Governance or Poverty Reduction?

Assessing Budget Support in Nicaragua

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Abstract

General Budget Support (GBS) is assumed to lead to more effective poverty reduction through non-earmarking of the money and through recipient country ownership. A second and more hidden objective of GBS, however, is to influence policies and governance of recipient countries. This paper develops an evaluation framework that takes the tensions between these two objectives into account. It then assesses the results of GBS in Nicaragua under two administrations. It concludes that for most donors, the aim of improving governance was more important than poverty reduction, in both government periods, thus reducing the effect of GBS on poverty reduction. In addition, donor influence on governance was limited.

Keywords: aid effectiveness; budget support; evaluation; Nicaragua

1. Introduction

From around 2000 onward, many donors began to see budget support as the preferred aid modality. This drive towards budget support received a boost through the various High-Level Forums on Aid Effectiveness held in Rome (February 2003), Paris (March 2005) and Accra (September 2008). General Budget Support (GBS) was seen as the ideal form of meeting both the alignment objective (aligning with recipient governments' strategies, institutions and procedures) and harmonisation. By improving national 'ownership', reducing transaction costs, and strengthening national systems, budget support was expected to increase the efficiency and effectiveness of aid and to enhance poverty reduction in recipient countries.

In practice, many donors also see GBS as an instrument to improve policies and governance of recipient countries, and sometimes even to promote democratic governance. Studies of the conditionality around budget support (Molenaers et al., 2010; Hayman, 2011) revealed that there are tensions and possible trade-offs between the objective to influence governance and the official GBS objective of achieving more effective poverty reduction through improved country ownership and more donor harmonisation. These tensions and possible trade-offs also complicate the evaluation of budget support.

Most evaluations of GBS roughly follow the evaluation framework established by Lawson and Booth (Lawson and Booth, 2004), in turn based on earlier evaluations of programme aid (White, 1996; White and Dijkstra, 2003). However, while the attempt to influence policies in the past was one of the two inputs for earlier programme aid and was meant to enhance the ultimate objective, economic growth and poverty reduction, this is much less clear for the attempt to influence governance. Although donors claim that good governance and democracy are necessary for development, the empirical basis for this conviction is weak (See, for example, Leftwich, 1993; Doucouliagos and Ulubasoglu, 2006; Khan, 2006; Chang, 2011). In addition, GBS is supposed to be based on country ownership, and is therefore called 'partnership GBS' (Hammond, 2006; IDD and Associates, 2006). Commonly used evaluation frameworks include the words 'policy dialogue' , 'conditionality', along with 'ownership' (Lawson et al., 2005; Hammond, 2006; IDD and Associates, 2006; Lawson et al., 2007), they do not take into account that donors will only be prepared to respect 'ownership' if there is at least a minimum of preference alignment between donors and recipient. If this preference alignment is absent, some of the assumed advantages of GBS are unlikely to be achieved.

This paper builds on evaluation frameworks used in earlier studies, but recognises the contradictions in the underlying intervention theory of the donors . An adjusted evaluation framework is then used to examine the results of budget support provided to Nicaragua between 2005 and 2009. Nicaragua is one of the poorest countries of the Western Hemisphere and has an aid dependency level similar to many Sub-Saharan African countries. The country provides an interesting case to study the possible trade-offs between the two objectives for GBS. During the period 2005-2009 the country had two different governments. In the first period, Enrique Bolaños of the liberal party was president. He was in favour of institutional and governance reforms in the country and these ideas very much coincided with donor priorities. He also favoured liberalisation of the economy and was not very interested in the consequences for the poor. After the presidential elections at the end of 2006, President Daniel Ortega of the FSLN took over.

This new government prioritised poverty reduction in its socio-economic policies but was much less inclined to change governance.

The paper begins by reflecting on the expected advantages of budget support and examining the possible contradictions in the underlying intervention theory. This leads to an outline of the methodology used for the evaluation of GBS in Nicaragua. The next section provides some background on the political economy of Nicaragua and on governance in the two periods in which GBS was provided. The paper then proceeds to assess the implementation of GBS in Nicaragua, and in particular whether this implementation was in line with the objectives ownership, harmonisation and predictability. The next two sections examine the results of the donor attempts to influence policies and governance and the other possible intermediate and final results of GBS. Section 7 concludes.

2. Expected advantages of budget support and methodology

General Budget Support (GBS) is a form of programme aid, along with balance of payments support and debt relief. Programme aid is aid that is not linked to specific project activities (OECD, 1991). The idea of general budget support as the preferred aid modality has grown, first, out of growing disenchantment with the dominant aid modality, namely project aid. Project aid leads to high transaction costs for recipient governments, as each donor has its own disbursement conditions and its own implementation and reporting requirements. In addition, donors often set up their own project implementation units, poaching highly qualified staff away from local institutions.

Furthermore, project money is often highly unpredictable. All these practices undermine and weaken the country's own capacities for planning, budgeting and implementation of development projects. In addition, many of these donor-driven projects are not aligned with the country's own priorities and weaken domestic accountability. GBS would therefore contribute to a better coordination of development projects under the country's leadership, to lower transaction costs, more predictability of funding, and a strengthening of domestic capacities. It would ultimately also have political effects in the form of enhanced domestic accountability.

