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Entitlement, Rules, Coordination, Club, Market and Hierarchy: General Budget Support Practice and Theory

Implications of Results of the Joint Evaluation of General Budget Support

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Abstract

The paper discusses implications for practice and theory of the recently completed Joint Evaluation of General Budget Support 2004-06 based on case studies in Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam.

The paper first looks at the extent to which general budget support, on the evidence of the evaluation, stands up to common criticisms of the effects of aid on government in low income, aid dependent countries. Allowing for much caution owing to the short period of partnership general budget support (PGBS) programmes in some countries, the finding is that there are small but positive impacts (notably reducing unnecessary transaction costs and increasing discretion of government—thereby raising allocative and operational efficiency). Net benefits are generally greater where PGBS programmes are longer established.

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Keywords: aid, budget support, entitlement, rules, club, market, coordination

JEL classification: H41, H50, O10, O20

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Areas of uncertainty regarding future effects are its uncertain overall contribution to the private sector and growth, its vulnerability to changes in political relations, and the limitations to raising 'pro-poor expenditure'—the main tool it has used to leverage increases in health and education spending; long term improvements in access and quality of public services will rely on better planning, budgeting and services management.

The paper then considers how the evaluation results affect the way that PGBS is understood in theory: (i) it first suggests that PGBS raises entitlements (by increasing confidence that there will be continuing flows of budget support) which encourages policy development and stable donor-government collaboration structures, to which other shorter term aid arrangements gravitate, thereby reducing previous coordination failures; (ii) relations in organizations are then identified on a spectrum from market through club to hierarchy. Applied to PGBS coordination structures this suggests they are aspirant clubs, with hierarchical features strongest where PGBS is least established, and club features stronger where government is more capable and assertive; (iii) entitlements are accompanied by rules which attempt to raise positive incentive effects of the entitlement and reduce its negative incentive effects. In PGBS arrangements rules vary from hierarchical (e.g., prior actions), through club oriented (e.g., assessment on medium term trends) to market oriented (performance payments related to achievement on specific indicators). The analysis of rules in relation to PGBS incentives and operating environments (on a spectrum from rigid/uncertain to flexible/predictable) concludes that fine tuning rules in rigid/uncertain operating environments is counterproductive. Integrating PGBS performance assessment frameworks (PAFs) into government plans and monitoring systems will serve to unify rules.

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1 Introduction

This paper discusses implications for practice and theory of the recently completed Joint Evaluation of General Budget Support 2004-06 based on case studies in Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam,[1] and the separate evaluation study in Tanzania (Lawson et al. 2005). The evaluation was commissioned by a consortium of DAC-based donors. The evaluation was preceded by the design of an evaluation framework, which was further developed during the evaluation studies. The evaluation framework is in the form of a logical framework with feedback effects. It sought to find out the effects which the partnership general budget support (PGBS) (via its inputs of finance, policy dialogue, conditionality, technical assistance, harmonization and alignment) has had on collaborating governments, and particularly the services they deliver to the poor. The short duration of PGBS programmes to date, even in Uganda where they have been established since the mid-1990s, reduced the extent to which effects on services to the poor could be attributed to PGBS, though PGBS is argued to have contributed to the expansion of education and health services (e.g., in Tanzania).

Budget support as a form of aid takes a variety of forms. In the transition from colony to independence, it was used by the colonial power to close the budgetary gap in newly independent states (e.g., Uganda, Botswana) on a short-medium term basis. It has been used on a short-term basis by individual donors and international financial institutions (IFIs) to help states carry out major, politically difficult reforms after economic crises (e.g., Japanese assistance to southeast Asian states after the Asian financial crisis of 1996-97). It is used on a short-term basis to assist governments to provide humanitarian assistance after natural disasters (e.g., Pakistan after the Himalayan earthquakes). It is also used on a longer-term bilateral basis to support politically favoured regimes under military threat (e.g., US support to Israel and Egypt).

Partnership general budget support (PGBS) is longer-term budget support with active policy dialogue and supporting capacity-building activities, designed to support recipient government policy for poverty reduction. It emerged from the Highly Indebted Poor Countries (HIPC) Initiative of the late 1990s which sought to establish the common purpose of donors and government to reduce poverty, in return for debt relief. The partnership approach of HIPC was in part a reaction to the confrontational experience with budget support for structural adjustment purposes in the 1980s and 1990s, particularly in low-income, aid dependent states. PGBS is used as a tool for assisting committed political leadership to strengthen state functions and performance and get flexible resources to pursue desired policies: by providing a more reliable stream of funding through government and both demanding and enabling higher standards of performance from government systems; by rationalizing and simplifying donor demands on weak governments in line with the government's own objectives. To achieve these objectives, it sets up long term communication and negotiation structures, and agreements regarding timetables of disbursements, performance levels and joint funding by donors.

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1 The study was carried out by a consortium led by IDD, University of Birmingham. Synthesis and country reports from the evaluation are at www.idd.bham.ac.uk/general-budget-support/ and at www.oecd.org/site/0,2865,en_21571361_34047972_1_1_1_1_1,00 .

The evaluation was based on analysing the content and effects of PGBS programmes in the case countries. This had to proceed by identifying PGBS programmes on a programme-by-programme basis since different donors and different countries use their own labels and categorize similar flows differently. This problem prevented the evaluation from carrying out in parallel an intended econometric study of the effects of budget support over a longer period.[2]

The paper first looks at the extent to which PGBS, on the evidence of the evaluation, stands up to common criticisms of the effects of aid on government in low-income, aid dependent countries (section 2). A number of queries are then raised (section 3). In section 4 the paper turns to its second main task of looking at what the findings of the evaluation contribute to understanding of the nature of PGBS. Section 5 concludes.

