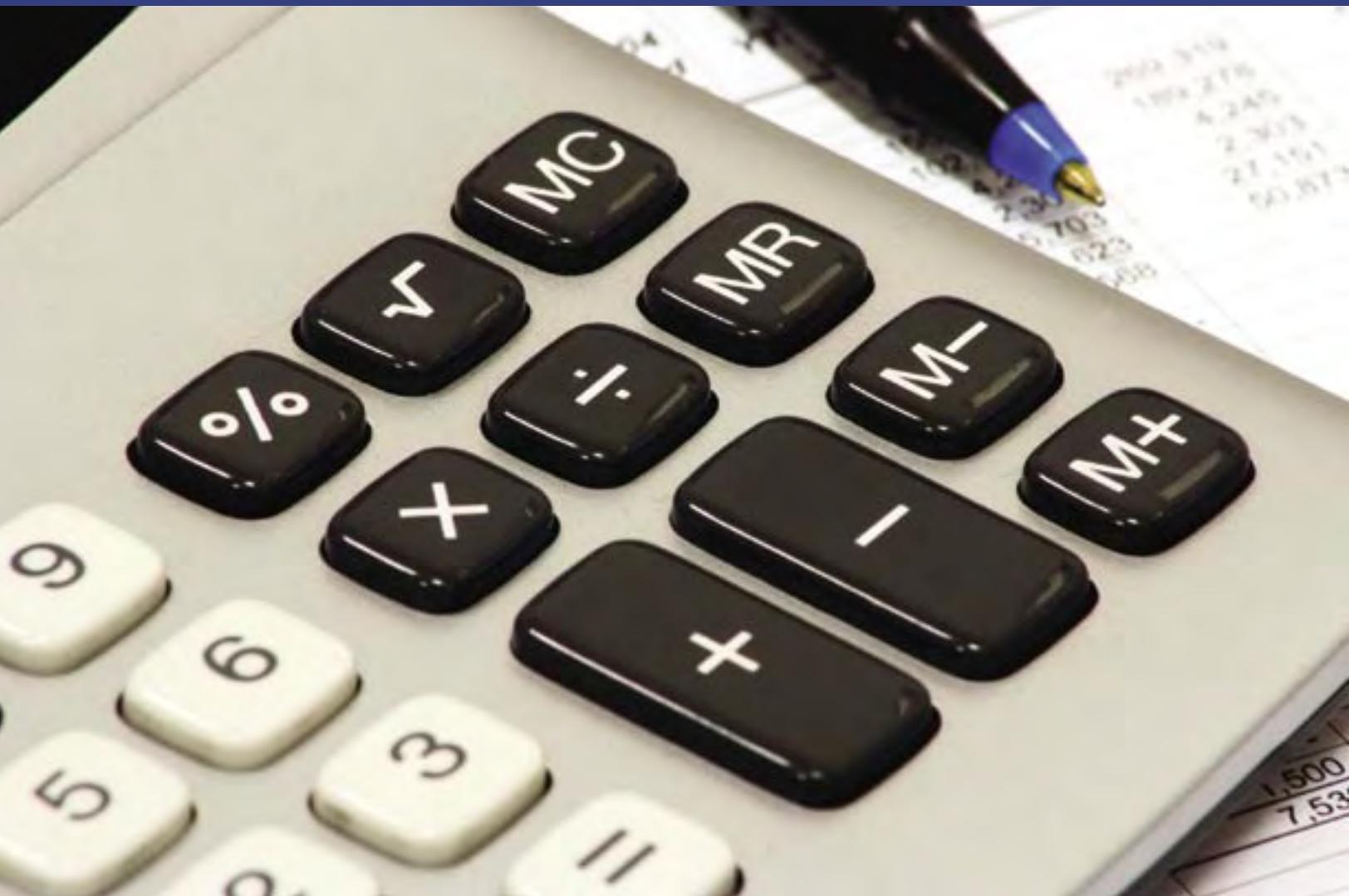




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# GENERAL BUDGET SUPPORT KEY FINDINGS OF FIVE USAID STUDIES



This paper synthesizes the following studies:

#### MALAWI

*General Budget Support and Sector Program Assistance: Malawi Country Case Study* Evaluation Working Paper No. 19, by Joseph Lieberman, Diane Ray, and Brian Frantz (PN-ADA-999)

*What Conditions Favor the Success of General Budget Support and Sector Program Assistance? Malawi Country Case Study*, Evaluation Brief No. 12, by Joseph Lieberman, Diane Ray, and Brian Frantz (PN-ADA-356)

#### MOZAMBIQUE

*General Budget Support: An Alternative Assistance Approach: Mozambique Country Case Study*, Evaluation Working Paper No. 19, by Joseph Lieberman, Diane Ray, and Maxine Lunn (PN-ACW-878)

*What Conditions Favor the Success of General Budget Support? Mozambique Country Case Study*, Evaluation Brief No. 11, by Joseph Lieberman (PN-ACU-999)

#### NICARAGUA

*General Budget Support in Nicaragua: A Case Study of an Alternative Assistance Approach*, PPC Evaluation Paper No. 6, by Robert V. Burke, David Colin, Aldén J. Jirón Z., and Lisette González (PN-ADD-631)

#### TANZANIA

*General Budget Support in Tanzania: A Snapshot of Its Effectiveness*, by Brian Frantz (PN-ADA-029)

#### TIMOR-LESTE

*Program Assistance: The Democratic Republic of Timor-Leste Country Case Study*, PPC Evaluation Paper No. 5, by Jeff Malick, Anne Beasley, Andrew Melnyk, and Shinichi Mizuta (PN-ADC-714)

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# GENERAL BUDGET SUPPORT

## KEY FINDINGS OF FIVE USAID STUDIES

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# Preface

**D**onor interest in program assistance, particularly general budget support (GBS), has been rising in recent years. GBS is a resource transfer channeled directly into the budget of a recipient government. The recipient uses its own procurement and budget systems to manage the transferred resources, which are not directly linked to projects.

In early 2003, there was discussion on mechanisms that the U.S. Government's newly created Millennium Challenge Corporation might use to efficiently provide quick-disbursing development assistance resources to top performers. It was in this context—and because some European governments were strong advocates of the use of GBS—that USAID's Center for Development Information and Evaluation (CDIE) authorized evaluations in several countries where GBS had been used or was being considered. The evaluations sought to determine how and when using GBS as an assistance mechanism would be appropriate and to identify conditions that contribute either to its successful use or lack of success.

