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### Transaction Costs in Aid: Case Studies of Sector Wide Approaches in Zambia and Senegal

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## **Transaction costs in aid** **Case studies of Sector Wide Approaches in Zambia and Senegal**

### **Aid transaction costs in the education sector: the case of Zambia**

Zambia is one of the poorest, most heavily indebted and most aid dependent countries in Africa. Between 2000 and 2002, Zambia received an annual average of \$595m in net ODA; in 2002 ODA represented 18% of national income, and over 40% of total public expenditure. 43% of the education budget is externally funded, and more than 60% of the budget for basic education. In recent years, the top five donors in volume terms have been the World Bank, IMF, EC, Japan and UK. In total, some eighteen official donors are currently active, or have recently been active in the Zambian education sector.

Zambia faces some of the region's greatest human development challenges. Its HIV-AIDS infection rate has reached 21%, and health indicators have declined markedly in recent years. The education system suffers from extremely low quality, and inadequate access, especially in rural and peri-urban areas. Over 600,000 primary aged children are estimated to be out of school, and today's generation of teenagers are more likely to reach adulthood unable to read and write than their parents' generation. The HIV-AIDS pandemic has contributed severely to educational decline, by impacting both on the state's capacity to deliver basic services and on households' ability to utilise those services.

### **Background**

After fifteen years of steep educational decline, in 1994 the World Bank initiated discussions on the introduction of a sector wide approach to education development, or Sector Investment Programme, that would encompass the work of all four ministries involved in education and training. Previously, aid to education had been provided through individual donor projects, resulting both in a piecemeal approach to the massive education challenges facing Zambia, and in onerous multiple administrative, technical and management costs for the government. The underlying rationale of the SIP was twofold - to achieve comprehensive strategic progress by aligning donor and country efforts, and to significantly lower the transaction costs associated with a fragmented, projectised approach.<sup>1</sup>

In response, the government revised its education policy in 1996, called 'Educating Our Future', with a view to it forming the basis of a SIP. However, in 1997 attempts to establish an education SIP broke down – largely because of the complications of working with different ministries, and because of donor concerns about government capacity and commitment. In its place two sub-sectoral programmes were established for basic education and vocational education. The four year Basic Education Sub-Sector Investment Programme (BESSIP) was launched in 1999, with a view to establishing a full Sector Wide Approach, or SWAp, in 2003/04. This case study will discuss the BESSIP and the subsequent Ministry of Education Sector Plan – introduced this year – in turn, and trace the evolution of key administrative and financial transaction costs over the course of the two programmes.

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<sup>1</sup> The key study of Sector Investment Programmes is Peter Harrold (World Bank, 1995) 'An exploration of Sector Investment Programmes with guidance for their further development'

The principal goal of the BESSIP was to arrest and reverse the deteriorating education system in Zambia. Nine components were identified – infrastructure, teacher development, teacher deployment and compensation, materials, equity, health and nutrition, curriculum, decentralisation, and HIV-AIDS. But in the course of delivering these components, it was expected to significantly change how donors and government worked together on the ground and make aid more effective. Together with the health sector, education was regarded as a key testing ground for a new ‘partnership’ approach to aid that involved the following key characteristics:

- strong government ownership, in place of a donor driven reform agenda
- pooled or basket funding, initially at a sector level, with a longer term view to direct budget support and pooled technical assistance
- harmonised reporting, financial and procurement procedures among donors
- alignment with country systems and procedures

### **Coordination and participation in BESSIP**

Zambia receives education aid from at least twenty official donors,<sup>2</sup> and this poses major challenges in terms of managing transaction costs. Fifteen donors provided some form of support to the BESSIP, and their involvement was coordinated through a number of planning groups and committees. Perhaps the greatest initial challenge was building sufficient trust to get donors to start relinquishing the visibility, tight financial monitoring and ability to earmark that come from running projects. A critical element in building this trust was the establishment of financial management, procurement and monitoring and evaluation systems that could improve transparency and accountability, with the state of public financial management in the ministry a particular donor concern. The fact that BESSIP coincided with a decentralisation programme further complicated efforts at coordination, with several donors citing its slow progress as a cause of bottlenecks in making progress towards a full Sector Wide Approach.<sup>3</sup>