2 Charges against aid—how well does PGBS stand up to them?

A summary of the charges regarding the negative effects which aid can have on the recipient state would include:

- policy statements and policy realities may be driven further apart;
- donors may dictate an inappropriate policy agenda;
- domestic accountability may remain poor even though accountability to donors improves;
- government resource management systems may be sidelined by putting resources through alternative channels (e.g., project management units outside government);
- cost and waste in public services may increase;
- domestic public revenue collection may be reduced;
- opportunities for fraud may be increased;
- unnecessary management costs may be imposed on government by having to deal with multiple donors individually;
- aid raises resource availability risks to government through unpredictability of funding and donor short-termism;
- aid raises debt dependency, by expanding public expenditure commitments based on loans; and
- aid biases against vigorous private sector growth by expanding an unreformed public sector;

2 The main international database on aid flows (OECD-DAC) was found to lack clear definition of aid modalities and suffers from inadequate coverage of aid flows and unreliable categorisation. Reliable multi-country quantitative analysis of programme aid flows and effects was found not to be possible with existing data. This emphasises the need for aid categories to be internationally standardised and aid flows captured in an international database much more comprehensively than at present.

PGBS (partnership/poverty reduction general budget support) is supposed to avoid the negative effects of other aid modalities, and to create benefits of wider and more secure collaboration between donors and governments, and among donors. Above all it is supposed to raise the capability of the state.

We consider each of the main areas to which the charges above apply, but with a caution: the main differences observed were between countries, with great variation in the way PGBS is designed and managed. Also in each country, PGBS as mode of aid is evolving. Therefore it is dangerous to generalize specific effects of PGBS.

Other cautions: many effects noted are not of PGBS alone but of parallel initiatives by government and donors (e.g., via DAC on harmonization and alignment). PGBS is presently the standard bearer aid mode for a wider movement of change, of which sector programmes and projects with governments are increasingly part, where they are increasingly on-treasury and on-budget.

Charge 1: Donors dictate policy; policy statements and realities may be driven further apart; domestic policy processes are weakened by donors

A hypothesis underlying PGBS is that more flexible resources enable more coherent policy. The country studies found evidence to support the following observations with respect to the effects of PGBS:

- The prospect of predictable funds to finance policies provided an incentive for policy review and development (e.g., flexible and predictable funding for the budget in Rwanda encouraged governments to take risks in policymaking, being confident of the funding availability, e.g., implementation of public sector reform, and capitation grant for full fee-free basic education); in Uganda two of the policy moves that have had dramatic positive effects—universal primary education and the abolition of health care charges—were introduced unilaterally by the government of Uganda despite initial donor scepticism. The Tanzania evaluation found that GBS has enabled shifts in budget allocations, which indicated that the poverty reduction strategy (PRS) with its stress on social services was not a good reflection of political priorities (Lawson et al. 2005: para 146).

- Making funds available through the regular planning and budgetary systems of government helped strengthen processes, gave sector agencies more incentive to compete for such funds, and increased coherence across public agencies (e.g., financing a broader and more articulated set of sector policies in Burkina Faso's revised PRSP, 2004);

- More coherent donor inputs to policy: this is a general effect of donor collaboration and coordination, plus more specific effects at sector level, e.g., in Mozambique the PGBS working groups exposed sectors' progress to comparison and mutual learning, and increased pressure for change in sectors by making them part of the overall Performance Assessment Framework rating);

- Increased transparency and participation: participation in policy processes is not strong in the case countries. However better connecting of line ministries with central ones, particularly through medium-term budgeting, is an advance in many cases (e.g., in Burkina Faso, and in Rwanda despite the difficulties with developing the MTEF);

- Technical assistance (TA) more focused on policy (e.g., in Vietnam, PGBS with complementary TA projects help strengthen policy design and implementation).

In sum, although there is plenty of evidence of donors trying to set policy agendas (e.g., the criticisms of PRSPs and the Washington consensus—both of which inform donor thinking in PGBS), the evaluation found a correlation between overall PGBS effect in providing greater policy space and policymaking capacity to governments and the degree of PGBS penetration (duration, and relative importance, and sophistication of dialogue arrangements). Thus, ironically, deeper involvement of donors in partnership arrangements with governments and other donors (joint funding arrangements, agreed performance assessment frameworks), characterized as 'government ownership with donor influence', is positively correlated with providing discretionary funding for government via PGBS.

Charge 2: Domestic accountability remains poor even though accountability to donors improves

A hypothesis motivating PGBS is that accountability to donors shifts from concern with how their specific packages of resources are spent (as in projects) to focus on how well government manages resources through its planning, budgeting and financial controls. Such better resource management by government is more transparent and worthy of challenge by parliament and society. Hence domestic accountability should increase as a result of PGBS.

The country studies found that:

- A strong effect of PGBS is in focusing donors on the quality of government systems. It has led to more (and more joint) analysis of PFM issues, and is beginning to lead to more coordinated and coherent TA (see Charge 3 below);

- Stronger links between policy and strategic expenditure planning are needed to achieve accountability for results. Medium-term expenditure/budgetary frameworks (MTEFs) are the tool for achieving this. But creating MTEFs is not easy: it is not just a technical reform; it requires strong leadership on the government side to enforce expenditure limits and performance targets, and good management of public services. Uganda's headstart in medium-term budgeting is the reason for its better scores across the range of PFM performance indicators than other case countries (credibility of the budget, comprehensiveness and transparency, policy based budgeting, predictability and control in budget execution, accounting and reporting).

- Weaknesses in the budgetary process are also inhibitions on democratic accountability (e.g., as found in Mozambique: the fact that a large part of public expenditure is off-budget means it is not subject to either parliamentary scrutiny or external audit).

In sum, in none of the case countries is domestic accountability strong. Democratic accountability emerges from political processes as much as from better governance (e.g., relatively strong parliamentary accountability in Rwanda, and political accountability in Vietnam within the ruling party). Though the effect is not (yet?) strong, PGBS is arguably serving as a stimulus to debates over accountability (e.g., civil society feeling cut out of donor-government processes e.g., in Tanzania), providing better information on which accountability can be based, and helping to construct medium-term budgeting.

Charge 3: Aid causes government resource management systems to be sidelined by putting resources through alternative channels (e.g., project management units outside government)

Another hypothesis motivating PGBS is that putting resources through government systems and demanding higher standards from them will improve their quality. PGBS should therefore help to counter negative effects on government capacity of other aid which bypasses government. The finding is that wherever PGBS has become established, there are some positive effects on government's expenditure management systems, though these are only beginnings from a still low base[3]; and there is greater alignment of aid with government planning and budget cycles. Non-PGBS modalities have also benefited from funds flowing directly into the budget as a whole, allowing a better balance between recurrent and capital expenditures; this also makes it easier for governments to provide the counterpart funds required by some donors' projects.