Four countries where GBS was being used were chosen by CDIE for

in-depth evaluations. Mozambique's history with GBS was apparently one of success, while its use in Malawi was considered less successful. Nicaragua was included because of its location in the Latin America and Caribbean region, and Timor-Leste was an example of a postconflict country in the Asia and Near East region. Also included in this synthesis paper is an evaluation of GBS in Tanzania that was prepared for the Bureau for Africa.

John Simon, at the time USAID's deputy assistant administrator of Policy and Program Coordination, and Elaine Grigsby, then deputy director of CDIE, identified the need for and the scope of the evaluations. The authors of the original evaluations and case studies (see inside cover) received support from USAID mission personnel in the countries studied. Editorial support and technical suggestions for this synthesis were provided by Noreen O'Meara, Deanna Gordon, and Joan Atherton of the Bureau for Policy and Program Coordination, and by Brian Frantz of the Bureau for Africa.

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# Abbreviations

CABS	Common Approach to Budget Support (Malawi)
CDIE	Center for Development Information and Evaluation (USAID)
DFID	Department for International Development (UK)
FY	fiscal year
GBS	general budget support
GDP	gross domestic product
IMF	International Monetary Fund
MCA	Millennium Challenge Account
NGO	nongovernmental organization
GDP	gross domestic product
PER	public expenditure review (World Bank)
PRSP	poverty reduction strategy paper
SWAp	sector-wide approach
TSP	Transition Support Program (Timor-Leste)



# Executive Summary

## Background

In 2003 and 2004, USAID commissioned country studies—in Malawi, Mozambique, Nicaragua, Tanzania, and Timor-Leste—that examined program assistance, including general budget support (GBS). Under this aid instrument, donor funds are channeled directly to a recipient government’s budget, using its procurement and accounting systems.

**This synthesis briefly describes the use of GBS in the five countries studied, provides insight on the interaction of GBS with other forms of assistance, and summarizes key findings.**

This synthesis briefly describes the use of GBS in the five countries studied, provides insight on the interaction of GBS with other forms of assistance, and summarizes key findings on the relationship of GBS to

- host-country ownership of development programs
- budget allocation, performance assessment, and disbursement predictability
- donor coordination and harmonization
- transaction costs
- management and technical capacity
- fiduciary risk

- progress toward democratic and development goals

## Host-Country Ownership

Host-country ownership exists when a country’s priorities are aligned with its development programs. This factor is critical to the effectiveness of GBS, together with governmental commitment to sound fiscal and poverty reduction policies.

In 2003, host-country ownership in Nicaragua and the government’s willingness to reduce spending, meet social targets, and increase productive development contributed to donor support for the country’s development strategy. Conversely, donors suspended GBS disbursements in Malawi in March 2004 as a result of the government’s inability to implement IMF reform programs.

## Budget Allocation, Performance Assessment, and Disbursement Predictability

GBS donor disbursements are “on budget,” whereas donor-financed projects often are not included in government budgets. Further complicating matters, some governments that lack discipline leave some regular expenditures out of their budgets.

GBS, however, can strengthen accountability relationships within govern-

**During GBS startup periods, transaction costs tend to increase, especially when donors are designing new programs and concurrently managing projects.**

ments. For example, it discourages off-budget activities that result from negotiations between donors and ministries. It also strengthens the budget process because line ministries compete for scarce funds allocated by ministries of finance.

Increasingly, donors are attempting to improve predictability by using their assessments of a recipient's current performance to determine future (rather than current) GBS disbursements. Many donors tend to assess progress toward mutually agreed-upon indicators, as opposed to specific conditions that must be satisfied prior to disbursement.

## **Donor Coordination and Harmonization**

Donor agreement and coordination on desired policies and engagement with the host government are implicit in GBS arrangements, which seek to establish performance targets and link policies to budget line items.

In some countries, donors have formed groups that have considerable voice in the policy dialogue and national-level impact on the allocation of resources. While the process of harmonization is not yet complete, donors have made progress toward adopting common policies and procedures for disbursements and reporting requirements.

When donors and host governments share the same objectives, partnerships can evolve and development assistance may increase. When shared objectives and a coordinated strategy are applied to a unified sector, the result may be a sector-wide approach (SWAp). In this case, donor assistance and funding support a single sector policy and expenditure program, under government leadership. SWAps can be funded in different ways, including support for projects, sector program assistance, and budget support.

But when donors disagree on policies and approaches, the use of GBS and SWAps becomes more challenging. Differences in approach may also result in some ministries being stronger than others because they receive more donor support.

## **Transaction Costs**

Some GBS proponents argue that transaction costs will be reduced for both donors and governments as procedures and practices become harmonized, an expected outcome of increased use of GBS. However, there is little evidence to date to substantiate this argument.

During GBS startup periods, transaction costs tend to increase, especially when donors are designing new programs and concurrently managing projects. Working groups set up to harmo-

nize policies and procedures also take up valuable time and resources, and senior staff on both sides have added responsibilities because of their participation in policy dialogue. Increased monitoring responsibilities are also assumed by recipient governments, especially by ministries of finance that oversee a wide range of programs and reforms. However, these management burdens may be reduced as capacity is built up and efficiency increases.

## **Management and Technical Capacity**

When assistance is delivered through GBS, the recipient government takes full control of the development process. This assumes sufficient capacity—especially in ministries of finance, though disparities in capacity may exist among ministries and between levels of government. Capacity building (such as the installation of integrated financial systems) is sometimes a component of GBS.

The need to strengthen capacity was identified in all countries studied. Capacity building can also be provided concurrently through projects, as was the case in Nicaragua and Timor-Leste.

## **Fiduciary Risk**

Tolerance for risk often determines a donor's willingness to use GBS, which relies on a host government's financial management and procurement systems.

Primary tools used to gauge risk are World Bank assessments, especially the public expenditure review. Donors use these assessments to design fiduciary risk monitoring systems and regulatory

frameworks and to set conditions for disbursements.

When weaknesses are recognized, GBS donors collaborate with governments to improve their financial management. The installation of integrated financial management systems may also help increase transparency when a government is resolved to use them effectively.

## **Progress toward Democratic and Development Goals**

Though GBS may strengthen the central government and ministries that provide social services, this aid instrument does not always strengthen democracy or public accountability. Accountability may be more appropriately enhanced by projects that support parliamentary oversight, effective media, and citizen groups.

Heavy focus on sectors delivering government-financed social services may be at the expense of strengthening sectors charged with increasing private-sector growth. To promote growth, measures aimed at increasing the enabling environment for business can be included in the policy dialogue.