Secondly, general budget support is considered a response to disappointing effects of earlier practices of programme aid, in particular balance of payments support, in the 1980s and 1990s. This programme aid was accompanied by policy conditions, and research showed that these conditions were only implemented if they coincided with domestic political preferences and interests (Collier et al., 1997; Dollar and Svensson, 2000; Dijkstra, 2002). This led to a plea for more selectivity: budget support should be targeted to countries with good policies and good governance. It was hoped that selectivity 'ex post', on proven levels of policies and governance, would reduce the need for conditionality 'ex ante' and bring about more 'ownership'. Ownership would lead to better implementation of policies, and thus to more effective poverty reduction. All in all, the advantages of GBS are based on two crucial elements: the non-earmarking of the money provided and country ownership.

However, country 'ownership' in the sense of the country having 'ownership of development efforts' cannot be taken for granted (Booth, 2011: 4). Often the country's policies do not promote development. Many studies show that in order for a policy dialogue to have a chance of success, a minimum of preference alignment between donors and recipient is necessary. This can be guaranteed, to some extent, by the use of entry conditions. Most donors claim that they maintain strict entry conditions for GBS, including, for example, prudent macroeconomic policies, good governance, transparent and accountable public financial management systems, and a national development plan that prioritises poverty reduction. But in practice they have also started budget support if governments had (stated) intentions of improving policies, governance or public financial management or even if some of these conditions were not met at all. As a result, donors (begin to) *use* budget support to bring about the desired changes in policies and governance Some donors, for example the European Commission, are very explicit about this objective of budget support. For them, GBS is 'no blank cheque' but a means to guarantee that countries will 'stay on course' with respect to improvements in (democratic) governance and policies (European Commission, 2008). This may not only imply a return of 'ex ante' conditionality, but also means that GBS in fact has two objectives. One objective is to achieve more effective poverty reduction by providing freely spendable money that can be used in line with the country's own priorities, and the other is that of influencing the country's policies and governance. If countries do not sufficiently comply with donor conditions, a trade-off between the two objectives may appear. For example, if donors reduce disbursements in order to pressure the government to change policies or outcomes with respect to one objective, they will hamper the achievement of the other one.

The return of ex ante conditionality can also be expected to undermine other assumed advantages of GBS, especially if there is a large gap between preferences of donors and those of the recipient. First, the attempt to influence governance and policies will increase transaction costs, both for the donors and for the recipient government. In general, transaction costs exist precisely *because* donors want to secure spending and implementation in line with their preferences (Martens, 2008). Second, if the criteria for compliance are not clear or if donors do not respond in a reliable way, sanctions may affect the predictability of budget support disbursements. Third, conditionality may hamper the hoped for more effective implementation of (donor-desired) policies. Fourth, donor opinions on what good governance, good policies, and good policy outcomes are, may vary. The World Bank, being constrained by its articles of agreement, is usually only concerned with the more technocratic aspects of governance, while bilateral donors and also the EU usually add a concern with democratic governance, demanding free elections and the protection of civil and human rights (Leftwich, 1993; Doornbos, 2001). Also among different bilateral donors, priorities within good governance and poverty reduction policies will vary. This will reduce donor harmonisation, both with respect to inputs for the policy dialogue and with respect to disbursement criteria. Fifth and finally, there is the risk that an extensive policy dialogue between donors and recipient government will weaken domestic accountability. Governments that succeed in pleasing the donors and consequently receive a lot of discretionary aid, are able to buy out, neglect or even suppress the domestic opposition (Whitfield, 2009).

These contradictions of the intervention theory must be taken into account when evaluating the results of GBS. The evaluation matrix (Table 1) shows the intervention theory for GBS, tracing the expected outputs, outcomes and impact that follow from the two GBS inputs, the money and the donor priorities for entry conditions and for the policy dialogue. The fact that there are two objectives for budget support implies that improved governance must also be included both at impact level.

Table 1 here

When investigating the implementation of GBS, it is important to examine whether entry conditions have been complied with and to what extent the preferences of donors and recipient are aligned. It will also be assessed to what extent the entry conditions and donor inputs for the policy dialogue are harmonised among the donors. With respect to the other input, the money, it will be examined to what extent donor procedures and disbursement criteria are harmonised, and whether disbursements have been predictable. At output level, a first question is whether donor conditions have led to changes in governance and policies that would otherwise not have come about. Other expected outputs are related to the other expected benefits of this aid modality: domestic systems strengthened, transaction costs lowered and domestic accountability improved. Furthermore, it is examined whether the additional money provided in the form of budget support leads to a lower deficit, higher government expenditure for poverty reduction, or both.

If the right conditions have been set and if they are implemented, governance indicators and policies of the country should improve. The additional money for poverty reduction, combined with lower transaction costs and strengthened domestic systems should lead to more and better service delivery. Ultimately, by way of better government policies and more available money, GBS should promote economic growth and poverty reduction. This leads to four evaluation questions:

1. Has General Budget Support (GBS) been implemented in a harmonised and predictable way and were the preferences sufficiently aligned for donors to respect 'ownership'?
2. Have the donors through GBS been able to influence policies and governance? If the answer is yes, then how did they do that and what are the results?
3. Has GBS been able to strengthen national systems, to reduce transaction costs, to strengthen domestic accountability and to increase government expenditure, in particular social expenditure?
4. Have government policies and institutions, supported by GBS money and possibly changed by donor influence through the GBS policy dialogue, become more effective in fostering economic growth and in reducing poverty?

For answering these questions, many documents have been consulted published by the Nicaraguan government and donor organisations, and statistical data have been gathered. In addition, interviews have been held with representatives and officers of consecutive Nicaraguan governments and government institutions, of donor organisations and of civil society. These interviews were conducted during two field visits for this evaluation in the year 2009. The author also used interviews conducted in 2004 and 2006 in the context of previous studies.