In order to build donor confidence in the capacity and commitment of government, a management system separate from existing ministry structures was created, with ‘BESSIP’ staff reporting directly to a series of committees jointly convened by government and donors (see table 1). Overall responsibility for the BESSIP lay with a Joint Steering Committee that met twice yearly and functioned as a ‘high level’ forum for policy dialogue between the Education and Finance Ministries and senior donor representatives. A programme coordinating committee meeting 6 times a year provided in-depth oversight of the programme and managed a Management Implementation team responsible for generating twice yearly audits, quarterly progress reports, annual and semi-annual reviews and occasional evaluations, as well as coordinating Technical Assistance expenditures, organising meetings, workshops and seminars and supervising BESSIP activities across the ministry. In 2003 the MIC was subsumed into the ministry, in an effort to cut back on parallel structures, while the PCC has been renamed the strategic programme coordinating committee as Zambia has moved towards a full SWAp.

A financial committee and a task team comprising four donor representatives and four government officials (later expanded to ‘6+6’) reported directly to the PCC and were responsible for overseeing financial management, and with supporting the preparation of reviews and reports respectively. A more ad hoc committee tasked with addressing equity

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<sup>2</sup> Including UNICEF, UNESCO and UNDP

<sup>3</sup> IHSD, ‘Sector Wide Approaches in Education’, August 2003.

and gender issues was also established, while the ministry established a system of informal – often bilateral – meetings with lead donors such as the World Bank and DFID, in an effort to build consensus and confidence. According to ministry of Education officials spoken to in the course of the research, these processes - while onerous and involving considerable start up costs - did improve donor coordination. Whereas at the start of the BESSIP each participating donor insisted on individual reporting procedures, these became much more harmonised over the course of the programme, with the six bilateral donors that have pooled funding now using standardised reports. As the programme evolved, the BESSIP was seen less as a World Bank initiative, and monthly donor coordination meetings have built strong bilateral ownership of the programme, at least among the poolers who sat on the PCC and the ‘6+6’ group.

**Table 1: Administrative transaction costs in the BESSIP**

meeting	frequency	outputs	participation
Joint Steering Committee	Twice yearly	<ul style="list-style-type: none"> <li>• Policy formulation</li> <li>• Approval of work plans and budgets</li> <li>• Oversight of implementation</li> <li>• Coordinating donor funds</li> <li>• Reviewing reports</li> </ul>	Minister of Education, senior MoE management, Ministry of Finance, donor representatives
Programme Coordinating Committee	Every 2 months	<ul style="list-style-type: none"> <li>• Coordinate workplans and budgets</li> <li>• Monitor MIC</li> <li>• Coordinate Technical Assistance</li> <li>• Commission twice yearly audits</li> </ul>	Deputy Minister, BESSIP management, Donor representatives
Management Implementation team	weekly	<ul style="list-style-type: none"> <li>• Preparation of budgets and reports</li> <li>• Supervision of activities</li> <li>• Organise semi-annual and annual reviews, PCC meetings, workshops, seminars</li> </ul>	Senior MoE management
Financial Technical Committee	weekly	<ul style="list-style-type: none"> <li>• Financial management</li> </ul>	Donors, MoE staff, BESSIP accounting unit
6+6 task team	weekly	<ul style="list-style-type: none"> <li>• Preparation of reviews, reports, audits</li> </ul>	6 senior MoE staff, 6 donor representatives
Equity and gender committee	Ad hoc	-	-
‘Informal’ bilateral ministry-donor meetings	Ad hoc, but regular according to ministry staff	-	-