## **Conclusion**

Given the benefits and limitations of GBS in different country and developmental contexts, donors should be selective in its use. In practice, USAID's use of GBS—as distinct from sector budget support and balance of payments—has been limited in recent years to situations of high U.S. foreign policy importance.



# Introduction

## Background

The aid instrument known as general budget support (GBS) is increasingly being used by donors, who argue that it gives host governments ownership of the development process by encouraging them to assume a more active role. When governments and donors work together to identify development priorities, development programs are likely to be more efficiently managed and sustainable. The policy dialogue encourages harmonization, as donors work in concert to achieve common objectives. However, for GBS to be effective, it is critical that the recipient government be capable of responsibly managing donor funds and implementing development programs effectively, within a policy and institutional framework that is conducive to growth.

Donors who select GBS as an aid instrument are aware of its advantages. USAID has acknowledged in its White Paper on foreign aid that these advantages include fostering important development principles, such as “increased ownership, partnership, and participation in country assistance strategies” and “improved donor coordination and harmonization” (USAID 2004b).<sup>1</sup> In

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<sup>1</sup> USAID’s White Paper, *U.S. foreign aid: Meeting the challenges of the twenty-first century*, is intended to stimulate discussion of major policy issues surrounding development and foreign aid. It is not a statement of official U.S. Government policy.

this analysis, program assistance is most appropriate to promote transformational development in countries that are reasonably stable and have been assessed as top or good performers.

GBS is not appropriate for all activities—for example, if the host government does not have sufficient capacity to manage programs and funds. In such cases, project support may be used to strengthen capacity, either ex ante or in tandem with GBS. Other assistance instruments may also be more appropriate when donors do not agree on a coordinated approach to address sector issues. Other instruments may also be indicated when there is a need to strengthen democratic accountability, including support to parliaments, citizen oversight groups, and the media.

## Five USAID Studies

During 2003–04, USAID funded five studies to examine how well program assistance and GBS are working in Mozambique, Malawi, Nicaragua, Tanzania, and Timor-Leste,<sup>2</sup> countries that all have poverty reduction strategy papers (PRSPs) or national development plans that define their poverty allevia-

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<sup>2</sup> The Mozambique, Malawi, Nicaragua, and Timor-Leste studies were commissioned by USAID’s Bureau for Policy and Program Coordination. The Tanzania study was prepared by USAID’s Bureau for Africa to inform the development of USAID/Tanzania’s Country Strategic Plan for the period 2005–14.

tion objectives.<sup>3</sup> The studies did not assess the impact of GBS and program assistance, but analyzed conditions that may contribute to their effectiveness.

This synthesis describes some key findings, reviews definitions of GBS, and summarizes discussions of issues such as ownership, budget allocation, performance assessment, donor coordination and harmonization, management capacity, fiduciary risk, and progress toward democratic and development goals.

### What Is Budget Support?

The definition of GBS used in the studies was accepted in 2003 by donors participating in planning workshops for the Joint Donor Evaluation of General Budget Support and endorsed by the DAC Network on Development Evaluation.<sup>4</sup> Participating donors represented a range of bilateral and multilateral agencies, including USAID.<sup>5</sup>

The Terms of Reference for Joint Donor Evaluation (DFID 2004) define GBS

as a type of program assistance that can take the form of food or financial program aid. Financial program aid is subdivided into budget support (sometimes referred to as direct budget support) and balance of payments support, such as debt relief and import support. Participating donors define budget support as a type of resource transfer in which funds are channeled directly to recipient governments. The recipient uses its own procurement and accounting systems, and the funds are not linked to projects. Budget support entails “a lump sum transfer of foreign exchange, but there may be differences on the extent of earmarking and on levels and focus of the policy dialogue and conditionality” (DFID 2004, 3).

There are two types of budget support: GBS and sector budget support. GBS contributes to the overall budget of a country; it tends to move away from requiring specific conditions to be met

prior to disbursement and moves toward using assessments of performance for a past period to determine future disbursements. Funds are not specifically earmarked. Sector budget support is a resource transfer to support activities in an area with a common theme, such as health or education.

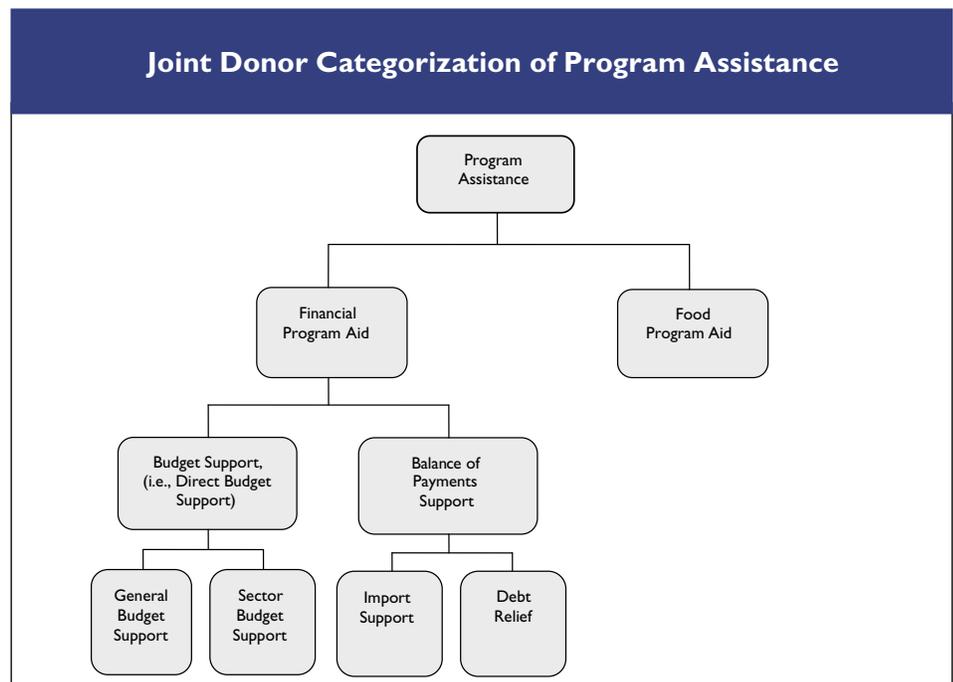
But sector budget support should not be confused with the sector-wide approach (SWAp). Whereas sector budget support is a financing instrument, a SWAp is a coordinated strategy in which donors and host governments agree on a single sector-wide policy and expenditure program.<sup>6</sup> A SWAp is not an aid delivery instrument, though it may be supported with different financing instruments.

