

GRIPS Development Forum

Good Donorship and the Choice of Aid Modalities

— Matching Aid with Country Needs and Ownership —



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Acronyms and Abbreviations

AFD	French Development Agency
APR	Annual Program Review
BoP	Balance of Payments
CAS	Country Assistance Strategy
CHC	Community Health Centers
CIDA	Canadian International Development Agency
CPRGS	Comprehensive Poverty Reduction and Growth Strategy
DFID	Department for International Development
DPM	Development Priority Matrix
ESP	Education Strategic Plan
ESSP	Education Sector Support Program
GBS	General Budget Support
HIST	Health In-Service Training System
HPSP	Health and Population Sector Program
IDA	International Development Association
IEC	Information, Education and Communication
IMG	Independent Monitoring Group
IST	In-Service Training
JBIC	Japan Bank for International Cooperation
JETRO	Japan External Trade Organization
JICA	Japan International Cooperation Agency
KFW	German Development Bank
LICUS	Low-Income Countries under Stress
LMDG	Like-Minded Donor Group
MCH/FP	Maternal and Child Health/Family Planning Center
MDBS	Multi-Donor Budget Support
MTEF	Medium-Term Expenditure Framework
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organization for Economic Cooperation and Development
PAF	Performance Assessment Framework
PEDP	Primary Education Development Plan
PLU	Program Liaison Unit
POW	Program of Work
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
SAL	Structural Adjustment Lending
SBS	Sector Budget Support
SECAL	Sector Adjustment Lending
SIP	Sector Investment Program
SWAp	Sector-Wide Approach
SWiM	Sector-Wide Management
TA	Technical Assistance
TAS	Tanzanian Assistance Strategy
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
UNICEF	United Nations Children's Fund

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1 Introduction

A successful aid programme requires matching one or more elements of a desirable development strategy with an appropriate aid strategy, supported by well designed modalities and effective implementation.[Robinson and Tarp 2000: 13]

The 1990s saw the emergence of new aid approaches—especially general budget support (GBS), sector budget support (SBS) and pooling fund arrangements under the Sector-Wide Approach (SWAp)—along with the introduction of the Poverty Reduction Strategy Paper (PRSP) and the related institutional frameworks (such as the Performance Assessment Framework (PAF) and the Medium-Term Expenditure Framework (MTEF)). Their emergence is a reaction to overcome the weaknesses of the existing aid modalities, typically 'stand-alone' projects and structural adjustment operations, especially in the sub-Saharan African context. However, the experiences with new approaches are still recent, and there is a continuing debate on the relative merits of different aid modalities and the relevance of new aid approaches to the other regions, especially in Asia.¹

The Rome Declaration of Harmonization (February, 2003) endorsed principles of a country-based approach, considering such factors as country ownership, government leadership and the need to recognize diverse aid modalities.² While such principles are widely accepted, practical criteria regarding how to apply general principles in the country- and sector-specific context is yet to be established. More recently, the World Bank [2004a] clarified its views on the use of aid modalities in the African context, in the *IDA Strategic Framework for Assistance for Africa*. UK DFID [2004] published a policy paper on budget support (named "Poverty Reduction Budget Support"), while Canadian CIDA [CIDA 2002, Lavergne et al. 2003] declared its policy to adopt the program-based approach [See Annex 1 for Donor Policies on the Use of Different Aid Modalities]. Thus, we consider it important to deepen these discussions and establish a common ground for applying different aid modalities, taking account of contextual factors.

Against such a background, this paper aims to address the following:

- To provide a conceptual framework for deciding the choice of aid modalities, based on the country and sector-specific context;
- To clarify features of respective aid modalities and show examples of how and under what conditions specific modalities and/or their mix can help address development needs while fostering ownership of recipient countries; and
- To suggest how donors can effectively assist in achieving sustainable growth and poverty reduc-

¹ A number of studies are underway or have been recently completed, to assess the contribution of new approaches to aid effectiveness. These include: two GBS evaluability studies [OPM 2002, Europe Aid and ODI 2004] which provide an evaluation framework for joint OECD-DAC evaluation of GBS, a case study of Tanzania on GBS evaluation [Frantz 2004], and joint evaluation of external support to basic education [Netherlands MOFA 2003]. DFID has also conducted a study on the use of different aid instruments in the Asian context.

² Rome Declaration on Harmonization, at the High-Level Forum on Harmonization held on February 24-25, 2003.

tion by properly practicing aid ("good donorship") and draw implications for Japan's aid policy.

Although the topic of aid modality has gained popularity in the recent aid literature, it mostly focuses on clarifying conditions for introducing a specific aid modality—rather than looking into complementarities among different aid modalities.³ We argue that it is not realistic to assume that a single aid modality can resolve all development needs in a recipient country. Moreover, the relative usefulness of a particular modality to the other may differ by country. There are marked country differences in the relative weight of aid in development-related activities, which could have important implications for the extent of an immediate need for financial transfer, the volume of aid transaction, and the nature of recipient-donor relationship. Thus it is necessary to go beyond theological debates on which aid modality is "superior" or "progressive" over the others. Greater efforts are needed to understand the features of respective aid modalities and examine how they (or their appropriate mix) can enhance development effectiveness, with due attention to the country- and sector-specific circumstances.

In this paper, we stress the importance of matching aid with country needs and ownership, especially taking account of: (i) development priorities in a recipient country; and (ii) recipient-donor relationships in the aid process. We suggest a common framework for deciding the choice of aid modalities, based on these two factors.

We also stress that there is a set of issues, or "good donorship" principles, that should be honored by donors—regardless of their choice of aid modalities—in order to realize effective aid. These could include: respecting country ownership, alignment to government policies, improving predictability of aid flows, promoting simplification and harmonization of aid procedures, using the government system, identifying local needs and supporting implementation with realistic recipient capacity, and so on. While donors are strongly encouraged to practice such principles, there should be various approaches to reaching this end. Pragmatism and flexibility are key in exercising "good donorship."

Lastly, this paper does not discuss aid approaches to conflict-affected or Low-Income Countries under Stress (LICUS)-type countries. These countries are in protracted crises and require humanitarian aid, even in the absence of a legitimate functioning state and institutions of government. Since the PRSP framework is premised on the existence of a reasonably functioning state, with whom the donor community can be engaged in partnership, how to adapt the current aid modality discussions to conflict-affected and LICUS-type countries will require separate examination.⁴

³ For example, Foster [2000] provides the criteria for appraising the introduction of SWAp and alternative forms of aid delivery. Foster and Leavy [2001] presents a decision tree for choosing aid instruments with a primary focus on GBS.

⁴ On this point, see Harmer and Macrae [2004] and Macrae et al. [2004] which suggest the changing role of aid policy in protracted crises.

2 Aid Modality Debates Revisited

Foreign aid involves the transfer of money, goods, and knowledge from developed to developing countries. Aid modality (equivalent to aid instruments, or aid forms) is a tool to transfer some or all of these factors. Aid modality is not a development strategy *per se*. But, it determines how funds and knowledge are transmitted to recipient countries, how goods are procured, and how recipients and donors interact in such processes. Consequently, it importantly affects the nature of aid relationship and the effectiveness of addressing development problems in recipient countries [See Box 2-1 for explanation, Definition of Aid Modalities].

In this chapter, we examine the evolution of aid modalities and its underlining factors, based on a review of existing literature. We then highlight key issues to be considered in the choice of aid modalities.

Box 2-1 Definition of Aid Modalities

- **Project aid:** A form of aid to finance specific activities with a limited objective, budget and time-frame to achieve specific results. Here, objectives require inputs to be linked to outputs. The project approach is based on the identification of a specific area of intervention for donor involvement, and the targeted use of funds for specific activities for which the objectives, outputs and inputs required to achieve them have been defined.
- **Budget support:** A form of financial aid to channel donor funds directly to the partner government's budget, using the government's own allocation and accounting systems, with any conditionality focused on policy measures related to growth, poverty reduction, fiscal adjustment, and strengthening institutions, especially budgetary processes. Budget support is divided into: (i) general budget support (GBS)—a general contribution to the overall budget; and (ii) sector budget support (SBS)—earmarked to a discrete sector (with any conditionality relating to these sectors).
- **Pooling funds:** A form of aid to pool donor funds to the government's accounts. The government manages and accounts for funds, preferably using standard budget procedures indistinguishable from those used for government revenues. Funds are earmarked to the activities in a specific sector.
- **Sector-Wide Approach (SWAp):** SWAp is not modality *per se*; it is about the approach to increase donor alignment with government policy and expenditure framework. SWAp can encompass a wide range of instruments, from a set of coordinated projects to the provision of SBS and sector pooling fund arrangements. SWAp usually includes three components: (i) an approved sectoral policy document and overall strategic framework, which define government priorities; (ii) a medium-term expenditure framework for the sector; and (iii) a coordinated process amongst the donors in the sector, led by government.

It is important to note that there is diversity even within the same modality [see Table below]. While project aid (including technical assistance projects) is often criticized for bypassing government systems and imposing transaction costs to the recipient government, a variety of options exist for its procedural arrangements. For example, there are cases where a donor directly controls all funds; but other cases exist where a donor disburses funds into a bank account maintained by the recipient government and entrusts the government to organize procurement. Some projects operate through Project Management Units (established within or outside the recipient institutions), while others do not (and directly work with counterpart personnel in the recipient institutions).

Table Characteristics of Main Aid Forms

Aid Form	Conditionality	Earmarking	Accountability
BoP support	Macro	None	None
General Budget Support	Macro & budget	None or nominal	Govt. systems
Aid financed debt relief	Macro & budget	None or poverty virtual fund	Govt. systems
Sector Budget Support	Sectoral	To sector	Govt. systems
Sector earmarked	Sectoral	Within sector	Govt. systems
Projects using govt. systems	(Sector &) project	Project	Govt. systems
Projects using parallel systems	Limited by low ownership?	Total	Donor

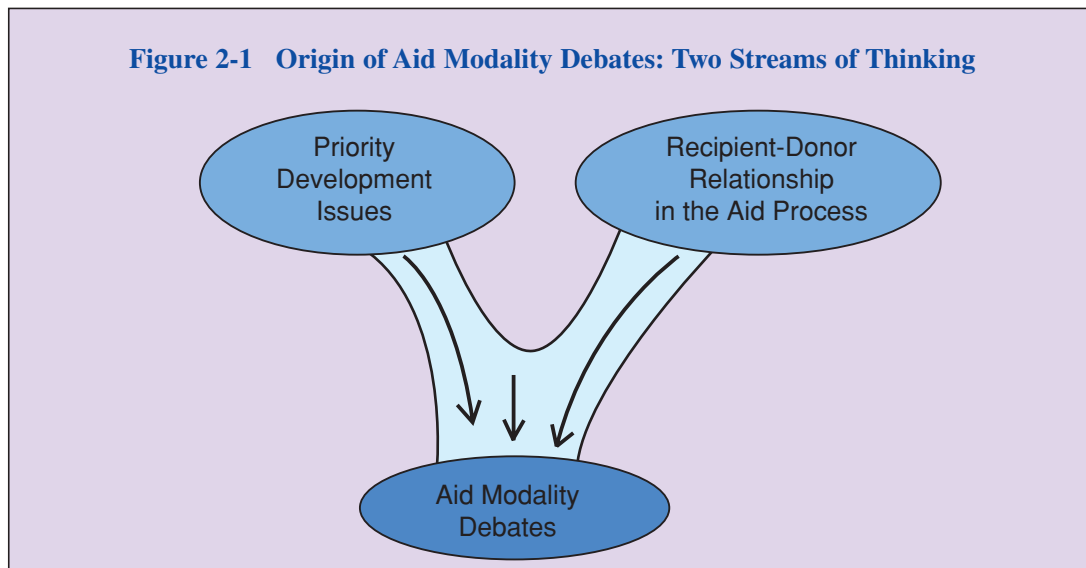
Source: Foster and Leavy [2001], Table 1.

Such diversity suggests that the evaluation of transaction costs by aid modality is far more complex than a simple comparison between projects vs. program aid. This is so especially because, as Killick [2004] notes, transaction costs can be further classified into various categories—e.g., administrative, tying, fiscal costs—which are distributed differently by forms of delivery between recipients and donors [See Annex 2].

Source: Elaborated by the authors, based on EuropeAid and ODI [2004], DFID and Japan Team in Vietnam [2004], Lavergne et al. [2003], Foster et al. [2001], and World Bank [2004d].

2-1 Lessons from the Past Experiences

The current rethinking of aid modalities originates from the lessons learned from the past aid practices and the changing emphasis on the role of aid in development. In particular, as Figure 2-1 shows, two streams of thinking are important: (i) the need to address priority development issues in a comprehensive and coherent manner; and (ii) the need to improve the recipient-donor relationship in the aid process.



Priority Development Needs and the Role of Aid

Over the last fifty years, various aid modalities have evolved—both project and program aid—in response to emerging development priorities. Originally, lack of capital was considered as the key resource gap facing developing countries; however, it has become clear that development is a complex undertaking and that there is a need to pay attention to its multi-dimensionality including human, social, policy and institutional aspects. Accordingly, the expected role of aid in development has changed. This has led to the evolution of diverse aid modalities [See Table 2-1].

A series of recent studies [World Bank 1998] also find that aid effectiveness critically depends on the institutions and policies of recipient countries.⁵ Furthermore, the fungibility argument highlights the importance of policy priorities, budget allocation and management. These findings have contributed to resolving the 'micro-macro paradox': even if aid is effective at the project level, no macro impact can be found. [Robinson and Tarp 2000] For projects to be effective, good policy and good institutions are required to back them up.

Table 2-1 Evolution of Development Thinking and Aid Modalities

Development Priorities	Aid Modality
1950s- : <ul style="list-style-type: none"> • Capital shortages (domestic and foreign exchanges) • Knowledge and technology gaps 	Projects (mainly infrastructure) and program aid (typically, balance-of-payments (BoP) support through commodity loans), aimed at financial transfer Technical assistance (TA) projects
1970s: <ul style="list-style-type: none"> • Basic Human Needs (BHN) 	Expansion of project aid to support social services and rural development
1980s: <ul style="list-style-type: none"> • Macroeconomic stability • Structural reforms 1990s: <ul style="list-style-type: none"> • External debt problems 	Structural Adjustment Lending (SAL) and Sector Adjustment Lending (SECAL), in the form of program aid, adding policy conditionality to BoP support Later, program aid became linked to debt relief initiatives (e.g., Enhanced HIPC Initiative)
Mid-1990s- : <ul style="list-style-type: none"> • Building of the core government systems • Recurrent financing • Policy and institutional coherence • Addressing fungibility issues 	New types of program aid, including budget support (general and sector budget support), pooling funds under SWAp arrangement, as well as pooled TA

Notes:

- (1) Projects were a dominant form of aid delivery until the early 1980s; but with the introduction of structural adjustment operations, the share of program aid increased drastically. For example, in the World Bank, the share of project aid declined from 82% to 48% during 1980-1996, while that of program aid rose from 2% to 23% during the same period. [Mosely and Eeckhout 2000: 132]
- (2) On financial terms, these modalities can take the form of both loans and grants.

⁵ The subsequent studies by Burnside and Dollar [2000] and Collier and Dollar [2002] stress that, while in countries with sound economic policies, aid promotes growth, in countries with bad policy environments, aid is dissipated in unproductive government consumption. It should be noted, however, that academically there exist debates over their analytical results [See Easterly, Levine, and Roodman 2003, and Easterly 2003].

Aid Relationship

Another important trigger for this modality shift is the recognition of the need to improve aid relationship. This derives from disappointing experiences with the existing aid modalities, as summarized below.

(1) Critical assessment of 'stand-alone' projects

There was widespread frustration with 'stand-alone' projects, due to: (i) coordination failure, with a number of aid projects becoming development enclaves; (ii) under-budgeting of recurrent expenditures, with donor-driven projects leading to inefficient public spending; (iii) high transaction costs of aid delivery, with the proliferation of aid projects (often with different reporting requirements and sometimes with competing objectives) imposing heavy administrative burdens on recipient countries; and (iv) parallel off-budget systems undermining the effectiveness of government systems and accountability.

Particularly in highly aid-dependent countries in sub-Saharan Africa, it was felt that donor projects were increasingly isolated from local realities and that they would make no or rather limited sustainable development impact. The situation had led to further undermining local ownership and capacity, thus impeding development progress. [Andersen 2000, Mosely and Eeckhout 2000]

This was also the case for technical assistance (TA) projects. In the 1990s, a series of critical reports on TA were published, including the Berg Report [Berg 1993]. Their main criticisms are: (i) supply-driven nature of TA; (ii) excessive emphasis on tangible, measurable output as opposed to institutional development; (iii) bypassing existing government system; and (iv) distortions in the market for TA (generally viewed as a free good). As a result, recipients have little incentives to decline the resources offered, but have very little to say in the ultimate form and goals of the project. Under these circumstances, TA projects can easily end up addressing low priority needs. TA proliferates and simultaneously undermines local capacity and ownership. [Arndt 2000, IDCJ and IC Net 2003]

Box 2-2 illustrates a well-known case of Tanzania, cited from Helleiner et al. [1995], popularly known as a Helleiner Report. The report examined the relationship between donors and the Tanzanian government and provided specific recommendations on how to improve the relationship.

Box 2-2 Concerns about Aid Coordination in Tanzania

The problems with regard to aid effectiveness and coordination in Tanzania remain, at their roots, the results of failure to match individual donor and government agencies' interests with agreed and coordinated priorities. Operationally, the situation is characterized by uncoordinated proliferation of projects across a large number of donors and a wide variety of disbursement accounting arrangements. In our interviews with donors and the government of Tanzania alike, reference was often made to the more than 2,000 projects and the 40 donors that have been involved in aid to Tanzania. We also heard that weak coordination capacity and lack of authority on the part of the GOT were making overall coordination among donors extremely difficult. Donor-driven proliferation of projects..... to a large extent, a reflection of this weakness as well as the product of strong donor vested interests in their own identifiable 'monuments'.

Source: Helleiner et al. [1995:15]

(2) Critical assessment of adjustment operations

There is shared consensus that structural adjustment did not bring about the expected results, particularly in low-income countries and sub-Saharan Africa. This point was recognized by the World Bank itself in its self-evaluation reports. [World Bank 1990, World Bank 1992]

The mixed performance of adjustment operations in the 1980s led to the redesign of conditionality. Aid released on the promise of policy change backed by the threat of aid secession has come to be regarded as ineffective, being criticized for undermining ownership. There is growing recognition that donors should switch from attempting to “buy” a pre-specified menu of policy changes (*ex-ante* conditionality), to the allocation of aid on the basis of periodic overall assessments of government achievements (*ex-post* conditionality).⁶ [Collier et al. 1997, Leandro et al. 1999]

2-2 Shifts toward New Aid Modalities

The above experiences have promoted shifts in the existing aid modalities toward programmatic aid in three ways.

The first shift is from 'stand-alone' projects to project 'clustering,' often in the form of pooling funds under the SWAp arrangement. This shift took place in the mid-1990s, initially called the Sector Investment Program (SIP). [Harrold 1995] Sector budget support (SBS) were also introduced, and the terminology of SWAp (or Sector Program, Sector Development Program) has come to be widely used. Under SWAp, major donors provide support within an agreed sector framework, coordinated by the government. Donor support can then be linked to a unified public expenditure framework for government and donor resources, with common management and reporting arrangements. SWAps can encompass a wide range of instruments, from a set of coordinated projects (such as SIP), pooling fund arrangements, to the provision of sector budget support. [DFID 2004]

It is expected that this shift would enhance synergies and externalities across projects within broad sectors, improve donor coordination and facilitate more effective policy dialogue and ownership by the recipient, and lower transaction costs associated with multiple donors and multiple projects.

