Overseas Development Institute

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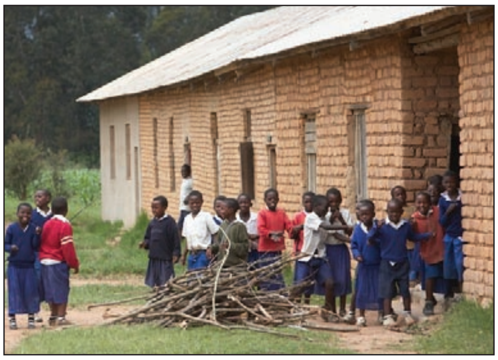
Common funds for sector support

Building blocks or stumbling blocks?

In the continuing effort to provide more effective aid, donors have committed themselves to making greater use of country systems and harmonising the way aid is delivered. Donor agencies that agreed to the Paris Declaration on Aid Effectiveness in 2005 are free to choose the modality with which they deliver aid to the government sector, as long as they move progressively towards modalities that use country systems in full.

Budget support and debt relief are the modalities that best meet these criteria. Yet donors are hesitating in taking the obvious step of moving decisively towards them, even in contexts where programme-based approaches have been well-established by the adoption of sector-wide approaches and national poverty reduction strategies. Instead, they either continue to use project arrangements or adopt intermediate modalities, such as common, pooled or basket funds.[1] The justification usually offered is that recipient country systems are too weak for a shift to budget support. Common funds are presented as 'transitional' aid modalities by means of which donors can help strengthen country policies and systems, while ensuring that aid funds are well spent.

But is this reasoning justified? Can aid instruments such as common funds help smooth the transition from traditional project-based aid to the effective use of budget support? This Briefing Paper presents evidence on the effectiveness of different modalities of aid, investigating in particular what effect 'transitional' modalities have on a country's systems and capacities. We highlight three case studies of aid modalities at the sector level, covering the education sector in Tanzania, the water and sanitation sector in Uganda, and the health sector in Mozambique.[2] The paper focuses on the lessons learned about the use of country systems at the sector level, and in particular the role of common funds.



How to support primary schooling in Tanzania?

Our analysis draws on research, led by the Overseas Development Institute in collaboration with the Economic and Social Research Foundation of Tanzania, within a project commissioned by the Advisory Board for Irish Aid.

The failures of project aid and the potential of direct budget support

The interest in aid modalities that use country systems, and sit more comfortably with national and sector plans, grew in response to extensive reports on the ineffectiveness of the typical forms of project support. Uncoordinated projects, delivered in parallel with government systems, duplicate activities, divert valuable skilled staff working in the public sector, and create a mismatch between needs and resources by perpetuating geographical or thematic inequities. Where donor commitments have a short time horizon, they can also create contingent liabilities for governments, making it difficult to sustain expenditure to particular areas when donors withdraw their funding. By bypassing weak government systems in this way, project aid undermines the ability of government organisations to perform their core functions, setting in motion continuing cycles of

Key points

- In moving away from project aid, donors often prefer to create common funds rather than support government budgets
- In service delivery sectors, the effort involved in constructing common funds can actually weaken country systems and capacities
- Sector budget support represents a more viable transitional mechanism for strengthening country policies and systems

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Figure 1: The vicious circle of traditional aid delivery

State of the sector
- Absent/weak policies
- Fragmented budgets
- Weak sector organisations and capacity
- Service delivery systems inefficient or broken
- Weak domestic accountability
- Patronage and corruption

Effects of aid and donors
- No attention given to improving country policy or systems
- Projects take best staff from government
- Sector is accountable to multiple donors not to government
- Government's ability to perform core functions is weakened

Donor response
- Project aid preferred over programmatic aid
- Multiple projects that avoid government systems and are not aligned with policies
- Act bilaterally
- Build project implementation units outside government structures

weak governance and aid ineffectiveness (Figure 1).

In contrast, budget support delivers financial aid directly to the government budget. It is usually associated with mechanisms to help donors coordinate better among themselves and with the government, including monitoring arrangements and technical assistance. These inputs are meant to give recipient governments greater discretion in allocating resources towards their policy priorities, while also proving opportunities for dialogue on overall systems and policies. New approaches to conditionality, which link policy dialogue to domestically owned policies and strategies, are typically part of the package.