3. The political background in Nicaragua

Nicaragua is one of the poorest countries in Latin America with a per capita income of around US$1000 in 2009 (World Bank, WDI-online 2011). It has a turbulent political economic history. Between 1939 and 1979, the country was ruled almost continuously by the Somoza family under a dictatorship. Although economic growth was high during the 1950s and 60s, with real GDP rising at an average rate of 7 per cent a year (Bulmer-Thomas, 1987), much of the Nicaraguan population lived in poverty and did not have access to education, health care or water and sanitation. After the victory of the left-wing FSLN (Frente Sandinista para la Liberación Nacional) in 1979 the economy first recovered. State influence over the economy became strong and access to social services expanded. However, growth could not be maintained. This was partly due to policy inconsistencies and partly to a devastating civil war in which the US government financed the armed opposition (Leogrande, 1996).

The elections in 1990 led to a victory of the opposition under the leadership of President Violeta Chamorro. This government managed to control the hyperinflation and started a series of economic reforms supported by IMF and World Bank. During Ms Chamorro's presidency aid was provided in large amounts, but this changed after the 1996 elections won by Mr Arnoldo Alemán. This government did not show much interest in cooperating with the donors, and there were increasing signs of large-scale corruption by the president and his closest allies. In October 1999, the ruling liberal party (Partido Liberal Constituyente, PLC) made an agreement with the second largest party in the Assembly, the FSLN, in which they divided all seats on the Supreme Court, the Electoral

Council, and several other public bodies. This '*Pacto*', still in operation today, virtually meant the end to parliamentary opposition and also to independent state institutions.

The 2001 elections were won by Mr Enrique Bolaños of the same PLC, who had been vice-president under Alemán. However, one of his first actions was to have the corruption of his predecessor investigated. In August 2002 Alemán was indicted for misappropriating US$ 97 million during his presidency. Later that year he was convicted and sent to jail. This gained Bolaños ample support from the donors. But almost all PLC members in the National Assembly continued to side with Alemán so that Bolaños did not have much support in Parliament.

The primary objective of the Bolaños government, as laid down in its National Development Plan, was economic growth. This was to be achieved by maintaining macroeconomic stability and by creating a more favourable climate for investment and in particular foreign investment. Ownership rights had to be better guaranteed, and state institutions had to be modernised. It was assumed that economic growth would automatically trickle down to the poor. However, the lack of support in Parliament and the earlier concluded Pacto between the FSLN and the PLC prevented many institutional changes from coming about. The Bolaños government was only able to change institutions over which it had direct control, such as public financial management.

Early 2007, the newly elected FSLN government of President Daniel Ortega took office. This changed the governance context. In fact, this change already began at the end of 2006, when the National Assembly approved the penalisation of therapeutic abortion,[1] with support of the FSLN. This gained the FSLN important support from the conservative Catholic Church in the upcoming presidential elections.

The Ortega government showed a willingness to maintain macroeconomic stability and to negotiate an agreement with the IMF, which was achieved in October 2007. It also appeared willing to maintain the improvements in public finance management. Moreover, the government gave a high priority to poverty reduction. It announced free education and health care services, and introduced special programmes for the poor, such as *Hambre Cero* and *Usura Cero*.[2] The aim of these programmes is to make the poor more productive. On the other hand, the government operated in a more secret way, and more power became concentrated in the hands of the president and his wife. The country began to receive large amounts of aid from Venezuela but these funds were managed in a non-transparent way, thus providing rumours that they were primarily used for party interests - in particular, securing re-election of President Ortega - rather than state interests.

In the course of 2007 and 2008, there were increasing signs that the Ortega government did not have much affinity with values related to a liberal democracy. It promoted so-called 'direct democracy' by installing CPCs, Councils of Citizen Power, leading to concerns of exclusion on party-political basis. There were instances of harassment of civil society representatives and concerns about decreasing press freedom. In June 2008, the government took away legal personality of two opposition parties, so that they would not be able to participate in the municipal elections of November that year. In the elections themselves, the leading party committed fraud in at least 33 and probably around 40 of the about 180 municipalities, including the capital Managua and the second largest city, León.[3]

4. The implementation of budget support

In 2003, Sweden and The Netherlands took the initiative for setting up a Budget Support Group, with the aim of establishing, together with the government, a harmonised system for general budget support. The expectation of higher aid effectiveness, in line with the official donor wisdom, was the most important motivation. In addition, at a general level donors had confidence in the Bolaños' government: its policy priorities (economic growth and macroeconomic stability) and its perceived willingness to fight corruption - evidenced from jailing predecessor Alemán - , to modernise the state and to improve the rule of law. Most members of the Budget Support Group were involved in technical assistance programmes for the improvement of public finance management, and they were confident that these efforts would be successful.

Design of GBS and harmonisation

After two years of preparation, in May 2005 a Joint Financing Arrangement (JFA) was signed by the government of Nicaragua and nine donors: the European Commission, Finland, Germany, The Netherlands, Norway, Sweden, Switzerland, the United Kingdom (UK), and the World Bank. The IDB joined in 2007. The JFA defined the procedures for providing GBS, with an annual Meeting in May of year n in which the achievement of the past year (n-1) would be assessed. Within four weeks after the meeting, donors would indicate their preliminary commitments for the next year (n+1). In the Mid-Year Meeting in August, the country's performance in year n would be assessed and within four weeks after that the donor commitments for year n+1 had to be confirmed in order to include them in the government budget.