The Financial Technical Committee and 6+6 team reported directly to the PCC

Ministry officials also reported that the BESSIP had fostered a ‘culture of systematic planning’ that was previously missing, with the reports and reviews encouraging a more evidence-based approach to policy, and the setting of realistic targets and detailed budgets. Meanwhile regular meetings were felt to have created a more open climate of information-sharing and critical discussion. Less positively, parallel structures were created until the Ministry directorates were restructured to the satisfaction of donors, allowing the Management Implementation committee to be disbanded. While coordination was felt to have reduced overall administrative transaction costs, respondents also felt that these costs had been concentrated, with senior ministry staff spending very large amounts of time in formal and informal meetings with donor representatives.<sup>4</sup> Attempts to promote local ownership and reduce donor micromanagement have also sometimes faltered. For example, a programme evaluation carried out by Zambian consultants in 2002 was rejected at the Annual Review meeting,

<sup>4</sup> Netherlands Ministry of Foreign Affairs. ‘Local Solutions to Global Challenges: Towards Effective Partnerships in Basic Education’. Final report, September 2003

and a 2003 Dutch-Canadian study, part of a four country survey, supplanted the first evaluation.

### **Financing arrangements in BESSIP**

From its outset, the government’s preferred financing modality for the BESSIP was pooled funding, with a single agreed system of reporting and accounting. At the same time, donor confidence in the quality of ministry public financial management was low, and many donors cited administrative or legislative obstacles as preventing them from providing pooled funding (the EC is the only donor to provide direct budget support to Zambia at the present time). There was an initial attempt by MoE to get donors to sign up to a Memorandum of Understanding (MoU) and a Joint Statement of Intent in 1999, which failed partly because of what were seen by donors as unrealistic demands in the text to move swiftly to a full SWAp. The UK Department for International was one donor that, having agreed in principle to provide pooled funding for the sector, pulled back from this position in 2000 until further fiduciary safeguards were provided and a stronger track record of successful implementation was established.<sup>5</sup>

Initially, only four bilateral donors agreed to channel money through a basket under the control of the ministry, although this was held in parallel accounts. The government responded by identifying three other financing options, which in effect were a post-hoc rationalisation of what donors happened to be doing. These four cases are identified in table 2. In all, eleven donors provided funding under 16 different modalities. In addition, a further eight donors provided some form of assistance to the sector outside the BESSIP – much of it to secondary or tertiary education and through separate ministries.

**Table 2: Funding arrangements under BESSIP in 2001**

<b>Case</b>	<b>arrangement</b>	<b>% of aid</b>	<b>Donors</b>
1	Pooled funding controlled by ministry	34%	Denmark, Finland, Ireland, Netherlands, Norway, UK
2	Funds in separate accounts, controlled by ministry, for all activities	66%	World Bank
3	Funds in separate accounts, controlled by ministry, for earmarked activities		Ireland, Netherlands, ADB
4	Separate donor managed funds		Denmark, Finland, Japan, UK, US, UNICEF

Source: Netherlands Ministry of Foreign Affairs

A number of pre-existing projects were nominally brought under the BESSIP umbrella in cases three and four (see table 3). Some of these had their own implementation units in the ministry and persisted over the lifetime of the BESSIP, with some donors such as the Danes, the British and the Finns funding both under cases 1 and 4. Several donors justified this by arguing that projects gave donors direct feedback from the ground on BESSIP’s progress, suggesting that donors were hedging their bets on whether to align fully with government processes. The ability to directly manage technical assistance budgets, and thereby keep a strong degree of influence over sector planning, was a further motivation. Regardless of the underlying factors, the ongoing burden of managing multiple projects in BESSIP was considerable, and the combination of project and programme approaches is likely to have increased overall transaction costs for government, at least in the medium term.

For the ministry’s part, by incorporating projects within the BESSIP it hoped that donors would be persuaded to ‘upgrade’ over time to pooled funding. For donors, pooled

<sup>5</sup> Scanteam. ‘Lessons for SWAPs: a review of NORAD’s participation in 4 programmes’. August 2000.