Proponents of budget support argue that shifting the focus of aid to country systems and policy processes gives domestic actors a greater incentive to engage with them. This empowers the authorities to improve their policies and budgets, and strengthen service delivery systems. In addition, it reduces the tendency for external demands to skew accountability away from domestic constituents towards donors. In these respects, budget support has substantial advantages over conventional project aid.

Recent evaluations of budget support[3] have found evidence of some of these benefits in practice. However, they also note that that the continued use of project modalities undermines the potential benefits that can be derived from budget support. Put another way, there has not been a significant enough shift towards budget support for the change in incentives and other benefits to be realised.

Donors are not shifting decisively towards direct budget support

Evidence on aid flows is notoriously unreliable. However, available data point to discrepancies between donor commitments and how aid is actually delivered. Despite the apparent enthusiasm for it, the proportion of aid going to recipient countries through budget support remains low. A survey undertaken by the Strategic Partnership with Africa (SPA) indicates that budget support is in aggregate only 20-25% of total aid for a sample of committed budget support donors in Africa. Other data (see Table 1) suggest that project aid remains dominant and that the share of non-traditional aid modalities in the total aid for low-income countries is small. The biggest increase seems to fall under the broad heading of sector programme aid, which includes projects, common funds and sector budget support aligned with sector programmes.

The three sectors we studied were chosen because of the countries' use of new modalities in service-delivery sectors. In Tanzania and Mozambique, we observed an increase in the importance of budget funding. But more striking was the scale of the use of common funds. In the Mozambique health sector, common funds made up approximately half of sector aid and a third of sector funding. In Tanzania, a common fund dominated aid to primary education. A common fund has also been established in the Ugandan urban water sector. Donors are using these common funds to support very different sets of activities (Box 1).

The rural water sub-sector in Uganda was the only case in which a decisive shift from projects to budget support modalities[4] was observed early on. Subsequently, government provision of rural water services moved from being entirely donor-project funded to being almost fully funded via domestic budgetary and delivery systems.

The fallacy of common funds

Is it necessarily wrong for donors to use common funds to deliver aid? After all, both stand-alone projects and common funds can be managed in ways that engage more with country policies and systems than projects have done in the past. The Paris Declaration acknowledges as much; it allows space for a range of modalities of aid delivery so long as they are shown to be working towards greater integration with government policies and systems.

However, our analysis suggests that the characteristics intrinsic to some modalities make it difficult for them to realise these theoretical possibilities and comply with the spirit of the Paris Declaration. Take projects for instance — although, in principle, projects

Table 1: Non-traditional aid modalities as a percentage of aid to low-income countries

	2001	2002	2003	2004
Sector programme aid	0%	1%	2%	8%
General budget support	5%	6%	4%	5%
Debt relief	4%	6%	15%	8%
Total	9%	13%	21%	21%

Source: CRS Online

can be a mainstream instrument of public planning, their use in developing country contexts has usually been motivated by the decision to avoid government systems. In theory, projects can use government procurement and accounting systems, be harmonised with other donor projects and be aligned with government policies. However, so long as resources and management are kept separate, fragmentation of service delivery efforts is inevitable.

Common funds are meant to generate efficiency gains over individual projects and to work better with government systems. Donors argue that they are useful in building the preconditions for an eventual adoption of budget support modalities. Our research does not suggest that this is true, at least in regard to service delivery.[5] To develop systems for supporting service delivery nationally with a common fund requires efforts similar to those needed to strengthen the mainstream government systems. Thus, common funds face the same capacity constraints and weaknesses as the systems that they attempt to side-step. Moreover, once common funds are created, they often, de facto, overshadow or even replace any domestic delivery systems that exist. As a result, the latter get little attention. Once created, this arrangement is difficult to take apart and the transition towards use of domestic systems may become permanently blocked.