The second shift is from structural adjustment operations (and BoP support) to general budget support (GBS). This shift is a reaction to overcome the weaknesses of SAL and SECAL. The past ineffectiveness of "inducement" as the objective of conditionality has led to the gradual redesign of the conditionality contract. The emerging consensus is that new type of conditionality contract should be *ex-post*, policy-linked, empirically based and country-specific. [Collier et al. 1997, Leandro et al. 1999] In this sense, the PRSP initiative, led by the World Bank and the IMF in 1999, is the manifestation of their intention to improve the nature of aid relationship. The PRSP aims that the recipient government

⁶ The issues on conditionality arose controversy and were debated from various aspects. Killick [1997] focuses on the difficulties of properly enforcing conditionality, while Collier and others [1997] analyze how the imposition of increasingly detailed conditions may create serious incentive problems.

takes the lead in formulating a medium-term, comprehensive strategy for poverty reduction, based on which donors will make multi-year financial commitment. A typical example is the introduction by the World Bank of Poverty Reduction Support Credit (PRSC) [See Box 2-3].

Third, more recently, some donors (particularly, UK DFID) are moving from SWAp to GBS, based on the view that GBS is a "preferred" or more "progressive" aid modality. It is argued that GBS is the most flexible and effective in strengthening accountability relationships. SWAp is less flexible because they are typically funded by donor pooling funds or trust funds that are kept separate from the government's allocation and accounting systems. [EuropeAid and ODI 2004]

GBS is an instrument to implement budget priorities envisioned in PRSP by: (i) using the budget to bring public sector programs into line with government goals and service delivery targets; (ii) aligning PRSP processes with government systems and cycles; and (iii) promoting alignment and harmonization by donors. Main arguments for GBS are that it would encourage greater local ownership of the development process by reinforcing accountability relationships within governments and drawing on and developing the capacity of governments to define and manage programs. This, in turn, is thought to translate into more significant and sustainable reductions in poverty. [EuropeAid and ODI 2004]

Box 2-3 Conceptual Shift from SAL to PRSC

The World Bank has recently updated (“modernized”) an operational policy (OD 8.60, Adjustment Lending), to explicitly reflect the PRSP principles into its policy-based lending. The updated policy uses single terminology of “Development Policy Lending” to call all types of policy-based lending, except for PRSC whose approach and familiarity have already been established.

Table How PRSCs are Different from Traditional Adjustment Lending

	PRSCs	Traditional Adjustment Lending
Initiative	CAS based on core objectives of country-owned PRSP	Development partners in dialogue with government
Focus	Public sector management, governance, capacity building, service delivery, regulatory frameworks	Policy frameworks, sector reform
Stakeholder participation	Broad consultation with government and civil society	Bank dialogue with government
Modalities	Single annual tranche within rolling framework	Multi-tranche
Performance triggers	Ex-post development outcomes	Ex-ante conditionalities on promised policy changes
Timing	To national budget cycle	Per program arrangements
Response to performance	Adjustment in amounts committed in following PRSC	Stop-start of entire program

Source: World Bank [2004d], p.84, Table 4.2.

This analogy holds for TA projects, as well. The past criticisms have led to the argument for innovative funding channels for TA, i.e., budget support and pooling funds, as a way to effectively address the issue on local ownership. [UNDP 2002] Also, there has been increased awareness of the need to: (i) make the TA project structure work better, with greater attention to institutional development; and (ii) resort to comprehensive planning of TA. [Arndt 2000]

2-3 Emerging Consensus on "Good Donorship" Principles

In the 1990s, the lessons learned from the past have led donors to re-think their aid practices—in terms of both responding to newly recognized challenges (e.g., building the core government systems, financing recurrent expenditures, improving policy and institutional coherence, and addressing fungibility issues) and improving aid relationship (e.g., enhancing ownership and reducing transaction costs of aid procedures). There has been emerging consensus on the elements of "good donorship" to be practiced by respective donors, as follows:

- Respect for country leadership and ownership, with due consideration to recipient capacity and aid relationship;
- Alignment to government policies and programs, and donor coordination within a common policy framework;
- Increased predictability of aid flows, including multi-year planning of aid, transparency and information sharing of aid budget, and alignment to government budget cycle;
- Simplification and, where possible, harmonization of aid procedures, including procurement and disbursement procedures, safeguard policies, formats of reporting, monitoring and evaluation etc., and other measures to reduce transaction costs of aid delivery;
- Increased reliance of government systems and procedures where desirable, avoiding the use of parallel systems;
- Identification of local needs based on the realistic assessment of recipient capacity;
- Implementation on the ground, and the incorporation of the lessons learned into the policy and institutional design by creating feedback mechanisms; and
- Capacity development for the long term, at both the institutional and human levels.

The above list may not be exhaustive, given a great deal of ongoing research in this area.⁷ But, we believe that it merits serious consideration, as it is built on the reflection of donor practices in the past.

In sum, the emergence of new aid modalities can be understood as an attempt to pursue "good donorship" principles, by shifting a modality from one to the other. Such modality shift is also viewed as part of integral efforts to support the PRSP framework.

⁷ For example, OECD/DAC [2003] and discussions at H/L Forum on Harmonization (Rome in February 2003 and Paris planned for March 2005). Also, ODI/CAPE has an ongoing research project "Aid Effectiveness and Good Donorship" (ODI Research Stream No. 1: Aid Policy and Donor Practice). See Karin Christiansen, PPT presentation "Aid Effectiveness and Donor Behavior" at the May 13 2004 CAPE seminar.

2-4 Issues for Further Consideration

The recent move from projects to program aid is supported by the argument that new aid modalities have a stronger influence on the policy environment, superior ownership properties, and greater aggregate coherence. It is also claimed that they incur smaller transaction costs than an equivalent amount given in the form of traditional projects. [Killick 2004] A key question here is whether we should pursue "good donorship" by always shifting to a particular aid modality. While we do not deny the potential usefulness of modality shift in certain circumstances, we consider it important to explore a possibility of improving the existing ones, as well.

The alleged superiority of new aid modalities is based on a chain of causal linkages between their inputs and the final impact of sustainable poverty reduction [See Annex 3 for the framework for a causality chain between GBS and poverty reduction]. While such a causality chain may hold theoretically, the benefits are not automatic at least in the short run. Furthermore, there remain theoretically unresolved, technically difficult and institutionally complex issues on designing and implementing PRSPs, on which GBS and SWAp are based.

Assessment of the Early Experiences with New Aid Modalities

While it is too early to give a definitive judgment on their effectiveness, there are views to suggest that a complete shift to a single modality, typically GBS, would be neither realistic nor desirable. First, in light of fiduciary requirements, the number of countries where GBS is applicable is limited. The recent study shows that only nine countries have been using GBS with the participation of two or more donors, of which seven are African countries (Uganda, Tanzania, Mozambique, Ghana, Rwanda, Burkina Faso, and Ethiopia). [EuropeAid and ODI 2004]

Second, the early experiences with GBS and SWAp have mixed results in reducing transaction costs and increasing predictability of aid flows. Killick [2004] and Frantz [2004] stress that there is little evidence to show that providing greater shares of aid as budget support significantly reduces transaction costs.⁸ There are considerable start-up costs of establishing joint monitoring frameworks, and the process is very time consuming. [World Bank and IMF 2004] The recent joint donor evaluation of program aid in basic education also finds that in the short run, the introduction of budget support and SWAp appears to have resulted in a massive transfer of administrative work from donors to the Ministry of Education and Sports in Uganda. [Netherlands MOF 2003] Furthermore, there are cases where aid has become less predictable under GBS and SWAp. [Foster et al. 2000, Frantz 2004] Especially because GBS is high-profile and highly flexible aid from the donor's perspective, the predictability of its aid flows continues to be a challenge.⁹

⁸ Killick [2004] argues that the language of transaction costs has been used too loosely and would merit a substantial empirical study. The trend in aid share, away from projects in favor of program aid, may not be as strongly based on evidence as is commonly assumed.

⁹ In a research paper, Blair and Hamann [2001] demonstrate the large uncertainties of aid flow in general, and much larger prediction errors in program aid than project aid (with a stronger tendency to over-estimation).

Unresolved Issues on the PRSP Framework

In addition, we would like to raise fundamental issues that hinge on the assumptions on the causality chain and the functioning of the PRSP framework.

(1) Capacity constraints

The effectiveness of GBS and, to some extent, SWAp is grounded on the functioning of elaborate systems guided by the PRSP framework. This is by no means easily achievable. In fact, the latest World Bank progress report of PRSP recognizes that the PRS approach is still a work in progress and that few countries have fully aligned their PRS cycles with domestic decision-making processes, especially the national budget cycle. The report stresses the need to overcome capacity constraints. [World Bank and IMF 2004]

More specifically, the functioning of the entire system requires that capacities be developed across a wide range of organizations and at different levels—from the central economic ministry, line ministries to the local level of service provision. These include capacities for: (i) financial management and accountability (budgeting and accounting, procurement and contracting, etc.); (ii) planning and designing development programs; (iii) implementing programs and deliver services; (iv) developing viable data bases on development results and process indicators; and (v) monitoring and evaluating performance. [Lavergne et al. 2003]

Thus, capacity constraints of the government and related entities could pose serious challenges. A variety of complementary interventions are needed so that GBS could contribute to the achievement of its ultimate objective of sustainable poverty reduction. While the central economic ministry is responsible for managing the process based on MTEF and PAF and establishing accountability relationship with the line ministries, full range of activities are required to translate policies and public expenditures into final outcome. There is also a need to build the capacity of enforcement and implementation entities, including that of the private sector itself.

(2) Analytical underpinnings of "pro-poor growth"

Sustainable poverty reduction requires broad-based growth including private sector development, or so called "pro-poor growth." However, there is no consensus on how to operationalize the concept of "pro-poor growth" including the methodology for identifying country-specific measures and budget items to this end.¹⁰ This parallels with one of the most common criticisms of PRSPs (i.e., emphasis on direct-poverty targeting measures and the social sectors, with less attention to private sector development and productive investments).

The analysis of "pro-poor growth" and the sources of growth is vitally important because, in the long run, recipient countries should lower aid dependency and graduate from aid ("aid exit"). Since GBS is

¹⁰ A series of research by Ishikawa [2002] attempts to address this question.

primarily concerned with the use of public resources, those measures indirectly related to public resources tend to receive lower priority. This points to the need to strengthen local capacity for policy analysis, including the strategic direction and content of PRSPs. Donors should also consider how aid can effectively support this process.

(3) Country diversity, regarding development priorities and ownership

In discussing aid effectiveness, it is important to recognize country diversity. There is a spectrum of recipient countries, facing different development priorities. The current discussions on aid modalities are primarily driven by the development experiences with highly aid-dependent and low-income countries (in fact, originated in sub-Saharan Africa).

Even if we focus on low-income countries, recipients differ in their levels of aid dependency, capacity, ownership, and so on. For example, highly-aid dependent countries face an immediate need for financial transfer (even to fill a gap of recurrent expenditures)—often, at the cost of huge volume of aid transaction. Here, aid relationship critically affects the way the governments coordinate development planning, resource mobilization and utilization. Lacking recurrent expenditures, these governments face priority needs to establish a basic system for social service delivery. On the other hand, in low-aid dependent countries, aid is only a supplementary source of development. Having established a basic social service delivery system, these governments are interested in attending the higher level of development agenda, e.g., improving the quality of social services and promoting dynamic growth, where public expenditures or fiscal transfer through aid may not have a central role. Diverse actors are engaged in development-related activities, including domestic and foreign private enterprises, and aid relationship is just one aspect of the government's coordination mechanisms. Therefore, it is important to recognize such contextual differences. There is a need to broaden the perspectives of the ongoing discussions and establish an analytical framework which can sufficiently accommodate country diversity.

All the above suggest that we should be pragmatic and perceptive to local reality in the choice of aid modalities. There is a need to develop an understanding of how various aid modalities complement one another, taking account of their features in relation to a specific country's circumstances. This is the context in which donors should seek and practice "good donorship" principles toward more effective aid.

3 Key Factors Affecting the Choice of Aid Modalities: A Proposed Framework

In this chapter, we propose a conceptual framework for deciding the choice of aid modalities, taking account of the two factors previously mentioned: (i) the nature of priority development problems in recipient countries; and (ii) the nature of recipient-donor relationships in the aid process and ownership. To this end, we present the Development Priority Matrix (regarding (i)) and two prototypes of ownership and capacity (regarding (ii)) as analytical tools. We also examine how country- and sector-specific factors should be considered in applying this framework, since contextual differences could have important implications for modality choice.

3-1 Development Priority Matrix (DPM)

What are key development priorities in recipient countries, and what is the nature of development problems? To examine these questions, we have constructed a Development Priority Matrix (DPM). DPM focuses on the public sector domain, namely, the areas covered by public expenditure and policies.

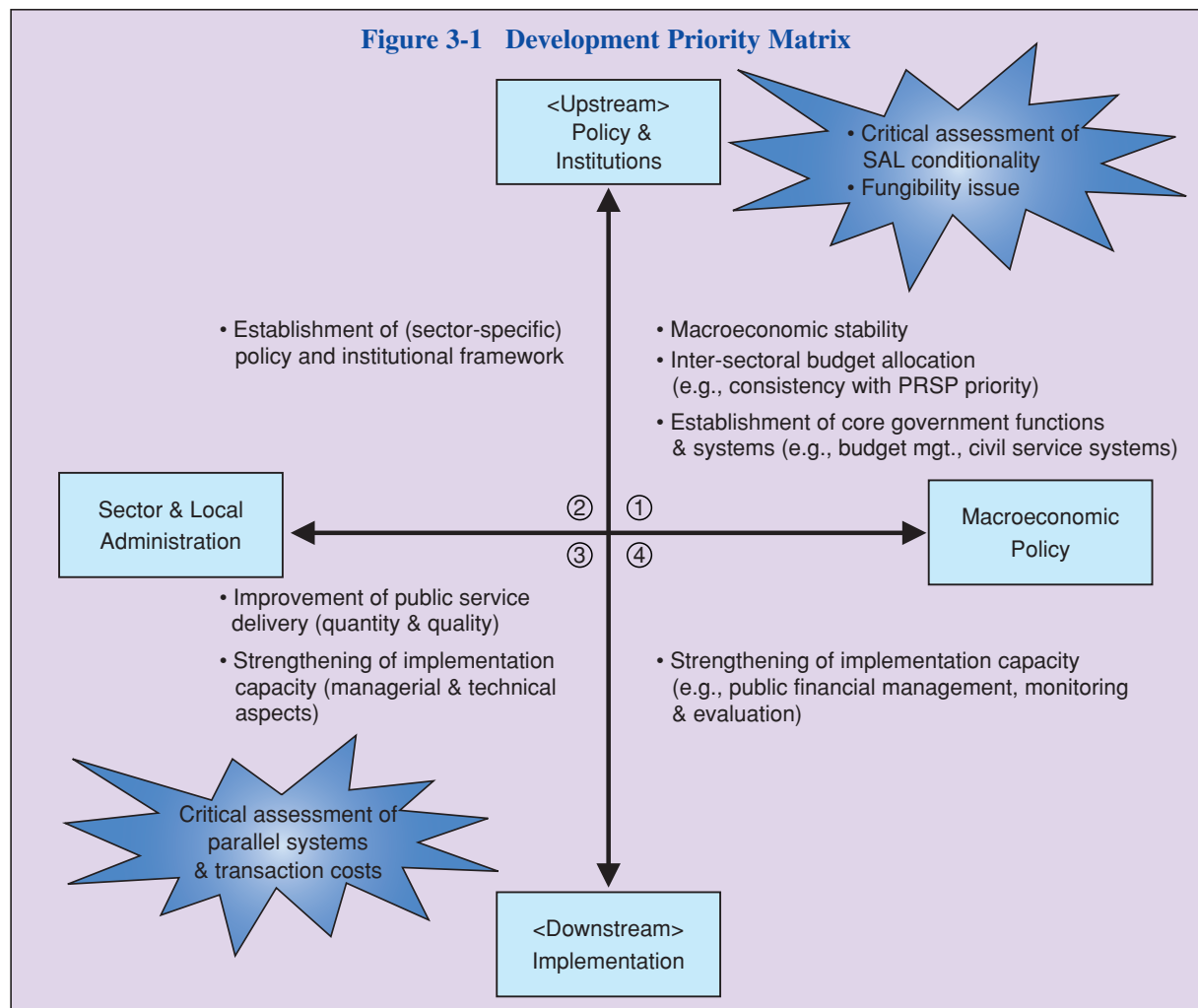


Table 3-1 Development Priority Matrix (DPM)

Quadrants	Priority Problems	Responsible Agents
(1) Upstream + macro-level	Policy and institutional framework at the macro level	Central economic ministries and the central bank
(2) Upstream + sector & local levels	Policy and institutional framework at the sector and local levels	Line ministries and agencies, and local governments
(3) Downstream + sector & local levels	Implementation and service delivery to the intended beneficiaries at the sector and local levels	Line ministries and agencies, and local governments
(4) Downstream + macro-level	Implementation of macro policy and institutional framework at the macro level	Central economic ministries and the central bank

The vertical axis shows a range of tasks—from policy and institutional reforms (upstream or high level) to operational and implementation issues (downstream, or actions on the ground). The horizontal axis shows a range of agents responsible for carrying out these tasks—from central economic ministries and agencies, line ministries, to local authorities. More specifically, DPM classifies development priorities into four quadrants, as shown in Table 3-1.

Linking DPM and Aid Modalities

Effective public sector requires the functioning and coordination of all the four areas in DPM. In this regard, it is important to understand how modality choice is related to priority problems in recipient countries.

The quadrant (3) is where project aid is primarily used. In well-planned, organized, and sustainably financed government systems, input supply projects can make a valuable contribution of lasting benefit. However, if recipient authorities make inadequate provision for the maintenance and replacement of donor-supplied inputs, techniques and methods transferred through projects (including TA) will not be properly integrated into local practice. [Roberts 2003]

The quadrants (2) and (3) are the areas where project aid, typically large-scale projects with policy and institutional reform contents, is used. But, under the situation with aid fragmentation, individual projects may not sufficiently address coherent policy and institutional reform. This is why SWAp has emerged to rectify coordination problems. Also, SECAL used to be applied to address sector policy and institutional reforms; but the urge to redesign conditionality has replaced this modality with SWAp and/or SBS.

The quadrants (1) and (2) are the areas where SAL and SECAL were respectively used, previously. However, the failure of conditionality under adjustment operations has prompted the emergence of GBS and SBS.

In general, higher-level and systemic problems call for higher-level aid relationship and dialogues on fundamentals, such as policy reforms (around PRSP) and inter- and intra-resource allocation. It is understood that budget support and SWAp attempt to cover multiple areas in DPM and seek for synergies among policy and institutional reforms, budget allocation and execution, and implementation. Therefore, these modalities can be effective if priority problems in recipient countries are complex and correspond to several quadrants in DPM. Moreover, since budget support and SWAp permit large resource transfers, they are likely to be suitable if services to be financed call for mainly recurrent expenditures.