PGBS is by definition disbursed through, and therefore aligned with, government financial management and procurement systems; this accounts for many of the effects found. Much aid remains off-treasury and off-budget in most case countries—including aid provided by some of the same donors who participate in PGBS in the same country. Since performance in procurement was weak in most case countries, though improving, weakness of government system appears not to be the reason for slowness in getting on-budget; entrenched practices in sector programmes and projects, and the habit of sector ministries receiving direct payments from donors rather than from the budget, may rather be the reason. There is therefore the prospect of more aid coming on-budget as practices change and central government exerts more budgetary authority.

However, greater reliance by donors on government TA management, statistics and analytic work is neither automatic nor immediately in prospect. Government leadership in aid coordination is usually limited, and even where it is stronger (e.g., Uganda, Rwanda, Nicaragua, Tanzania) does not yet include leadership in TA management. Collaboration in the analytic work on which donors rely (e.g., expenditure and impact reviews) is rare—let alone reliance on government's own analytic work. The evaluation found some increase in reliance on government auditing and reporting, but little if any

3 The evaluation estimated levels and trends of change for a variety of PFM indicators used by PEFA and HIPC in the categories: PFM out turns; credibility of the budget; key crosscutting issues: comprehensiveness and transparency; budget cycle; donor practices. While most levels were reported as weak or moderate, most trends were constant or rising.

use of government analytic work. Difficulties in creating capacity, particularly in small countries, may be the cause: either high costs of setting up adequate services of this sort within government, or political obstacles to opening up public service employment sufficiently to skilled external candidates (which is a possible reason for the absence of government leadership in TA management), or to contracted services, or to developing such services on a regional basis. The Bretton Woods institutes lead the provision of analytic work, particularly in PFM.

Charge 4: Aid can increase cost and waste in public services, by putting money too rapidly into poorly managed services without reform

A hypothesis of the PRS approaches is that increased funding of essential social services reduces poverty. The charge is that aid can increase cost and waste in public services, by putting money too rapidly into poorly managed services without reform.

The country studies found that state expenditure on social sectors—health and education particularly—expanded as a proportion of GDP in response to HIPC and PGBS.[4] But expansion has been in quantity rather than quality of services, extending access to often low-grade services.

The tool for leveraging PGBS payments into increases in social expenditure has been ‘pro-poor expenditures’ (PPEs). The HIPC initiative in the late 1990s prompted the focus on PPEs, with the aim of ensuring that the poor benefit from debt relief. PRSPs have further raised the profile of the concept. The finding was that defining pro-poor expenditures has been useful in reorienting budgets towards underfunded programmes (e.g., Uganda), or for tracking key expenditures and enhancing their predictability while budget systems are strengthened (Malawi, Mozambique). But raising the proportion of PPEs is not a tool that can easily be used more than once. Regarding quality, broad definitions of PPEs may insufficiently prioritize expenditures within sectors, while narrow definitions may be inadequate in a comprehensive strategy for poverty reduction. Thus in the long run, PPEs may distract from the need for decisionmaking processes which deliver efficient expenditure allocations for the budget as a whole, and strong, comprehensive PFM systems.

In sum, PPEs are a blunt instrument and no substitute for strengthening the link between planning and medium-term budgeting. PPEs are not an efficient means to ensure that substantial increases in PGBS further reduce social poverty. This suggests the absorptive capacity for increased aid is limited to the pace at which services quality and the public finance systems funding the services can be improved; that in turn raises reform issues, including non-state provision of public services.

4 In Nicaragua and Malawi where the experience of PGBS is very brief, HIPC Initiative is the sole cause of the rise in health and education spending.

Charge 5: Aid disrupts the public finance accountability relation between taxpayers and government, and reduces public revenue collection

Regarding revenue collection, revenue reforms in the case countries (particularly the move to set up independent revenue authorities) predated or accompanied HIPC and PGBS, supported by projects and TA. There was no fall in the revenue/GDP ratio in the case countries during the PGBS period and in some cases it rose. Further increases in PGBS could be linked to maintaining revenue/GDP, or even increasing it to a target level that would enable budget support to be phased out by a desired date, provided that desired GDP growth is maintained (Foster and Keith 2003).

Accountability problems tend to be less with revenue levels than revenue processes, owing to underperforming domestic institutions: e.g., inadequate parliamentary scrutiny; predatory revenue collection by local governments; failure to prosecute revenue fraud owing to a weak criminal justice system. Arguably GBS is a vital means for raising accountability by creating policy space through flexible funding for committed governments to improve such institutional functioning, and by raising capacity in PFM, as indicated above (Charge 2).

Charge 6: Increased aid through government systems may increase opportunities for corruption

The assumption often is that programme aid, being less directly controlled by donors, is more open to fraud than is project aid. Although corruption in relation to PGBS was not a focus of the evaluation, no evidence was found that GBS is more prone to fraud than other aid instruments. The increased focus accompanying PGBS on improved fiduciary management of public funds may make it less so, though the improvements are slow and from very low levels. Much fraud is associated with construction contracts, and programme aid is less oriented to the capital budget than is project aid. Furthermore, aid agencies themselves as they move away from tied aid and towards budget support are less likely to attract charges of collusion in non-transparent contracts and in tax avoidance on imports.

Charge 7: Unnecessary costs are imposed on government by having to deal with multiple donors who impose conflicting demands, with uncertain disbursement of committed aid

An assumption motivating PGBS is the expectation that donor collaboration with government and with each other to support government budgets will reduce costs of dealing with multiple donors (harmonization and alignment) and increase predictability of disbursement.

Country studies found that PGBS savings on costs stem from the built-in harmonization that it brings through donors working together. The difficulties of measuring transaction costs meant that the studies were not able to assess whether PGBS had resulted in overall changes. It was clear that PGBS transaction costs are substantial at the setup stage (costs of concentrated PGBS negotiation are significant); and may be lower than at the implementation stage, though this is less clear. Further, many of the increased costs accompanying PGBS—many of which arise from coordination and review meetings—may have long-term external benefits for greater coherence. An important observation is that the net effect of PGBS programmes on overall transaction costs must be to raise them as long as other forms of aid continue in parallel on a large scale.

