mentioned above, the length and detail of the World Bank's conditionality matrix received a great deal of criticism from bilateral donors in the Budget Support Group, and they are currently discussing a set of no more than 10 development indicators they would use to trigger disbursement of their budget support. In practice, most bilateral donors who provide budget support propose to divide their future-year budget support commitment into two portions. One portion would be conditioned only on the maintenance of basic macroeconomic stability indicators. The other would depend on each individual donor's assessment of the government's success in meeting the development indicators now under discussion. In no case would current-year disbursements be affected.

Though the precise indicators are yet to be determined, the group's most recent proposal is for three social service delivery indicators, four indicators of private sector development (actually rural development), and three indicators of the efficiency of government spending in social service areas. All of the currently proposed indicators are already gathered and published regularly, either as part of the National Development Plan reporting process or in the government's own budget documents. All are implicitly measures of output and effectiveness rather than measures of budget inputs. In all cases, linkage to actual reductions in poverty or increases in citizen welfare from these accomplishments will have to be judged by each donor for itself.

Some donors are adding staff to carry out such assessments.

Some might question whether the bilateral donors'[7] approach to evaluation should be called conditionality at all, since current disbursements are assured and are not conditioned on host government performance. Although perhaps more accurately characterized as a program-based approach, "conditionality" was the term used by all donors to describe the performance matrix, and that is the term used in this report.

The World Bank, in defending its approach against calls from some bilateral donors for it to adopt a simplified approach to conditionality, explains that the detailed lower-level indicators contained in its matrix are measures within the direct control of the Nicaraguan government.[8] The Bank points out that higher-level indicators do not necessarily accurately reflect the government's own efforts but can be affected by extraneous factors, both positive and negative. Also, as was discussed earlier, measures related to fiduciary risk are necessarily detailed, and a large portion of the Bank's conditionality directly addresses fiduciary risk issues.

For the moment, the World Bank and the bilateral donors providing budget support seem to be inclined to go their separate ways, with the IDB occupying a position somewhere between the two, but closer to that of the bilateral donors. It is too early to assess the relative merits of the two approaches.

Using results as an indicator seems a sensible approach overall. However, if a development effort goes off track, results monitoring will reveal the problem only after a long delay—when it may be too late for corrective action.

The Donors' Approach to Additionality

One issue that neither group of donors has addressed is additionality—the donors' expectation that their disbursements will supplement host government spending, not supplant or displace it. There are really two separate issues associated with additionality: development resources, and results. The question is typically raised at the sectoral level to express a concern that donor resources (provided for either projects or sectoral programs) will enable the host government to divert its own resources to other uses—for example, that a host government will take a dollar from a donor for the Ministry of Health, increase that ministry's budget by only 50 cents, and give the other 50 cents to the Ministry of Defense. The problem for donors is that with a government as heavily dependent on donor resources as Nicaragua's, it is virtually impossible to say how much funding the Ministry of Health would have received in the absence of donor funding.

While it is thus impossible, as a practical matter, to assure additionality of resources at the sectoral level, it is entirely possible to assure a specified level of resources in the aggregate as part of a GBS process. In fact, the government of Nicaragua provided precisely such a guarantee for poverty-related spending in the PRSP as part of the HIPC process, and SECEP provides periodic information on such spending to both donors and the Nicaraguan public. Apart from this, however, donors have chosen not to negotiate specific levels of budget resources in the budget support process.

The IDB addresses additionality only in terms of results achieved. In its upcoming health sector loan, conditionality will relate to measures and outcomes in the health sector as new progress occurs additional to previous gains. IDB conditionality does not deal directly with additionality of resources, as loan disbursements will be to the Single Account with no specific level of Nicaraguan budget resources specified for the health ministry. Other donors have also accepted this concept of additionality of results, rather than additionality of resources.

On the whole, this seems a sensible approach. However, using results as an indicator does have a disadvantage in terms of timing. In general, data on host government spending are available fairly quickly, while data on results are available only after the fact and often after

7 The EC is generally, in this context, considered a "bilateral" donor.

8 Although not necessarily of the executive branch. A number of conditions call for the passage of legislation "satisfactory to IDA [the World Bank]." This may prove to be a serious problem, since the president does not command the unqualified support of either major party in the National Assembly. Passage of the government's program to date has required assembling ad hoc coalitions, often including the Sandinista Front.

considerable delay. If a development effort is on track, this makes no difference. However, if the effort is going off track, results-focused monitoring will reveal the problem to government and donors only after a long delay—when it may be too late to take corrective action. Donors might therefore find it useful to keep an eye on the level and distribution of public sectoral spending as well.

Sector Assistance as a Transition to General Budget Support

A final question is whether sector assistance and SWAps can represent an intermediate or transitional step toward GBS. As there are not yet any true SWAps in Nicaragua, this is difficult to say. A number of donors are moving toward a SWAp with the ministries of Health and Education. This, however, is seen as an alternative to project assistance in an already strong ministry, rather than as a move toward budget support. Donors contemplating such a SWAp view it primarily as a means to improve coordination and perhaps reduce donor staff costs, although the latter is highly speculative.