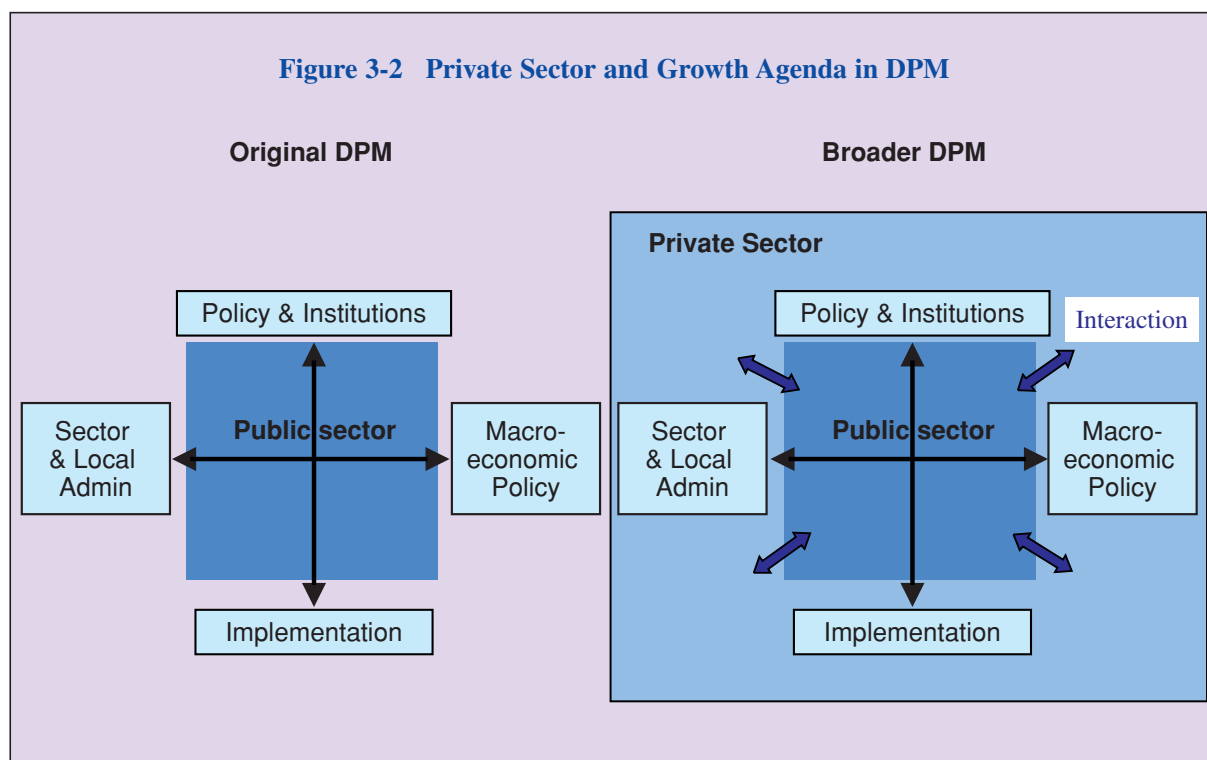
On the other hand, if the identified problems are specific, for example, the search for technical solutions, project aid focusing on the quadrant (3) may be appropriate. Also, if policy innovation is sought, project aid can contribute to the quadrant (2). Therefore, it is important to identify and locate priority development problems of recipient countries in DPM, and then decide a suitable modality, based on the understanding of properties of respective modalities.

Technical assistance (TA) can be used in all the quadrants—(1), (2), (3), (4). TA is often provided in the form of project aid, or the dispatch of experts contracted by donors. Since TA aims to support recipients' capacity development at the individual, organizational, institutional and societal levels (through knowledge and skill transfer, pilot innovation and so on), it can promote not only implementation on the ground, but also policy and institutional reform. But, as mentioned in the previous chapter, efforts are needed to enhance its effectiveness by better aligning TA projects to the existing administrative structure and policy framework. This is why recently pooled TA has been attracting attention.

Treatment of the Private Sector and Growth Agenda in DPM

It is important to note that the original DPM discusses priority problems that can be addressed by direct public actions via public expenditures and policies. These are public sector agenda, including macroeconomic management, the establishment of core government functions and institutions, and the provision of social service delivery. In fact, many low-income countries are striving for meeting such immediate priorities. But, pro-poor growth equally requires growth promotion and private sector development (PSD), namely, the development of agriculture, industry and business, for which both public actions and the behavior of private agents (e.g., firms and farmers) matter. Thus, DPM can be extended beyond the original area by explicitly indicating the private sector [See Figure 3-2]. There exist interactions between the public and private sectors. On the one hand, public policy and actions influence the business environment, for example, through macroeconomic environment, trade policies, legal and regulatory framework, physical and financial infrastructure. On the other hand, the private sector—through tax contributions—helps generating additional budget for poverty-targeted programs and public investment. The size of the private sector domain differs by country by country.

Figure 3-2 Private Sector and Growth Agenda in DPM



3-2 Identifying Priority Development Needs in Recipient Countries

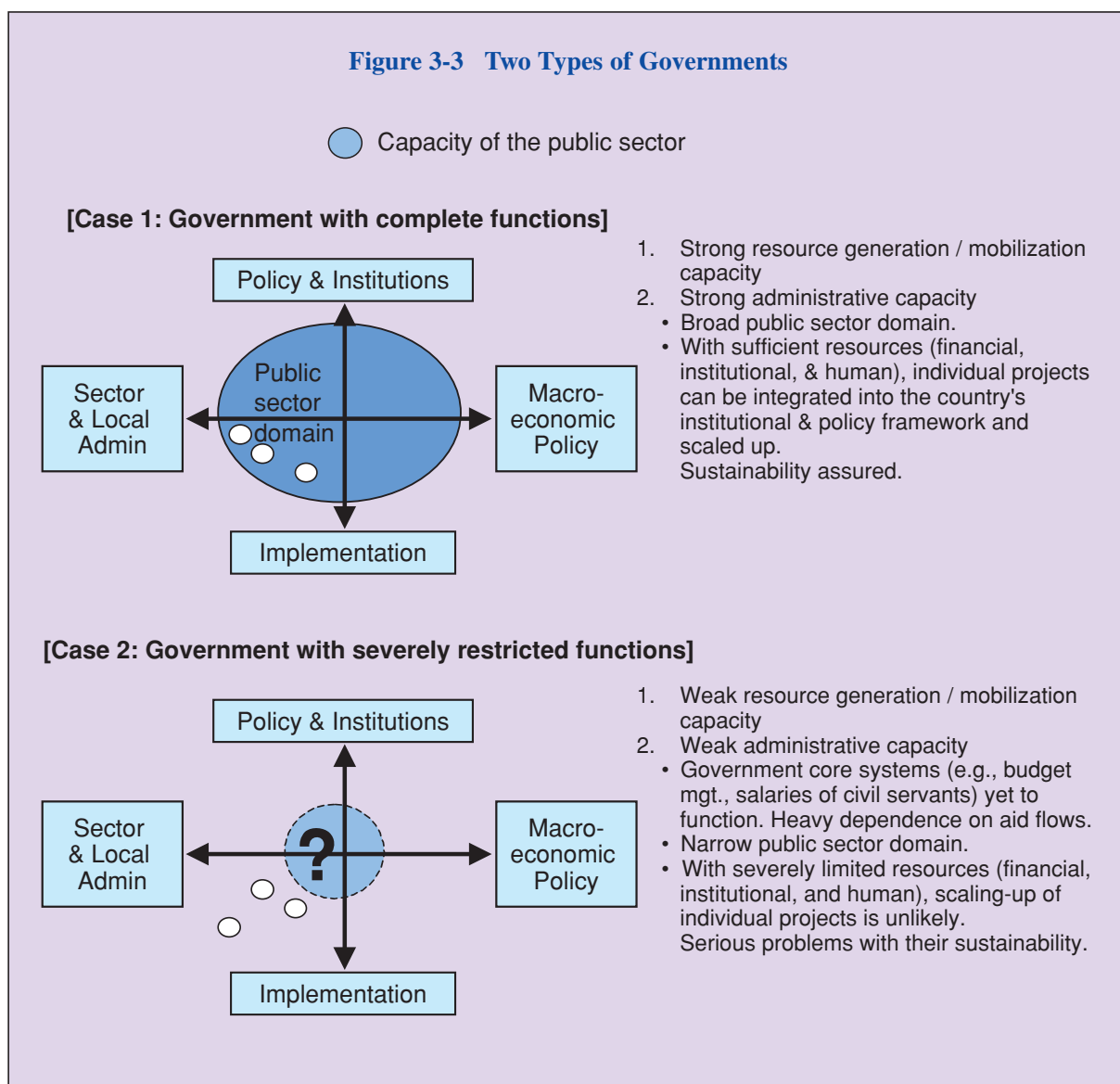
Country-specific Context

Relative effectiveness of aid modalities should be assessed in light of the location of priority problems in DPM. This suggests the need to understand the degree of government capacity and the functioning of the government's core systems, and then match aid with country-specific problems.

Figure 3-3 hypothetically illustrates two extreme types of governments. Case 1 is the government with sufficiently strong capacity, in terms of macroeconomic management, resource mobilization, public expenditure management, public administration, service delivery, and so on. Here, internally generated resources can largely finance the government's core systems, and the government is capable of providing essential public services to the population in need. Under such circumstances, individual projects can be integrated into the country's institutional and policy framework and their sustainability is likely to be ensured. There is a great chance of "scaling up" their impacts.

Case 2 is the government with severely restricted functions, heavily dependent on aid flows to make the core systems work. Under such circumstances, merely supplying inputs into individual projects is unlikely to "scale up" their effects, and projects face serious problems with sustainability. As Hyden noted, this is the typical situation of sub-Saharan African countries, where the patrimonial features are still prevalent and public administration is 'underbureaucratized.' [Hyden 1983:79] ODI [2001] also gives the following summary of the features of eight countries included in the PRSP Institutionalization Study (Benin, Ghana, Kenya, Malawi, Mali, Mozambique, Rwanda and Tanzania).

- Semi-democratized states and fragmented policy processes, characterized by low coordination between different centers of decision-making, and between the formulation and implementation of policies;
- Patronage-based domestic politics, with fragmented party systems and weak civil societies;¹¹
- High levels of financial and institutional aid dependency, producing low accountability to domestic actors;
- Public expenditure and revenue management systems, which have, until recently, been weakly driven by public policy objectives; and
- Administrative systems characterized by low morale and weak performance incentives.



¹¹ While recognizing its important effect on the functioning of government system, we do not intend to provide in-depth analysis of patrimonialism in the paper. We believe that this topic merits separate attention.

To better understand country differences in the government's capacity, we show the data on selected countries (Ethiopia, Tanzania, Ghana, Bangladesh, Cambodia and Vietnam) in terms of: (i) aid as a percent of macroeconomic aggregates (including selected sources of foreign exchange inflows); (ii) central government's tax revenue as a percent of GDP; and (iii) indicators for public service delivery (primarily on the access to social services). Although rough, these data are useful in assessing the degree of the government's functioning in the spectrum of two extreme cases and locating priority problems in DPM.¹² Moreover, whether and to what extent a country has alternative sources of development financing (such as domestic resources, FDI, export earnings), other than aid, can affect its bargaining position vis-a-vis donors in aid relationship.

(1) Aid as a percent of macroeconomic aggregates

Among the six countries, Vietnam and Bangladesh are less aid dependent. The ratio of aid to macroeconomic aggregates is not particularly high. In Vietnam, aid accounted for around 4.6 percent of GDP and less than one tenth of imports in 2001. Aid's share in the government expenditures is relatively small, at 18 percent and at about less than one-sixth of total investment. As Table 3-2 shows, aid is just one of several sources of foreign exchanges. Bangladesh exhibits similar tendency, at aid accounting for around 3.3 percent of GDP and about 23 percent of government expenditures in 2001.

The situation is quite different from those of Tanzania, Ethiopia, and Cambodia. In these countries, aid accounts for about 60 percent (or more) of government expenditures and 12-18 percent of GDP, and is the main source of investment (70-90 percent). Such a high share of aid in government expenditures suggests that the governments in these countries must rely on aid flow to finance crucial parts of core public functions (including recurrent financing). In Cambodia, the sources of foreign exchange earnings are somewhat diversified. But, in Tanzania and Ethiopia, aid accounts for nearly half of the foreign exchange earnings, and aid receipts are higher than export earnings and FDI. This suggests the very limited size of economic activities by non-government, for profit sectors [See Figure 3-4].

Ghana is less aid dependent than the three countries mentioned above and has more diverse sources of foreign exchange earnings. But, the nature of its problems resembles that of the three countries above (rather than that of Vietnam and Bangladesh). This is also because Ghana's export earnings mainly come from primary commodities (e.g., cocoa, gold, timber), which are vulnerable to price fluctuations in international markets. In contrast, Vietnam has a stronger industrial base and its exports include labor-intensive manufacturing products.

¹² The World Bank uses CPIA as an indicator for assessing capacity of IDA countries. CPIA uses 20 (16 from the 2005 exercise) indicators which have both short- and long-term impacts on development effectiveness; but it does not take account of aid dependency. Here we use simpler indicators, focusing on the functioning of Government core systems and the degree of aid dependency, which roughly suggests the government's ability to mobilize alternative resources (indicators (i) and (ii)). The indicators for public service delivery (iii) at particular time may not necessarily show the sustainability of service coverage. But, given the difficulty in obtaining comparable data, we consider that these can serve as proxy to assess the functioning of core systems when combined with other indicators (i) and (ii).

Table 3-2 Aid as a percent of Macroeconomic Aggregates (2001)

Unit: %

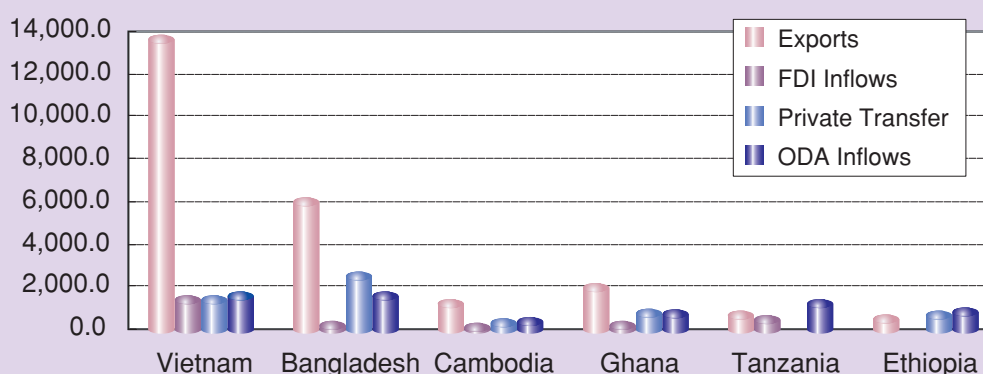
	GDP	Imports	Forex. Revenue	Investment	Gov't Exp.
Vietnam	4.6	9.4	7.0	14.8	17.9
Bangladesh	3.3	18.2	14.1	13.1	22.8
Cambodia	12.4	24.4	19.0	69.1	64.4
Ghana	14.9	26.6	18.5	55.8	45.4
Tanzania	14.3	89.2	41.8	83.8	75.0
Ethiopia	18.0	69.3	48.6	92.2	57.1

Source: IMF Statistical Appendix [2003], OECD/DAC [2004].

Note: The aid data (gross disbursement) are based on donor report to OECD/DAC, which may not coincide with those reported by the government.

Figure 3-4 Selected Sources of Foreign Exchange Inflows (Average of 1999-2001)

Unit: \$mn



Source: IMF Statistical Appendix [2003], OECD/DAC [2004].

(2) Tax revenue

Table 3-3 shows the data on central government's tax revenue as a percent of GDP in four of the six countries (Vietnam, Bangladesh, Ghana, and Tanzania), on the average of 2001-2002. Among the four countries, Ghana and Vietnam have higher ratios of tax collection. Bangladesh has extremely low tax collection ratio at 7.4 percent of GDP (especially, income tax). This ratio is much lower than those of sub-Saharan Africa. Judging from that the levels of standard VAT and corporate tax rates are not quite different from those of the other countries, the low tax collection ratio may imply the government's limited capacity for enforcement and capturing locally generated resources.

Table 3-3 Central Government Tax Revenue, (Average of 2001-02)

Unit: %

	Vietnam	Bangladesh	Ghana	Tanzania
Tax	16.6	7.4	17.2	12.1
Income tax	6.0	1.4	5.6	2.7
VAT or sales tax	4.2	3.9	5.1	4.1
Excise taxes	1.4	0.1	0.7	2.1
Trade taxes	3.8	2.0	4.1	1.0
Other taxes	1.2	0.1	1.7	0.0
Memo				
Standard VAT rates	10.0	15.0	12.5	20.0
Corporate tax rates	30.0	35.0	32.5	30.0

Source: IMF staff reports.

Table 3-4 Access to Essential Social Services

	GNI per capita (2002)	Child Immunization Rate (% of children under age one, 2001)	Primary School Completion Rate (2001)	Access to Improved Water (% of pop., 2000)
Vietnam	\$430	98%	101%	77%
Bangladesh	\$360	83%	70%	97%
Cambodia	\$280	60%	43%	30%
Ghana	\$270	80%	64%	73%
Tanzania	\$280	85%	60%	68%
Ethiopia	\$100	56%	24%	24%

Source: WDR 2004 [World Bank 2003]

(3) Indicators for public service delivery

Table 3-4 compares the data on selected social services, mostly delivered by the public sector (primary school completion rate, child immunization rate, and the access to improved water source). Although not perfect, these data could roughly provide a basis for judging the government capacity for public service outreach (access). Vietnam surpasses the other countries in the functioning of social service delivery, although there is room for quality improvement. This is followed by Bangladesh, Ghana, and Tanzania. The indicators on Cambodia and Ethiopia are very low, suggesting that systems for delivering basic public service are yet to be established.

The above three kinds of information give a rough idea of government capacity in generating internal resources to finance its core functions and delivering essential public services. Such information can help clarify the country-specific circumstances, particularly addressing such questions as: (i) what is the magnitude of problems associated with the four areas in DPM; (ii) what are priority issues and where they are located in DPM; and (iii) whether and to what extent GBS, or alternative modalities can be useful in addressing the identified, priority problems. It also suggests whether the nature of immediate priorities should be understood within the original DPM or the broader DPM [Figure 3-2].

Sector-specific Context

The role of public expenditures differs by sector and by type of services to be financed. If the sectors and desired services are recurrent-intensive and the country is heavily aid dependent, large resource transfers would be required on a constant basis. This implies the importance of ensuring links among quadrants (1), (2) and (3) in DPM. Furthermore, the nature of desired services matters, too. If the required action is the system-wide application of homogeneous and standardized technology, increasing public expenditures or reducing the unit costs of measures may be appropriate. On the other hand, if the required action is highly context-specific, innovative and targeted interventions are needed to meet heterogeneous demands of beneficiaries. In such case, simple expansion of public expenditures may not be enough. Carefully designed interventions in quadrant (3) of DPM need to be accompanied.

Therefore, it is important to identify suitable aid modalities, considering the role of public expenditures in the sector or services to be financed. We pay attention to the following two criteria:

- Intensity of public-goods components and the role of recurrent expenditures; and
- The nature of required public sector actions, particularly the degree of the system-wide applicability of standardized, homogeneous approaches.