The JFA defined some 'fundamental principles' that both donors and government had to abide with. They were formulated as:

> 'commitments to international law and conflict prevention, respect for human rights, democratic principles including free and fair elections, the rule of law, independence of the judiciary, free, transparent and democratic processes, accountability and the fight against corruption, sound macroeconomic policies and commitment to poverty reduction.' (Government of Nicaragua and donors, 2005: 5).

In case of non compliance with these principles, disbursements could be withheld. However, it was not very clear how this would be applied. Some of them, like an independent judiciary, were not fulfilled at the start, and several other principles were only weakly present, if at all. For none of them a minimum level was defined so that it was impossible for the government to know in which case disbursements would be at risk.

Donors and government also agreed on a Performance Assessment Matrix (PAM). This PAM contained in total 160 policies, measures and indicators for a period of two years (2005-2006). Although the JFA specified a time schedule for the monitoring of the PAM and of the consequences, also in this case it was not clear how it was going to be used. In practice, all agencies had their own implicit priorities within the PAM and the fundamental principles. Some donors made their disbursement criteria explicit. The World Bank continued to identify specific disbursement 'triggers' related to its Poverty Reduction Support Credit. Both the EC and Switzerland applied a so-called split response mechanism: part of disbursements were linked to a general assessment of the PAM and the fundamental principles. Another part was linked to the degree of performance in specific indicators.

Alignment of preferences

It can be doubted whether the conditions for providing budget support were met in Nicaragua. First and as argued above, some of the 'fundamental principles' were not fulfilled at the start and others were only weakly present. The 'Pacto', supported by the majority in the National Assembly, prevented the coming into being of institutions related to liberal democracy like the rule of law and an independent judiciary. The donors expected that they would be able to use the leverage of budget support to support the Executive in its governance modernisation agenda, against an unwilling parliament and unwilling other state institutions. This can be considered optimistic and naïve.

A second problem was that at the start of the agreement, donors knew or could know that the Bolaños government was not much interested in poverty reduction, for example judging from the first version of the National Development Plan. Some donors agreed with the government that private sector growth would result automatically in poverty reduction, but most donors expected to address the government's lack of attention for poverty reduction in the policy dialogue accompanying budget support. However, it can be doubted whether budget support is relevant at all if donor and government preferences regarding poverty reduction are so divergent.

Given these divergent preferences, it is not surprising that the content of the 2005 PAM was dominated by donor wishes. Donors wanted to use budget support to influence all areas and sectors of government policy: macroeconomic, public financial management, social policies, governance, infrastructure policies and policies for the productive sector. 'Actions' often included laws to be approved by the National Assembly, or measures to be taken by entities over which the Executive had little influence, such as the Supreme Audit Institution or the Supreme Court. In the next year, donors and government managed to reduce the number of actions and indicators from 161 to 109, but they were still largely donor-driven.

Under the Ortega government, both donors and government were willing to continue the GBS agreement. However, given that the FSLN was signatory to the Pacto, opinions about the fundamental principles now widely differed between the Executive and the donors. The JFA was maintained, but the new government managed to reduce the number of indicators and targets of the PAM and to bring them more in line with its own policy priorities.

Amounts and predictability

Appendix Table 1 shows that programme aid in general, and budget support in particular, was small relative to total aid disbursements 2001-2008, although in 2004 (pre-JFA), 2006 and 2007 the amounts were substantial and exceeded US$ 100 million. In 2004 and 2006, budget support constituted more than 10 per cent of the government budget and about 2.5 per cent of GDP. Total aid in most years amounted to more than half of the budget and more than 10 per cent of GDP, showing that project aid was still the dominant aid modality in Nicaragua.

On average, programme aid represented 13.3 per cent of total aid between 2005 and 2008, and 5.9 per cent of total expenditure. This is higher than between 2001 and 2004, when the relative figures were 7.2 and 4.2 per cent, respectively. However, if we look at a longer time frame, programme aid has become less important. Between 1995 and 2000, the share of programme aid in total aid was 22 per cent (Dijkstra and Komives, 2011).
In the period of the JFA, the European Commission was the largest budget support donor with a quarter of total resources provided. The World Bank and IDB also provided large amounts.

Appendix Table 1 also shows that year-to-year fluctuations in budget support disbursements were large. While pledges and disbursements were almost equal in 2006 and 2007, this was not the case in 2005 and 2008, mostly as a result of donor sanctions to government behaviour. Since the criteria for disbursement were not very clear, donor responses were not always predictable for the government. Another aspect of predictability is about the timing of disbursements within a budget year. In all four years, a large part of budget support resources was received in the last quarter of the year. This complicated financial management for the government.

5. Influence

This section assesses the processes and channels used for exerting influence, and the results. The main channel for the policy dialogue were the bi-annual high level meetings between donors and government in which performance on the PAM was assessed. During these meetings, the government explained its performance and the donors were able to express their priorities within PAM and fundamental principles. During the first Annual Meeting in May 2005, when the ink of the JFA had barely dried, a first conflict appeared. While 'macroeconomic stability as defined by the IMF' was part of the agreed PAM, the government did not comply with some requirements of the IMF programme. All macroeconomic targets were met, but the National Assembly had failed to approve some laws that the IMF considered necessary for medium-term macroeconomic stability, one of them being a pension system reform. In response, the donors decided to hold up their disbursements for about six months. The suspension of disbursements actually added leverage not only to the IMF, but in particular to the executive power vis-à-vis the National Assembly.