Inputs provided under common funds interact with government systems in very different ways from budget support modalities. In the context of sector-wide approaches, both sector budget support (defined in footnote 4) and common funds are meant to provide a platform for more harmonised dialogue between donors and government, focusing on government policies and systems. It is argued that that such exercises can lead to substantial organisational learning for government and donors alike.[6] This may be true. However, our research finds that in a typical low-capacity environment, common funds can focus the efforts of several donors and the lead sector institution for a lengthy period solely on the design and management of the common fund. This can have the effect of diverting attention away from vital sector policy issues and the strengthening of mainstream systems. As sector budget support uses government systems, the opposite is the case — the dialogue will be focused on government systems and encourage their strengthening.

The establishment of common funds for sub-sectors can be particularly damaging, skewing dialogue towards them and reducing the government's discretion to allocate resources to sector priorities. Lack of both policy-focused dialogue and discretionary expenditure in turn affects the ability of the sector authorities to plan comprehensively and strategically.

Common funds can easily weaken domestic accountability systems. At important multi-stakeholder events, such as joint reviews, they can draw attention to the accountability demands of the funding modality itself. Prescriptive guidelines on the use of common-fund resources can also conflict with the objectives of local government decentralisation whenever these include a genuine devolution of resource-allocation decisions.

For all these reasons, the vision of common funds as 'transition mechanisms' towards more effective aid to service delivery is destined to fail. Common funds are typically much bigger operations than the individual projects they replace. To the extent that they retain many features of the traditional project approach, the detrimental effects on the coherence of policies and strength of systems in the host sector can therefore be worse than before. The move to common funds can do more harm than good.

Box 1: Use of common funds in Tanzania, Mozambique and Uganda

In Tanzania, the Primary Education Development Programme (PEDP) emerged from the Education Sector Development Programme but quickly outgrew this framework. It operates like a large project. This is especially evident in the way donor-pooled funds are released, monitored and audited. World Bank support to PEDP is disbursed through the government treasury but is clearly earmarked to a sub-sector within education.

In Uganda, the Joint Partnership Fund (JPF) uses a centralised project approach for delivering water supply systems in small towns. It helped to halt fragmentation of funding in the urban sub-sector and was more aligned with the urban department structure than previous projects. However, it does not use government systems beyond being reported in the budget and appearing on the agenda of the Ministry contracts committee.

In Mozambique, three common funds in the health sector were set up to align external financing better with sector strategies and national procedures. However, in practice these resulted in the development of new structures and procedures, and created mechanisms that potentially undermine national efforts to reduce transaction costs and attain a more integrated approach to health development in terms of execution, monitoring and auditing of funds.

Why, then, do donors continue?

Why is the use of common funds perpetuated by both donors and governments? The answer is in the interlocking incentives that continue to characterise the aid relationship. There are incentives for both donor agencies and recipient governments that discourage the use of budget support. These factors also help explain why purportedly transitional modalities continue to exhibit many of the features of traditional projects.

Within recipient governments:

- Parallel funding and management mechanisms generate perks for individuals, including salary top-ups, allowances, vehicles, training and travel opportunities. Politicians, centrally and locally, find that attracting a stand-alone project to a specific sector or area is to their political advantage.
- The resource flows from a freestanding project or common fund are perceived as more reliable and simpler to manage than funds received via the government budget. Government officials at the sector or local government level often prefer to avoid the unpredictability, rigidities and reporting associated with funding through the national budget.

In donor agencies:

- Benefits flow from the visibility associated with

Box 2: Breaking the circle: Budget support and the education sector in Tanzania

In view of weak government systems at the start of the PEDP, the Pooled Fund Partners set up parallel processes. These were soon recognised to be overlapping and a burden on the sector's capacity, leading to delays in funding releases and bitterness between the donors and the government. Acrimony within the sector, together with commitments by donors at a national level to provide more general budget support and better division of labour amongst themselves, has since caused education donors to move away from basket funding. This combination of 'push' and 'pull' factors has led to more aid being provided to the education sector through the budget. There are also signs that a broader sector-wide focus is developing.