6 A program-based approach is “a way of engaging in development cooperation based on the principle of co-ordinated support for a locally owned program of development, such as a national poverty reduction strategy, a sector program, a thematic program, or the program of a specific organization” (Lavergne 2003).

3 Two of the countries studied—Mozambique and Nicaragua—were ranked as eligible for Millennium Challenge Account (MCA) funding, while three—Malawi, Timor-Leste, and Tanzania—were ranked as MCA threshold countries. Timor-Leste had the status of a postconflict or fragile state in 2002, when budget support began (USAID 2004, 19).

4 The definition was developed by Lawson and Booth (2004) for this evaluation, drawing on a schematic developed by White (1999).

5 USAID divides foreign assistance into two broad categories: project assistance and program assistance. Program assistance, also referred to as nonproject assistance, “provides a generalized resource transfer, in the form of foreign exchange or commodities, to the recipient government” (USAID 2005, 200 series 44). USAID identifies two types of program assistance: 1) sector program assistance and 2) balance of payments and budget support.



# Issues Analyzed

## Host-Country Ownership

Host-country ownership refers to the leadership role a recipient country takes in initiating and moving forward its development program. It includes the government's commitment to key reforms and the building of civil society agreement around priorities.<sup>7</sup> Host-country ownership also strongly implies alignment of donor policies and priorities with those of the national government. Processes that strengthen ownership include the ongoing policy dialogue with donors—led by ministries of finance—and evolving internal accountability relationships within recipient governments.

**Host-country ownership strongly implies alignment of donor policies and priorities with those of the national government.**

Under GBS, donors channel funds through host-government systems for allocating, monitoring, and managing financial resources. This encourages long-term commitment to development objectives and helps the government institutionalize its own development management. Commitment to sound policies is critical to the effectiveness of GBS.

<sup>7</sup> See Johnson and Wasty (1993) and annex F in the final inception report (University of Birmingham 2005a) for discussions of ownership that focus on these issues.

Governments may revise policies or take political risks to achieve poverty objectives. For example, the Government of Mozambique agreed to revise its primary education curriculum and broaden its network of rural health centers after education and health targets were missed. Donors viewed this willingness to change as evidence of the government's commitment to its poverty reduction plan (EC 2005, 50). Another example was provided by the Bolaños government in Nicaragua, which committed in 2003 to reducing spending and increasing productive activities to accelerate GDP growth, in line with its national development strategy.<sup>8</sup> Conversely, in Malawi in 2003, the government was not able to stay on track with IMF programs, and GBS disbursements were suspended (Liebersohn, Ray, and Frantz 2004a, 1, 19–21).<sup>9</sup>

## Policy Dialogue

An important input to the GBS process is policy dialogue between recipient governments and donors that assesses past performance and sets future targets. Ministries of finance normally lead policy discussions, and this process

<sup>8</sup> The Government of Nicaragua agreed to continue to meet social targets. Although donors had some reservations, they encouraged the government to revise its PRSP to recognize the new strategy (Burke et al. 2005, 4).

<sup>9</sup> With the election of a reform-minded government in mid-2004, performance has improved, and Malawi is now an MCA-threshold country.

strengthens their commitment to the development agenda. Reviews focus on progress on indicators in a performance assessment framework, an action matrix, or a medium-term budget expenditure framework. The studies recommend that these discussions include measures aimed at improving the enabling environment for private-sector business, economic growth, and social service delivery.<sup>10</sup> This has not always occurred.

Donors in all the countries studied consider participation in policy dialogue one of the most important aspects of the GBS process because it enables them to coordinate on and influence policy. Participation is especially important for smaller donors because it allows them to increase the impact of their limited resources (Frantz 2004, 7).

Several donors in Timor-Leste commented that working toward common objectives fostered collaboration. They also said that including items on the action matrix was the most effective way to influence government policy (Malick et al. 2005, 16).

Participation of non-GBS donors in the policy dialogue varies by country. In Tanzania, Timor-Leste, and Nicaragua, all donors participate in the dialogue, although with some restrictions. In Tanzania, meetings where targets are negotiated are closed to non-GBS donors. The Budget Support Group that negotiates with the Government of Nicaragua includes both GBS donors and those who provide technical assistance to the government. In Mozambique, USAID, a non-GBS donor, is an observer, as op-

posed to a full participant in budget and policy negotiation (Liebersohn, Ray, and Lunn 2004, 9).

The quality of the dialogue may be compromised when the government does not fully participate or important issues are omitted. For example, lack of senior government participation in Tanzania led some donors to conclude that the government might view the process as more technical than policy oriented (Frantz 2004, 7). The country study questions whether the government would be willing to seriously discuss non-poverty reduction priority expenditures or have its internal processes scrutinized.

One caveat noted is that host-country ownership may be compromised when ministries of finance have capacity constraints and donors are closely aligned on policy issues.<sup>11</sup> The study team concluded that rigorous biannual reviews with donors might have caused the Government of Timor-Leste to have a perception of diminished sovereignty.

### **Internal Accountability**

Internal accountability refers to interactions of government ministries with each other during the budget process. Three studies (Nicaragua, Mozambique, and Tanzania) indicate that line ministries vie with each other for scarce resources and justify their requests to central ministries (Nilsson 2004, 30). Over the long term, this process strengthens internal coordination and management within the recipient government, but it

may cause tension between ministries over the short term.

Under projectized aid, line ministries often negotiate directly with donors for funds. Weaker ministries may need to be institutionally strengthened so that they can effectively carry out these negotiations.

Donors in Nicaragua acknowledge that health and education are the strongest ministries. They have been strengthened since the mid-1990s by donor resources used for projects in these sectors. Frequently, the ministries negotiated directly with donors, bypassing the Ministry of Finance and the Presidential Secretariat for Strategy and Coordination, which normally play lead roles in planning and budgeting. Under GBS, the responsibility for budget allocation is expected to return to these two central ministries, a healthy process that is expected to strengthen the government's management of its development (Burke et al. 2005, 10).

### **Budget Allocation and Disbursements**

Unlike project funds, GBS funds are not earmarked, and their use is determined through the budget allocation process. This results in "on-budget" donor funding and contributes to strengthening poverty reduction strategies and tracking expenditures. GBS also entails compromises from donors and the host government as they negotiate priorities.

### **Funds on Budget**

GBS proponents maintain there is less opportunity for access to extra-budgetary

<sup>10</sup> See Harvey (2002) for a provocative discussion of the situation in Mozambique.

