

What Conditions Favor the Success of General Budget Support and Sector Program Assistance?

Malawi Country Case Study



Introduction

General Budget Support (GBS) has stirred interest among many aid donors. Rather than running their own projects, donors provide GBS funds to a government, which spends the money on its own development projects. GBS funds are not earmarked for specific uses, but support the government's overall development effort. Another approach is Sector Program Assistance (SPA), where policy-based conditionality promotes institutional reforms. A third is the Sector-Wide Approach (SWAp), where all donor assistance is coordinated in support of a common set of reforms and a sector expenditure program.

This evaluation uses Malawi as a case study to identify the country conditions needed to make these aid approaches successful—and pitfalls and problems to avoid. The study, part of a multicountry field evaluation effort, was undertaken by the Evaluation Studies division of USAID's Bureau for Policy and Program Coordination (PPC). In addition to Malawi, PPC completed studies on Mozambique,¹ Nicaragua, and East Timor. The Bureau for Africa has completed a GBS study of Tanzania.²

GBS donors argue that if a developing country has a logical poverty reduction plan, a sound budget system, and the ability to implement development projects, it makes sense for donors to provide GBS. Those donors see GBS as an effective way to build government commitment and ownership. They note that if development is to be successful and self-sustaining, the developing country must “own” the process. GBS donors are enthusiastic about their new aid approach and feel it should be used in most developing countries. Other donors note that GBS might work well in some countries but not in others: country conditions matter.

Malawi had successful sector policy reform programs in the mid-1990s. But in recent years there have been

¹ PN-ACU-999 and PN-ACW-878, available online at www.dec.org.

² PN-ADA-029, available online at www.dec.org.

KEY IDEAS

- USAID sector programs lasted five to nine years. Conditions changed, and the original plans became outdated. Much better would be a short timeframe of two to three years.
- Policy reform programs can change policies and create an enabling environment. But to implement new policies, there must be accompanying institutional changes. To varying degrees, this did not occur in Malawi, a disconnect that proved to be a problem for USAID's three sector policy reform programs.
- A common vision and commitment is needed by government leadership and USAID management. Changing priorities and personnel changes for both the government and USAID delayed reform efforts.

serious problems with GBS and, to a lesser extent, SPA. Malawi's economic numbers tell a sad story. Annual per capita GDP growth rates were a dismal -0.2 percent from 1982 to 1992 and only slightly better, at +1.4 percent, from 1992 to 2002. Per capita gross national income was \$220 in 1998 but had fallen to \$160 in 2002. Sixty-five percent of the population lives below the national poverty line, and life expectancy at birth is only 38 years.

Donors want to help Malawi, but they are reluctant to move from donor-managed projects to GBS, SPA, or SWAps. While Malawi's development policies may be sound, all too often they are not reflected in budget expenditures. The government lacks financial and monetary discipline and, as a result, donors lack confidence in government budget management. Finally, government corruption is a growing problem. Macroeconomic and budget conditions will have to improve before these assistance approaches will be widely accepted by donors.

In early 2004, Malawi failed six Millennium Challenge Account (MCA) indicators, the most troubling being those dealing with corruption and fiscal policy. With the election of a reform-minded government in mid-2004, the indicators have improved, and Malawi is now an MCA threshold country.

Assistance Approaches

While donor-managed projects are the usual way to deliver assistance, there are other approaches. In Malawi donors have used SPA, SWAps, and GBS. It is important

to understand the different approaches and how they can contribute to development.

Sector Program Assistance: SPA refers to a set of activities unified around a common output that includes significant investment and policy issues. Donor assistance usually supports policy and institutional reforms in broad sectors such as agriculture, education, or health. USAID's experience in Malawi with SPA includes

- NATURE (Natural Resources and the Environment)
- GABLE (Girls' Attainment of Basic Literacy and Education)
- ASAP (Agriculture Sector Assistance Program)

All of these sector programs were conditionality-based. Disbursements were made following government implementation of policy and management reforms. USAID funds were not earmarked for any specific task. USAID's key interest was that the government adopt critical sector reforms to improve program efficiency and beneficiary impact.

Some donors have sought to move away from such conditionality-based approaches in favor of a model that emphasizes partnership with government and other donors. The government and donors agree in advance on the direction of change, which limits the need for stringent conditionality. Ideally, the reforms are in place and attention can shift to the manner in which funds are spent and whether the funds are supporting the objectives of the agreed strategies. It is within this context that SWAps and GBS have emerged.