Donors have also sometimes used the *threat* of suspension of disbursements, in particular in relation to some governance-related indicators of the PAM. This occurred for example when the Supreme Audit Institution failed to audit the public accounts and when the Supreme Court refused to approve the 'regulations' for the implementation of the Judicial Career Law.

After the change in government in 2007, the policy dialogue was increasingly focused on the fundamental principles rather than on the PAM. From 2008 onwards, donors again began to withhold GBS in response to concerns about governance. Donor responses were now much less harmonised than in 2005. In addition, the number of GBS donors was reduced: Sweden and the UK decided to stop GBS because headquarters had decided to leave the country and Germany because there were doubts about the GBS instrument globally. In 2008, a government change in Finland provoked the unilateral withdrawal of this country from the JFA. The removing of legal personality from two opposition parties in 2008 led to a decision by headquarters in the Netherlands to halve its planned GBS amount for that year. After the November 2008 election fraud, the bilateral donors and the EU decided to suspend their disbursements fully.[4] In the meantime, the two banks continued to provide GBS resources.

In March 2009, under the influence of the economic crisis which provoked much lower tax revenues and also lower aid from Venezuela,[5] the government re-opened the dialogue with the remaining bilateral donors (Netherlands and Switzerland) and the EU. The donors began to focus on guaranteeing the democratic nature of the *next* elections - elections for three regional governments held in March 2010. In June 2009, the government conceded that it would admit observers to these elections. In response to this concession, the EU decided to unfreeze an amount of €10 million of a total of €60 million in programmed budget support, earmarking this money for the education sector. The other donors kept waiting for more concessions. However, no other political concessions came about, and in fact no national observers were admitted to the March 2010 elections. The remaining non-bank donors decided not to renew the JFA in 2010.

Results of the policy dialogue

It is impossible to analyze the results on all indicators of the PAM and on all fundamental principles. For this reason, the analysis focuses on i) average compliance with PAM policies and indicators, ii) cases in which donor disbursements were suspended, and iii) topics that received a lot of attention during the policy dialogue (as revealed in the reports of those meetings) and/or that were seen as important achievements of the policy dialogue by donor representatives interviewed.

Average compliance with the indicators of the PAM was limited during 2005 and 2006 and much higher in 2007 and 2008.[6] This is not surprising, since in the later period the policies and targets were much more in line with government wishes, and were often easier to achieve. The average degree of compliance of the PAM did not have consequences for the flow of budget support. During the Bolaños government donors continued to disburse although some important social indicators were deteriorating, such as the primary school enrolment rate. In spite of the good performance on the PAM in the second period, the donors used the instrument of suspending (part of) disbursements - for political and governance reasons.

In 2005, the combined pressure of all GBS donors was successful in the sense that towards the end of the year, Parliament approved the required laws. However, some of these laws violated the Constitution and the extent of implementation of all approved laws was low. The Dutch decision to halve budget support in 2008 was meant to pressure the government to return legal personality to the two opposition parties but this did not happen.[7] The suspension of disbursements after the municipal election fraud did not lead to changes in that election result nor did the subsequent policy dialogue succeed in improving the democratic nature of next (regional) elections.

According to the donors, the most important achievements of the policy dialogue were increases in poverty expenditure, improved transparency of budgets, the fact that for the first time budget execution has been audited by the Supreme Audit Institution, the approval of the Judicial Career Law and its regulations, and the approval of the Law of access to information.

Poverty expenditure increased as per cent of total expenditure and as per cent of GDP between 2002 and 2005, but remained at about the same level after that (Appendix Table 2).The rise in poverty expenditure thus preceded GBS and cannot be ascribed to the policy dialogue around GBS. Furthermore, the increase in poverty expenditure between 2002 and 2005 covered only 44 per cent of the resources released by debt relief in that period (Guimarães and Avendaño, 2011). Social expenditure in per cent of GDP continued to increase in 2006, but especially in education a relatively large share of this went to tertiary education of which mainly the non-poor benefit (Moore and Soto, 2007). Health expenditure also proved to be badly targeted, with much more emphasis on curative care than on prevention (World Bank, 2007). During the GBS policy dialogue, donors repeatedly requested figures on the regional breakdown of health expenditure in order to track resource flows to the poorest regions, but to no avail.

As a result of continuous donor pressure, budget execution has indeed been audited from 2007 onwards. This occurred with long delays and the audits (supposedly a constitutional task of the Supreme Audit Institution) required additional donor money. More importantly, the Supreme Audit Institution is led by persons appointed according to the Pacto, so the actual results are limited. In addition, so far no follow-up has been given to the - limited - findings.

The approval of the Judicial Career Law in 2005 was clearly a result of donor influence. It implied that judges - at least, those below the highest level - were to be appointed according to merit. However, the government maintained that the law could not be implemented without 'regulations'. After three years of heavy donor pressure, the EU for example postponing its Judicial sector budget support programme, these regulations were approved in 2008. But even after this approval judges were still appointed 'retroactively'. Independent observers are of the view that no impartial justice exists in the country and that the law did not bring improvements.

All in all, there were some formal results of the influence attempts, but the extent of actual influence was limited. The donors were not able at all to exert influence on political topics such as free and fair elections and the importance of the CPCs.

6. Intermediate and final outcomes of GBS

The third evaluation question focuses on intermediate outcomes of GBS: has GBS been able to strengthen national systems, to reduce transaction costs, to strengthen domestic accountability and to increase government expenditure?