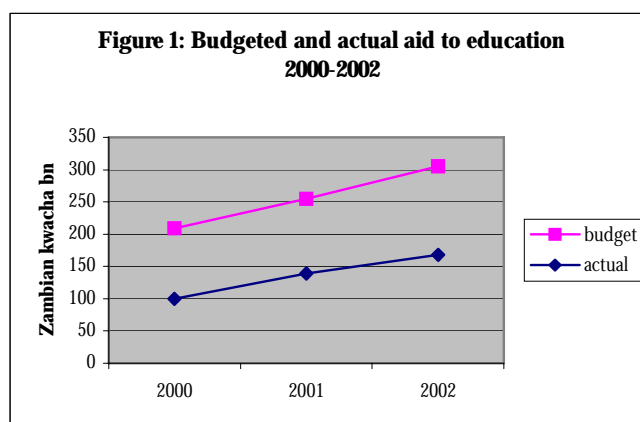
funding had the attraction of giving them privileged access to the key planning processes, such as the PCC and the '6+6' group, something that government was able to use as an incentive (the 'insider'/'outsider' split among donors was also cited as a weakness of the BESSIP). In 2003, another donor started to provide pooled funding while the volume of funding has also risen from \$19m in 1998 to \$40m in 2001 and a projected \$87m in 2004, evidence of growing donor confidence in government's ability to deliver on key sectoral goals.

**Table 3: projects under BESSIP, 2001**

Donor	Project activity
African Development Bank	Civil works through ZEPIU
DANIDA	CDC, Zonal Resource Centres, Teacher Education
DFID	Teacher Resource centres, Reading Programme
FINIDA	Education Sector Support Programme Phase 3: Infrastructure, Special Education, capacity building, learning materials, HIV-AIDS
JICA	School construction
Netherlands	Western Province Education Project
NORAD	Education Information Management System (EMIS), School construction and rehabilitation, capacity building activities
OPEC	Civil works through ZEPIU
UNICEF	PAGE project, Community schools project, HIV-AIDS, life skills project, WASHE
USAID	EMIS, SHN, Gender and Equity, IRI, CHANGES

Source: LT Associates

The establishment of a separate TA-funded BESSIP accounting unit in the Ministry of Education, headed by a senior accountant, was a key step in building this confidence. The unit reported to the Ministry's chief accountant, and included a 'BESSIP finance manager' who maintained regular communication with the donors. The budget expenditure monitoring system that was created allowed donor disbursements to be tracked to cost centres, but was not integrated into MoE or MoF systems – precluding joint financial and performance audits. An internal audit department in the ministry was responsible for a twice-yearly audit of all BESSIP transactions, and for reports to the Permanent Secretary and PCC. At the same time, the Auditor General has been responsible for an overall audit of BESSIP, which generally satisfied pool donors. The only significant concerns about mismanagement of funds occurred at the local level, and were usually acted upon decisively by the Ministry.



While BESSIP resulted in modest but important progress on the ground – enrolment and retention rates have improved, ratios of teachers and textbooks to students have

fallen, and test scores have slightly improved – implementation generally lagged behind plans. Several donors have attributed this to lack of government capacity, but slow donor disbursements seem to be a further cause (see figure 1). In general, the Zambian government has made available the resources approved by parliament, whereas donor disbursements have stood at about 50% of pledges in the budget. The reasons for this gap are unclear, but probably reflect in part bureaucratic delays in donor agencies, and a lack of standardised procedures and sequencing between donor and government budgets.<sup>6</sup> That only two donors – Finland and the UN – provide regular updates to the government on actual disbursements further complicates the picture. Slow procurement procedures – especially where donors have attempted to make use of government systems, as with textbook purchases – have also been cited as a source of delayed disbursement, and a reason for a lack of harmonisation in this area.<sup>7</sup>

The difficulties posed by unstable donor flows are exacerbated by a lack of predictability in donor funds. This is a particularly urgent problem in education, where achieving the MDGs will require a major scaling up of recurrent costs – especially for teacher salaries – that cannot be easily reversed. While the government of Zambia is planning against a five to ten year horizon, only 4 donors in Zambia – Denmark, the EU, UN and USAID – are providing details of 3 year indicative envelopes they expect to release. According to ministry officials, these problems persist despite the new commitments made by donors under the sector wide approach.