(1) Intensity of the public-goods component and the role of recurrent expenditures

The role of government and public expenditures differ greatly by sector (or sub-sector). Where the sector (or sub-sector) provides services with the high public-goods component, public expenditures—recurrent expenditures in particular—play a key role. Roughly speaking, the sector-context can be grouped into the two depending on the intensity of the public-goods component:

- Case 1: Government as provider of service delivery and public goods. This is typically the case of the delivery of basic social services (such as primary education and primary health care), where the government is a key provider of services, with expenditure dominated by recurrent costs in local currencies (especially salaries).
- Case 2: Government as regulator and/or coordinator of various stakeholders including the private sector. Here, the private sector covers both "for-profit" (e.g., growth promotion, private sector development) and "non-profit" (e.g., NGO support to social service delivery) actors. In this case, the role of public expenditures is less important. The main role of the government is not financing itself, but creating an enabling environment for these actors, i.e., sustaining macroeconomic stability and establishing sound policy framework and institutional mechanisms for supporting the activity of non-government actors.

The implicit assumption behind budget support is that public expenditure programs are by-and-large efficient and effective in bringing about development outcomes. While this is primarily concerned with Case 1, the applicability of such assumption should be examined by sector (or sub-sector) and by type of services to be financed.

The education sector is a most representative example of Case 1. This is the sector where the government plays a key role in directly providing essential public services (or by outsourcing to private providers). Most expenditures on education are non-tradable, with 75 percent or more consisting of wages and salaries. Public provision far exceeds non-governmental provision in the supply of schooling, particularly at the primary level, and public expenditure greatly exceeds private expenditure. Thus, it is generally assumed that public expenditure is the prime policy instrument for achieving educational outcomes. [Robert 2003]

The government also plays a key role in the provision of health services. However, compared to education, the effects of government interventions on health may be more indirect since they affect health outcomes through a multiplicity of channels—economic, social, cultural, geographical and environmental. The most direct interventions include preventive action (e.g., immunization campaigns) and curative care services provided in the public sector. Also, governments are responsible for health status and epidemiological monitoring, information, guidance and education on health matters, coordinating and regulating private providers of health care and insurance, and health-improving environmental expenditure and regulation. [Robert 2003]

Infrastructure, particularly large-scale infrastructure like trunk roads, is capital-intensive public works. Although often treated as public goods, infrastructure works tend to be planned and implemented in the form of projects, regardless of sources of financing (government, donors, private). Because of their complexity, construction works require coordination with various ministries and agencies—such as procuring goods, securing financing, examining design and technology, and responding to environmental and social concerns—all of which go beyond regular channels of communication within the government. With such multifaceted ramifications, their planning and management may well exceed local capabilities. This is a case where the project approach—a targeted use of funds, goods, technology and knowledge for well-defined, specific objectives—may be appropriate. Moreover, the size of financial requirements makes it imperative for the government to conduct careful cost-benefit analysis and detailed design on a project basis, prioritize investment decisions under a Master Plan, and secure project financing in a multi-year public investment program.

At the same time, its large investment size suggests the importance of assigning sufficient recurrent budgets for operations and maintenance, and there is a need for careful infrastructure planning, considering the balance between capital and recurrent budgets (for operations and maintenance costs). These are systemic issues and concerned with inter-and intra-sectoral budget allocation. In such cases, higher-level, policy dialogue is required to address the problem, which may go beyond the reach of a single project.

Regarding Case 2, "for-profit," private sector development (PSD) aid has firms as immediate beneficiaries. The interventions to support PSD can be at macro, sector, or firm levels—which are not necessarily confined to public expenditures or a single sector. Often, market framework institutions and policies, and consensus building (private-public partnerships) are as important as public expenditure itself. Thus, aid can go through various channels. Examples include interventions to promote: (i) macroeconomic stability; (ii) creation of the enabling investment climate, including rules and regulations, information, physical and financial infrastructure, privatization and commercialization, infrastructure development,

education and training; (iv) direct support for the private sector through lines of credit, matching grant schemes to encourage firms to invest in knowledge transfer and new processes and explore new markets; and (v) partial risk-guarantee to encourage private participation in infrastructure and enable banks to relax country limits on trade finance, and so on. [World Bank 2004a, Kragh et al. 2000]

Given the decentralized and competitive nature of the private sector, a coordination mechanism for PSD aid is quite different from that of the other sectors. When giving aid through the public sector, a sector strategy or a master plan of one sector can be laid out in a ministry and each donor can take on some of the tasks outlined in the plan. But, such form of a coordination mechanism is unlikely to work in PSD aid. "For profit," productive sectors do not predominantly involve public spending, and clear policy prescriptions for growth do not exist. Often such sectors are the responsibility of more than one line ministry. In some cases, the government faces the situation to reduce the influence of government bodies in the sector. [Warrener 2004]

Agriculture is the sector where private agents, i.e., farmers, are immediate beneficiaries. Foster et al. [2001] gives a useful account of the different role of the government and the ministry concerned in support of agricultural development [See Box 3-1].

Box 3-1 What's Different about Agricultural SWAp?

There are crucial differences that may make the SWAp approach less suitable in agriculture than in the social sectors. Fundamental characteristics of agriculture as a sector include:

- The most important government roles in supporting agriculture do not concern public expenditure at all. The most immediate government influences are policies on exchange rates, interest rates, prices, trade, taxation, land reform, the structure and regulation of markets for agricultural inputs and outputs, and the enforcement of peaceful conflict and the rule of law.
- The most important public expenditures for supporting agriculture may not be in the agricultural sector. Investments in, for example, roads may be more important in terms of both budget and impact.
- Conversely, much of what the ministry of agriculture is doing may be better done by the private sector, and an effective agricultural strategy may actually involve cutting the budget, staffing and responsibilities of the ministry which is expected to take the lead role in implementing it.
- Unlike health, education or roads, there is no single technology that can be applied across the sector with only minor adaptation..... The agriculture sector is far more diverse in what it produces and the circumstances in which activities are performed, and neither the problems nor the solution can be defined for the whole sector.
- Government is a minor player in the agriculture sector, which may employ 80 percent of the population, and the relationships with farmers and commercial firms supplying services are even more fundamental than those with private providers in other sectors.

Source: Adapted from Foster, Brown and Naschold [2001].

Channeling aid through "non-profit" actors is, by definition, another example where public expenditures (including recurrent) have a limited role in service provision. Here, the role of the government is to establish a regulatory framework for facilitating the participation of qualified NGOs, outsourcing funds, and directly financing specific NGO activities. Furthermore, as Table 3-5 shows, NGOs can assume various functions such as policy research, advocacy, operational, and networking, which could be relevant not only to quadrant (3) but also (1) and (2) of DPM.

Table 3-5 NGO Functions and DPM

Type of Functions	DPM Quadrants	Examples of Activities
Policy and research; Advocacy	(1), (2), (3)	<ul style="list-style-type: none"> • Policy analysis and recommendations • Monitoring and evaluation
Operational	(3)	<ul style="list-style-type: none"> • Service provision (e.g., education, health, relief, micro-credits, training), with own resources • Service provision, with government resources
Linkage and networking	(3)	<ul style="list-style-type: none"> • Facilitation between communities and local administration (e.g., coordinating visits of local officials in light of community needs) • Social mobilization

Box 3-2 Vibrant NGO Activities in Bangladesh

Bangladesh is well known for its vibrant NGO activities. NGOs cover large populations with a wide range of activities. This is so particularly in the operational functions. Examples include: micro-credit programs covering about 11 million individuals (BRAC, Grameen Bank, Proshika etc.), education services (provided to over 1.2 million students by BRAC non-formal primary education program), and certain health and population control services are provided exclusively through NGOs (population control in the 1970s, HIV/AIDS prevention currently). Linkage and networking is another promising function. For example, under a JICA-supported development partnership program, Shaplaneer has been supporting networking between community residents and local government. Building on its extensive work in the Ishwarganji Upazila (one of the 12 Upazilas in Mymensingh District), Shaplaneer organizes a number of meetings and training at its own Community Development Centers, establishing contacts between Upazila officers (fishery, livestock, family planning, agriculture etc.) and beneficiaries. Such approach is worth noting because it aims to complement—rather than replace—the functions of public administration.

Source: Elaborated by the authors, based on World Bank [2003a] and Shaplaneer [2001, 2002, 2003].

(2) The nature of required public sector actions, particularly the degree of the system-wide applicability of standardized, homogeneous approaches.

The above (1), in particular Case 1, focuses on public sector actions to be realized through public expenditures (e.g., higher levels of expenditures, reduction in unit costs of standardized services). However, the quantitative expansion of services through public expenditures is only one side of the equation. Even in the education and health sectors, in which the public-goods component is high relative to the other sectors, there are cases where targeted-interventions are necessary to improve the quality and outcome of services. Although many possibilities exist, we would like to consider two illustrative situations:

- Case 1: Homogeneous and standardized services, which can be replicated (with local adaptation) and expanded by increasing public expenditures. In this case, policy and institutional design is important to support the quantitative expansion of service packages.
- Case 2: Heterogeneous and context-specific services, which are difficult to replicate and not suitable for massive expansion. This must be accompanied by carefully designed, targeted interventions, with due attention to implementation issues (including out-reach and feedback mechanisms).

Generally, interventions through public expenditures are appropriate in the situations where: (i) there exists consensus on the technology and program design to be adopted; and (ii) standardized, homogeneous technology—often a nationally determined approach (although with some local adaptations)—can be applied. Typical examples are the construction of primary schools, the provision of school lunches, and immunization. While their implementation is by no means easy or simple, their main problems are administrative and logistical. [World Bank 2003b]

On the other hand, activities such as classroom teaching and curative care are demand-driven, and service providers must respond to behavior and attitudes of different individuals and exercise discretion in choosing teaching and treatment methods. Here, the main problems are to respond to heterogeneous needs, and interventions must be tailored to specific, local needs. Thus, standardized, scripted approaches would not give enough latitude. [WB 2003b] In this regard, the recent evaluation of program aid in basic education stresses the role of project aid in providing assistance to local needs, based on the case analyses of four countries (Burkina Faso, Bolivia, Uganda and Zambia). It suggests that the movement to support basic education through SWAps and other forms of program support be accompanied by an understanding of the positive role of project aid, especially in supporting innovations and in providing targeted support to marginalized groups. [Netherlands MOFA 2003]

Pritchett and Woolcock [2002] classify public sector activities in light of the levels of "discretion" and "transaction intensiveness" involved.¹³ Noting that both discretionary and transaction-intensive services are extremely difficult to replicate, they conclude that a programmed approach to service delivery is

¹³ Discretion refers to the extent to which an activity requires extensive professional or context-specific knowledge (i.e., judgment). Transaction intensiveness refers to the number of transactions required to undertake an activity. [Pritchett and Woolcock 2002]

appropriate in areas involving standardized services, but less appropriate where heterogeneous services are involved.

Practice of Aid Modalities across Sectors

The above analysis is consistent with the actual practice of aid modalities across sectors. The experiences show that most of the SWAp operations and sector conditionality emphasized in GBS are found in education and health, particularly at the primary level.

Table 3-6 indicates the proportion of total support for SWAps being provided in the form of pooled or common basket funding, budget support, projects, and funding channeled through NGOs or other forms of off-budget support (e.g., technical assistance or other off-shore payments that are not included in the budget). There are notable differences across sectors. Fully 70 percent of funding the education sector took the form of pooled funding or budget support in 2002; this fell to 48 percent for the health sector; and dropped to only 2 percent in the transport sector, where large infrastructure projects tend to dominate. The Table also confirms the trend of increasing budget support and pooled funding (the former in particular) in Africa, while the project support and funding through NGOs etc. continue to be important form of funding. [Lavergne et al. 2003]

Table 3-6 Funding Modalities in African SWAps

Funding Modality	2000 (%)	2001 (%)	2002 (%)	2002 Education	2002 Health	2002 Transport
Pooled funding	8	11	11	7	20	0
Budget support	20	24	35	63	28	2
Project support	56	49	40	27	28	91
NGOs and other off-budget support	16	16	13	3	24	7
Total (%)	100	100	100	100	100	100
Total (US\$mn)	678.2	791.2	1070.6	331.9	484.2	162.1

Source: SPA Secretariat [2003], cited from Lavergne et al. [2003]

3-3 Assessing Real Ownership and Aid Relationship

Another important factor affecting the choice of aid modality is the degree and nature of "ownership" exercised by recipients in an aid relationship. It is well recognized that local ownership of the development process is a pre-requisite for the achievement of sustainable results. The following statement illustrates how local ownership is important in the aid process.

"Local ownership is thus at its greatest where aided activities reflect local goals and priorities, preferable based on a genuinely consultative national consensus, where the identification of projects and programmes to be assisted rests primarily with the recipient government and where there is minimum resort by donors to policy conditionality (as distinct from the standard stipulations concerning accounting, procurement, etc.)." [Helleiner et al. 1995:9]

Here, we would like to focus on the following three perspectives to analyze ownership:

- Capacity—encompassing the design of development strategy, the implementation of development program, and aid management;
- Aid relationship, particularly aid dependency; and
- Recipient perception of ownership.

Ownership and Capacity

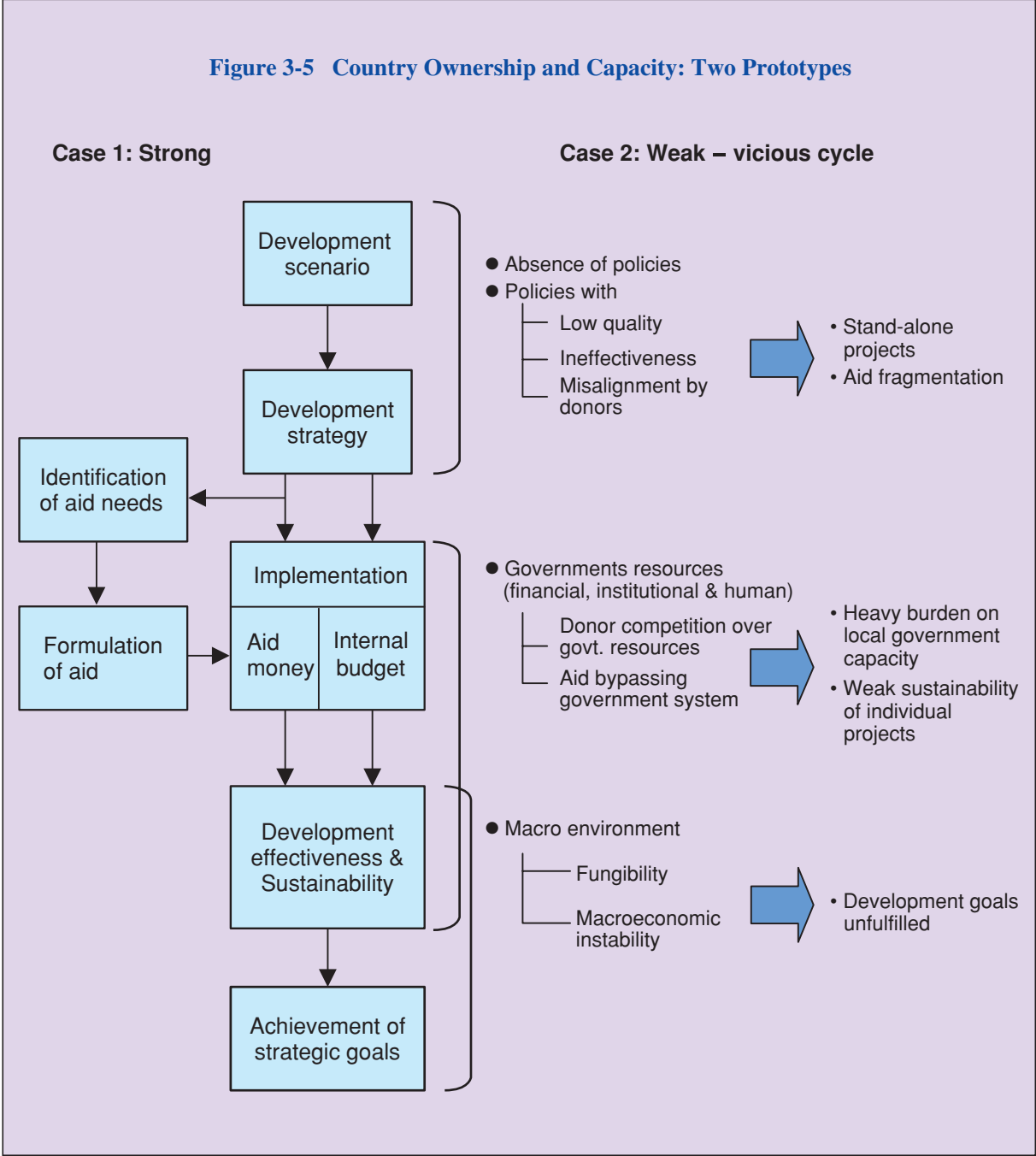
Ownership and capacity are connected concepts. It is not possible for recipient country institutions to exercise ownership of development programs if they do not have the required capacity to design and implement development programs, or to provide the leadership required for donor coordination. At the same time, capacity development itself depends upon the existence of local ownership. [Lavergne et al. 2003]

Figure 3-5 shows two extreme types of government in terms of the degree of ownership ("two prototypes of ownership and capacity"), as follows:

- Case 1 (left) shows the government with strong ownership. Here, the recipient government is capable of formulating development strategy, identifying specific needs to be financed by aid, matching its own internal budget with aid programs and projects, delivering services, and monitoring and evaluating their performance. As such, it is likely that even if implemented as individual projects, they can achieve and sustain developmental impacts.¹⁴
- Case 2 (right) is the government with weak ownership. Due to capacity constraints, there are problems with the absence of policies (or insufficient policy content even they exist), and externally-funded individual projects are unlikely to be integrated into the government's policies and programs, resulting in aid fragmentation. Aid fragmentation in turn would divert human and financial resources from recipient governments and impose high transaction costs of aid and heavy administrative burden on the government. All these would severely limit the sustainability of individual projects. These problems are especially serious for heavily aid-dependent countries.

¹⁴ Nevertheless, this does not mean that no efforts are required to reduce transaction costs. Even in Case 1, it is important to make efforts to promote procedural simplification or harmonization of aid delivery.

Therefore, it is important to assess the capacity of recipient countries and implications for the choice of aid modalities—such as whether conditions exist for individual projects to work and to what extent budget support or other type of programmatic aid may contribute to minimizing aid fragmentation, increasing policy coherence, reducing transaction costs, and eventually enhancing ownership.



Ownership and Aid Relationship

In the recipient-donor relationship, ownership is demonstrated through the aid process. In this sense, the degree of aid dependency is an important determinant for the levels of ownership. If a recipient

country is highly-aid dependent, it has weak negotiation power vis-a-vis donors and faces difficulty in exercising full ownership. Moreover, high aid dependency implies a large volume of aid transactions, which in turn places heavy administrative burdens on the recipient government (i.e., transaction costs). As such, the degree of aid dependency affects recipient's capacity for policy dialogue with donors and aid management.

Recipient Perception of Ownership

Recipient perception of external actors is another determinant for ownership. This is more subjective, embedded in local society, and may be even shaped by historical factors. Some recipient countries are prepared to establish an open relationship with donors, including a high degree of donor involvement in policy dialogue on strategic direction, budget priorities, and performance evaluation; but other countries may wish to have their own boundaries of internal and external relationships and may be reluctant to allow donors to influence over high-profile policies and budget priorities.