<sup>11</sup> See Fozzard (2002) for a discussion of the role of the Ministry of Finance in Mozambique and Odén and Tinnes (2003) for a similar discussion on Tanzania.

finance when donor funds are channeled through the government's budget. Nevertheless, there is greater budgetary discipline in some countries than in others.

In Tanzania, GBS has become the predominant aid delivery mode.<sup>12</sup> In Timor-Leste, highly centralized budget and payments systems have contributed to on-budget finance. On the other hand, in Mozambique and Malawi, many donor projects have been off budget,<sup>13</sup> and significant expenditures have been excluded from recurrent budgets.<sup>14</sup>

### **Performance Targets versus Conditionality and Predictability**

GBS donors are attempting to use performance targets to guide disbursements, as opposed to ex ante conditionality. Much of the current literature on aid effectiveness concludes that basing disbursements on policy reforms is not very productive unless recipient governments are committed to such reforms over the long term (Dijkstra 1999, 1; Dollar and Pritchett 1998; Nilsson 2004, 47; DFID 2005). Accordingly, GBS donors hold reviews with the government to discuss progress and outcomes on mutually agreed targets in an assessment framework or action matrix.

The “new” GBS focuses on shared objectives for public sector reform and reducing poverty (University of Birmingham 2005a; DFID 2005). Performance is usually assessed on indicators related to both poverty alleviation and macroeconomic stability.<sup>15</sup> A stable macroeconomic environment is necessary for growth; thus, staying on track with IMF programs is important.

Another approach is to divide budget support funding into tranches linked to different criteria.<sup>16</sup> This is what bilateral GBS donors have done in Nicaragua, where poverty alleviation indicators are related to social services and private-sector development (Burke et al. 2004, 18).

In Malawi, GBS disbursements have been delayed because of poor fiscal management, notably large government deficits. The suspension of disbursements resulted in government deficits financed with domestic debt. This drove interest rates up and impinged on the government's implementation of its poverty reduction program.

In Tanzania, a number of indicators in the assessment framework are based on the development of laws, strategy documents, plans, and reports, rather than poverty alleviation results (Frantz

2004, 5). Assessing these results implies additional costs, as they require surveys and other instruments to be up and running.

Because Timor-Leste is a postconflict, fragile country that became independent in 2002, early milestones stressed building new institutions, establishing a legislative and regulatory framework, and strengthening management of core government functions. Some early targets were intentionally ambitious and could not be achieved. Discussions thus focused on progress rather than achievement of goals, and disbursements could occur when progress was deemed satisfactory (Malick et al. 2005, 17). Less ambitious indicators were set in Timor-Leste's third Transition Support Program (TSP), at the urging of the World Bank and other donors.

Poor fiscal policy can cause delays in GBS disbursements. When donor funds provide a large portion of a government's recurrent budget, predictable disbursements are critical to the government's ability to plan, function, and provide services to constituents.<sup>17</sup> The studies find that some GBS donors have adopted practices that contribute to more predictable disbursements. These include the following:

- Assessments of past performance affect disbursements for future periods rather than the current budget cycle, improving predictability.

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12 In Tanzania in FY 2002, the share of assistance provided as program support was 58 percent, up from 32 percent in FY 1999 (Frantz 2004, 1).

13 The proportion of total funding provided through program assistance and GBS was not available during the Mozambique study, although it ranged from 0 to 75 percent as proportions of individual donor aid packages.

14 In Malawi, extra-budgetary requests were a standard part of the budget process (Liebersohn, Ray, and Frantz 2004a, 22).

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15 Donors may also add their own specific assessment criteria. In Tanzania and Nicaragua, individual donors determined the size of disbursements, based on their perception of progress made by the recipient governments toward targets (Frantz 2004, 4; Burke et al. 2005, 18).

16 The European Commission disburses by fixed tranches, linked to performance on IMF programs and macroeconomic performance, as well as variable tranches, linked to the achievement of indicators related to PRSPs and poverty alleviation indicators (EC 2005).

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17 The Tanzania study suggests that budget support has been less variable than project support, although no political events have occurred to test this suggestion (Frantz 2004, 16). However, in Uganda, Ireland delayed disbursements of GBS when a defense issue could not be reconciled.

- Disbursements are coordinated with the budget cycle of the recipient government.

## Donor Coordination and Harmonization

A premise of GBS is that donors will work with host governments to achieve development goals that correspond to the recipients' priorities. Donors working together harmonize their activities and aid management procedures, including their reporting requirements, conditionality, disbursement mechanisms, and provision of technical assistance.<sup>18</sup>

### Donor Coordination

The studies find that GBS is typically participatory: donor groups and host governments engage in discussions on development objectives, set targets, and review progress. When the groups are aligned, their impact on development objectives is significant. This is often cited as a principal advantage of GBS. Nevertheless, close alignment of donors may inadvertently compromise ownership of a host government's program, especially when donor funding constitutes a large portion of the government's budget.<sup>19</sup>

In the African countries reviewed, donors formed groups that facilitate coordination. In Tanzania, the group refers to itself as the Poverty Reduction Budget Support Donors; in Mozambique, it

is the G-11;<sup>20</sup> in Malawi, the group is called Common Approach to Budget Support (CABS). In these countries, donors are aligned on most issues and work with host governments to set priorities on the assessment framework.

Coordination issues may arise when donors do not agree on all issues or when the host government's agenda is not aligned with that of the donors. For example, donor alignment in Mozambique is not completely harmonized on issues such as fiduciary risk and corruption. In Malawi, the government's failure to meet fiscal targets caused a coordination problem between donors and the IMF. The IMF had to make some optimistic assumptions to show that the country was moving ahead on indicators to which CABS disbursements were tied. This created a stalemate: progress could not be made without the disbursements, and disbursements could not occur until targets were met.

Donors may coordinate by participating in SWAPs, which are discussed in the Mozambique, Malawi, and Nicaragua studies. An underlying assumption of a SWAP is that donors and the host government agree on a sector strategy. Collaboration enhances donor coordination and encourages ministry leadership of donor activities. For example, when a number of donors in Mozambique and the Ministry of Agriculture adopted a common strategy to support raising incomes in rural areas, they collaborated by participating in Pro-Agri, a SWAP.

USAID uses various instruments, including program assistance, to support Pro-Agri.

In Nicaragua, however, donors and the government have not been able to agree on overall strategies in the agricultural sector. Some European donors and the UNDP favor the development of smallholder agriculture, whereas the government and other donors (including USAID) prefer to assist large-scale producers with more commercial and export potential. These differences impede the development of a common strategic sector approach.