### Moves to a Sector Wide Approach

BESSIP had been designed with the intention of graduating to a comprehensive sector plan with pooled donor support. The strategic planning process for a new five year education plan, to run from 2003 to 2007, started in early 2001 with a public consultation. This new plan was expected to reflect the decentralisation and restructuring of Zambian education, which was finalised in 2000, and the 2002 Zambian Poverty Reduction Strategy Paper (PRSP) that was a condition of debt relief under the Heavily Indebted Poor Country Initiative, and which identified education as one of the key development priorities for the country.

**Table 4: donor commitment to harmonisation efforts**

Harmonisation MoU		Education MoU	
Donor signatories	Non-participating donors	Donor signatories	Non-participating donors
Denmark	Af. Development Bank	Denmark	Af. Development Bank
Finland	Belgium	Finland	Belgium
Germany	Canada	Ireland	Canada
Ireland	EC	Netherlands	EC
Netherlands	France	Norway	France
Norway	Italy	UNICEF	Germany
UK	Japan	UK	Italy
UN	Spain	World Bank	Japan
World Bank	USAID		Spain
			USAID

The sector plan covers the education sub-sectors, from basic to tertiary, and also addresses early childhood education and adult literacy (although these two areas continue to be managed by separate ministries). In contrast to BESSIP, where the key themes were not reflected in the ministry structure, all the programmes are coherent with the

<sup>6</sup> Scanteam. 'Lessons for SWAPs: a review of NORAD's participation in 4 programmes'. August 2000.

<sup>7</sup> IHSD, 'Sector Wide Approaches in Education', August 2003.

new Ministry line functions, while financial management procedures have been established with the eventual aim of integration into the main ministry accounts. According to ministry officials, the main source of this delay is the slow progress of a new Medium Term Expenditure Framework by the Ministry of Finance.

Following a visit to Lusaka by the Director Generals of 'like-minded' bilateral donors, as follow-up to the Rome aid harmonisation agenda adopted by the OECD-DAC in 2002, Denmark, Finland, Germany, Ireland, the Netherlands, Norway, the UK, UN and World Bank signed on to an MoU to support a common framework for 'Harmonisation in Practice' (see table 4). The education and health sectors were selected as the test grounds for an accelerated push to harmonise donor practices, reduce transaction costs and increase aid effectiveness. The key commitments made in the MoU were to:

- deliver aid in line with needs and priorities identified in the PRSP
- Align with Zambian government budgets, financial systems and monitoring
- Address institutional capacity constraints that undermine donor confidence in use of these systems
- Review the number of missions, reviews, reports and conditions, with the aim of reducing transaction costs for the Zambian government
- Promote coordination and harmonisation at all levels
- Work towards silent partnerships between donors where possible
- Improve information sharing
- Clarify the donor division of labour around PRSP themes