Because budget support and SWAp involve a fair to high degree of donor involvement in recipient's country programming and budgeting, they imply a certain loss of sovereignty for the host country at that level. As a result, the recipient country is unlikely to find this an acceptable approach unless it is highly aid dependent.[Lavergne et al. 2003] In this sense, donors should recognize the "duality" of budget support and to some extent SWAp. On the one hand, GBS intends to enhance local ownership by changing the design of conditionality from *ex-ante* to *ex-post*, as well as by improving policy coherency and accountability incentives. But, on the other hand, by providing GBS, donors gain access to policy dialogue, enabling them to exercise leverage and greater influence over central government policies and budget priorities. [Frantz 2004]

While there is no denying the importance of policy dialogue, donors should duly recognize the political sensitivity of general budget support. There is a need to identify pragmatic entry points for aid intervention, based on careful assessment of perception-related ownership of recipient countries.

Table 3-7 shows three types of the inter-dependent relations among ownership, capacity and aid relationships, as well as their dynamic processes of changing problems as capacity increases and aid dependency declines.

In this sense, it is interesting to compare Tanzania, Vietnam and Cambodia, because the three countries exhibit different types of ownership (including perceived ownership), capacity and aid relationship. As shown in the previous section 3-2, Tanzania and Cambodia are more heavily aid dependent than Vietnam, with lower capacity for providing core public services. Tanzania is an example of a country engaged in Scenario 2, while Vietnam is most likely to be in Scenario 3. Cambodia offers another different country context, being on the way to graduate from Scenario 1 to Scenario 2. Over the last decade, Cambodia has made steady transition from post-conflict to development stages. In the following, we describe how the three countries differ.

**Table 3-7 Changing Problems in Aid Relationship:
As Government Capacity Rises and Aid Dependence Falls**

Aid Relationship	Characteristics of Aid Relationship	Main Problems and Challenges in Aid Relationship
<p>Scenario 1: High aid dependence, but aid poorly integrated into government</p>	<ul style="list-style-type: none"> - Low government capacity - Aid poorly integrated into public services 	<ul style="list-style-type: none"> - Low ownership by government as donors bypass government - Low trust between government and donors - Risk of 'low ownership trap' (low trust leading to low ownership, which leads to low capacity leads to low trust)
<p>Scenario 2: High aid dependence, with aid better integrated into government</p>	<ul style="list-style-type: none"> - Government capacity low but rising - Aid better integrated into public services (SWAps, budget support) 	<ul style="list-style-type: none"> - Government increasingly undertakes management of aid (leading to ownership strengthening) - Assurance arrangements to reduce risk to both government and donors
<p>Scenario 3: Lower aid dependence, aid integration into government less of a problem</p>	<ul style="list-style-type: none"> - Government capacity higher - Lower dependence of public services on aid - Aid becomes decentralized once more, going to specific organizations and purposes (projects) 	<ul style="list-style-type: none"> - Aid integration less of a problem for government since core public services are funded principally from own revenues (strong ownership)

Source: OECD/DAC [2003: 113-115]

(1) Tanzania¹⁵

Tanzania is often cited as a model of donor-government partnership. The aid relationship is open and covers a broad range of issues including budget allocation. A variety of mechanisms have been developed to encourage the alignment of donor assistance to the PRSP priorities and the harmonization of operational procedures among donors. These include: annual public expenditure review process, opening of the budget process to actors outside the Ministry of Finance (MOF), and Performance Assessment Framework (PAF) as the basis for policy dialogue and performance monitoring. Principles governing the relationship between donors and the government are spelled out in the Tanzanian Assistance

¹⁵ This part largely draws on Frantz [2004].

Strategy (TAS), and both parties' adherence to their respective commitments is evaluated in advance of Consultative Group meetings by an Independent Monitoring Group (IMG).¹⁶

This type of institutionalized "mutual review" process, conducted by an independent body, is unique to Tanzania. Most recently, donors have begun discussing the possibility of developing a joint country assistance strategy. All of these are intended to enhance local ownership of the development process and reduce the transaction costs of aid for the government.

This was possible in Tanzania because both the government and donors had shared understanding of the problems prevailed in the past aid relationships (including aid fragmentation, transaction costs, and weakening of ownership). In the context of Tanzania, the 'solutions' to the problems are to: (i) deliver aid in accordance with the priorities outlined in PRSP; (ii) harmonize donor procedures with the government systems; and (iii) channel aid increasingly through program aid, particularly general budget support. The Tanzanian government, including the President, indicates strong preference for GBS as the most flexible aid modality and an effective way to enhance the country ownership. Nevertheless, we should be aware of the reality that aid finances substantial parts of the government's core functions and that the government has limited negotiating power vis-à-vis collective voice of donors under the GBS arrangement.

MOF is a focal point of such an institutionalized "mutual review" process. The MOF is responsible for budget planning and management, and aid coordination. Although the National Planning and Development Commission (NPDC) under the office of Vice President, is officially charged with development planning including the formulation and monitoring of PRSP, the established link among PRSP, MTEF and PAF—in which the budget process plays a crucial role and attracts donor attention—gives the MOF *de facto* centralized power for conducting dialogue with donors on policy and budget priorities.

(2) Vietnam

Vietnam is also regarded by donors as a partnership model, led by strong country ownership [Dongé et al. 1999, Jerve et al. 2003, Pincus and Thang 2004]. But, the nature of ownership exercised by the Vietnamese government is different from that of the Tanzanian government. The Vietnamese government has kept a restrained relationship with donors and made clear its wish to retain selectivity and diversity in obtaining donor advice. Although partnership groups are active in Vietnam, their role has been primarily to facilitate information sharing and coordination of assistance among donors. In Vietnam, partnership groups do not discuss intensively the policy framework and conditionality (overall and sectoral), budgetary allocation, and performance monitoring.

While the government receives budget support (World Bank-supported PRSCs, which are cofinanced by bilateral donors via trust funds set up in the World Bank), its size is limited compared to the

¹⁶ The development of the TAS and IMG can be traced to a report prepared under the leadership of Gerry Helleiner in 1995, popularly known as the Helleiner Report, which examined the relationship between donors and the Government and recommended ways in which the relationship might be improved.

receipts from the other aid instruments. Generally, the government is cautious about the full-scale introduction of budget support because it is normally accompanied by policy conditionality.

In contrast to Tanzania, harmonization and modality issues are more loosely linked in Vietnam. The government strongly argues for the diversity of aid modalities and treats the issue on new aid modalities part of the broad harmonization agenda. Of course, Vietnam is not free from problems with the transaction costs of aid delivery. But, with the government's core functions being in place (although not perfect) and with low aid dependency, the nature of Vietnam's development priority is different from that of many countries in sub-Saharan Africa. So, project aid continues to be dominant in Vietnam. Major donors—Japan, the World Bank, and the ADB—provide project aid in various sectors.

At least three factors have contributed to shaping Vietnam's unique relationship with donors. First, Vietnam's growth and poverty reduction record over the past decade, combined with the country's manageable external debt and healthy export growth, afforded the government an unusual degree of bargaining power vis-à-vis donors.[Pincus and Thang 2004] Second, historically, national sovereignty has been a cornerstone in Vietnam's external relationships. A strict separation between external advice and domestic decision-making process exemplifies Vietnam's nationalistic bent to donor-government relations. The government is sensitive to any form of aid conditionality and shows a strong resistance when donors push on policy reform. Third, Vietnam has unified institutional setting for aid management. The Ministry of Planning and Investment (MPI) is a powerful ministry, which holds centralized functions for development planning, FDI absorption and aid coordination. The Ministry of Finance (MOF) is another important organ charged with the allocation of recurrent budgets and the negotiations with legal agreements with donors; but its role is largely confined to the treasury.

(3) Cambodia

Cambodia is a good example of the post-conflict countries which are making the transition to a progressive, state-led country in the process of development. The total destruction of institutions and human resources by Khmer Rouge left a devastating impact over the country. In the emergency relief and reconstruction period (1994-1999), Cambodia experienced an influx of foreign aid. This was the beginning of the country's heavy aid dependence. The new government established under the 1993 Constitution operated in a fragile political environment where former conflicting parties formed a coalition government while the civil war against Khmer Rouge continued along the Thai border. As a result, the government was not fully prepared to take leadership of aid partnership at a time when donors were sending hundreds of missions to Cambodia to develop their projects. [Govt.-Donor PWG 2004] Due to such historical legacy, Cambodia manifests socio-economic features similar to those of sub-Saharan Africa, including high aid dependency and capacity constraints [See the above section 3-2].

While much literature notes that aid relationships in Cambodia have been donor-driven, there is no denying that during the relief and reconstruction period, donors did pay insufficient attention to Cambodian ownership and promoted their preferred aid projects or programs, taking advantage of its fragile political situation and limited institutional and human capacity.

Over the recent years, the country has made an important and positive step forward in terms of its aid relationships. The Cambodian government is making a genuine effort to restore ownership and lead aid partnership processes. At the same time, the government recognizes that there are gaps in its management capacities. Thus, at the CG meeting in May 2000, the government launched the new development partnership paradigm.¹⁷ There are significant progresses in establishing partnership mechanisms and designing innovative SWAp arrangements in education and health [See the next Chapter 4-3]. In the latest CG meeting (in December 2004), the government and donors discussed responsibilities and action plans of the existing 17 thematic working groups, as part of partnership efforts. The issues of harmonization of aid practices are an important area of concern to the government. Cambodia is one of the 13 pilot countries for harmonization and alignment, and the government has become increasingly vocal in international fora. Cambodia is yet to receive GBS.

Compared to the previous two countries, Cambodia's institutional setting for development planning, budget management and aid coordination is more fragmented, and this appears to have further strained the already weak capacity of the government.¹⁸ There are three organs: (i) the Ministry of Planning (charged for development planning); (ii) the Ministry of Economy and Finance (charged for budget management and coordination with loan donors); and (iii) the Cambodian Rehabilitation and Development Board (CRDB) within the Council for the Development of Cambodia (CDC) (charged for overall aid partnership and coordination with grant donors). The functional responsibilities for national development planning, implementation of development projects, and receipt of foreign assistance are dispersed among the three. Also, different organs deal with loans and grants. Recently, CDC/CRDB has been making increased efforts to strengthen overall coordination, for example, by leading the organization of CG meetings and harmonization initiatives.

¹⁷ In the 2000 May CG meeting, the Cambodian government presented an overall vision of the new partnership paradigm, declaring a paradigm shift from “Donorship” to “National Ownership.” The government also showed its commitment to moving from *Control* to *Leadership*, from mere *Coordination* to *Collaboration*, and from *Dependency* to *Sustainability*, building on the existing aid coordination and management mechanisms. [Govt.-Donor PWG 2004]

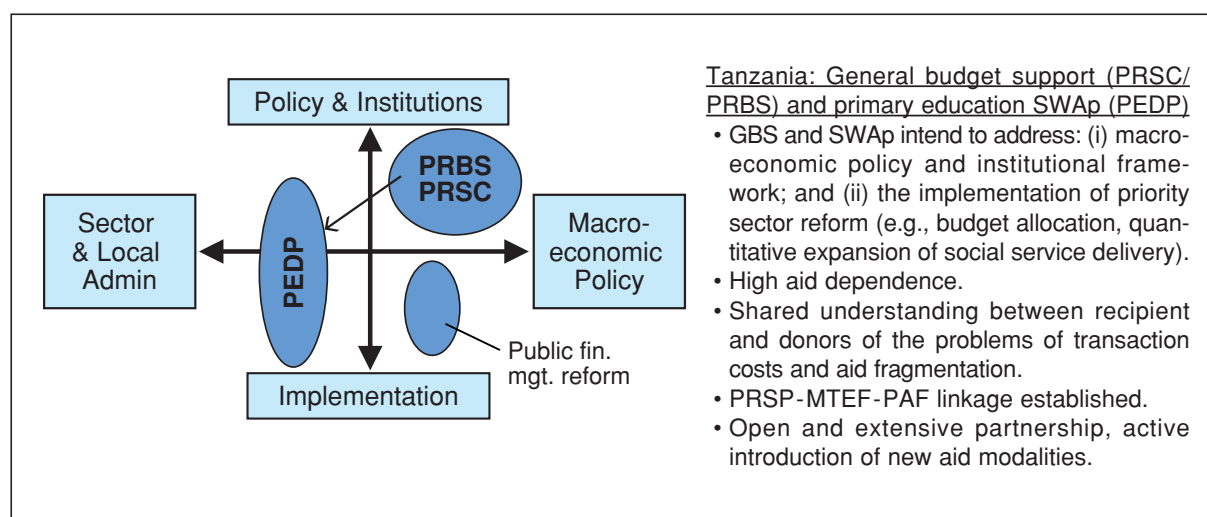
¹⁸ As a symbolic example, WB [2004b] notes the parallel preparation of two strategic documents—SEDP II (Second Socio-Economic Development Plan) and NPRS (National Poverty Reduction Strategy, Cambodian version of PRSP)—and the resultant duplication and confusion, due to rivalries exercised by the ADB and the World Bank.

4 Matching Aid with Country Needs and Ownership: Selected Examples

This chapter shows selected cases to illustrate how to match aid with country needs and ownership, in light of the framework presented in Chapter 3. We present five examples in four countries in order to explain how to combine or select aid modalities, tailored to diverse development needs and types of ownership of recipients. These examples can be analyzed from three aspects: (i) different role of GBS in supporting priority needs, with different aid mix (Tanzania vs. Vietnam); (ii) pragmatic and flexible arrangements for SWAp (Cambodia); and (iii) project aid in two distinct country context (Ghana vs. Vietnam).

4-1 Different Role of GBS in Supporting Priority Needs: Tanzania vs. Vietnam

Tanzania: Building Government Systems and Supporting the Implementation of Priority Sector Reform through GBS and SWAp



Over the recent years, GBS has become a key tool for promoting policy dialogue and financing the government's priority development programs in Tanzania. The country has been implementing SWAp in priority sectors in PRSP, including primary education. In FY2002, the share of program aid stood at 58 percent, up from 32 percent in FY99, and this trend is likely to continue. [Frantz 2004] Currently, 11 donors participate in GBS through: (i) Poverty Reduction Budget Support (PRBS), supported by eleven bilateral donors including Japan; and (ii) the World Bank-supported Poverty Reduction Support Credit (PRSC). These account for about 16 percent of government revenue (FY2003/04 budget).¹⁹ Furthermore, a TA program for public financial management is to be implemented to support the implementation of PRBS/PRSC, with 13 donors expressing their interest in participating through pooling fund.

¹⁹ Fiscal year covers July 1-June 30 in Tanzania.

As mentioned in the previous chapter, Tanzania's drive to program aid derives from critical reflection of the past problems with 'stand-alone' projects. There is broad consensus between the government and donors on the importance of building government systems and channeling aid to priority sector reform by using program aid.

The current PRSP, formulated in October 2000, identifies seven priority sectors (education, health, water, agriculture, roads, judiciary, and HIV/AIDS) and envisages increased budget allocation in these sectors. Education, especially primary education, enjoys strong donor support.

Primary education is a good example where a strong link between PRBS/PRSC and SWAp has been established in terms of supporting PRSP and budget priorities and financing sector programs. The Ministry of Education and Culture (MOEC) formulated the Primary Education Development Plan (PEDP), which was endorsed by donors in July 2001. PEDP aims at improving education quality, expanding school access, and increasing school retention at the primary level—through measures to increase and improve resource availability, allocation and utilization, and to improve educational inputs, and to strengthen institutional arrangements for effective primary education delivery.²⁰ Donor support to PEDP started in January 2002 (school year) through SBS and multi-donor pooling fund. More than 95 percent of the PEDP budget is recurrent expenditure, which is funded by general revenue, GBS, HIPC fund (savings from debt relief), and donor support via SBS and pooling fund. More recently, there is a sign that some pool-funding donors (e.g., UK DFID) are channeling their funding increasingly through GBS.

While it is too early to assess the effectiveness of PEDP, the joint sector review (covering the period of January 2002- June 2003) shows the following progress:²¹

- School enrollment of the first year increased 43 percent in 2002, compared to the previous year. Textbook distribution has been expanded through the use of a capitation grant.
- There are clearer functional responsibilities among MOEC, the Ministry of Regional Administration and Local Government, the offices of local governments, and schools, which should facilitate the implementation of PEDP.

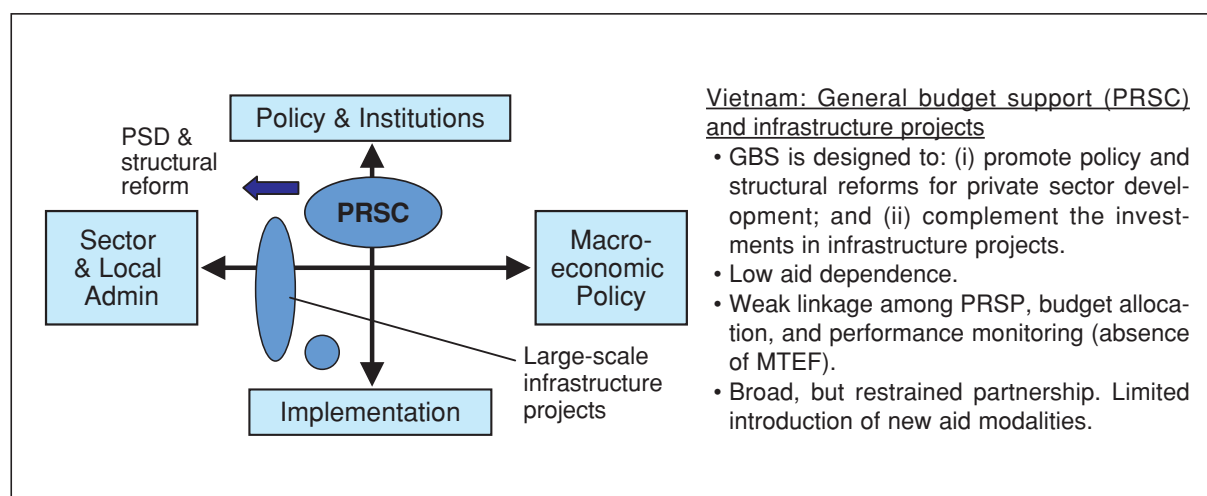
Vietnam: Promoting Private Sector Development through GBS and Large-scale Infrastructure Projects

Poverty Reduction Support Credit (PRSC III), approved by the World Bank Executive Board in July 2004, is the third in a series of PRSCs. It seeks to implement reforms envisaged in the Comprehensive Poverty Reduction and Growth Strategy (CPRGS) completed in May 2002 and updated in the Annual Progress Report of December 2003. PRSC III intends to deepen the reforms supported by the first two PRSCs, particularly in the areas of trade, finance, state-owned enterprise (SOE) reforms, investment

²⁰ Tanzania Primary Education Development Program (PEDP), PID by the African Regional Office, World Bank, August 2001.

²¹ The PEDP experiences are so recent that it is premature to make impact assessment. Furthermore, there are other factors that can affect PEDP performance, including the introduction of free compulsory education in 2002.

climate, infrastructure development, and so on. In other words, it supports the Vietnamese government's externally oriented growth strategy.