Sector-Wide Approach: Individual donors usually negotiate their own SPA agreements and set their own conditionality. In contrast, in a SWAp, all donor assistance is coordinated in support of a common set of reforms and a sector expenditure program. In actual practice, SWAps can be many things. SWAp financing may include donor-managed project aid, technical assistance, or cash

PREPARED BY

Joseph Lieberman, Team Leader
PPC, Evaluation Studies Division

Diane Ray
Academy for Educational Development

Brian Frantz
Bureau for Africa

transfers. Donors may pool their funds in a “basket” outside the government’s budget, or they may provide cash transfers to the government that are disbursed through the government’s own budget process. The defining characteristic of a SWAp is that donor funding supports a set of sector policy reforms and a single expenditure program. The government provides the leadership, and donors coordinate a common approach to support the government’s effort. The only functioning SWAp in Malawi is the HIV/AIDS “mini-SWAp.”

A SWAp is an excellent way to focus donor efforts on sector policies and institutional issues, along with needed technical assistance, training, and supporting projects. SWAps encourage government ownership and direction of the development process and support government budget discipline and accountability. SWAps have drawbacks, however. For example, there could be a well-functioning SWAp in the health sector. However, if the government does not pay workers on time, or trade controls prevent the import of essential medicines, it could be difficult to achieve good results. GBS donors argue that addressing more fundamental, government-wide issues is only possible with a GBS arrangement.

General Budget Support is used by donors when they are satisfied with the government’s overall development policy environment. With agreement on policy and the budget as a whole, there is no need to earmark aid flows to specific projects. There is also no need for conditionality-based disbursements. Donor funds are disbursed to the host government, which uses its own allocation, procurement, and accounting systems to implement its development programs. Since support is for the budget as a whole, donors are interested in overall developmental results.

The benefits claimed for GBS are improved recipient-government efficiency, effectiveness, and ownership of development activities, along with reduced transaction costs for the government and donors. From the donors’ perspective, GBS

improves donor coordination and policy dialogue while firmly fixing responsibility on the government to achieve results. GBS works best in countries that have stable, progressive, and accountable governments with good management skills; a recent history of good macroeconomic policies and strong economic growth; and good working relations with donors. Development is not helped by providing GBS to a government that lacks skilled staff to run effective projects, has ineffective institutions and inappropriate economic policies, lacks an adequate financial management system, or suffers from high levels of corruption. In such situations, donor-managed projects are more appropriate.

The Development Problem Determines the Approach

If *policy reforms are needed*, the donor may concentrate on the reforms. The donor and the government agree on the need for reforms, and donor funds are provided to the government once the reforms are in place. The donor is concerned about the policies, not the specifics of where the money is spent. This is what USAID did with its SPA support to NATURE and ASAP.

If good policies are in place, but implementation lags, the donor can provide funds to support the government’s own implementation of the reforms. The concern is ensuring the right amount of money goes to the right programs: expenditure tracking is important. That is what GBS donors want to do to support implementation of Malawi’s Poverty Reduction Strategy Paper (PRSP).

If both policies and implementation are the problem, the donor may target project funds to specific sector bottlenecks and problems, and disburse a portion of the funds when policy reforms are achieved. Both the policies and program expenditures are important. That is what donors are doing with the health sector SWAp; and that was USAID’s approach with GABLE.

USAID's Long History of SPA in Malawi

USAID'S Sector Program Assistance helped the government replace controls with market-based incentives and opened access for disadvantaged groups. Improvements in investment efficiency, markets, and a reorienting of government development priorities proved more difficult and had mixed results.

USAID funds were disbursed to Malawi's treasury and were not earmarked for specific government expenditures. Unlike GBS, however, the assistance came with conditionality and, as is often the case with conditionality-based disbursements, serious delays occurred when the government failed to meet its policy commitments. The policy reforms were sector-specific rather than the comprehensive reforms of a PRSP or similar national development strategy. It was also a bilateral USAID-government of Malawi program that did not have other donor participation.

The programs eventually met their targets, but there were delays. Generally they met the initial one- and two-year benchmarks, but it was more difficult to meet targeted reforms in later years. The earlier targets were well defined and achievable. However, conditions changed, and outyear targets often were overtaken by events. While flexibility is essential, a long-term commitment with undefined intermediate steps does not contribute to achieving program expectations. Such flexibility also requires time-intensive redesign efforts that take scarce USAID and government staff time away from implementation.