**Table 5: External Education Funding by Modality, 2004**

TYPE	SOURCE	2004		% of External	% of Total Budget
		USD	ZMK('000)		
DIRECT SECTOR SUPPORT FUND	DCI	10,249,292	49,196,602	11.7%	4.2%
	Norway	12,000,000	57,600,000	13.8%	4.9%
	DFID	10,100,000	48,480,000	11.6%	4.1%
	Netherlands	6,000,000	28,800,000	6.9%	2.5%
	Finland	2,400,000	11,520,000	2.8%	1.0%
	CIDA-PSU	1,210,000	5,808,000	1.4%	0.5%
	<b>Sub-total</b>	<b>41,959,292</b>	<b>201,404,602</b>	<b>48.1%</b>	<b>17.1%</b>
DESIGNATED SUPPORT FUNDS	World Bank	8,462,434	40,619,683	9.7%	3.5%
	EC	2,923,556	14,033,069	3.4%	1.2%
	UNICEF	3,079,000	14,779,200	3.5%	1.3%
	Japan (JCVF)	1,222,005	5,865,624	1.4%	0.5%
	Denmark	5,700,000	27,360,000	6.5%	2.3%
	ADB	8,546,196	41,021,741	9.8%	3.5%
	<b>Sub-total</b>	<b>29,933,191</b>	<b>143,679,317</b>	<b>34.3%</b>	<b>12.2%</b>
OTHER SUPPORT FUNDS	USAID	6,000,000	28,800,000	6.9%	2.5%
	Denmark	1,500,000	7,200,000	1.7%	0.6%
	Finland (TA fund)	600,000	2,880,000	0.7%	0.2%
	JICA	1,565,714	7,515,427	1.8%	0.6%
	DFID	4,800,000	23,040,000	5.5%	2.0%
	DFID (TA Fund)	480,000	2,304,000	0.6%	0.2%
	EC-ZECAB	395,000	1,896,000	0.5%	0.2%
	EC-EMIS	TBD	TBD		
	<b>Sub-total</b>	<b>15,340,714</b>	<b>73,635,427</b>	<b>17.6%</b>	<b>6.3%</b>
<b>TOTAL</b>		<b>87,233,197</b>	<b>418,719,346</b>	<b>100%</b>	<b>35.6%</b>

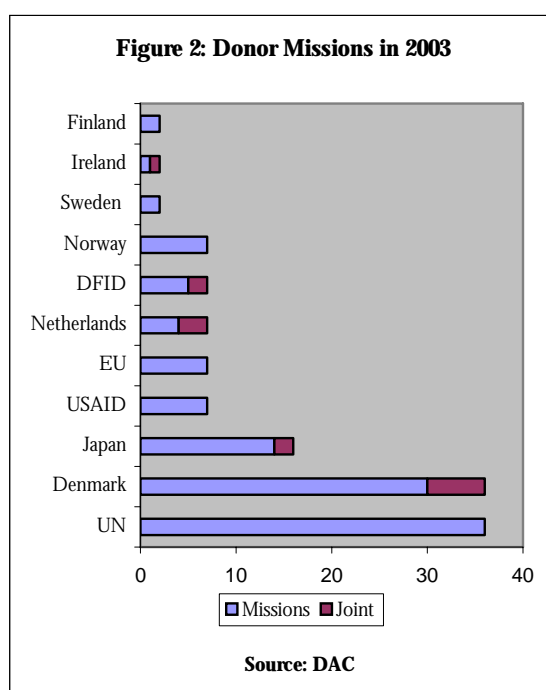
Source: Zambia Ministry of Education

In the education sector, a joint Memorandum of Understanding was signed at the same time between the government and eight donors, including the World Bank and UNICEF, that sets out actions to deliver on these objectives and attempts to establish



some measure of mutual accountability by creating procedures for handling disputes in the Joint Steering Committee, which now meets quarterly and includes donor heads of mission. The administrative and financial arrangements for the new sector plan are largely a continuation of what existed under BESSIP. Two of the most significant changes are that government is now formally restricting donor membership of the Strategic Programme Coordinating Committee to donors that have pooled their funding, while further efforts have been made to streamline funding arrangements under three cases (see table 5).

Under the pooled funding arrangement, donors are continuing to deposit money in a common parallel account, although this is under the management of the ministry. Before these releases are made, a number of measures must be taken, including a donor review of Annual Work Plans and budgets, an agreed financial commitment by the government to spend at least 20.5% of the discretionary annual budget on education, the publication of a quarterly disbursement forecast, approved quarterly financial and progress reports, and the receipt of a formal request for funds from the MoE, copied to the Ministry of Finance.