The preparations for the JFA and the policy dialogue around budget support brought an intensive schedule of meetings for both donors and government representatives, so transaction costs were high. All three types of transaction costs (information and search costs, negotiation costs, and monitoring and bonding costs) were probably higher and sometimes much higher than for projects. Yet, given that the amounts disbursed in GBS were much higher than those for an average project, GBS has contributed to a lowering of transaction costs.[8]

GBS and the accompanying policy dialogue also contributed to improved policy coordination within the government. In addition, before and during the period in which donors provided GBS, the government's budgeting, planning and reporting systems improved. This was largely due to technical assistance programmes of donors, and was helped by a strong commitment of government officers. Yet, budget support gave the impulse for these technical assistance programmes. Under the Bolaños government, these government systems also became more transparent. This led to some improvements in domestic accountability: Parliament began to discuss not only budgets but also the actual use of resources, and civil society actively used the available information as well. However, under President Ortega, and despite the adoption of a Public Access to Information Law in 2007, actual government transparency was greatly reduced.

With respect to the macroeconomic effects of GBS, there is no evidence that it led to reduced tax income, as this income steadily increased from 2002 onward (Appendix Table 2). Expenditure remained at about the same level (in per cent of GDP) from 2004 onward, so the deficit decreased. GBS may have contributed to a reduction in the deficit, but it is more likely that the government was determined to reduce it irrespective of the level of GBS, especially in view of the relative uncertainty about GBS and the fact that most resources were disbursed in the fourth quarter of the budget year. Given that there is a close link between movements in GBS (in particular the increase in 2004 and the decrease in 2008) and movements in the domestic financing of the deficit (Appendix Table 2), the most likely effect of GBS is a decrease in the domestic financing of the budget deficit, in other words, amortisation of domestic debt. This means that GBS contributed to macroeconomic stability during the years 2004-2007.

Final outcomes and impact

The fourth evaluation question was whether government policies and institutions, supported by GBS money and possibly changed by donor influence through the GBS policy dialogue, have become more effective in fostering economic growth and in reducing poverty. This question partly builds on the results of donor influence on policies and governance, which turned out to be limited. After 2005 poverty expenditure did not increase and the donors did not succeed in (or did not try hard enough) inducing the Bolaños government to pay more attention to poverty reduction or to improve the targeting of social expenditure.

Poverty reduction has become much higher on the agenda of the Ortega government, but this was not the result of donor influence. From 2008 onwards, donors have reduced GBS disbursements. In this sense they only briefly supported the poverty policies of the new administration.

Impact on poverty reduction

The trends in poverty and social indicators broadly support the differences in policies over the years. Over the long term, from 1993 onwards, most social indicators improved. However, in the period 2001-2006, the period of the Bolaños government, the picture is much less favourable. Progress on social indicators was limited, with small improvements in infant and child mortality and virtual stagnation in primary school enrolment rates (Appendix Table 3). Family planning coverage declined from 25 per cent in 2001 to 13 per cent in 2005 (World Bank, 2008). In access to water and sanitation, some progress was made between 2001 and 2005 and also, it seems, between 2007 and 2008 (Appendix Table 3). Government figures show increased school enrolment and a much lower illiteracy rate in 2008. However, the reliability of many of these figures, especially those provided by the government, can be questioned.

The developments in the poverty headcount are even more striking. After a slow but continuous decrease in poverty between 1993 and 2001, the poverty rate and also the extreme poverty rate slightly *increased* between 2001 and 2005, during the Bolaños presidency. This increase occurred despite a positive average growth of 3.2 per cent in those years. Nicaragua had a positive poverty elasticity in this period (World Bank, 2008), which is very unusual. Between 2005 and 2009, and although average growth declined somewhat to 2.7 per cent per year, mainly due to the 2009 global economic crisis, poverty decreased, especially in rural areas (Figure 1). This trend continued in 2010. The fall in extreme poverty after 2005 was even more spectacular, and again especially in rural areas (FIDEG, 2010, 2011). It seems that changes in policies during the Ortega administration did make a difference.

Figure 1 here

7. Conclusions

The expected advantages of General Budget Support are based on two features: the provision of freely spendable money and respect for ownership. Donors will only be prepared to respect ownership when there is a minimum degree of preference alignment, for example as a result of the application of entry conditions. In practice, entry conditions have not been very strict and donors use GBS to influence policies and governance in the recipient country. This paper has shown that the re-introduction of substantial conditionality may theoretically undermine several of the assumed advantages of GBS, including its final objective of more effective poverty reduction. In addition, there may be a trade-off between the poverty reduction and objective to improve governance.

The paper answers four questions for the case of Nicaragua. The first question was whether GBS was implemented in line with the principles ownership, harmonisation, and predictability. The paper concludes that not all conditions for setting up GBS were fulfilled at the start. The Bolaños government wanted to change government institutions in line with donor preferences, but lacked support from these institutions and from Parliament to do so. Furthermore, this government gave a very low priority to poverty reduction. As a result, donors practiced extensive ex ante conditionality, trying to push the Executive to care more about income distribution and social sectors, and trying to pressure unwilling other state institutions for modernizing governance. The preferences of the Ortega government allowed for a more harmonious policy dialogue on poverty reduction, but donors then began to only focus on governance issues - in which preferences of government and donors laid far apart. Although not all disbursement conditions were harmonised, donors by and large succeeded in coming to a joint assessment of government performance - at least during the first three years of the GBS agreement. This changed from 2008 onwards when donors had different responses to perceived breaches of the fundamental principles of the JFA. The predictability of GBS resources was good in 2006 and in 2007, but lower in 2005 and 2008 when donors reduced disbursements for reasons that were not always clear in advance.