Vietnam's PRSCs differ from Tanzania's PRBS/PRSC (and its equivalents in sub-Saharan Africa) in two ways. First, it has stronger focus on private sector development than that of Tanzania. The latter has concentration on budget management and public sector governance issues. In Vietnam, private sector development and transition are mutually reinforcing, and these are priority policy and structural reforms. While Vietnam's PRSC III also includes the conditionalities on budget management and governance issues, their role is much smaller than those of Sub-Saharan Africa.²² Thanks to the country's relatively low aid dependency, the transfer of budgetary resources to the treasury itself is not the prime objective of PRSCs. More specifically, Japan pledged to support PRSC III through cofinancing of the World Bank loans, together with other bilateral donors. Some of the conditionalities on investment climate are based on policy inputs derived from high-level business dialogue involving Japanese investors. There has been close policy dialogue among the Vietnamese government, the World Bank, and the Japanese government.

Second, Vietnam's PRSC III addresses measures to enhance the effectiveness of infrastructure development, which receives significant donor support mainly in the form of project aid.²³ For example, the Vietnamese government expanded the original CPRGS in November 2003, in order to make the role of large-scale infrastructure more explicit in promoting growth and poverty reduction. The CPRGS expansion involved intensive discussions between donors and the government on complementary measures to make infrastructure investment effective, such as the enabling business environment, investment planning to balance recurrent and operations and maintenance budget, environmental and social concerns, and so on.²⁴ The conditionalities included in PRSC III are consistent with these discussions at the time of the CPRGS expansion.

²² Ozeki [2004] makes an interesting comparison of PRSCs between Vietnam and Ghana, stating that Vietnam's PRSC III places greater emphasis on private sector development than public financial management.

²³ According to UNDP ODA survey, about 50 percent of the total ODA was devoted to major infrastructure in 2002 (e.g., transport, energy, water and sanitation, urban development).

²⁴ See GRIPS Development Forum [2003] on the CPRGS expansion and the role of large-scale infrastructure in poverty reduction.

Box 4-1 How can Growth Promotion and PSD Fit into DPM? : A Case of Vietnam

As part of consultation process in finalizing this report, GRIPS-affiliated Vietnam Development Forum (VDF) organized a workshop in Hanoi in early December 2004. A most debated issue at the workshop was how growth agenda and PSD strategy can fit into DPM. Many participants noted that DPM is a useful tool to consider the role of aid in the development activities that fall on the public sector domain. This is so especially where the expansion of basic social services is national priority. At the same time, they suggested that DPM be adjusted to capture a range of Vietnam's priorities, which cannot be addressed simply through coordination and resource transfer within the public sector domain. Vietnam's development needs are quite diverse and include many growth agenda, such as FDI promotion, industrial development, SOE reforms and PSD. It already has a functioning network of basic social services; and even social needs are more complex, such as rising income gaps, environmental problems and political pluralism ("growth pains"). Currently, the Vietnamese government is faced with a challenge of improving coordination capacity among the different levels of the government and between the government and various stakeholders that go beyond the public sector domain.

Source: Minutes of VDF workshop in Hanoi, December 8, 2004 (see <http://www.vdf.org.vn/WS/workshop.html>)

4-2 Pragmatic and Flexible SWApS to Improve Aid Relationship at the Sector Level: Cambodia

Improving aid relationship toward greater country ownership is one of the primary concerns to the government of Cambodia. Faced with serious capacity constraints, the Cambodian government recognizes potential merits of program aid in reducing transaction costs and increasing policy coherence.

In this regard, it is notable that the Cambodian government has adopted a pragmatic and flexible strategy in pursuing program aid in education and health—which is called “Sector-Wide Approach (SWAp)” and “Sector-Wide Management (SWiM)” respectively. This is because the government has recognized: (i) the internal constraints faced by donors themselves; and (ii) that excessive restriction of flexibility in the program design may lead to the exclusion of potentially interested donors and the lower level of resource mobilization. Thus, while pushing ahead with the implementation of program aid in education and health, the government has left the choice of the participation modality to donors, within the overall agreed framework.²⁵ Cambodia's experiences with SWAp (education) and SWiM (health) show that: (i) even in the same type of modality, various approaches exist to promote policy and procedural harmonization among donors; and (ii) pragmatism and flexibility are important to fully exploit merits of program aid.

²⁵ Cambodia Position Paper, DAC Task Force on Donor Practices (October 7, 2002).

Education SWAp

In 1999, the Ministry of Education, Youth and Sport (MOEYS) introduced the concept of SWAp for national education reforms. This was a reaction to rectify unsatisfactory progress of massive donor assistance (totaling US\$224 million in 1994-99)—largely attributable to the lack of an integrated policy framework and the proliferation of discreet and ill-coordinated donor-funded projects.²⁶ The MOEYS developed a SWAp process in which a wide range of stakeholders could participate, including an Education Strategic Plan (ESP) and a rolling Education Sector Support Program (ESSP). A number of aid modalities, including budget support and project-support, have been accepted to ensure the participation of a broad range of donors. The MOEYS, donors and NGOs jointly reviewed the performance of the education sector in 2002 and 2003.

The recent study notes the following improvements in managerial aspects of aid coordination after the introduction of SWAp.

Criteria	Indicative Evidence
Local ownership	<ul style="list-style-type: none"> • High level of commitment by top senior officials • Willingness to direct donors to country needs • Enhanced confidence and leadership
Capacity development	<ul style="list-style-type: none"> • Positive changes in attitude toward ESSP joint review • Officials lead the drafting of documents in English
Overlap of donor assistance	<ul style="list-style-type: none"> • Reduced overlaps through improved information about donor assistance (a comprehensive list of donor assistance and Aid Management Information System)
Transaction costs to the government	<ul style="list-style-type: none"> • Reduced transaction costs to the government (resulting from better coordination among donors through Education Sector Working Group and NGOs through NGO Education Partnership, respectively)
Sustainability of aid coordination	<ul style="list-style-type: none"> • Enhanced institutional capacity at MOEYS (through ESP/ESSP development and joint review process)

Source: PPT presentation by Toshiyasu Kato, IC Net Ltd., “Education SWAp in Cambodia” at the LENPA Forum on PBA in Asia, June 2004.

Health SWiM

In March 1999, the Ministry of Health (MOH) developed a document entitled *Step by Step to a SWAp: Action Plan for 1999 and 2000*, which foresees the gradual introduction of the SWAp process. However, the results of the stakeholder analysis indicated that each donor had different views and positions on their support to SWAp (with some donors reluctant to support a pooling fund generally associated with ‘SWAp’). Various options were discussed, and by mid-2000 the MOH decided to adopt Sector-

²⁶ Education for All (EFA): The Year 2000 Assessment: Country Report, cited from [Govt.-Donor PWG 2004].

Wide Management (SWiM) to allow for the participation of all the key donors. The MOH also proposed developing a Sector-Wide Master Plan (Health Sector Strategic Plan 2003-2007, or HSP) and a MTEF under SWiM. The principle of SWiM is in line with that of SWAp, but the key difference between them is that SWiM does not require budget support or pooling fund. The first joint sector review was held in April 2003.

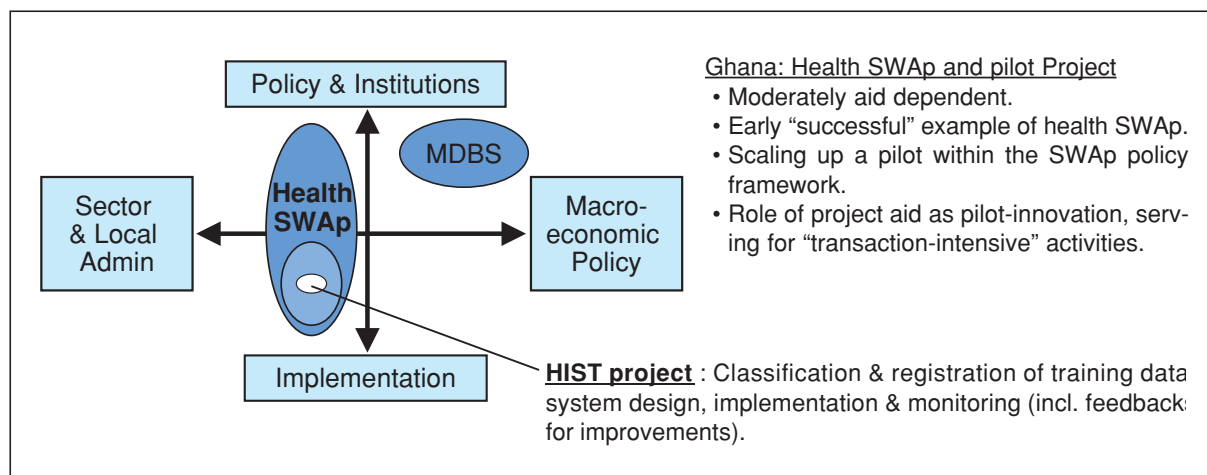
The recent study finds some improvements in managerial aspects of aid coordination after the introduction of SWiM. More importantly, it is fair to say that the development of SWiM capacity in the MOH is the reason for—and an outcome of—strengthening partnerships in the health sector. Its design process has opened dialogue among the MOH, various MOH-affiliated technical institutions, and donors. [Govt.-Donor PWG 2004]

Criteria	Indicative Evidence
Local ownership	<ul style="list-style-type: none"> • High level of commitment by top senior officials • Better understanding of HSP and readiness to implement HSP as their own strategic plan • Enhanced ownership of HSP at provincial and operational district offices
Capacity development	<ul style="list-style-type: none"> • Joint activities perceived by many as a capacity building process for MOH officials (but, it is too early to draw conclusions on the impact of capacity building)
Overlap of donor assistance	<ul style="list-style-type: none"> • Reduced overlaps through improved information on donor assistance around HSP, at Health Sector Partners Meeting (although this has primarily served as a forum among donors)
Transaction costs to the government	<ul style="list-style-type: none"> • Limited evidence in the reduction of MOH administrative burdens, although there is a potential for reduction if the current aid coordination mechanisms (e.g., joint planning and reviews) continue.
Sustainability of aid coordination	<ul style="list-style-type: none"> • HSP serving as the basis to enhance the sector-wide management capacity of MOH, a first step towards the development of a sustainable government system for coordinating aid in the health sector.

Source: Elaborated by the authors based on Govt.-Donor PWG [2004].

4-3 Project Aid in the Two Different Country Context: Ghana vs. Vietnam (“with” and “without” the SWAp Policy Framework)

Ghana: Scaling up a Pilot Project to Improve the System-wide Efficiency within a SWAp Policy Framework²⁷



Ghana's Sector-Wide Approach for health development is considered one of the most successful, early SWAp arrangements. The vision and strategies for the health sector development were defined in 1996 in a Medium-Term Health Strategy. These orientations were translated into the 1997-2001 Program of Work (POW-I) of the Ministry of Health (MOH). In 2001, in line with the Ghana Poverty Reduction Strategy, MOH developed a 2002-2005 POW (POW-II). The five-year POW uses performance data to assess progress, defines sector policy, and allocates resources based on the financial management system. The JICA-supported TA, Health In-Service Training System (HIST) Project, is a good example of project aid, which performed experimental functions and was subsequently expanded within the five-year POW framework.

The HIST Project aimed at the development of healthcare human resources in Ghana through developing, introducing, and operating an "in-service training (IST) system."²⁸ Prior to the HIST Project, a number of donors and NGOs had been supporting IST activities without coordination. This uncoordinated situation led to such problems as: (i) lack of IST-related information; (ii) poorly planned ISTs; (iii) not (or less) standardized IST contents; (iv) unequal distribution of IST opportunities among health workers; and (v) inappropriate, donor-driven IST contents with limited attention to the needs of local health workers. By taking a systemic approach to data collection, registration and monitoring, the HIST Project addressed the above problems and contributed to improving the efficiency of IST for health workers.

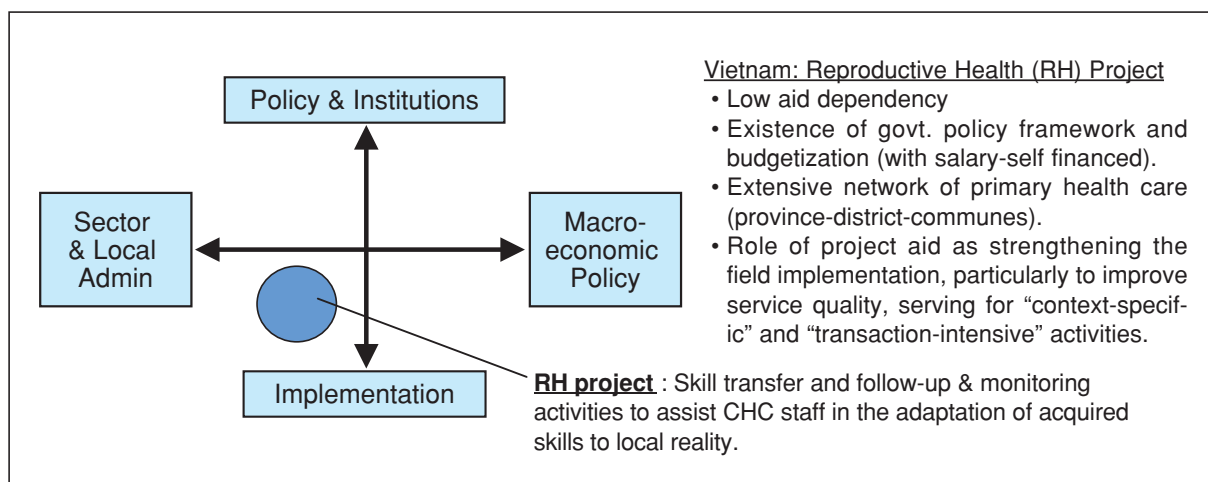
²⁷ This section largely owes to Akiba et al. [2004].

²⁸ In-service training is defined as “training for health workers currently in service that enables them to gain updated professional knowledge, skills and moral necessary for providing local populations with a better quality of health services.” [Akiba et al. 2004]

During 1997-2002, the Project focused on the development of IST system in three pilot regions. Then, the Project was evaluated, and in the follow-up period of 2003, the system was expanded to cover all the 10 regions in Ghana. At the end of the Project, the coverage of IST logbook holders among health workers employed by the MOH reached 59.9 percent. The distribution of IST opportunities in the three pilot regions became more equal (with the ratio of IST repeaters in a year dropping from 63 percent in 2002 to 29 percent in 2003). The planning and review of IST contents have been progressing according to the IST official classification. These facts suggest efficiency improvement of IST in Ghana, through systemic approach taken by the Project.

More specifically, four components were developed under the system: (i) IST official classification systems; (ii) IST information system; (iii) IST logbook; and (iv) IST monitoring system. All the system components were developed through: (i) scrutinizing the needs at district, regional and national levels; (ii) designing a system to meet these needs; (iii) frequent feedback for further improving the system; and (iv) building a consensus of all IST-concerned parties in Ghana on each component. These processes were essential to developing a new system that did not exist in other countries, even in Japan. Furthermore, they are transaction-intensive activities, requiring constant testing, monitoring and feedback of the results. Thus, the HIST Project can be considered an example where the merits of project aid has been fully utilized.

Vietnam: Supporting Field Implementation by Using Project Aid to Address the Context-specific, Heterogeneous Demand of Beneficiaries



The JICA-supported TA, Vietnam Reproductive Health (RH) Project in Nghe An Province, offers a good example of how project aid can effectively support the field implementation (i.e., the fourth quadrant of the DPM). At the same time, it clarifies country-specific, complementary factors that have made the project approach function: (i) the existence of primary health care networks; and (ii) the existence of the government's RH policy framework.

The Project started in 1997, with the objective of improving the reproductive health situation in Nghe An province. It takes an integrated approach encompassing the facility improvement of Community Health Centers (CHCs), training of CHC staff, and the strengthening of IEC (information, education

and communication) through local organizations. The Project covered 244 communes in 8 districts in the phase I and has been expanded to include all 469 communes in 19 districts in the phase II (ongoing).

The Project is designed to transfer two types of skills from a group of Japanese experts to the Vietnamese professionals: (i) medical skills, and (ii) capacity for disseminating and utilizing the acquired medical skills by adapting to local reality. The success of the latter depends on whether there exists an institutional framework for disseminating medical skills, and whether CHC staff can perform well by applying the newly obtained skills.

The Project has adopted a cascade-type knowledge dissemination framework, with the Maternal and Child Health/Family Planning Center (MCH/FP) in the capital of Nghe An Province acting as the counterpart and the base to support CHCs, either directly or through District Hospital (DH). Establishing an institutional framework itself is not an easy task; but capacity development of CHC staff (e.g., midwives) is also essential to enable them to discharge the expected functions. Therefore, special efforts have been made by the national counterpart at the MCH/FP Center and Japanese experts to train midwives assigned to CHCs and conduct post-training "monitoring" activities so that the midwives can practice the acquired skills in the local context.

The vital importance of the post-training "monitoring" of midwives is stressed by a Japanese expert as follows: *"Traditionally, in the Vietnamese context, monitoring tends to mean 'giving instructions.' But, this is not a kind of monitoring we intend. Monitoring is a skill to support the self-learning process. The midwives who have received training always face the difficulty of how to apply the acquired skills in the complex reality. The important thing is to reflect this experience in their next practice. As post-training 'monitoring' activities, we visit CHCs frequently to go through this process together with midwives and help them start the self-learning process. Normally, midwives at CHCs must work in the environment isolated from professional stimuli. Our visits intend to motivate them to break up this isolation."* The number of communes visited by this expert amounted to 137 in the phase I and 70 in the phase II (as of June 2003). DH staff accompanied her visits as part of on-the-job training of "monitoring" skills. Recently, representatives of community organizations and the MCH/FP staff started to accompany their visits, too.

Donors can support the establishment of a knowledge dissemination framework through interventions at the second quadrant of DPM. However, such a framework will work only when individual staffs are equipped with the capacity for properly performing respective functions. To this end, intensive transactions among foreign experts, national counterpart (MCH/FP personnel), DH and CHC staff are necessary. Also, these interventions can be made, with due attention to the local context and specific demand of beneficiaries. This is why the project approach has proven effective in this case.

Nevertheless, we should recognize that at least two complementary factors have contributed to the successful implementation of this Project. First, as an important pre-condition, the Project could rely on the existing primary health networks in Vietnam. CHCs were located at almost all communes from the beginning of the Project, and since 1995 staff salaries have been covered by the national budget. So, there were little problems with staff attendance with training, and the Project could purely seek to

stimulate their professional motivation rather than a financial one. However, under the situations where such basic service networks do not exist, it is unlikely that project interventions would work.

Second, there exists a policy framework for reflecting the project experiences at the higher, upstream level (e.g., the second quadrant of DPM). In 2001 the Ministry of Health formulated the Master Plan of Reproductive Health and now intends to prepare its action plan. As a pilot experience, this Project can provide valuable information on reality, including what works and what does not. It is important to widely share such experiences and examine their policy implications in Vietnam.

5 Practicing Good Donorship Towards Effective Aid

The case analyses in the previous chapter confirm that there exist various ways of addressing country priorities and aid relationships—even within the same modality and regardless of modality choice. Thus, "good donorship" requires different approaches to different countries. Based on this understanding, this chapter shows selected examples of the recent donor effort to practice "good donorship" through GBS, SWAp, and project aid. Although these are only part of many examples, we consider that they can provide useful information on how to: (i) integrate aid flows into recipient budget process (Tanzania); (ii) promote simplification and harmonization of aid procedures for both GBS and project aid (Ghana and Vietnam); and (iii) design SWAp based on realistic assessment of local capacity (Bangladesh).