A concern has been the emergence of performance assessment frameworks (PAFs) as separate donor oriented mechanisms of accountability, proliferating multiple performance indicators. There is no doubt that these raise transaction costs both for donors and government and reduce ownership. The evaluation, extending the recommendations of the Paris Declaration, notes the opportunity and importance of:

- integrating PAFs into new generations of government operational strategies;
- linking PAFs more systematically to strategies for developing national monitoring and evaluation capacity, and
- linking central and sector dialogue and monitoring.

Regarding predictability of aid disbursements, each of the study countries had experience of programme aid suspensions, and even in the case of mature PGBS relationships (Uganda, Mozambique) there are concerns in government about the extent to which disbursements by donors can be relied upon.[5] However, PGBS has the advantage of providing a collective forum in which such problems have been addressed, even if not fully resolved. Positive changes include: timetables for PGBS reviews and deadlines for disbursements dictated by government's budget cycle, rankings of donor performance in budget support (SPA 2005), mutual accountability reviews (Mozambique), and revision by IMF of its on-track/off-track signalling to reduce risks of donor overreaction.

The main risk remains broadly political: PGBS disbursements are particularly vulnerable to suspensions to register political protest, since they are direct transfers to government to carry out its everyday business, rather than emergency humanitarian aid, or projects in which commercial contractual commitments have been signed. Proposed ways of reducing the political vulnerability of PGBS include associating it more clearly with its budgetary uses—such notional ring-fencing might serve to protect it a little better, particularly where budget support is assigned to local governments for essential services, since local governments usually are not the cause of international political stand-offs.

Charge 8: Aid doesn't effectively reduce unsustainable debt of poor countries

The charge is of continuing moral hazard and adverse selection in the aid industry; that HIPC despite its innovations[6] has not ended the 'debt-go-round' in which donors

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5 Predictability of direct budget support was estimated as weak in Malawi and Uganda and only moderate in Nicaragua and Vietnam, though improving in Uganda and Vietnam. And 'predictability in the availability of funds for commitment of expenditures'—a government rather than donor responsibility—was also mostly weak, though good in Vietnam and moderately in Burkina Faso and Uganda (IDD and Associates 2006: annex D).

6 HIPCs' innovations in debt relief included greater size, focus on creating debt sustainability for the most debt-ridden poor countries, coverage of debt stock as well as debt servicing, insistence that

pretend to enforce conditions and recipients pretend to fulfil them; multilaterals continue to make risky loans to governments which cannot realistically service them, confident that bilaterals will provide debt relief if needed; IMF still plays the contradictory role of gatekeeper and creditor, under pressure to reopen the gate virtually immediately after closing it. In this way the development banks and IMF provide a safety net for insolvent governments, at the expense of incentives to governments and themselves to manage resources well. Those making the charge (IOB 2003; Easterly 2001) cite decades of repeated debt relief which have not reduced indebtedness.

PGBS, emerging from the HIPC, consisting of loans as well as grants, is easily classified as part of this alleged global welfare arrangement for insolvent governments cum business generation for development banks and IMF.

The crunch questions for PGBS are whether it is countering or reinforcing this alleged incentive to poor management of resources and debt, and whether it is encouraging economic growth better to enable the economy to use and service loans. On the first of these questions, the evaluation finds that PGBS is contributing positively to recipients' PFM systems, though progress is necessarily slow and uneven among countries. IFIs are also participating increasingly in PGBS structures for donor-government collaboration, including joint funding arrangements and performance assessment frameworks (Lawson, Gerster and Hoole 2005), which makes rogue behaviour by donors less likely. PRSPs are also beginning to be altered by governments towards their own plans (e.g., Vietnam, Mozambique). To the second question there is not such a confident defence, as is discussed below.

Charge 9: Aid does not encourage the private sector sufficiently

The theory of GBS gives priority to governance institutions, with better functioning governance institutions leading to greater investor confidence and growth (as in endogenous growth theory). The charge is that aid is now neglecting investments in infrastructure and reforms to promote private business. In doing so, it risks expanding an unreformed public sector, which competes for scarce skilled resources and capital. This is a charge levelled particularly against HIPC and against the content of current PGBS programmes, because of their orientation towards raising social sector spending.

PGBS can claim some credit for higher growth rates where instability in donor government relations had restricted investment; however this effect is difficult to isolate since flows of budget support tend to accompany political change, particularly where this involves ending of civil hostilities, or regime change towards more open politics and trade. In these circumstances, there is a bounce-back effect in investment and business activity, to which aid contributes. All of the PGBS evaluation case studies were in such countries, except Burkina Faso.

Large aid inflows can raise real exchange rates, discouraging exports and foreign investment and encouraging imports, in Dutch disease style. Given that in the case study countries PGBS has generally substituted for other aid rather than increased aid levels

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World Bank, IMF and regional development banks should pay a portion of the debt relief themselves, plus commitment of recipients to PRSPs.

overall, this is a charge which does not immediately stick. However, the intention is to raise PGBS and overall aid levels (as in Monterrey commitments) in order to achieve the Millennium Development Goals (MDGs); therefore the vulnerability of exchange rates to increases in aid is a pertinent concern. In Uganda and Tanzania, both with mature PGBS relations with donors, sterilization costs in the form of higher interest charges, have been substantial in recent years. These result from open market purchases by the treasury in order to stabilize nominal exchange rates and reduce inflationary tendencies. The cause of the problem is not aid alone, since there are other inflows of foreign exchange (e.g., investment, remittances, exports proceeds) but aid is a major factor. Collaboration with IMF on this problem has resulted (e.g., in Tanzania) in reduced sterilization of inflows, letting inflation rates creep up. The problem is partly one of small low-income economies with their own currencies, and small, shallow financial markets, which reemphasizes the potential benefits to be gained from greater regional integration in both trade and factor markets. There is a strong case for investigating the extension of PGBS to regional priorities in infrastructure, trade promotion, employment and financial market development.