From 2000 to early 2004, inappropriate government fiscal and monetary policies, along with problems in budget management, further dimmed the prospects for additional policy reforms or institutional changes. Given those problems, USAID stopped using SPA in Malawi.

Agriculture Sector Assistance Program

Starting in 1991, USAID worked with the government to take state controls and restrictions off the backs of small farmers. Malawian agriculture included highly productive large estates producing cash crops, with the bulk of the population living on small farms growing subsistence food crops. USAID-supported analysis demonstrated that smallholders growing maize would always live in poverty. They needed higher-value cash crops. In order to "help" small farmers, the government had a number of commodity and trading restrictions, along with price controls and ineffective government parastatals that controlled both input and output markets. ASAP supported reforms and provided supporting analytical studies and technical assistance. As a result of the USAID-supported program, restrictions on private imports and domestic trading of fertilizer and seed, as well as price controls on fertilizer and seed, were lifted. The control of parastatals over the production and sale of cash crops was eliminated, and smallholder farmers were allowed to grow highly profitable crops previously reserved for estates. In addition, the government was able to reduce budget outlays by eliminating money-losing parastatals, as well as inappropriate subsidies.

Girls' Attainment in Basic Literacy and Education

In the early 1990s, fewer than 50 percent of children aged 6–13 were enrolled in school, and there was a large enrollment gender gap. In 1994, USAID's GABLE program started working with the government on a number of policy, budget, and organizational problems. In the first few years, GABLE achieved remarkable results:

- increased 60 percent to over 85 percent enrollment of children aged 6–13
- girls' enrollment increased at all grade levels and almost fully closed the gender gap
- government commitment to education increased: the education budget increased every

year from 1994 to 2000; allocations were increased for more teachers, teacher training, and learning materials; and new-school construction increased

- through social mobilization, village attitudes toward school changed, and girl's education and a stronger partnership developed between communities and their schools
- a 30-year-old parastatal monopoly for the supply of learning materials ended within the creation of a privatized and competitive learning materials system

GABLE was successful in the 1990s, even though its strategy of pressing for a large number of changes, rather than concentrating on only a few, may have distracted government efforts. However, by 2000 it was clear that government commitment was weakening. Education's share of the total budget was only 13 percent in 1991 and had peaked at 27 percent in 2000. In 2004 it had slid backward to only 17 percent.

While getting access for girls and the poor was the success of the 1990s, the current need is to improve quality through improved teacher training, curriculum development, and materials; dealing with HIV/AIDS-infected teachers; improving the government's accounting for financial flows to the district and school levels; and improving community involvement. USAID is working with donors and the government to develop an education SWAp and to help the Ministry of Education develop its sector strategy and plans.

The experience in education policy reform demonstrates that success with policy reform is not a one-time effort. As new problems develop, there will always be a second (and often third) generation of reforms needed.

Natural Resources Management and Environmental Support Program

In the mid-1990s Malawi's environmental base

faced increasing pressure from a growing population that lacked economic opportunities. The water, soil, fisheries, forests, and national park system were under growing pressure. National institutions needed to be strengthened and sustainable financing sources identified.

While all agreed that action was needed, appropriate solutions were blocked. This was because the government lacked an appropriate policy and legislative framework and had weak enforcement capacity and an inadequate budget. To help create the enabling environment, in 1995 USAID launched NATURE. It was designed to help the government create, in just two years, a policy and legislative environment that promoted conservation in cooperation with local communities. Then, over the next three years, USAID would concentrate on training, technical assistance, and other efforts to help with policy implementation.

Reforms were designed to unify policies and legislation affecting forestry, fisheries, water and irrigation, soil conservation, land administration, and national parks and forests. This meant working with nine separate government agencies. USAID did not fully anticipate the bureaucratic and legislative actions that were required. What was to have been a five-year program stretched out to nearly nine years. USAID made the final disbursement of funds in September 2003, and the final conditions were satisfied in early 2004. USAID's COMPASS-II project will work with the government to implement the new policies.

NATURE was a policy reform program. Once policy conditionality was met, USAID disbursed funds. There was no legal requirement for the government to provide the funding to implement the policy reforms. But it was important to make sure that policies were actually implemented. USAID used the time leading up to the final disbursement of NATURE funds as an opportunity to discuss development issues with the government and to press for action on implementation problems.

As a result of discussions, the government agreed on a number of measures to implement the

NATURE policy reforms. For example, it put in place a policy to decentralize its programs to the district level and to fund the decentralized programs. The government also created the Malawi Environmental Endowment Trust (MEET) and, at USAID's urging, provided the needed funds.