5-1 Integration of Aid Flows into Recipient's Budget Process: Tanzania

Tanzania Assistance Strategy (TAS)

Improving the predictability, transparency and accountability of aid flows and strengthening the government capacity for integrating projected and actual (disbursed) flows in the budget process are essential elements of "good donorship" principles. While GBS is often regarded as the modality to realize these benefits, it is possible to design a framework and procedures to accommodate project aid and other modalities in the national budget process. The Action Plan of Tanzania Assistance Strategy (TAS), published in January 2003, offers a framework for promoting the budgetization of aid channeled through various modalities—including project aid directly implemented by government agencies. This framework covers both the formulation and execution stages of the budget and promotes the alignment of aid flows with the national budget process.

The TAS exercise can be considered a good practice in the highly-aid dependent context, where external resources occupy significant proportion of the government budget and are hardly captured. Nevertheless, it is important to note that the framework and procedures applied here are a part of the joint efforts in Tanzania toward improving aid relationship that had begun in mid-1990s, as described in Chapter 3.

(1) Budget formulation

By the end of October every year, donors are required to report to MOF the amount of: (i) their aid commitments for the next year; and (ii) their projected disbursements in the subsequent two years. Based on donor reports, MOF allocates the funds into development and recurrent budgets and integrates them into MTEF and annual budget plan. This exercise contributes to improving the predictability of aid flows and strengthening the integrity between domestic and external resources.

(2) Budget execution

Donors are strongly encouraged to use the government's Exchequer system (i.e., Treasury) when they disburse aid money.²⁹ In case donors provide financial and material resources directly to projects charged by line ministries or local governments (so called "D-fund [Direct Fund]), the Dummy Exchequer Issue Notification should be prepared. Although the Tanzanian government prefers the direct use of the Exchequer system, this dummy voucher arrangement makes it possible to capture D-funds (in other words, in-kinds type of project aid) in the budget system. It is expected that the integration of aid into the Exchequer system would improve the transparency of aid flows and strengthen the domestic accountability of aid money.

Donors must report their compliance with these procedures to the TAS Secretariat established in MOF, which is charged with monitoring the entire implementation process of the TAS Action Plan. The TAS Secretariat regards the procedural compliance as one of the measurements of good donorship.

5-2 Simplification and Harmonization of Aid Procedures: Ghana and Vietnam

Ghana MDBS and PRSC: Harmonization of Multilateral and Bilateral GBS Frameworks

By definition, GBS is a form of aid to use the government systems with the intention to strengthen the government's policy framework. But, there exists room for further synchronizing the frameworks for two types of GBS—(i) bilaterally-supported, Multi-Donor Budget Support (MDBS) and (ii) the World Bank-supported PRSC. The recent agreement on a common policy framework for MDBS 2005 and future PRSC III in Ghana offers an example in this regard.³⁰ This includes the preparation of a joint policy matrix as the basis of dialogue for programmed reforms between Ghana's major partners, the utilization of common review meetings, and joint planning for the use of aid flows as well as joint monitoring and assessment. (An exception is the number and timing of tranches, which are yet to be harmonized. While MDBS expects two disbursements in a year, PRSC will disburse in one tranche.)

The core of this synchronized MDBS/PRSC framework includes the review and appraisal sessions. There will be a minimum of two such sessions per year, and the timing of these sessions will be linked to the Ghanaian budgetary and policy cycle. It is envisaged that by 2006 all bilateral and multilateral donors are able to follow these cycles as far as programmatic aid is concerned. [World Bank 2004c] Under this synchronized framework, same performance indicators will be used. These should lead to significant gains in human resource use and the critical element of time saving. Moreover, the quarterly mini-Consultative Group meetings, chaired by the Minister of Finance and Economic Planning, serve as a platform to inform all donors of the progress made in economic and monetary terms and of policy dialogue.³¹

²⁹ Based on a note prepared by Accountant General, for the Tanzania DAC in November 2001.

³⁰ Currently, there are nine partners involved in MDBS. These are the African Development Bank, Canada, Denmark, Germany, European Union, the Netherlands, Switzerland, United Kingdom and the World Bank. France also plans to participate in MDBS.

³¹ At the same time, there is increased recognition that further work would be needed to better align the MDBS/PRSC with the sector review process.

Vietnam's Procedural Harmonization of Project Aid under the Government-led Common Framework: 5 Banks Group, LMDG, EU, and UN

In Vietnam, Decree 17-CP, promulgated in May 2001, lays the foundation for all the harmonization efforts. The decree established a common framework for ODA-related procedures and regulations. More recently, the government elaborated an *Action Plan on Simplification and Harmonization of ODA Procedures* (December 2003). What is notable about this Action Plan is the pragmatic approach taken by the Vietnamese government. The government is encouraging the donor community, by donor group, to simplify and harmonize respective procedures.

More specifically, four different donor groups (with similar aid schemes) are working to simplify and harmonize respective procedures, guided by a common and coordinated framework established by the Vietnamese government. Their work is focused on timing and documentation formats used in the different stages of the project cycle. The groups include: (i) 5 Development Banks (the World Bank, ADB, JBIC, KfW, and AFD); (ii) Like-minded Donor Group (LMDG consisting of Canada, Denmark, Finland, Germany, Netherlands, Norway, Sweden, Switzerland and UK); (iii) UN systems (UNDP, UNICEF, and UNFPA); and (iv) EU (Member States and the European Commission). In addition, bilateral effort is underway between the Japanese government and MPI, focusing on Japan's grant aid and technical assistance, to address the selected issues identified by the JICA-commissioned study on transaction costs of aid delivery.

In particular, since loan aid accounts for 80 percent of aid commitment in Vietnam (two-thirds on a disbursement basis),³² procedural harmonization among 5 Bank Group should significantly improve the efficiency of aid delivery. In May 2002, the World Bank, the ADB, and JBIC (Japan) agreed on a joint statement to harmonize the areas of procurement, financial management, environmental and resettlement issues. This was joined by KfW (Germany) and AFD (France) in 2003. The coverage of harmonization efforts by the 5 Bank Group centers around the five agreed priorities: (i) project preparation practices and procedures; (ii) procurement process; (iii) financial management; (iv) environmental and social safeguard policies and practices; and (v) portfolio management. In May 2003, the 5 Bank Group, in collaboration with the MPI, held a Joint Portfolio Performance Review.

5-3 Consideration to Local Capacity, Needs, and Aid Relationship: Bangladesh

Designing SWApS based on the Realistic Assessment of Local Capacity and Harmonizing Donor Aid Procedures: Bangladesh Health and Primary Education SWApS

Bangladesh offers valuable lessons of how the design matters for SWApS to achieve the expected impacts. In 1997, the country launched the Health and Population Sector Program (HPSP) for the period of 1998-2003. Despite its good intention to increase the range, coverage, quality and effectiveness of MCH care services, HPSP encountered difficulties at the implementation stage. This is partly

³² Cumulative figure during 1993-end of 3rd quarter of 2003. (MPI data presented at the 2003 CG Meeting).

because HPSP was the first SWAp in Bangladesh involving a pooling fund and also one of the early SWAp arrangements elsewhere. Until recently donor support for basic education took the form of project aid, including the Primary Education Development Plan (PEDP I); but in order to improve education quality and policy coherence, the government has decided to adopt SWAp in PEDP II for the period of 2003/04-2007/08 and introduce a pooling fund.³³ The lessons learned from HPSP have been incorporated into PEDP II operations.

The January 2003 Annual Program Review (APR) Technical Report concluded that there had been little progress on the HPSP reform agenda even four and half years into the program. [HPSO 2003] The existing literature also notes problems associated with the SWAp design, in particular: (i) ambitious and politically sensitive reform, such as the unification of two separate directorates of the Ministry of Health and Family Welfare (MOHFW) and that of services of health and family planning personnel working at Upazila (sub-district) and below levels, which led to resistance to the program; and (ii) rapid transition from project-based to sector-wide management, and the resultant concentration of administrative burden on a few units in MOHFW. In particular, there were problems with the synchronization between procurement and logistical systems in health services.³⁴

SWAps sometimes seek not only better aid coordination, but also policy and institutional reforms. In HPSP, the unification of two different services was not accompanied by a realistic implementation plan. The introduction of a pooling fund, together with radical changes in logistic functions, led to the concentration of heavy procurement burdens on Central Medical Stores Depot (and its equivalents of the lower levels) of MOHFW. Previously, these functions had been also assumed by different units and donors (in the case of "in-kinds" type project aid). These experiences underscore the importance of designing SWAps based on the realistic assessment of local capacity and readiness for reforms and supporting capacity development, if necessary. Otherwise, the simple transition from project-based to sector-wide management may not necessarily lead to positive changes.

(1) Realistic assessment of local capacity

Based on the above lessons, PEDP II has deliberately avoided radical institutional changes. Line-divisions have been made responsible for the execution of a pooling fund and national budget, and the Primary Education Directorate (i.e., the executing agency) will integrate the program's activities to the greatest extent possible within its regular administrative structure. To cope with extra managerial burdens, additional staffs are hired in each line division (often recruiting those with project management experience), and a new unit (Program Coordination Unit, not a Program Implementation Unit) charged with procurement and financial management has been established. Furthermore, at program inception, institutional assessment is to be conducted to identify specific needs and approaches to capacity development of the Directorate, and TA will be provided to support the establishment of an appropriate

³³ PEDP II became effective in April 2004. The Directorate of Primary Education in the Ministry of Primary and Mass Education is the executing agency.

³⁴ The APR 1999-2000 (by MOHFW, 2000) identified procurement as the most critical program support issue. The Independent technical report on HPSP also observed that the capacity building in logistics and procurement was below expectation [See also Iftekhar and Rahman].

chart of accounts, accounting and internal control guidelines and procedures, and strengthening of the accounting and internal control functions with the line ministry.³⁵

(2) Donor coordination mechanism within the Program Support to facilitate the transition phase from project to program mode

A unique aspect of PEDP II is the establishment of a Program Liaison Unit (PLU) aimed at donor coordination and aid harmonization. PLU is expected to support a consortium of the 11 donors participating in PEDP II, by managing intra-donor communication and linking the consortium (as a group) to the Program Coordination Unit within the Directorate in the process of policy dialogue and monitoring.³⁶ The head of PLU is the Bangladesh nationality with extensive professional career at the government and international organizations. Thus, PLU would serve as a mechanism for alleviating start-up transaction costs associated with SWAp, by building consensus among donors, and facilitating donor understanding of the local context, and channeling "harmonized" donor requests to the Bangladesh side.³⁷

³⁵ Based on interviews conducted by authors in June 2004. Also, see "Program Based Approaches to Formal Primary Education in Bangladesh," presentation materials at LENPA Forum on PBA in Asia, Tokyo, June 2004.

³⁶ The lead donor is the ADB and other members include: AusAID, CIDA, DFID, EU, JICA, Netherlands, Norway, SIDA, UNICEF and the World Bank. There are eight pooling donors.

³⁷ The PLU head considers its role "honest broker" and stresses that in moving to a programmatic approach, donors should: (i) not confront but accompany the challenges faced by the government; (ii) utilize to the greatest extent local officials, as there are enough capable persons; and (iii) not enter into micro management, once agreed on the overall direction of reform. (Based on our interview in June 2004.)

6 Implications for Global and Japan's Aid Policies

The final chapter will summarize key findings of the previous analyses. It will also draw implications for Japan's aid policy, particularly how Japan could better practice its aid modalities.

6-1 Key Findings Relevant to Global Aid Policy

Throughout this paper, we have argued the need to broaden the current modality debates, in order to accommodate a wider-spectrum of countries. Our proposed framework—the Development Priority Matrix (DPM) and the two prototypes of ownership and capacity—is a modest attempt in this endeavor.

A key conclusion of this paper is that: (i) contextual differences matter for the choice of aid modalities, which in turn could affect aid effectiveness; and (ii) it is important to match aid with country needs and ownership. It is not productive to debate which aid modality is superior over the others. The more important issue is to understand the features of respective aid modalities and apply (or combine) right ones, with due consideration to the country- and sector-specific circumstances. In doing so, donors should make maximum efforts to match aid with recipients' development priorities and ownership, sharing the overall policy and institutional framework. Donors may also wish to decide their interventions in light of comparative advantages, so that respective interventions can be mutually complementary.

Our case analyses reveal that there exist various ways of addressing country priorities and aid relationships. For example, the comparison between Tanzania and Vietnam shows how GBS can play different roles, according to distinct country needs. The case of Cambodia shows that alternative approaches can be explored within SWAp and that the benefits accrue when flexibility is provided in the program design. The comparison between Ghana and Vietnam (the health sector) illustrates how project aid can work in the different context—with the former as integral part of SWAp and the latter without SWAp, but within the government's existing policy, budget, and institutional frameworks. These two cases also confirm the complementarities between project and program aid. For example, the case of Ghana suggests that project aid can perform strategic and pilot functions, if properly integrated into the programmatic framework. The case of Vietnam's RH Project shows the role of project aid in supporting the field implementation by addressing context-specific, heterogeneous needs of beneficiaries.

Good donorship requires different approaches to different countries. There are a number of ways to enhance aid effectiveness—not only by shifting aid modality from one to the other, but also by improving the design and application of respective modalities themselves. Recognizing that there are a set of "good donorship" principles based on the lessons from past aid, donors should make serious efforts to improve their aid practice and the existing modalities along such principles.

For example, Tanzania's TAS suggests that it is possible to design a framework and procedures to accommodate project aid (including off-budget projects) and other modalities in the national budget

process. Vietnam offers an interesting example of harmonization of project aid, where different donor groups (with similar aid schemes) are working to simplify and harmonize respective procedures, guided by the government-led common framework. The case of Ghana shows that even if adopting GBS, donors must make efforts to harmonize policy and procedural aspects between bilateral and multilateral frameworks (PRSC and MDBS). And Bangladesh's SWAp experiences give hard lessons that simple modality shift is not enough, or can even be detrimental if proceeded too quickly without careful preparation. It is important to design SWAp, based on a realistic assessment of local capacity.

Lastly, we would like to stress that further work is needed to refine our proposed framework for the choice of aid modalities, particularly by addressing the following questions:

- How can the private sector issues—particularly the growth agenda and PSD—be better incorporated in the modality debates and our framework?; and
- What is the role of aid modalities in supporting the strengthening of local capacity for policy formulation (such as development scenario and strategies), without jeopardizing recipient ownership?, What is the nature of policy dialogue so that capacity development and fostering ownership can go hand in hand?

These questions merit due attention, especially when many PRSPs have entered into the second generation in the post-HIPC era; and not few countries including sub-Saharan Africa, have expressed their intention to make their PRSPs more growth-oriented. Also, they are the questions raised by less-aid dependent, Asian countries, since the beginning of PRSP. In the long run, recipient countries should lower aid dependency and graduate from aid ("aid exit") in order to achieve real ownership. This is only possible through sustainable growth, and it is important that the current modality debates take account of such fundamental issues.

6-2 Implications for Japan's Aid Policy and the Choice of Aid Modalities

In Japan, project aid is a dominant mode of aid delivery. Japan's aid consists of three types of schematic cooperation: (i) grant aid; (ii) loan aid; and (iii) technical assistance.³⁸ Financial aid covers (i) and (ii), and these can serve as non-project aid, too. Non-project aid accounts for 17-20 percent of its bilateral ODA, which can be used for GBS, sector budget support, and pooling fund under the programmatic framework. [MOFA 2004] Furthermore, in early 2004, the Ministry of Foreign Affairs (MOFA) adopted a measure to make the proceeds of non-project, grant aid more easily available for budget support. (Japan's contribution to Tanzania's PRBS is its first application.)

In Japan, aid policy planning and implementation are fragmented. While the MOFA is responsible for overall aid policy planning and exclusively charged with grant aid, the Ministry of Finance (MOF) plays an important role in policies for loan aid and multilateral development banks and IMF. The Min-

³⁸ Regarding procurement, direct contract method is employed for grant aid and technical assistance (procured by the Japanese agencies without disbursements to recipients), while indirect contract method is used for loan aid (procured by recipients according to the agreed procurement guidelines, and also disbursed into the accounts held by recipients.)

istry of Economy, Trade and Industry (METI) is also involved in policies for loan aid and technical assistance. Furthermore, aid implementation is dispersed to different agencies by scheme (with MOFA responsible for grant aid, JBIC for loan aid, and JICA for technical assistance etc.). Because of such institutional fragmentation, achieving the right aid mix consistent with the country- and sector-specific context requires extensive inter-institutional coordination.

Nevertheless, recent years have seen notable developments for ODA reform. These include: (i) the establishment of the Board on Comprehensive ODA Strategy (which aims at strengthening strategic functions of the MOFA and serves as advisory board for the Minister); (ii) the formulation of the new ODA charter; (iii) the establishment of a field-based, planning and coordination mechanism, called "ODA Task Force" (comprised of the Embassy of Japan, JICA, JBIC, and JETRO offices where relevant); and (iv) the formulation of country assistance strategies in selected countries, led by the field-based "ODA Task Force," and so on. In particular, (iii) and (iv) are vital mechanisms for achieving the right aid mix across schemes and integrating aid into the recipient's policy and institutional framework. Thus, it is important to consider how to link the emerging issues on aid modalities to the ongoing ODA reforms.

As the first step, Japan should clarify its policy on the use of different aid modalities, recognizing its comparative advantages and the lessons learned from the past. The June 2004 statement by a senior official of the MOFA (at the occasion of the LENPA Forum on PBA in Asia) is a good start. The MOFA statement clarified Japan's interpretation of the program-based approach and its basic stance of promoting the program-based approach, while allowing for a variety of modalities in a coordinated framework [See Box 6-1]. But, further details and strategic direction must be given to the field-based, "ODA Task Force," which assumes prime responsibility for the formulation of country assistance strategy, operational planning, and partnership activities in recipient countries. In this regard, we suggest that the Japanese government seriously consider issuing a policy paper on the use of aid modalities.

Box 6-1 Japan's Stance towards Program Approaches

...Japan defines Program Based Approaches as an aggregate of activities and policies leading to the comprehensive and coordinated planning and implementation of activities under the ownership of the partner governments. Japan believes that in the program approach, a variety of modalities, each having different advantages and disadvantages, should be made available to meet the various development needs in different sectors and countries. It is important to distinguish between stand-alone projects and those that are integrated in the national or sectoral development programs. Program assistance accompanied with the necessary capacity building would increase the absorptive capacity of partner countries. The most important point is whether the various types of assistance provided by different donors are appropriately coordinated in the program implementation and whether the coordination and the aid modalities are well-suited to the recipient government's capacity and needs.

Source: Quoted from "Japan's Experience with ODA and the Position towards PBA," Note prepared for the LENPA Forum on PBA in Asia, Tokyo, June 2004.

As a donor with extensive experiences with project aid, Japan should reinforce its efforts to: (i) maximize the impacts of project aid within the overall policy and institutional framework, by linking project experiences to upstream, strategic vision and supporting the implementation on the ground; and (ii) improve the efficiency and effectiveness of existing project aid, as outlined in "good donorship" principles, by overcoming its weaknesses. As we discussed in this paper, projects can perform certain, vital functions if properly integrated into the programmatic framework. It is important to ensure complementarities and synergetic effects between program and project aid.