Summing up

The evaluation of PGBS has thrown light particularly on operational arrangements and how well they work. Earlier research, e.g., Foster and Keith 2003, argues that GBS as a low-transaction cost means of increasing aid flows could enable states with demonstrated ability to generate economic growth and maintain political stability, to move more rapidly in reducing poverty, but without examining operational arrangements in any detail.

Allowing for cautions regarding its short period of operation and variation among countries, what the evaluation has demonstrated is that PGBS:

– can increase allocative efficiency in public spending, by providing flexible funds and enabling public priorities to be financed;[7]

– provides a focus on PFM which is enabling/encouraging other forms of aid to be brought on budget and/or on treasury;

– provides a forum of sufficient critical mass to: (i) enable flows of finance and rules of different donors to be consolidated; (ii) become increasingly influential in donor-government relations, involving most bilateral and multilateral donors and (in the most advanced cases) strong involvement of government; (iii) be able to evolve operational arrangements for PGBS, e.g., reducing its unpredictability through timetabling disbursements and clarifying conditions in joint funding agreements and performance assessment frameworks; and (iv) be stable and long term in its outlook.

The evaluation found that PGBS can, at worst, plead neutrality (i.e., does no harm) to the charges above and at best (notably costs imposed by donors and discretion to

[7] Defining allocative efficiency as publicly desired allocation of public resources/actual allocation, and operational efficiency as outputs of priority public services/inputs

government) some positive impact. The exception is its doubtful benefit to the private sector and growth.

3 Queries arising

Queries were raised with regard to:

- *pro-poor expenditures*: efficiency and future viability. Do net benefits from PGBS hit a ceiling which it is difficult to break through? Raising pro-poor expenditures leveraged a step increase in social spending under HIPC and PGBS. But this may not easily be repeated. There is no quick fix alternative to enabling central, sector and local systems of government to work better together in budgeting, service provision, cash management, monitoring and planning. This is an obstacle facing all aid modes and is therefore not an argument against PGBS.

- *marked expansions in aid to small countries risk Dutch disease* effects unless markets in foreign exchange, goods, services and factors, are deepened and widened; increased regional integration in trade, employment and financial markets could reduce Dutch disease effects;

- *tendency of PAFs to be separate from government strategy documents* and to multiply indicators and conditions instead of streamline;

- *revenue/GDP*: is it high enough to keep social poverty at the desired level and achieve non-aid dependence within a politically acceptable timeframe? Or is it already too high to sustain needed growth?

- *private sector development and economic growth*: are they sufficiently encouraged by PGBS and by other components of the wider relationship between poor and rich countries, particularly trade? and

- *government systems that are not used by PGBS*: analytic work, aid coordination, and TA management. Tying PAFs increasingly into government plans, and government data and monitoring systems is an important step.

A wider question which arises is: Does PGBS take any predictable path?

The only common element in entry conditions to PGBS was found to be political trust, which may or may not deepen. The operational arrangements for PGBS differ in terms of multilateral/bilateral leadership, donor-government working groups, degree of harmonization, approaches to disbursement and conditionality. However, much of these differences may be because PGBS is a new way of working. There is some evidence of learning from what appeared to be more advanced collaborative arrangements (Mozambique, Uganda, Vietnam, Tanzania), in which case greater convergence in PGBS operational arrangements might be observed in future. The flow of funds does tend to increase over time (compare Malawi and Nicaragua—where PGBS was just beginning—with Mozambique, Burkina Faso and Uganda, with programmes several years old). And, most importantly, the benefits from PGBS were found to be greater and the operational arrangements better developed in the countries where PGBS was longer established.

But the case studies do not provide evidence for confidently projecting these findings as a ‘happy trend’ in which there is increasingly productive collaboration until the recipient government is sufficiently able, and the country sufficiently wealthy, that PGBS is no longer required. First, political trust remains fragile at any stage of the PGBS relationship (e.g., in Malawi and Nicaragua it was fragile at the beginning of PGBS; in Uganda it became fragile after many years of PGBS). Second, there is no certainty that improvements in government capacity or economic growth can be continuously maintained by PGBS: the case studies found that even PFM systems, on which PGBS efforts are most heavily concentrated, though improved, are still very weak, while the effects of PGBS on economic growth are not clear. Third, the influence of PGBS is limited: it is only one influence among many on governments, with domestic and regional political considerations being far more important; and PGBS funds remain a minor flow of foreign exchange, even within aid flows.

In sum, while PGBS in different countries might tread an increasingly similar path in terms of operational arrangements (i.e., working groups, performance agreements, joint funding agreements, timetables, etc.), its future effects and continuity cannot easily be predicted, let alone taken for granted.

4 Understanding PGBS effects: entitlements, rules, hierarchy, club and market

This section discusses the implications of the study findings for how we understand the nature of PGBS and behaviour of actors within PGBS.

A major finding of the evaluation is that PGBS has effects on longer-term behaviour and relationships with government and other modes of aid, notably:

- the evidence of increased policy development by governments;
- the greater stability, longer term working arrangements and leadership it tends to establish in donor-government relations; and
- the gravitational influence it has on other aid to government (sector programmes, projects), attracting them into PGBS forums, and encouraging their aid to be paid into treasury and to be reflected in the budget.

4.1 Entitlement

What type of innovation then is PGBS, that it has such benefits? It contains a strong element of entitlement.[8] Entitlements arise from current economic activity (trade, own production, employment), from past economic activity (savings) and from social relations (inheritance, rights to receive transfers) (Sen 1981: 2). It is this last source of entitlement—the right to receive transfers—which describes PGBS in the context of aid.

8 ‘Entitlement refers to the set of alternative commodity bundles that a person can command in a society using the totality of rights and opportunities that he or she faces’ (Sen 1984: 497).

PGBS is not a guaranteed, fixed transfer but establishes a joint understanding that, subject to performance, transfers will be made.