### Donor Harmonization

GBS advocates maintain that the process of implementing the aid mechanism will lead to harmonization, as donors adopt common procedures for disbursements and reporting requirements.

The studies find that although progress has been made, harmonization is not complete. Donors in four of the five countries—Mozambique, Malawi, Nicaragua, and Tanzania—continue to use individual criteria laid out in bilateral agreements to guide disbursement decisions.<sup>21</sup> Timor-Leste is somewhat distinct: funds are disbursed by the World Bank rather than by individual donors.

## Transaction Costs

Transaction costs refer to staff requirements such as time and personnel, as well as financial outlays required to

<sup>18</sup> Nilsson (2004) presents definitions and findings from the literature.

<sup>19</sup> These are conclusions of USAID studies in Nicaragua and Mozambique. Nilsson (2004) found similar situations in Mozambique and Tanzania.

<sup>20</sup> The G-11 are the 11 countries providing GBS; this name is expected to change to the G-14 to reflect increased membership.

<sup>21</sup> In Tanzania, the universe of indicators that trigger disbursements are set out in a framework developed by the government and donors.

design, manage, and evaluate activities.<sup>22</sup> Early supporters of GBS argued that harmonization of procedures and reduced numbers of projects would lower costs for both donors and the recipient government.

Few studies have focused exclusively on this issue, but the evidence is that GBS may initially cause donor transaction costs to rise. Harmonizing procedures and processes may take longer than envisioned and require significant additional effort (Nilsson 2004, 43). For donors, transaction costs are expected to fall once common systems are in place and capacity is built up. But demands on staff time increase when donors manage project portfolios concurrently with the design of new programs, including GBS. Senior members of donor agencies often find their increased responsibilities include negotiating with the host government. Measuring the impact of budget support assistance on poverty alleviation may also increase costs.

When a multilateral organization takes a lead role in administering GBS, donor transaction costs may fall. This is the case in Timor-Leste, where the World Bank has primary responsibilities for administering funds and assessing progress in the country's TSP.<sup>23</sup> TSP donors

participate in and review missions and meetings organized for the World Bank, and they receive reports that summarize findings.

As GBS is implemented, there is likely to be heavy involvement of finance and other central ministries that take a lead role in organizing the policy dialogue, allocating budgets, and monitoring and evaluating activities carried out with donor funding, as was the case in Tanzania, Mozambique, Nicaragua, and Timor-Leste. Government negotiators thus need to be trained in macroeconomic analysis and have the ability to address complex issues.

In Nicaragua, some responsibilities have shifted from line ministries (which had previously negotiated with donors) to the Ministry of Finance, although project management responsibilities under GBS will increase for line ministries. In Timor-Leste, the Ministry of Planning and Finance takes the lead in preparing for and organizing meetings for intensive review missions led by the World Bank.

## Management and Technical Capacity

Ongoing discussions focus on the required level of management capacity in GBS-recipient countries and how this capacity can be effectively provided. Management capacity refers to the ability of the government to plan and administer its own development program as well as handle funds responsibly.<sup>24</sup> Disparities in capacity may exist

between different ministries, within the same ministry, and between central and local levels of government. The need to strengthen management and technical capacity is recognized as an issue in all country studies.

Donors realize that technical assistance must be a component when they provide GBS to countries where there is weak management capacity (Nilsson 2004, 23). A particular concern for donors is the capacity of the host government to transparently manage its finances and track funds.

Donors are moving to the position that capacity building can be concurrently carried out as funds are disbursed.<sup>25</sup> Technical assistance to build capacity is often provided through projects by donors.

## Capacity to Manage Financial Resources

Host-country capacity to manage financial resources is critical because the GBS mechanism uses a country's own financial and procurement systems. It is important that processes are adequate to allocate funds, execute the budget, and generate timely financial reports.

An integrated financial management system is a key element that facilitates linking expenditures to budgets. With the exception of Timor-Leste, technical assistance is being used to install

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22 Killick (2004) examines the argument that program aid is associated with lower transaction costs than project aid. He classifies costs as *administrative tying* when the recipient government loses national ownership as a result of tying aid to a large number of projects or procuring imported goods and services. He classifies costs as *fiscal* when fiscal discipline erodes due to a large number of off-budget projects being negotiated between line ministries and donors.

23 The World Bank charges a flat 2 percent administrative fee from donors' contributions. Many donors perceive that this is lower than the costs they would incur administering the program themselves.

24 The development of a poverty reduction strategy or national development plan by the recipient government is an indication of these skills.

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25 DFID, for example, stated in its *Mozambique Country Assistance Plan*: "We recognize the weaknesses which exist in planning and budgeting, in expenditure management, and in the responsiveness of government to civil society; but these weaknesses can only be addressed if donors work within the system" (DFID 2002b, 17).

the integrated systems in the countries studied:<sup>26</sup>

- In Mozambique, a new integrated financial management system is user-friendly; it is designed to be operated by relatively untrained staff, and training is planned so that users can train additional users.
- In Tanzania, the installation and use of an integrated financial management system is progressing slowly, especially in offices with capacity constraints (such as the National Audit Office and local government agencies).
- In Nicaragua, much of the World Bank conditionality focuses on successfully implementing an integrated financial system.
- In Malawi, an integrated system was first introduced in 1996, but the World Bank was still trying to install it in 2004.

### Capacity Constraints

GBS requires central ministries to play significant roles in budget formulation and implementation, negotiating with donors and overseeing policy reforms.

However, adequate management capacity was found only at the highest ministerial levels in Nicaragua, Mozambique, and Timor-Leste, and lack of ministerial capacity to implement projects was identified as an issue in the Nicaragua and Timor-Leste studies.

<sup>26</sup> In Timor-Leste, a computerized system was installed, presumably before the TSP, and used to track funds.

### Limited managerial capacity to implement projects was identified as the greatest single obstacle to rapid transfer of donor resources to GBS.

In Mozambique and Malawi, the strongest planning and budgeting capabilities are in ministries of finance. The Tanzania study noted that delivery of GBS is expected to strengthen the capacity of the Ministry of Finance to plan, budget, and negotiate.

In Timor-Leste, expatriate advisors occupy critical positions in a number of ministries, including the Ministry of Planning and Finance,<sup>27</sup> and management capacity and institutional strengthening have been ongoing since independence in 2002.<sup>28</sup> A recent TSP review mission identified capacity building as a high-risk area, and a program is being designed to strengthen skills in budget allocation, execution, and macroeconomic forecasting (Malick et al. 2005, 42).