In general, where a ministry has the technical and managerial capacity, and where the ministry and the donors share a common vision and approach, a SWAp has many obvious advantages in terms of effectiveness and efficiency. However, sector-focused assistance also has most of the disadvantages of project assistance in terms of transferring overall development strategy decisions from the host government to the donors. While donors are quite within their rights to do this—it is, after all, their taxpayers' money—their decisionmaking processes do not require them to explicitly recognize the opportunity costs of the resulting sectoral resource allocations (i.e., a particular donor-directed emphasis on one sector means that at least some development possibilities in another area will go unfunded). To govern is to choose; the problem is that donors implicitly seek the prerogatives of governing without the responsibilities of choosing.

Conclusions

Project Support, GBS, and Ownership

A dilemma for development donors in many countries is a lack of host government capacity. Though donors may see value in using the government as an implementing partner, they are hesitant to do so when it means working with weak ministries and agencies, with attendant ineffectiveness and corruption. One approach to the problem is to bypass the government units through projects carried out using NGOs, contractors, or other private actors. Though popular, this solution is self-defeating.

In dealing with essential government functions, donors must deal with the government as it is, not as they would like it to be.

It is true that the use of private implementers, whether for-profit or not-for-profit, is perfectly appropriate, and even preferred, in carrying out functions that are not inherently governmental (e.g., microfinance, healthcare provision on a full-cost-recovery basis). However, attempts by donors to achieve quick results by bypassing government in carrying out inherently governmental functions have highly negative and even disastrous results. Donor-funded NGOs and contractors seldom serve more than a tiny fraction of the population. They hollow out government ministries by luring away the most talented government officials with higher salaries and better benefit packages, and when the donor project comes to an end, nothing is left behind. In dealing with essential government functions, donors must deal with the government as it is, not as they would like it to be.

In the case of Nicaragua, advocacy for GBS has often centered on the idea that it will increase the government's ownership of the development process and therefore improve the outcomes of development assistance. The road to ownership, however, has been fairly complicated, for two reasons. One is the sheer scale of donor involvement in the country: 80 percent of its investment budget is donor-funded. The second is that beginning with the mid-1990s and the decline in balance of payments support, most donor resources went to projects implemented through the line ministries. This combination—the size of donor resources and the path they took—inevitably undermined the government's budget and planning processes and weakened the Ministry of Finance and SECEP, the agencies responsible for those processes.

Recently, as the funds available to the government through the budget and the Single Account have grown, the importance of the budget process itself has increased. Ministries now jockey for funding with each other and within the government rather than looking primarily to donors. Consequently, one complaint the team heard repeatedly from donors was that Nicaraguan officials did not work collegially as representatives of a single unified government. However, these same donors seem oblivious to their own role in shifting power relationships within the government, first away from the agencies responsible for the budget process and toward the favored line ministries, and now back to the finance ministry and SECEP. It is inevitable that the latter shift should produce conflicts pitting the line ministries—especially those favored by donors—against the finance ministry and SECEP, as well as other conflicts pitting SECEP against the finance ministry, as all of them sort out their respective roles. Although donors may find this frustrating, it is basically a healthy process and needs to run its course.

Ministries now jockey for funding with each other and within the government rather than looking primarily to donors. Although donors may find this frustrating, it is basically a healthy process.

Moreover, ownership is a two-edged sword, and donors are still in some denial about that fact. They want the host government to take control, yet also want the resulting priorities to be their own. The Bolaños government's insistence on the central importance of economic growth (pillar 1 of the PRSP), as well as on the key role of productive infrastructure, makes many bilateral donors uncomfortable. Nonetheless, one can already see the government reasserting its leadership in Nicaragua's development by insisting on its budget and sectoral priorities as the basis for discussion, in the National Development Plan and elsewhere.

Ownership is also critically important at the sectoral level, whether donors disburse funds to the Single Account or to earmarked sectoral accounts under SWAps. Donors must recognize that although SWAps can offer gains in effectiveness and efficiency, they often have the same drawback as project assistance—transferring development strategy decisions from the host government to the donors. Donors need to either explicitly recognize the opportunity costs of the resulting funding choices in their decisionmaking, or structure their SWAp process to leave the host government in control of the strategy.

The current situation in Nicaragua demonstrates the potential of the latter approach. The key to the success of Nicaragua's sectoral reforms in health and education has been the leadership of the ministries under strong ministers. In both cases, it is clear that the changes implemented have been the Nicaraguan government's policy reforms *supported* by the donors and not the other way around.