Under the 'designated support funds' bilateral agreements between individual donors and the MoE govern the allocation of resources, although any donor financed activities under this or the 'other support fund' category are expected to be in line with the objectives and priorities set out in the National Implementation Framework (NIF). At the same time, managing financial and administrative relations with such a large donor group poses major challenges to a severely resource-constrained country such as Zambia. In all, there are twenty different donor funding lines supporting the sector plan for 2004, ranging from under \$400,000 to \$12m. These are being provided by a heterogeneous group of agencies with widely differing approaches to the harmonisation agenda, about which some donors - such as the US and Japan - are highly sceptical. To date, there has been no formal discussion about whether the number of donors active in the sector should be reduced in a bid to lower transaction costs for government, or about how this could take place without reducing overall external support to education. There are a small

number of 'silent partnerships' in Zambia, where donors channel funds through another agency, reducing the number of interlocutors with government, but these have been limited to the agriculture sector, and funding for Quasi-Non-Governmental Organisations and NGOs.

Government officials report that the administrative burden of financial oversight has increased significantly as Zambia has moved from BESSIP to the sector wide plan, partly because this has been a precondition of a major increase in donor resources under the SWAp, and partly because the scope of programme coverage has increased with a full sector plan. Perhaps the largest administrative cost has resulted from the creation of budget tracking mechanisms and administrative structures down to the provincial level, as part of a common Financial Management System. The Auditor General's office has also reported a marked increase in workload as a result of donor demands in relation to the education and health SWAps. While many of these changes are doubtless bringing much needed fiduciary accountability to bear on the education system, there remain questions about whether an unrealistic burden is being placed on the ministry, and to what extent donors – rather than the government – stand to be the prime beneficiaries of many of the harmonisation measures.

Administrative transaction costs are monitored by donors and government through the Strategic Plan support group and the Financial Technical Committee, which were established under the BESSIP. Generally, progress towards harmonised donor missions and reviews, and procurement has been especially slow. In 2003, 120 donor missions took place to Zambia across all sectors, excluding the World Bank and IMF. Of these, just 12 were joint missions involving more than one donor, with the UN, US, EU, Norway, Sweden and Finland failing to participate in any joint missions (see figure 2). In the education sector, several key donors that have pooled resources, including Norway and Denmark, have so far failed to conduct any joint missions. Although several joint missions have now taken place in the education sector, ministry officials continue to cite their length and frequency as a problem, since they occupy the time of senior staff for two to three weeks at a time, thereby diverting energy from effective management of the sector plan. A similar picture emerges in relation to the use of joint reviews, where aside from a cross-sectoral Public Expenditure Review, there have been no major diagnostic studies supported by the donor group and government.

Procurement accounts for more than 50% of the SWAp budget, mainly allocated to construction, rehabilitation and learning materials, although a large share - over \$1m in 2004 - has also been allocated to Technical Assistance for capacity building and financial and information systems management. Although definite information was difficult to obtain, ministry officials reported that a large share of this was formally tied to purchase of goods and services from the relevant donor country. Donor and government perspectives on procurement differ: donors argue that government systems are unwieldy and untransparent, while government argues that managing numerous donor procurement procedures leads to administrative overload and slows disbursement. These differences mirror donor and government perceptions of the extent to which local systems are being used. A recent Development Assistance Committee (DAC) study found that whereas donors claimed that 52% of procurement expenditure utilised country systems, government respondents claimed that this applied to only 10% of donor spending. The true figure is likely to be somewhere between these two poles, but their disparity suggests a lack of shared understanding of what alignment and harmonisation means on the ground. It is also probably reflects the fact that many

'country systems' have in fact been designed and developed by donors – often through TA budgets – in the course of programme implementation, and for this reason are not strongly 'owned' by government.<sup>8</sup>

### **Conclusions**

The BESSIP and subsequent sector plan in Zambia have made significant progress in terms of education outcomes, where declining access and quality has been arrested and is starting to be reversed. They have also started to deliver on another, related objective, which is to improve the coherence of education planning, funding and delivery, and to increase levels of external support. However, given that the Zambia education SWAP is often cited by donors as being at the outer limits of good practice, the modest progress towards harmonisation needs to be put in perspective. Ten years after the World Bank initiated discussions with the government and other donors on a sector-wide education plan, just one third of aid is being channelled through a common basket, the majority of missions, reports and reviews are not harmonised, and procurement remains heavily tied. This is not simply a case of some donors, such as the US and Japan, not 'buying in' to the harmonisation agenda. Many of the key proponents of pooling and harmonisation, such as the Danes, Norwegians and UK, continue to perform poorly on many key indicators.