Inappropriate Budget Management and Corruption

Malawi's currency, the kwacha, has steadily lost value against the dollar due to slow export growth and inflationary pressures. In 1994, the exchange rate was 8.7 to the dollar, in 2001 it was 72, and in March 2004 it was 114. Consumer prices rose 27 percent in 2001 and 15 percent in 2002. The real interest rate was 24 percent in 2001 and near 20 percent in 2002. The Government of Malawi has recently been in a cycle of revenue shortfalls, overspending and then filling the gap with domestic borrowing. As a result, Malawi repeatedly missed IMF fiscal and monetary targets. From 2001 through most of 2004, Malawi met its IMF targets only once. The government's difficulty in staying on track with its IMF program caused GBS donors to hold back on aid disbursements—reducing the funds available for development programs. As a result, the government sharply increased its domestic borrowing, driving up interest rates, reducing capital available for private sector investment, and making it harder to meet IMF targets.

There are serious weaknesses throughout the government's financial management system. Budget execution is weak; there has been a lack of completeness, accuracy, and reliability of accounting and financial reporting; internal control procedures are ineffective; and external oversight mechanisms either have capacity constraints or lack teeth. Notwithstanding efforts to identify and fully finance pro-poor expenditures, there is a poor linkage between stated policies and the budget process. This makes it extremely difficult to measure results. Significant expenditures, including those financing parastatal activities, are not included in the budget. In general, there is little enforce-

ment of hard budget constraints, as overspending is often "regularized" into a final budget late in the fiscal year.

As in many parts of sub-Saharan Africa, corruption is a big problem in Malawi. Transparency International's Corruption Perceptions Index reflects perceived levels of corruption. For 2003, Malawi scored a low 2.8, on a scale of 1 to 10 (with 10 being a system free of corruption). In 2000, Malawi scored 4.1.

There is anecdotal evidence of an increase in corruption during the past decade since the end of autocratic rule and the move to democracy. Petty corruption is reported at the local level, but it is nowhere as severe a problem as high-level corruption. A report by the Accountant General in 2000 provided evidence of fraudulent contracting in the Ministry of Education and implicated ministers, members of Parliament, and senior civil servants. Prosecution was halted due to political interference. In September 2004, a senior government official was ready to speak about high-level corruption in court, but "disappeared" before he could testify. He was later found dead. Some feel that, in relative terms, the problem of corruption takes second place to the mismanagement of Malawi's macroeconomic environment. Others say the two go hand-in-hand.

The "ABCs" of the Three Donor Approaches

- A. *If the problem is policies*, concentrate on getting policy reforms adopted. Since the reforms will solve the problems, it is not as important how aid funds are spent.
- B. *If the problem is implementation*, provide aid to help fund the government's budget, but ensure that the funding implements the policy goals and that the funds can be tracked to their final use.
- C. *If the problem is policies and implementation*, mix policy conditionality with funding, making sure that the funds are spent to support the policies.

Lessons Learned

This report summarizes the findings from the analysis in the working paper *General Budget Support and Sector Assistance: Malawi Country Case Study*.³ The analysis in that paper developed nine lessons related to macroeconomic and sector policy reforms, budget discipline and sound financial systems, and the need for the government to manage and own the development process.

Macroeconomic and Sector Policy Reforms

1 Policy reforms are of little use if there is no will to execute them.

Malawi has sound strategies to develop the country and qualified personnel to carry out the plans. Donors are ready to help finance the government's efforts to reduce poverty. To get the country's macroeconomic situation back on track, the government needs to follow its plans and not constantly change priorities. To reduce poverty, Malawi needs to take the execution of its PRSP seriously and closely monitor its progress.

2 Cash transfers such as GBS will not have their expected impact if the government lacks budget discipline and fails to reform its macroeconomic policies.

GBS donors are interested in ensuring that the government's pro-poor expenditures increase and that their assistance supports improved service delivery. But if GBS is to be successful, macroeconomic conditions must be sound. In Malawi, monetary and fiscal policies were inappropriate for most of the time from 2000 through 2004. Government domestic debt, interest rates, inflation, and public expenditures increased at an unsustainable pace. This discouraged investment and development.

3 If government policies are not reflected in annual budgets, donor assistance to support budget initiatives is not appropriate.

Malawi has a PRSP that was developed in a consultative fashion with donors, civil society, and NGOs.