Box 3: Breaking the circle: The rural water sub-sector in Uganda

In Uganda's rural water sub-sector, a shift to modalities which use government systems in full, including debt relief, general budget support and notionally earmarked sector budget support, has helped build stronger local government systems for service delivery. Before the shift, government reforms only existed on paper. Systems and capacity in local governments were either weak or non-existent. The move to programme modalities has meant that donors have a far smaller operational role than previously (although they retain some visibility as supporters of the sub-sector). This leaves the Ministry of Water to play its primary role, which includes policy development, monitoring and supporting local governments, not the implementation of projects. The fact that funds are now transferred to local governments to finance service delivery creates stronger incentives for them to attract and retain qualified personnel, and strengthen local government systems for delivering services to the public.

'branded' interventions. Where more programmatic modalities are introduced, visibility is lost and the attribution of development results to the support of particular donors becomes problematic.

- Career prospects may be enhanced where a large project or common fund can be presented as the work of an individual or small team.
- Donors can be risk-averse. The management of projects can, at least in appearance, be tightly controlled. A switch to budget support, and even just allowing projects to use government procedures, requires a leap of faith that donors are reluctant to take. For many donors, a mix of free-standing projects, common funds and (perhaps) a quota of budget support seems a good way of minimising risks.

Policy conclusions: What do donors and governments need to do?

The drive to align aid with government policies and use government systems is well conceived. It has the potential to break the circle of ineffective aid. However, mechanisms such as common funds are more likely to weaken country systems, policy ownership and accountability. So what should be done?

The incentive structures faced by donors and governments need to be taken seriously. But recent experiences in two of our case-study sectors confirm that incentives can be changed. In Tanzania, a decisive shift towards general budget support by donors, and associated increases in budgetary funding, have altered the options for actors in the education sector (Box 2).

Few countries have seen the rapid shift to general budget support that has occurred in Tanzania. However, the same effects can be achieved with a mix of modalities including general budget support, sector budget support or budget support that is notionally earmarked to sector programmes in such a way that it does not create parallel management systems. This is illustrated by the change in Uganda's water sector (Box 3).

These arrangements are genuinely transitional. It is a short step to move from sector budget support, or notionally earmarked budget support, to general budget support and the comprehensive use of country systems. It will be far harder to dismantle the parallel systems created by common funds.

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Endnotes

1 These terms refer to a modified form of project aid, where donor resources are pooled but kept separate from other (government) resources intended for the same purposes.

2 For further details, see Tim Williamson and Zainab Kizilbash Agha, with Liv Bjornstad, Gerald Twijukye, Yamungu Mahwago and George Kabelwa, Building Blocks or Stumbling Blocks? The Effectiveness of New Approaches to Aid Delivery at the Sector Level, Research Project on Good Governance, Aid Modalities and Poverty Reduction, Working Paper 6, London: ODI and ESRF. http://www.odi.org.uk/pppg/politics_and_governance/what_we_do/Politics_aid/Governance_Aid_Poverty.html

3 IDD and Associates, Evaluation of General Budget Support: Synthesis Report, Birmingham: University of Birmingham, International Development Department, 2006; Tony Killick and Andrew Lawson, Budget Support to Ghana: A Gamble Rewarded? London: ODI Briefing Paper 24, July 2007; Andrew Lawson et al., Does General Budget Support Work? Evidence from Tanzania, London: Overseas Development Institute, 2005.

4 Technically, this involved adoption of notionally earmarked budget support and then sector budget support (SBS) alongside debt relief and general budget support (GBS). SBS is a form of direct budget support which differs from GBS only in that the related policy dialogue is focused on the sector, with no earmarking of the funds. Notionally earmarked budget support refers to donor funds that are provided directly to the government, are separately identifiable in the government's revenue budget and result in equivalent additional expenditure allocations to a particular programme, but where the expenditures funded by these resources cannot be distinguished from those funded from other revenues in the expenditure budget, budget reports or annual accounts.

5 Common funds providing technical assistance or supporting institutional capacity building may not have the detrimental effects outlined here.

6 Jan Kees van Donge, 'Flexible SWAps for Strategic Policy-making: Reflections on the Zambian Experience', *Development Policy Review*, 25 (4), July 2007.

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