Once significant oil revenues come on stream, the Government of Timor-Leste plans to phase out the TSP and opt for projects. Though the government believes that project assistance can address capacity constraints at the micro-level through joint planning and implementation, the study team believes that project assistance is insufficient to

<sup>27</sup> In September 2004, 58 critical posts were filled by expatriate advisors under the UN Mission to East Timor. Of these, 19 were in the Ministry of Planning and Finance (Malick et al. 2005, 42).

<sup>28</sup> In Timor-Leste, capacity was devastated when 28,000 high- and mid-level Indonesian civil servants fled after independence.

address the capacity constraints that exist throughout the government (Malick et al. 2005, 28).

In Nicaragua, some line ministries have more capacity than the Technical Secretariat of the President (the central ministry responsible for public investment planning and budgeting), where staff need training in basic budgeting skills. The country study concludes that management weaknesses are more serious constraints than technical weaknesses because technical experts (consultants) can be hired to provide specific expertise (Burke et al. 2005, 14). Limited managerial capacity to implement projects was identified as the greatest single obstacle to rapid transfer of donor resources to GBS.

All studies found that capacity tends to be weakest at local government levels:

- The Tanzania study indicates that only about 25 percent of local government agencies have adequate capacity to manage funds (Frantz 2004, 12).
- In Mozambique, low management capacity in line ministries coupled with low capacity in the provinces result in long delays before allocated resources reach the local levels where service delivery takes place.<sup>29</sup>

<sup>29</sup> The study team found that fewer than 3 percent of personnel in Mozambican provinces and districts had university degrees.

- In Malawi, similar constraints and insufficient local staff result in delays in resource transfers and service delivery, but the World Bank is encouraged by a high level of commitment to improving financial management at lower levels of government (Lieberson, Ray, and Frantz 2004a, 23).

## Fiduciary Risk

Fiduciary risk is defined in World Bank documents as “the possibility that actual expenditures will diverge from authorized expenditures, whether because of misappropriation or misallocation” (Allen, Shiavo-Campo, and Garrity 2004, 10). However, GBS donors add a third dimension that incorporates concepts of economy, efficiency, and effectiveness: funds “do not achieve value for money” (University of Birmingham 2005, annex F 154; DFID 2002a, 5). Corruption—defined as the “abuse of entrusted authority for private gain” (USAID 2004a, 1)—is not synonymous with fiduciary risk, but is usually addressed as a corollary to it.

The studies assessed fiduciary risk as high in Mozambique, Tanzania, and Malawi; low in Timor-Leste; and significantly decreased in Nicaragua under the Bolaños administration. In part, the high rates in Malawi and Mozambique were caused by budgets that were not comprehensive and only weakly linked to policy.

In Mozambique, line ministry budgets were not directly linked to the PRSP, and line items may not have reflected PRSP needs. In Malawi, neither parastatal funding nor normal ministry utility costs were included in the recur-

rent budget; ministries were expected to cover these items with supplementary budget requests later in the fiscal year (Lieberson, Ray, and Frantz 2004a, 22). Donors noted that the government’s effort to fully fund pro-poor expenditures was a “significant achievement,” but the number of budgeted pro-poor expenditures increased, as did the number of “special activities.”

Though budget allocation in Tanzania is fairly consistent with PRSP priorities, the government spent more on priority sectors than it received in official development assistance in FY 2003, when the budget increased. Proportions allocated to priority sectors did not increase faster than expenditures for nonpriority items, and this became an issue in the 2003 budget review (Frantz 2004, 8). Another issue for donors was that a key “pro-poor” ministry—health—was also one of the worst in accounting for funds and supplies and monitoring results. This unresolved issue could have an impact on the “value-for-money” dimension that many GBS donors include in their definition of fiduciary risk.

The system of public expenditure in Timor-Leste is sound and fiduciary risk is low. This is due to a highly centralized system of internal controls, World Bank oversight, and a significant number of expatriate personnel in key positions in the Ministry of Finance and line ministries. However, there are two potential weak areas in the system of checks and controls: the Banking and Payment Authority reports to the Ministry of Planning and Finance (absence of check on payments), and the auditor reports directly to the prime minister (affecting

perceptions of the integrity of independent findings) (Malick et al. 2005, 23).

## Systems Designed to Decrease Fiduciary Risk

Donors have different levels of tolerance for fiduciary risk. Risk can be reduced when a sound budget process is governed by a clear set of rules, allocations are linked to PRSP policies, and expenditures follow allocations and are spent on services or programs related to poverty alleviation. Other factors are transparent procurement systems, timely and accurate financial reporting, and regular internal and external audits.<sup>30</sup> If satisfactory systems are not in place, GBS donors partner with the host government to monitor and improve financial management, transparency, and accountability.

The ability to track public expenditures is facilitated by integrated financial systems. GBS donors widely use the public expenditure review (PER), the country financial accountability assessment, and the country procurement assessment, designed by the World Bank to strengthen the budget process, financial accounting, and controls and procurement.

The PER has become a forum where these and other issues are resolved. In Tanzania, the World Bank, Ministry of Finance, other government representatives, donors, UN agencies, academic

<sup>30</sup> These principles are laid out in the 2002 DFID policy paper on managing fiduciary risk when providing direct budget support (DFID 2002a). The DFID plans to publish a policy paper related to procurement systems.

institutions, and civil society participate in preparing the PER agenda. This reduces fiduciary risk. However, several public expenditure tracking surveys suggest that a significant proportion of resources are not reaching local schools and hospitals in Tanzania. This lack of transparency is probably attributable to both low capacity and outright corruption (Frantz 2004, 11–12).

### **Budget Execution**

When budget and procurement processes are highly centralized, fiduciary risk may be reduced. But bottlenecks in these processes also slow down budget execution, thereby delaying local-level activities identified for funding.

Weak budget execution was identified as an issue in Mozambique, Malawi, and Timor-Leste. In Mozambique, poor accounting, partial reporting, and weak cash management contributed to major delays in transferring funds from the Ministry of Planning and Finance to line ministries, and then on to provincial and district activities (Liebersohn, Ray, and Lunn 2004, 19).

In Timor-Leste, highly centralized controls and little delegation of authority contribute to poor budget execution. The problem lies with an insufficient number of local staff trained to carry out rigorous procedures associated with procurement and payments. Only a few key officials have approval authority, and this holds up procurement and spending. To overcome these problems, the government established a budget execution committee to monitor expenditures and drafted legislation to delegate procurement and financial authority to

line ministries. A UNDP pilot project to provide block grants to districts is also being initiated (Malick et al. 2005, 23–24).