Fiduciary Risk

Central to the success of GBS or any development effort is action on the part of the government to reduce fiduciary risk. In fact, improving financial control, accountability, and transparency and reducing fiduciary risk are essential steps to strengthen the state, not simply a precondition for assistance. The early stages of the budget support process in Nicaragua have had this as a primary focus. As detailed earlier, the government and the donors, assisted by the World Bank and IDB, have taken major steps to carry out the recommendations of the Bank's Country Financial Accountability Assessment and Country Procurement Assessment Report. While the government has implemented the measures called for in the Bank's conditionality matrix on schedule, only experience will tell whether these measures are adequate in practice.

It is clear that donors differ enormously in their tolerance for fiduciary risk. However, among the bilateral donors, only DFID has a clear, well-articulated policy. Thus far, because of the leading role of the World Bank in the early stages of the GBS process, the Bank's highly structured approach has been dominant. As the bilateral donors come to make up a larger share of GBS funding, it will be important, both for the Nicaraguan government and for each other, that they be clearer about their approach to fiduciary risk.

Additionality

Some discussions of nonproject assistance stress the question of additionality. Traditionally, such discussions reflect a concern that donor resources should be additional to, rather than substitute for, the host country's own efforts. At the level of the national budget, the best way to measure this is by examining a country's level of "tax effort"—the ratio of its tax receipts to its GDP—and how it behaves over time. This is not to suggest that a higher level of tax effort (and thus a larger share of government spending in the overall economy) is necessarily better than a lower level. Rather, it is simply a statement that when donors give the government more funding, they do not like to see it reduce the amount of resources it mobilizes through the tax system.

The level of tax effort in Nicaragua was raised significantly in the early days of the Bolaños administration and remains in the same range as that of other Central American countries. Given that the Bolaños government has also raised the proportion of development-related spending in its budget, the steadiness of Nicaragua's tax effort implies that donor resources are indeed being used to help finance an expanded development effort.

At the sectoral level, donors in Nicaragua have chosen to focus on additionality of results, not of resources. That is, targets in key sectors are set assuming the effect of additional donor resources, and the government is judged on whether those targets are achieved.

While this seems sensible enough, there is inevitably a long time lag before results can be measured. If problems develop during a sectoral development effort, donors who use results as their only indicators may not detect and address the difficulties in time. Donors may therefore wish to consider tracking public sectoral spending as well as results. Data on Nicaragua government spending are available fairly quickly—in fact, almost in real time. In addition, the government tracks aggregate spending in the social sectors as part of the PRSP process, and these figures are publicly available as well.

"Ownership" is a two-edged sword, and donors are still in some denial about that fact. They want the host government to take control, yet also want the resulting priorities to be their own.

Staff Workload and Transaction Costs

Both donors and the Nicaraguan government have found the budget support process to be extremely burdensome. It has proven particularly demanding on the time of senior staff of both sides. Donors who switched to GBS in the hope of reducing their local staffs have been severely disappointed. It is possible that the budget support process will eventually require less staff time, but there is no evidence of that at present. The coexistence of budget support and extensive project assistance is another factor that has kept workloads high.

The large number of continuing projects has also kept the onset of GBS from significantly lowering transaction costs for either side. However, the donors have placed a high priority on harmonizing procedures for both project and nonproject assistance, which would substantially cut transaction costs—for the Nicaraguan government, at least. Donors are also interested in timing disbursements to harmonize better with the Nicaraguan budget cycle, but conflicts with donor governments' own budget cycles makes this difficult. At a minimum, it would be very helpful for the donors to be more transparent about the level and timing of their assistance.

Ministerial Capacity

The complex question of the government's technical and managerial capacity to carry out a GBS program is perhaps the single most worrisome aspect of the entire process. The key concern is the lack of managerial depth in the line ministries, aggravated by frequent turnover of key personnel. In the opinion of donors, the line ministries differ enormously in their managerial capacity, with the ministries of Health and Education universally regarded as strong, and the ministries of Agriculture and Public Works similarly regarded as weak. The latter ministries cause particular apprehension, given the prominent role that these two sectors play in the National Development Plan.

The technical capacity of line ministries is also a concern. Even in the relatively strong health and education ministries, officials expressed misgivings about the technical capacity of ministry staff. However, if there were greater managerial capacity, some technical skills could be obtained by contract. So the lack of management depth appears as the most serious shortcoming.

Prospects for the Growth of GBS

Given the donors' uneasiness about the capacity of the government of Nicaragua, none expects to shift its programs to 100 percent budget support. However, a number of them do see it as a long-term goal. Technical assistance and training to increase government capacity will continue to be essential for the foreseeable future. Several bilateral donors remain interested but skeptical, and prepared, in principle, to participate in GBS if the problems discussed above can be resolved. Nevertheless, there was almost complete consensus, even among donors that do not provide nonproject assistance, that the effort is worthwhile and will restore the Nicaraguan government to its proper leadership role in its development process.

Annex 1. Interview Contact List

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