In both periods, donors put more efforts in influencing the government on governance issues than on poverty reduction policies. This is also revealed by the motives for (threats of) suspension of disbursements, which were always related to governance issues or. democratic principles. The attempts to influence had only limited results: sometimes there was formal compliance but very little substantial compliance, and the attempts to influence political issues during the Ortega government were not successful.

GBS clearly had some positive intermediate effects in Nicaragua. It had lower transaction costs and helped strengthening government systems. There were also some positive effects on domestic accountability during the Bolaños government. The most likely macroeconomic use of GBS has been the repayment of domestic debts; this means that GBS resources have contributed to macroeconomic stability, so indirectly to economic growth.

The final question was whether government policies, supported by GBS resources and possibly changed under influence of the donors, have become more effective in reducing poverty. For the period of the Bolaños government, the answer must be no. The priorities of donors and government were elsewhere. During the Ortega government, the GBS resources can be expected to have contributed to poverty reduction, as this government carried out policies that were more effective for reducing poverty. Yet, bilateral donors and the EU began to suspend budget support from 2008 onwards, for governance reasons, so they only briefly helped financing these more effective policies.

All in all, the paper shows that improving governance was a more important objective for most donors than poverty reduction, in both periods. The results on this objective were limited. The provision of GBS did have some positive intermediate effects such as improved macroeconomic stability, improved government systems, reduced transaction costs and improved domestic accountability - the latter during the period of President Bolaños only. These intermediate effects may indirectly have contributed to economic growth and poverty reduction. But the paper also shows that the donor priority for governance rather than poverty reduction has reduced the effects of GBS on poverty reduction. GBS did not help changing the policy priorities of the Bolaños government and actual poverty increased during his presidency. Under President Ortega poverty began to decline but the donors stopped supporting these policies with GBS resources.

Endnotes

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[1] The approval meant that abortion would be punished even if the life of the mother was in danger or if the pregnancy was the result of rape.

[2] The first implies handing over a cow, a pig and a hen to a poor household, the second is a transfer of credit to female micro and small enterprises at an annual interest rate of 4 per cent.

[3] According to the NGO Etica y Transparencia, as published in *Revista Envío* No 332, March 2009. http://www.envio.org.ni/articulo/3952.

[4] Norway was willing to continue but did not want to be the sole remaining bilateral donor. Because this donor did not agree with the political use of the GBS instrument, it decided to leave the JFA early 2009.

[5] Venezuelan aid was dependent on the oil price, which decreased at the end of 2008.

[6] In 2005, 41 per cent of all actions and indicators was complied with, in 2006 only 33 per cent. This figure increased to 83 per cent in 2007. In 2008, 37 per cent of actions and indicators was complied with fully, while all others were achieved to a 50 per cent degree. Source: interview with government GBS coordinator.

[7] Representatives of the Dutch Embassy in Nicaragua argued that this was partly due to the fact that headquarters hesitated too long in making this decision.

[8] This conclusion is based on estimates of transaction costs involved in all three types of transaction costs for GBS and for projects, for donors and for government, and comparing this with the relation between the average annual amount of GBS disbursements (US$ 75 million) with the size of the average bilateral or multilateral project (US$ 5 million) The estimated transaction costs for GBS do not exceed 15 times the average project transaction costs.

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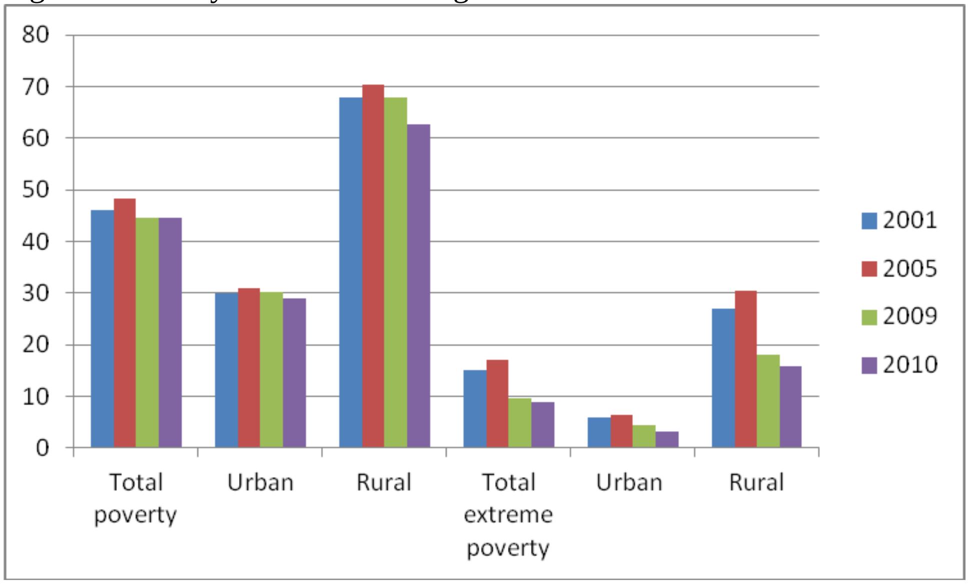
Figure 1. Poverty indicators Nicaragua 2001-2010



Sources: World Bank (2008) and FIDEG (2010, 2011).