### **Corruption**

Governments with weak financial systems offer more opportunities for abusing authority, and less transparent financial and reporting systems contribute to an environment conducive to corruption. Unsatisfactory or untimely financial reports make it difficult to discern whether resources have been stolen or simply not adequately tracked.

In the five countries studied, procurement weaknesses, along with the capacity to track expenditures to the service-delivery level, can contribute to corrupt practices. GBS donors work together to address these issues and discuss anti-corruption measures and civil service reform with host governments. Donors in Malawi use the share of investigations brought to court by the Anti-Corruption Bureau as an indicator of progress (Liebersohn, Ray, and Frantz 2004a, 20). In Nicaragua, the World Bank's performance assessment includes indicators linked to transparency in procurement (Burke et al. 2005, 21–22).

Some donors argue that there are fewer opportunities for diversion when funds are channeled and tracked through projects. GBS proponents counter that funds are fungible: those used for a specific project or activity can free up funds for less transparent uses (Burke et al. 2005, 5; Allen, Schiavo-Campo, and Garrity 2004, xi).

GBS donors work with recipient governments to improve financial manage-

ment because they believe that improved systems will result in less overall corruption. Donors in Tanzania do not believe that the increased use of GBS has been associated with more corruption. However, corruption may become more apparent as financial systems are strengthened, regardless of whether more funds are actually diverted (Nilsson 2004, 31).

### **Progress toward Democratic and Development Goals**

Governance is key to achieving development objectives,<sup>31</sup> and includes supporting parliamentary oversight, private-sector NGOs, and media and civil society. NGOs and think tanks can encourage transparency and responsiveness by conducting public surveys and making the results easily available. Investigative reporting by a strong media can discourage corruption. Project assistance, rather than GBS, may be more appropriate for strengthening these institution-building activities (Liebersohn, Ray, and Frantz 2004a, 13).

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<sup>31</sup> Kaufman (2003, 17) provides evidence that improving rule of law and controlling corruption lead to a fourfold increase in per capita income, significant literacy gains, and reduced child mortality.

# Conclusions

The selection of development approaches and instruments—such as project and nonproject assistance (including GBS)—should be based on country contexts.

The five case studies give country-based examples of the uses and limitations of GBS. They do not evaluate the impact of GBS on poverty alleviation. Instead, they focus on perceived benefits within specific conditions and timeframes, adding examples and explanations relating to whether or why the benefits have been achieved, as well as the following issues:

***Host-Country Ownership:*** Ownership of development programs has been strengthened through policy dialogue and improved accountability. The dialogue includes progress on indicators, many of which are drawn directly from PRSPs or their equivalents. Other indicators relate to fiscal and macroeconomic achievements and sound financial management practices.

A government's internal accountability is improved as line ministries justify policies and activities to each other and to their ministry of finance, rather than negotiating directly with donors for funds. However, when donors are closely aligned on policies, the host government may feel pressure to adhere to donor priorities, and this may compromise ownership somewhat.

## ***Budget Allocation, Performance Assessment, and Disbursement***

***Predictability:*** A benefit of GBS is that more donor funds tend to be “on budget” because ministries have less access to other sources of funding. This has been the case in Tanzania, where a high proportion of official donor funding is channeled through GBS. However, bilateral donors in some countries may continue to negotiate off-budget projects and other arrangements with favored ministries.

The use of performance targets, as opposed to ex ante conditionality, tends to increase predictability of donor funding, since assessments usually have an impact on disbursements in future—rather than current—periods. Aligning donor disbursements with the budget cycle of recipient governments also contributes to predictability.

## ***Donor Coordination and Harmonization:***

GBS and coordinated SWAps assume that differences in donor policy, philosophy, and approach are reconciled. The studies conclude that this is usually, but not always, the case: donors may not agree on an approach,<sup>32</sup> or they may have different concerns that feed into their individual criteria for disbursement. In most coun-

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<sup>32</sup> For a discussion on different approaches to productive sectors in Nicaragua, see Burke et al. (2005, 10).

tries studied, harmonization of donor procedures, policies, and reporting is taking longer than anticipated and has not yet been completed.

**Transaction Costs:** For both donors and host governments, staff time required to design, manage, and evaluate activities initially increased. When donor portfolios include projects, additional time is dedicated to designing GBS programs and participating in policy dialogue. The same is true for host-government staff, especially in ministries of finance. Many donors, however, are optimistic that these costs will drop once programs are running and policies and procedures are more harmonized.

**Management and Technical Capacity:** Weak management and technical capacity are noted in all country studies. In Mozambique and Malawi, capacity in ministries of finance exceeds that in line ministries. However, Nicaraguan line ministries, favored in the past by donors, have stronger capacity than central ministries. Weaknesses in local government capacity impede service delivery in Tanzania and Malawi. The assumption is that the process of delivering GBS will in itself build capacity because it is “learning by doing.” Nevertheless, capacity building (including the provision of expatriate advisors) may be also be offered concurrently through other aid mechanisms. To increase financial management capacity, integrated financial management systems are being installed and personnel are being trained.

**Fiduciary Risk:** Donors have different tolerance levels for fiduciary risk, which

may influence their decisions to use GBS. The possibility that funds will be used for unauthorized expenditures is important to GBS donors, who use the host government’s financial and procurement systems. Weak procurement systems and poor expenditure tracking are conducive to corruption. Instruments such as the PER, developed by the World Bank, are commonly used to assess the budget process and financial risk. Some donors believe that these issues can be addressed during the policy dialogue and that corruption does not increase with GBS.

Fiduciary risk is often linked to low capacity, so donors work in partnership with host governments to strengthen financial management. But when financial systems are highly centralized, poor budget execution and delayed procurement and spending may result.

**Progress toward Democratic and Development Goals:** GBS, which channels funds through the executive branch of the central government (usually the ministry of finance), may not be the most appropriate assistance instrument for strengthening parliament, civil society, the media, or NGOs. These entities have important roles in democracy, because they contribute to good governance and the ability of citizens to hold their government accountable for providing services and contributing to poverty alleviation and development. Assistance mechanisms— such as projects—that complement GBS may be appropriate for supporting these activities.

The studies find that the following contribute most to the effectiveness of GBS:

- strong host-government commitment to sound poverty reduction and fiscal and democratic policies
- agreement by donors and host governments on common approaches to development objectives
- sufficient host-government capacity to manage development programs, or, if not sufficient, capacity-building mechanisms provided by donors, either as projects or as a component of GBS
- low fiduciary risk

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