Where necessary, Japan may also wish to consider its participation in budget support and pooling funds, in order to: (i) support the process of policy formulation and dialogue; (ii) provide intellectual inputs to the policy content; and (iii) contribute to the transfer of financial resources. The possibility of Japan's participation in budget support should be judged whether and to what extent such participation could enhance the contribution of project aid and deepen the content of policy dialogue.

Lastly, Japan should assess what worked and did not work in its past assistance to East Asia and clarify the underlining factors. Japan's current aid approach is primarily derived from the experiences with its aid to East Asia and its own development. But, we should recognize that significant contextual differences exist between East Asian and sub-Saharan African countries (and even within East Asia). This implies that simple application of Japan's traditional aid approach to Sub-Saharan Africa may not work. At the same time, there is room for further improvements in its aid approach even in the East Asian context, learning from the ongoing aid modality debates. It is important to conduct a candid assessment of Japan's aid approach to East Asia and examine: (i) which aspects can be promoted, or applied for different countries with some modification; and (ii) which aspects should be fundamentally corrected. Such an undertaking should be helpful for Japan to concretize and properly exercise its comparative advantages.

Annexes

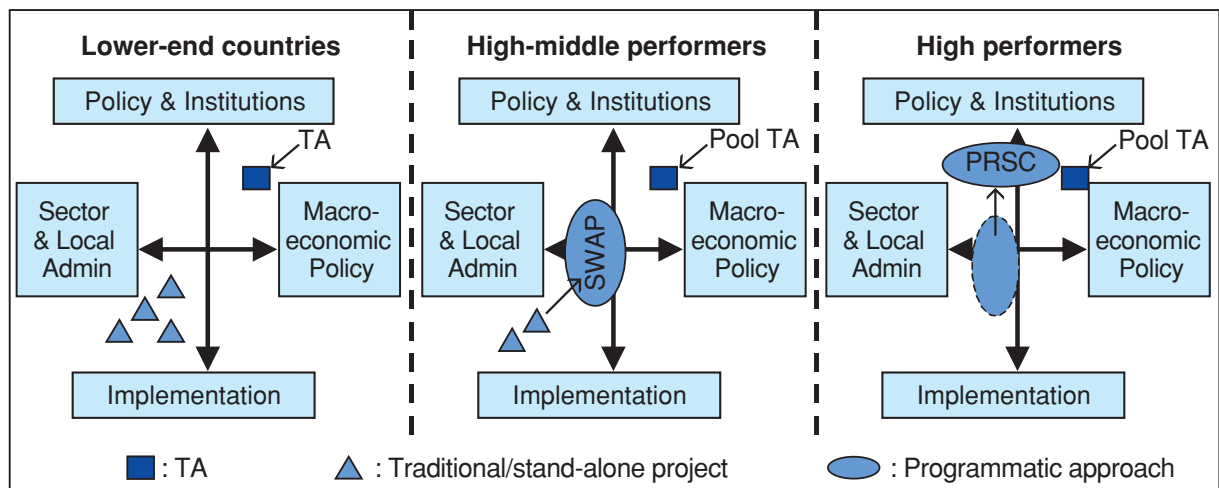
- Annex 1 Donor Policies on the Use of Different Aid Modalities**
- Annex 2 Re-examining Transactions Costs: Conceptual Issues**
- Annex 3 Simplified Logical Framework Analysis of General Budget Support**
- Annex 4 Accountability First, or Capacity First?**

Annex 1 Donor Policies on the Use of Different Aid Modalities

1 World Bank African Region: Emerging Partnership Model

In February 2004, the World Bank's Africa Region published a *Strategic Framework for Assistance to Africa* [World Bank 2004a]. This report proposes the Emerging Partnership Model as a way to improve aid effectiveness and clarifies the IDA's policy to link country performance to aid instruments. More specifically, it seeks to match the absorptive and management capacity of recipient countries to IDA's engagement levels (via aid modalities) as follows:

- Lower-end countries (mostly LICUS): Engagements will be limited, focusing on selected "entry points." Aid instruments will be through modest TA and capacity-building projects (to build a foundation for improved management and greater IDA engagement in the future). As countries progress, this engagement can be supplemented by projects in social sectors and basic infrastructure, health, and education, with the idea of building capacity to move further along the continuum.
- High-middle performers: A gradual shift from 'stand-alone' projects to SWAPs is anticipated, where appropriate. In the social sectors, engagement will shift from 'stand-alone' projects to more SWAPs-helping to coordinate the work of an increasing number of partners. Traditional projects would continue in some areas, e.g., large-scale infrastructure and rural projects, financial sector reform, and private sector development. Rather than a host of TA projects, a unified facility could reduce transaction costs, supporting an agreed program of capacity-building assistance closely tied to the program's objectives.
- High performers: These countries become candidates for programmatic support, such as PRSC. Each PRSC will have a core economic management component, but the sectoral emphasis may both grow and shift over time. As appropriate, sectors can be brought into PRSC (as the policy dialogue on and the support to certain sectors might revert to "maintenance" levels). TA would be provided through a unified facility. The number of separate projects per country would fall, rather than increase. Projects will continue in community-driven development operations, major investments in infrastructure.



The World Bank maintains the array of aid instruments—stand-alone projects, SWAPs, TA projects and pooling facility, and general budget support (PRSC). But, in the context of its assistance to Africa, it expects that there will be a move along the continuum from a project to SWAPs and then to a PRSC, according to a growing degree of confidence in national budget processes, combined with a progressive increase in recipient capacity. PRSC is envisaged as a form of instrument, for countries with superior or higher capacity and performance.

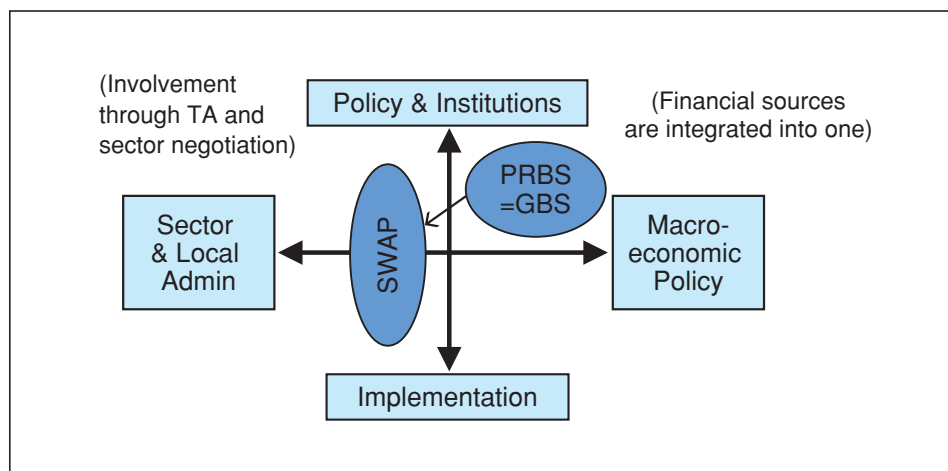
Source: World Bank [2004a].

2 DFID

In May 2004, DFID published a policy paper on Poverty Reduction Budget Support (PRBS), which covers both GBS and SBS. While recognizing that PRBS is one of a range of aid instruments, DFID stresses that PRBS is the instrument most likely to support a relationship between donor and developing countries which will help to build the accountability and capability of the state. This idea is clearly spelled out in UK Government's 2000 White Paper as such: *"The UK Government will work with other donors to channel more of our support through developing country budgetary systems, where governments have a strong commitment to poverty reduction, and help strengthen their planning, financial and procurement systems to make this possible."* [DFID 2000: 98]

The underlying hypothesis is that more predictable funding, together with more sustained and coordinated policy dialogue in support of a PRSP (or similar national development strategy) and a MTEF— together with some targeted technical assistance—might start to make the planning process more meaningful and objective. Budget allocations could in turn be more reliable, transparent and pro-poor. At the same time, the policy paper recognizes that PRBS is more relevant in the countries with high aid dependence than those with low aid dependence.

(African Region)



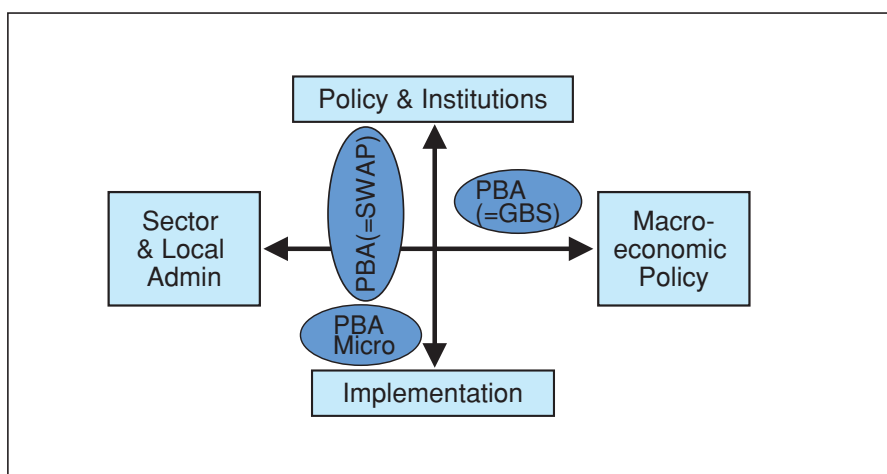
Source: DFID [2004]

3. CIDA

In September 2002, CIDA published the document, *Canada Making a Difference in the World: A Policy Statement on Strengthening Aid Effectiveness*. This document states CIDA's policy shift to increased use of "program-based approaches" (PBAs), in contrast to its traditional reliance on projects as a way of engaging in development cooperation. This was followed by the issuance of an operational guide to PBAs, *CIDA Primer on Program-Based Approaches* [Lavergne et al. 2003], which discusses the concept of PBAs, the modalities involved, and the issues to be addressed in the course of CIDA programming.

Conceptually, PBAs are the extension of SWAp and cover both SWAp and "SWAp-like" initiatives. The approach emphasizes comprehensive and coordinated planning in a given sector, or thematic area of intervention, or under a national Poverty Reduction Strategy (PRS). The program may be a PRS, a sector program (i.e, SWAp), a thematic program, or the program of a specific organization such as NGOs. In this sense, the PBA concept is similar to SWAp or budget support; but it is broader and does not assume "progressivity" of one aid modality to the other. Under PBAs, donors can work on several levels simultaneously—e.g., at the macro-level through GBS around PRS, the sector level through SWAp, and the sub-national level through district-wide assistance program.

CIDA Premier assumes that PBAs would be appropriate under conditions of high aid dependence, a fair degree of macroeconomic budget stability, and a sound policy framework at the program level.



Source: CIDA [Lavergne et al. 2003]

Annex 2 Re-examining Transactions Costs: Conceptual Issues

The evaluation of transaction costs by aid modality is far more complex than a simple comparison between project and program aid. Noting that the language of transactions costs is used too loosely, Killick [2004] attempts to classify types of transaction costs—i.e., administrative, tying, fiscal costs—and construct hypotheses how these costs are distributed differently by forms of delivery between recipients and donors.

Hypotheses about Comparative Transaction Costs of Program and Project Aid

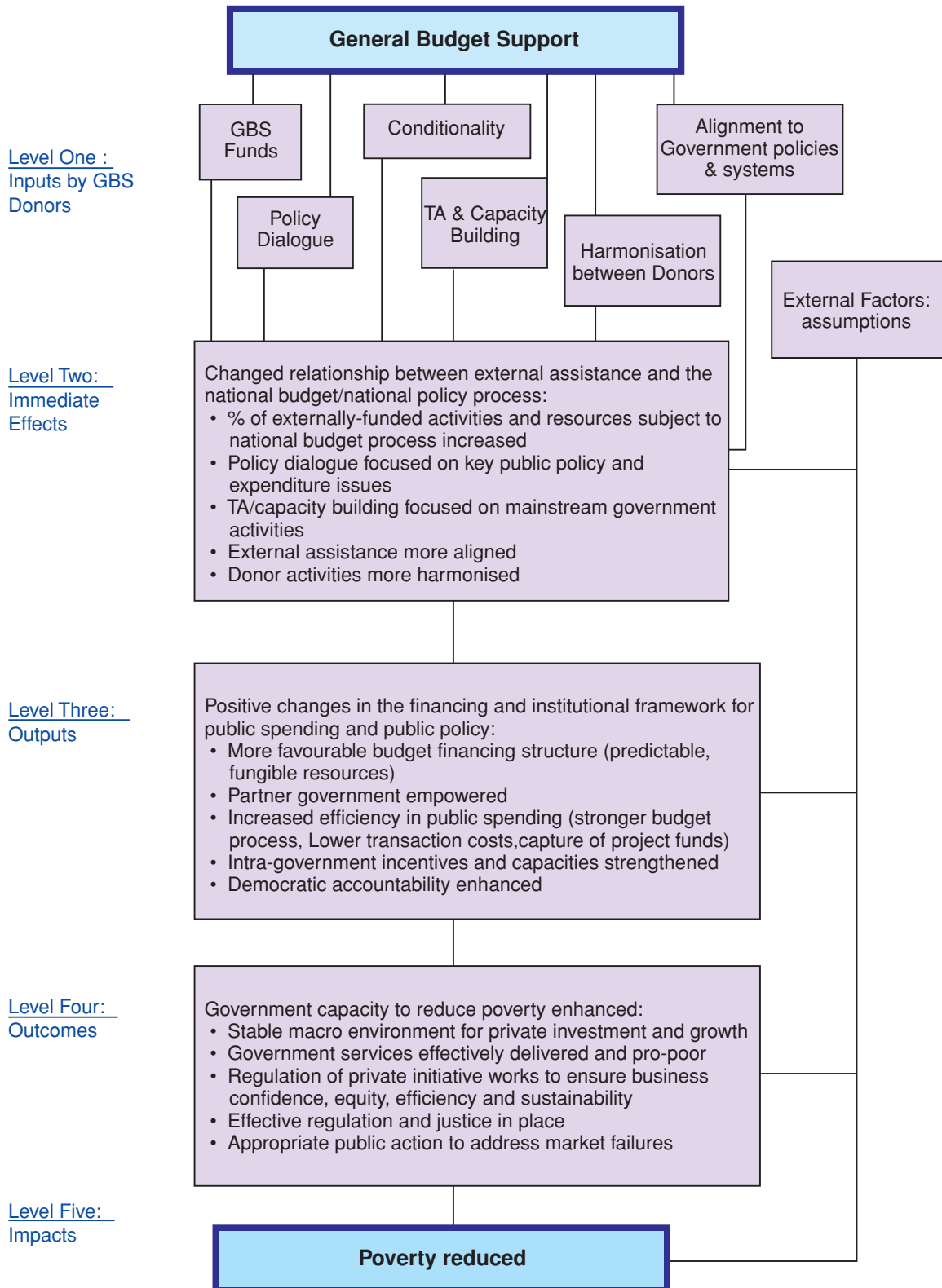
Transaction costs	Recipient		Donor	
	Program	Project	Program	Project
Administrative costs				
Pre-investment appraisal	Moderate	Moderate	Moderate	Very large
Implementation	Low	Potentially large	Low	Moderate
Monitoring & reporting	Large	Very large	Large	Moderate
Ex-post evaluation	Low	Moderate	Large	Moderate
Tying costs				
Loss of coherence & ownership	Nil (?)	Large		
Price premium	Nil	Large ('25%')		
Political etc. costs of policy conditionality	Potentially large	Low		
Fiscal costs				
Counterpart fund & recurrent cost problems	Nil	Large		
Volatility/unpredictability, destabilization	Very large	Moderate/large	Moderate	Moderate
Erosion of budget by extra-budgetary aid	Nil	Large		

Source: Killick [2004], Table 1, p.25.

The above table shows that the administrative aspects of transactions costs (a narrow definition) are more associated with project aid and mainly assumed by donors. On the other hand, if tying and fiscal aspects are considered, program aid appears to incur insignificant burdens on the recipient as well. Killick also notes that the table is limited because it treats all types of costs as of equal significance, where the seriousness of loss of freedom for political management or of fiscal destabilization is evidently on a different scale from, say, project evaluation costs.

In conclusion, Killick states that the alleged superiority of program aid in reducing transactions costs is not evidence-based and should not be taken for granted. He recommends that a serious evaluative study be conducted to clarify the whole transactions costs question.

Annex 3 Simplified Logical Framework Analysis of General Budget Support



Source: EuropeAid and ODI [2004]

Annex 4 Accountability First, or Capacity First?

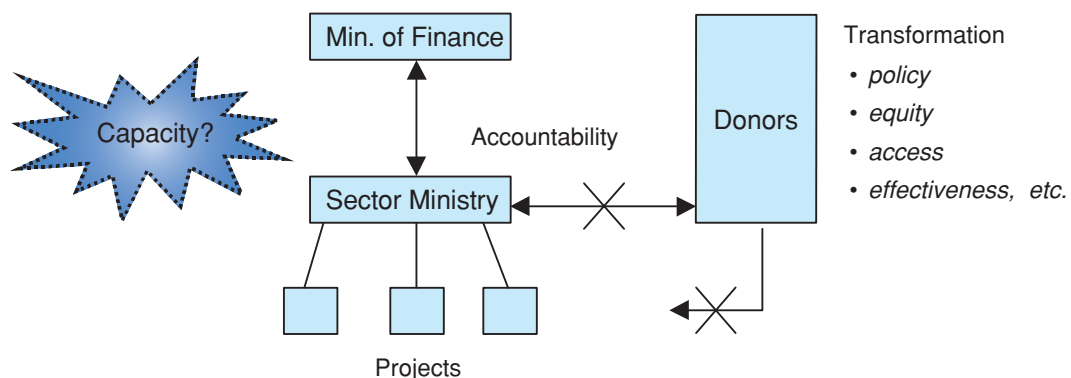
Which should come first—the accountability framework within a government, or the capacities of various actors? There are two contrasting views on how to sequence measures to improve government effectiveness in delivering public services and attaining pro-poor growth.

The clearest advantage of GBS over other aid modalities is that it does not hinder, or instead strengthens the accountability relationships that should exist between budget allocation authorities and authorities to which public resources are allocated. Rather than being accountable to donors that may have previously funded them directly, line ministries are forced to be accountable to the Ministry of Finance (MOF) when assistance is provided as GBS [See Figure below]. By limiting access to extra-budgetary finance, GBS reinforces budget discipline within a recipient government. GBS also requires that line ministries develop greater technical capacity to more effectively make their cases to the MOF for budget allocations. These arguments are based on the view that the accountability relationships within a government system matters most.

Another view places greater importance to capacity development of various actors within and outside a government system. Effective service delivery depends, to a great extent, on the capacities of actors at different levels, such as MOF, line ministries, local authorities, and NGOs. It is argued that GBS offers little assistance to these entities for strengthening their capacities and that complementary interventions are necessary, e.g., in the forms of TA and projects. Furthermore, the effectiveness of GBS is grounded on the functioning of PRSP framework, which, for many recipient countries, remains technically difficult and institutionally complex. Many countries continue to face capacity constraints in translating PRSP priorities into budgetary policies in annual budgets and in MTEF and establishing monitoring and evaluation systems.

Probably, a more balanced view would be that both are necessary. A web of accountability relationships and capacities should be strengthened—not simply those within institutions in a recipient government, but also between citizens and government and between citizens and service providers.

Accountability Framework Assumed under GBS



Source: Elaborated by the authors, based on Frantz [2004] and DFID [2004]

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