Table 1. Evaluation framework for general budget support

Inputs	Donor priorities for entry conditions and for the policy dialogue		Money	
Necessary features	Harmonisation	Extent of alignment of preferences	Harmonisation	Predictability
Output	Changes in policies and governance		Domestic systems strengthened by using them Lower transaction costs Domestic accountability improved Lower deficit or additional (poverty reduction) expenditure	
Outcome	Improved policies and governance Improved government effectiveness: higher quantity and quality and better targeting of services			
Impact	Improved governance More effective poverty reduction			

Appendix Table 1. Budget support, programme aid, and total aid in millions of US$, and in per cent if so indicated

	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**Average 2001-04**	**Average 2005-08**
Total budget support	0	31.2	25.2	109.3	40.2	131.9	98.5	30.0	41.4	75.2
Loans	0	14.9	0	50.9	5.2	62.6	45.7	0.0	16.5	28.4
Grants	0	16.3	25.2	58.4	35	69.3	52.8	30.0	25.0	46.8
Total Programme aid	3.7	33.9	27.5	110.4	51.3	132.7	109.1	30.7	43.9	81.0
Budget support as % of total aid	0.0	5.9	4.3	16.8	7.1	20.6	14.3	7.3	6.7	12.3
Programme aid as % of total aid	0.7	6.4	4.7	16.9	9.1	20.7	15.8	7.4	7.2	13.3
Budget support as % of total expenditure	0.0	3.4	2.7	10.8	4.2	10.6	7.1	1.9	4.2	5.9
Budget support as % of GDP	0.0	0.8	0.6	2.4	0.8	2.5	1.7	0.6	1.0	1.4
Total aid as % of total expenditure	49.0	57.0	62.8	64.7	58.4	51.3	49.7	26.3	58.4	46.4
Total aid as % of GDP	13.1	13.1	14.3	14.6	11.6	12.1	12.1	7.7	13.8	10.9

Sources: Central Bank of Nicaragua (CBN) for aid figures and GDP in US$, Ministry of Finance and Public Credit (MHCP) for total budgets, CBN for exchange rates; and own calculations.

Appendix Table 2. Sources and uses of government resources, in per cent of GDP

	2002	2003	2004	2005	2006	2007	2008
Government revenues	14.8	16.4	17.2	18.0	18.8	19.6	19.0
Tax revenues	13.4	15.1	15.7	16.7	17.4	18.0	17.6
Other income	1.4	1.2	1.4	1.3	1.4	1.6	1.5
Total expenditure	20.4	24.1	22.4	22.5	22.7	22.7	22.9
Deficit	-5.6	-7.8	-5.3	-4.5	-3.9	-3.1	-3.8
Financing of deficit:							
Grants	3.7	5.3	2.8	3.8	3.8	3.7	3.3
Net external financing	2.0	4.0	5.7	3.5	2.7	2.6	1.7
Net internal financing	-0.1	-1.5	-3.2	-2.8	-2.6	-3.2	-1.2
Total expenditure	20.4	24.1	22.4	22.5	22.7	22.7	22.9
Poverty expenditure	9.1	11.1	12.0	13.1	12.3	13.3	13.4
Social expenditure	8.5	10.2	10.3	11.2	11.1	11.7	12.3
Interest internal debt	1.6	2.5	1.6	0.6**	1.2	1.0	0.7
Interest external debt	1.1	1.9	0.3	0.4	0.5	0.4	0.3
Other expenditure*	9.2	9.6	10.2	10.3	9.9	9.5	9.5
Memo items:							
Programme aid	0.8	0.7	2.5	1.1	2.5	1.9	0.5
Amortisation external debt	2.0	3.2	0.5	0.6	0.8	0.7	0.6
New external loans	4.0	7.2	6.2	4.1	3.5	3.3	2.3
Deficit after grants	-1.8	-2.5	-2.5	-0.7	-0.1	0.6	-0.5

*Total minus social minus debt payments.

**The 2005 figure for interest on internal debt is much higher in Table VI-9 of Fiscal accounts from the Central Bank (1.4 per cent of GDP), but here the figures of the Ministry of Finance and Public Credit (MHCP) are used.

Sources: Own calculations based on: MHCP (Liquidación presupuestaria) for budget data, Central Bank of Nicaragua for GDP data and exchange rates (year average)

Appendix Table 3. Some social indicators 1993-2008

	1993	1998	2001	2002	2003	2004	2005	2006	2007	2008
Net primary enrolment	76		83	86	86	87	84	86	87	87
Illiteracy	19		19				18		20	8
Infant mortality	58	42	30					29		
Child mortality	72	51	37					35		
Chronic malnutrition	20		18				17	17		
Immunisation rate		80	72					85		
Institutional births		64	66					74		
Access to water*	68		70				72	85	65	70
Access to sanitation*	45		52				56		36	42

* Given the large fall in 2007 and 2008, the definition of this access has probably changed over time.

Sources: 1993, 2001, 2005: World Bank (2008); child and infant mortality, immunisation rate and institutional births 1998, 2001, and 2006: Nicaragua Demographic and Health Survey 2008; For 2002, 2003, and 2004: Data from Nicaraguan ministries of Education and Health as published in Guimarães J. and Avendaño, N. (2008) Por fin, la pobreza? Country report Nicaragua 2007. Evaluation of Poverty Reduction Strategies in Latin America. Stockholm: Sida.; for 2006: Government of Nicaragua (2007), Nicaragua: Progress report national development plan 2006. Managua: Secretaría Técnica del Poder Ciudadano SETEC; for 2007 and 2008: Government of Nicaragua (2008), 'Programa Económico-Financiero 2007-2010, Evaluación de Indicadores Sociales 2008' (from www.bcn.gob.ni, accessed 10 November 2009).