The right to receive transfers confers some degree of confidence that there will be a future stream of income in addition to the income currently received from that source. Entitlements to a future income are particularly valued as hedges against risk, in the manner that a 'put option' raises the asset value of a security held.[9]

In this way PGBS, through current non-earmarked transfers into treasury and through creating the confidence that they will be repeated in future, potentially makes for increased policy discretion for government both immediately and in the future: it encourages policies to be pursued that previously may not have been funded (e.g., by projects), and also encourages policy development. These effects will not necessarily take place: that depends on priorities and the will of government leaders. But PGBS makes it easier to do so.

4.2 Coordination

The longer-term commitment encourages creation of structures to manage the relationship, which become a fixed point towards which passing relationships (e.g., short/medium term projects) or more specific relationships (e.g., sector programmes) tend to gravitate: because that is where the longer-term thinking is being done, and where the link to higher levels of government are stronger. Hence the evaluation found that PGBS forums increase in size as PGBS becomes more established, even tending to become unmanageably large (e.g., in Mozambique).

This is evidence of PGBS reducing coordination failure. Coordination failure lowers allocative efficiency, and typically stems from synchronization problems (poor timing), information problems (main actors having different information) and assignment problems (poor teamwork) (Milgrom and Roberts 1992: 90-2). The move to promote harmonization and alignment is designed to reduce coordination failures. PGBS, through both its inbuilt alignment (disbursing via government systems) and the gravitational pull of its structures on aid arrangements with lower mass (donors are keen to be part of more influential structures), reduces coordination failure.

4.3 Incentives

Entitlements which reduce future risk are recognized as having a greater effect on longer-term behaviour than what current income alone has, in the manner that 'permanent income' determines consumption spending. Positive effects are the stimulus to policy development and coordination, indicated above.

The right to receive future transfers also has potentially negative effects on behaviour—recognized in the monopoly model as inefficiencies, and in moral hazard as increased risk displacement onto the insurer once the contract is in place. Single transfers are

9 'An option contract that gives the holder the right to sell a certain quantity of an underlying security to the writer of the option, at a specified price (strike price) up to a specified date (expiration date)'. Source of definition: Investwords

much more likely to be free gifts (i.e., no strings attached) than are repeated transfers, because of the latter's greater cost and the stronger incentive effects of commitments to future transfers.

Therefore entitlements to future transfers tend to come packaged with rules which govern them. However, rules differ (e.g., in content and means of enforcement) according to the operating environment, the nature of the entitlement, and nature of the organization through which the entitlement is provided. Before exploring differences in rules and their effects as they apply to PGBS, we need first therefore to set out the range of features of organizations.

4.4 Hierarchy, club and market

It is suggested, as set out in Figure 1, that there are three types of relation in organizations, in different mixes:[10]

- *market* relations are those in buying and selling, focused on the transaction, in which the rules are those governing commerce;
- *club relations* are those in collaborating for a primarily non-commercial purpose, in which rules are decided by club members to govern their behaviour towards each other and towards non-members;
- *hierarchy relations* are for control, in which the rules are decided by leaders of the hierarchy.[11]

One or other relation tends to be dominant in any one structure, and is usually the relation appropriate to the main purpose for which the structure exists, and by which it then tends to be labelled overall. Thus a structure labelled *business firm* contains relations of hierarchy and club within it, but the market relation predominates in its behaviour. A bureaucracy contains market and club relations, but its primary function is decisionmaking in a hierarchical manner. A voluntary organization contains elements of hierarchy and market but club elements predominate.

Predominance of one relation also characterizes relations between organizations. They are predominantly market or hierarchy when confined to the activity which is their *raison d'être* (e.g., selling/buying books, enforcing/paying taxes). But when the activity is a common interest (e.g., setting/maintaining safety standards in an industry, improving waste disposal in a locality) relations are predominantly club.[12]

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[10] Building onto Williamson's concepts of markets and hierarchies (Williamson 1974) and inspired by Hirschman's (1970) analysis of dissent behaviour in organizations (exit, voice, loyalty).

[11] Different relations are appropriate to different operations of an organization: human resource management theory, learning from Japanese experience, stresses the importance of club relations among staff within the organization, while finance management stresses hierarchy, and strategic management stresses market.

[12] So-called 'hybrid organizations' are usually common interest collaborations among separate organizations and relations within them are therefore predominantly club in nature. Menard (2004) discusses the variety of 'hybrid organizations', differing in their degree of formality according to the purpose they serve.

Figure 1
Types and characteristics of relations in organizations

Characteristics	*Types of relations* **Market**	**Club**	**Hierarchy**
Objective	Mutual benefit from exchange	Common interest and purpose	Task to be accomplished
Focus	Transactions	Collaboration	Control
Rules	Commercial rules enforcing contracts	Club rules relating to entry, conduct, entitlements, exit	Decided by leaders
Entitlements	Exchange value in the transaction	As set out in club rules	At discretion of leadership
Incentives	Gain from the exchange	Joint achievement	Reward for success and punishment for failure
How uncertainty & risk are dealt with	Hedging, insurance	Participation, trust, transparency, information sharing	Feedback of specific indicators to decision makers
Dissent behaviour	Exit, sometimes preceded by voice	Voice and loyalty, with exit as last resort	Loyalty, then exit with voice

Source: Author.

Organizational structures are dynamic, and the relational element which is dominant may change as the purpose of the organization and/or its means of survival, changes; for example, charities which effectively or formally become firms, and vice versa.

Figure 1 sets out a range of organizational relations (market, club and hierarchy), then differentiates each according to its more detailed characteristics, identified here as objective, focus, rules, entitlements, incentives, approach to risk and uncertainty, and dissent behaviour.

In terms of the relations set out in Figure 1, how can PGBS be described?

Lawson et al. (2003: 79) suggest that PGBS partnerships are a club in which uncertainties regarding the government's development agenda that is being supported require donors to have *voice* (influence) in return for which they accept limitations on *exit*. *Loyalty* in the relationship can be increased by better understanding each others' motivations, constraints and risks.