The PRSP provides a good development policy framework. However, it is not linked to the annual budget. This disconnect between policy and budget makes it hard to see whether development priorities are being implemented. GBS donors have a difficult time in Malawi: multiyear strategies and policies are of little value, as they are not linked to annual budget expenditures.

4 Higher-level reforms are of little value by themselves. To maintain momentum, it is important to follow up on reforms with implementation measures that ensure benefits are realized.

For example, USAID sector program assistance helped create policies and new organizational relationships that should improve Malawi's natural resource management. Policy reform was a success. But there were implementation delays. In the field, in Lengwe National Park and Mwabvi Wildlife Reserve, government officials and local village leaders were concerned that—after much preparation for a new comanagement approach to environmental conservation—nothing on the ground had changed. To deal with such problems, USAID used policy dialogue to urge the government to put funds in place to implement the reforms.

Budget Discipline and Sound Financial Systems

5 If donor funds are to support a country's annual development budget, donors need to be confident in the budget process.

In Malawi a budget is developed each year, but it is rarely reflected in actual expenditures. Faced with annual revenue shortages, cuts and reallocations are made throughout the year, though the government does protect pro-poor expenditures. Budget transparency, execution, and accounting are extremely weak, so it is difficult to track expenditures. Over the years, many donor-supported financial and accounting systems have been launched, with few results. With government plans to decentralize operations to the 27 districts, it will be even harder to track financial flows and results.

³PN-AAA-XXX, available online at www.dec.org.

6 The government's financial and accounting systems must assure that funds are spent for their intended purposes. Governance reforms can improve service delivery and accountability.

In Malawi budget execution and accounting are extremely weak. The problems are due to inadequate financial systems, inappropriately trained staff, and a lack of political and bureaucratic interest in accountability. In 1996, the World Bank supported the introduction of an Integrated Financial Management Information System, with limited success. More recently, the Bank has worked with the government on the introduction of a Country Financial Accountability Assessment (financial management), a Financial Accountability Action Plan (to improve budget execution and tracking), and a system of audits.

In Malawi there is no shortage of donor-supported acronyms for new systems to improve public finance. What appears to be missing is government willingness to use such tools to deal with a dysfunctional financial system. A government must be accountable to its own citizens, not just the donors. Efforts are needed to encourage domestic oversight by Parliament, NGOs, media, and civil society through diagnostics based on public-services users and tools to track public expenditures.

Government Needs to Manage and Own the Development Process

7 A government's technical and management capabilities are critical to policy and institutional reform.

With a per capita GNI of \$160, Malawi is very poor. Almost by definition, low-income countries lack skilled manpower. Compared to those of other

African countries, Malawi's senior managers are well trained and highly skilled. At mid- and lower levels, skills are generally good. A looming problem comes from high HIV/AIDS rates (15 percent of adults), which could be a major threat to government capacity. Donor assistance can help the government build the capacity to successfully manage its own development efforts. In the case of Malawi, this includes HIV/AIDS programs.

8 Policy reform must have government ownership.

USAID's environmental and natural resources policy reform program (NATURE) worked with the government to develop a set of policy and institutional changes. It required actions on the government's part from several ministries and departments. Rather than working with all of the different ministries to get the reforms adopted, USAID left it to the Department of Environmental Affairs to take on the role of getting agreement from all ministries. This clearly added time to the process, but it was successful and helped the government gain ownership of the reform process.

9 Corruption drains resources from development; budget support (which is a cash transfer) is at high risk, and donors may want to avoid such situations.

In Malawi, corruption is not at the level of many other African countries, but it is visible at the highest political levels, where it sets a bad example for government employees and creates cynicism among the people of Malawi. The biggest danger, based on experience in other countries, is that corruption starts small but tends to increase and spread throughout the government. Corruption then creates serious economic distortions and destroys respect for the government.

This brief and other relevant documents can be ordered from USAID's Development Experience Clearinghouse (DEC). To order or download, go to www.dec.org and enter the document identification number—PN-ADA-356—in the search box. The DEC may also be reached at 8403 Colesville Road, Suite 210, Silver Spring, MD 20910; telephone 301-562-0641; fax 301-588-7787; email docorder@dec.cdie.org.

Editorial, design, and production assistance was provided by IBI—International Business Initiatives, Arlington, VA, under contract no. HFM-C-00-01-00143-00. For more information, contact IBI's Publications and Graphics Support Project at 703-525-2277 or pgsp@ibi-usa.com.