The observations of the PGBS evaluation and of the PAF study (Lawson, Gerster and Hoole 2005) enable further light to be thrown on relations within PGBS arrangements:

– In donor-government relations PGBS aspires to be a club (joint commitment to PRS. etc.) but is in weak states still often more of a hierarchy pretending to be a club.[13] Hierarchy is dominant owing to PRSPs not yet being fully owned, limited participation and 'voice' by government in constructing rules, lower levels of trust, and quick resort to punishment (usually suspension of disbursement)[14] by donors;

– PGBS operations have set up parallel structures to government (hierarchy with vertical integration) in the form of PAFs and annual progress reviews (APRs) which are separate from government's PRS and monitoring and evaluation systems—understandable where government systems are weak, but ironic since a major purpose of PGBS is to avoid parallel structures which sideline government systems; and a priority for integration into government plans and systems, as the evaluation recommends.

– Only where recipient governments have more capacity and commitment are club relations clearly evident in donor-government PGBS dealings. Uganda and Vietnam are examples: both have strong 'voice' and participation, both constructed their own PRS, insist on their own policy priorities and challenge donors (including Vietnam going 'off-track' with IMF but its PGBS continuing); and

– Among donors, club relations vary in strength. While there is strong desire to take part in PGBS meetings as important sources of information, participation ('voice' plus collaboration) is often confined to a smaller subgroup. It is sometimes regarded as a matter of chance whether or not there is effective leadership of the donor group. More generally, effective participation by government seems to be the crucial factor determining wider and deeper participation by donors.

Donors have different assumptions about how the PGBS relation with government should be conducted: some see more of a market orientation as appropriate, i.e., a transaction-focused approach in which there is an exchange of funds against actions and results delivered on particular indicators; others want more of a club approach, emphasizing attention to process, information richness, and trends as the basis for judging progress. The latter requires a harmonized and aligned approach (i.e., working together, using government systems as far as possible); the former, in principle, does not require harmonization among donors and relies entirely on government actions and systems—since payments are made on the basis of transparent performance indicator achievements (notably the principle underlying the Millennium Challenge Account of the US government, and that of the European Commission in budget support).

To discuss this issue further we turn to look at rules more closely.

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[13] A PGBS arrangement which is predominantly 'club' in nature might also deliberately masquerade as 'hierarchy' for external appearance; e.g., with regard to prior actions that are already a *fait accompli* but used for signalling to external stakeholders (e.g., World Bank board) that they are exerting influence. Thanks to Stephen Lister for pointing this out.

[14] Suspension of disbursement is less than 'exit' (termination of relations) since the underlying aid agreement between country and donor usually remains in place

4.5 Rules

Rules fulfil different purposes according to the nature of the organization through which the entitlement is provided: in a hierarchy, rules help retain control; in a club they are a means for rebalancing the incentives changed by alterations in entitlement, seeking to raise incentives for positive effects and reduce negative incentives. Whatever the organizational character, rules must be appropriate to the particular operating environment and should be reviewed and changed as circumstances change.

In sum, rules differ (e.g., in content and means of enforcement) according to the operating environment (risk and uncertainty, flexibility), the nature of the entitlement, and the nature of the organization through which the entitlement is provided.

Figure 2 sets out the types of rules currently present in PGBS arrangements.

The evaluation confirmed the expectation from contract theory that, owing to pervasive risk and uncertainty, PGBS—and PAFs in particular—currently resembles a 'relational contract' in design and operation. A relational contract 'specifies only the general terms and objectives of a relationship and specifies mechanisms for decision-making and dispute resolution' (Milgrom and Roberts 1992). Relational contracts are widely used when the contracted task is complex and/or the environment in which it is taking place has much risk and uncertainty (e.g., major engineering works). A relational contract partially/temporarily suspends market relations between principal and agent in order to allow them to work together in a club-like manner, i.e., collaborative problem-solving for a common purpose. It is also an important means of building trust through teamwork

Figure 2
Types of PGBS rules according to types of organizational relations

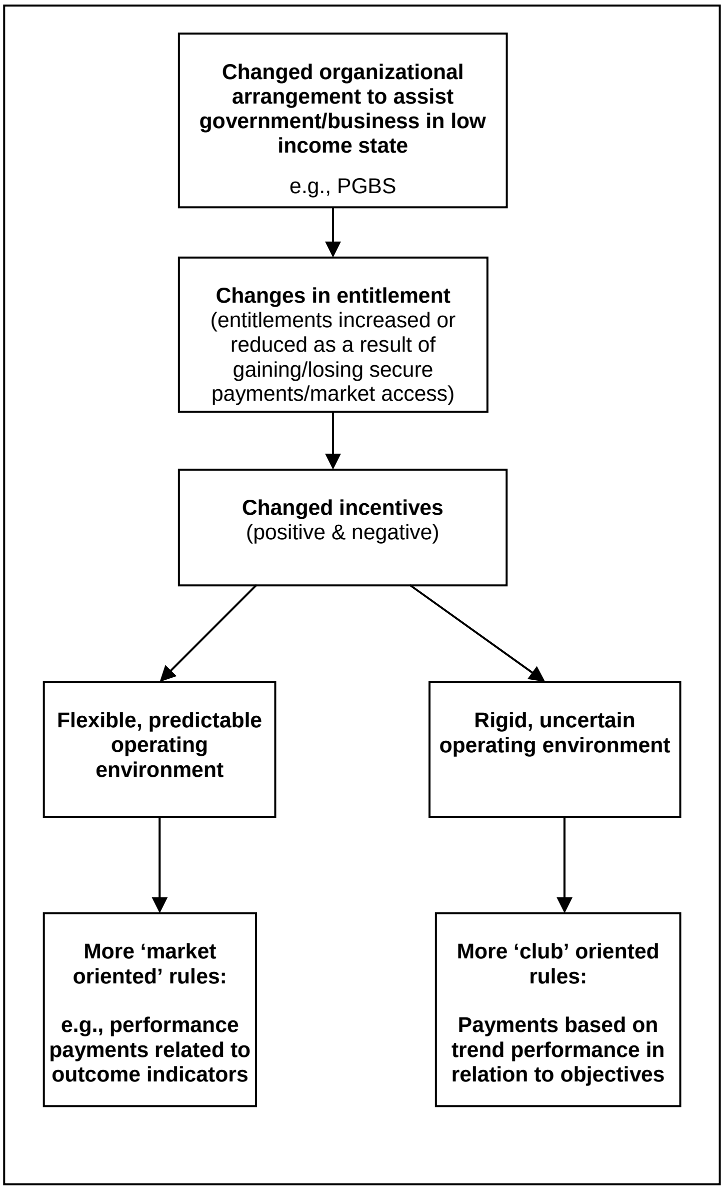
	Types of relations		
Types of rules	**Market**	**Club**	**Hierarchy**
General rules	Commercial rules enforcing contracts	Club rules relating to entry, conduct, entitlements, exit	Decided by leaders
Rules for basic payment	Macroeconomic stability on-track	Trend performance	Prior actions
Rules for results oriented payments	Performance related tranches, based on indicators		
Monitoring information: **- What is monitored?** **- What data?** **- Who monitors?**	Specific agreed indicators, using agreed data and objective monitor.	Ideally govt's own indicators and data for plan and budget, monitored by govt's own team, supported and reviewed for quality.	Leaders monitor indicators they choose, collecting own data.

Source: Author.

in the face of uncertainty. A relational contract amounts to a commercial framework with broad parameters (time, cost, quality) within which club relations predominate as long as the overall parameters do not look like being upset. If they do, there is a switch to more commercial (market) behaviour to alter the task or put in place more appropriate parameters. In the case of PAFs the parameters are necessarily very broad and there is no formal commercial contract at its heart.

The resemblance of PGBS behaviour to behaviour in relational contracts—the mix of market and club behaviour, and the switching between the two as confidence in the relationship fluctuates—may clarify why rules within PGBS arrangements vary: among donors there are varying levels of confidence in the relationship and there is much uncertainty about response to incentives. Integrating PAFs into government plans, budgets, data and monitoring systems—strongly recommended by the evaluation and Paris Declaration—will help to unify rules.

Figure 3
Appropriate rules for assistance depend on the operating environment



Source: Author.

Figure 3 illustrates the main point made above. It suggests that a change in organizational arrangements and resulting entitlement (e.g., introduction of PGBS) in turn changes incentives and rules. The appropriate rules depend on the operating environment, which is characterized as either flexible and predictable (necessary inputs are readily available, prices are stable, transaction costs are low, key actors are free to make necessary changes) or rigid and uncertain (the opposite), or in between these extremes. The more flexible and predictable the operating environment, the more beneficially can market oriented rules be used, since the incentive they provide can be responded to; and the more rigid and uncertain the operating environment the more appropriate are club rules, since performance incentives can less easily be responded to genuinely and may encourage fraud, and become a diversion from priorities.

Hence the recommendations of the evaluation regarding performance assessment frameworks:

- Take care that disbursement-linked conditions are kept to a minimum and are genuinely agreed with government.
- Ensure that performance assessment systems address all links in the results chain, so as to serve the management and monitoring of the implementation of strategies, as well as the monitoring of results.
- Decisions to increase or reduce levels of PGBS support should mainly be based on medium-term assessments of overall performance

(From Recommendation 7, IDD and Associates 2006: 6.54)

And the Paris Declaration states in this regard:

- Work with partner countries to rely, as far as possible, on partner countries' results-oriented reporting and monitoring frameworks.
- Harmonize their monitoring and reporting requirements, and, until they can rely more extensively on partner countries' statistical, monitoring and evaluation systems, [work] with partner countries to the maximum extent possible on joint formats for periodic reporting.

(OECD-DAC 2005)

5 Conclusion

There is an overall summary of the paper at the beginning. Therefore this conclusion is confined to discussing issues arising from the analysis.

First, theory suggests that club relations should be predominant in PGBS arrangements, since they are based on apparent common interest and the goals they set cannot easily be achieved by predominantly market or hierarchical relations between donor and recipient. There is evidence that more successful cases of PGBS have stronger club features. Where government capacity is low and government is heavily dependent on donors, PGBS relations are more hierarchic.

Second, a major issue in PGBS relations is that credible long-term commitments affect incentives more than single unrepeated payments, by creating a degree of entitlement. Positive effects were found to be investment in policy review, policymaking capacity and public finance management. Potential negative effects of PGBS entitlement on incentives may be to divert government attention from domestic revenue and domestic accountability. The evaluation did not find evidence of these negative effects.

Third, the rules of engagement in PGBS agreements (timetables, performance indicators) reflect the underlying club nature of PGBS. The effectiveness of club relations depends heavily on credible commitments by the main parties. This is especially so in PGBS relations, given their wide scope (the whole of government policy to reduce poverty and improve governance) and the uncertainties facing each party. Asset specificity does not create the risk in PGBS arrangements, since there are no investments which rely on PGBS arrangements continuing.[15] Rather, the problem is extensive uncertainties for all main parties, including how to control incentive effects resulting from PGBS.

Uncertainties underlie the preoccupation of PGBS partnership arrangements with designing performance assessment frameworks. They also underlie the problem of too many performance indicators, and the search for ways to make PGBS less vulnerable to changes in donor priorities and political standoffs. Attempts to shift PGBS rules towards a market basis (a small number of agreed outcome indicators which trigger/deny disbursements, without partnership working—as in MCA intentions) have had to be scaled back to fixed plus variable tranches, and pre-qualification finance in the case of MCA, disbursed through PGBS partnership working or through projects in the case of MCA funds via USAID.

General budget support using market-type rules based on outcome indicators, with arms-length relations, remains a prospect. As capacity of recipient governments rise—particularly in the quality of budgeting and monitoring—there may be shifts towards more marked-type rules. But an alternative is that PGBS donors particularly may shift from general to sector budget support as government capacity rises, in order to retain involvement in policy dialogue relevant to poverty reduction or growth. Current DFID budget support to the education sector in India may be a forerunner.

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15 Asset specificity creates particular risks related to the investment, whereas uncertainty in PGBS relations stems from many different sources for different parties, and therefore takes many forms.

Acronyms

APR	annual progress review of PRSP
BWI	Bretton Woods institutions
HIPC	highly indebted poor countries
IFI	international financial institution
MTEF	medium-term expenditure framework
MCA	Millennium Challenge Account
PAF	performance assessment framework
PGBS	partnership general budget support (also known as poverty reduction general support)
PPE	pro-poor expenditure
PRS	poverty reduction strategy
PRSP	poverty reduction strategy paper
TA	technical assistance

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