The weak capacity of the Zambian government, poor quality public financial management and political instability are undoubtedly factors in the mixed track record towards harmonisation and alignment. Several donors also cite the government's failure to hold them to account with the Memoranda of Understanding, or to pro-actively demand information from donors, and argue that peer pressure amongst donors has been the catalyst for harmonisation. At the same time, the limited progress towards using country systems, coordinating approaches to government and improving the stability and predictability of aid suggest capacity weaknesses, cumbersome bureaucracy, and the wrong incentives within donor agencies.

Despite a decade of efforts, the principal objective of harmonisation still seems ambiguous: is it primarily about reducing transaction costs and delivering cost efficiency for donors, or about improving the capacity of resource constrained recipient countries to deliver on their own goals? While it's clear that donors will only subscribe to an agenda that is likely to benefit them, as well as recipients, and it is possible that 'win-win' measures exist to achieve both objectives, the needs of the Zambian government often appear to have figured as an afterthought among donors active in the education sector. There are strong arguments for reducing the number of donors in the education sector, establishing a clear division of labour between them, and moving many of the transaction costs 'upstream' out of sector planning discussions into donor-only meetings. At present, too many donors continue to provide often small and unpredictable sums of money to support their own priorities at the expense of government, or alternatively insist on micromanagement and excessive administrative burdens as a *quid pro quo* for basket funding and a more 'country owned' approach.

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<sup>8</sup> This is hinted at in the DAC 'Survey on Progress in harmonisation and alignment', November 2004.

### **Aid transaction costs in the health sector: the case of Senegal**

Despite a relatively high per capita income by the standard of its West African neighbours, Senegal faces considerable human development challenges, standing 156<sup>th</sup> out of 175 in the Human Development Index. Eight per cent of children die before their first birthday, one quarter of children are malnourished, and immunisation coverage is declining. Despite 4.8% of GDP being spent on health care through a mix of public and private spending, the health system is in a poor condition, especially in the Casamance region where it has been damaged by low-level conflict. There are just 10 doctors per 100,000 people, and over 40% of births are without any medical support. It's estimated that between one half and a third of the population are unable to afford essential drugs. The HIV-AIDS infection rate is low by regional standards, and is an important success story for the country.<sup>9</sup>

Senegal is a major aid recipient, with ODA flows upward of \$400m in recent years, equivalent in 2002 to 9.2% of national income and 45% of public expenditure. In the health sector, donors account for approximately one third of all funding. In volume terms, the largest donors are the France, the World Bank, EC, Japan and the USA. Twelve donors are currently active in the health sector.

### **Background**

In 1997, the World Bank launched a \$35m Integrated Health Sector Development Project designed to run to 2002 in three regions. The project focused on health sector human resource management, and on preparing the central ministry for decentralisation. The IHSD was introduced in the context of a fragmented donor approach to the sector, with over twenty donor projects and no effective overall government health policy or vision.<sup>10</sup> More generally, donor interventions were characterised by low implementation levels, with the absence of an IMF programme, and weak public financial management cited by donors as key obstacles.<sup>11</sup> During the project identification and preparation stages, the Bank launched discussions with the government and other donors about whether to proceed with an investment project or a broader sector investment programme.

The Bank resolved to press ahead with a sector investment programme, based on signals of donor willingness to participate, and on the government's preparedness to develop a long term policy framework for health reform, building on the earlier 1991 policy (the government had already produced a national and district level health development plan at this stage, generating concerns about parallel processes amongst some government officials). Progress towards harmonisation around a country-led strategy proved slow, however, and individual donor projects continued to be the main funding modality. In 1997 a five year Programme de Developpement Integre du Secteur de la Sante et de l'Action Sociale d'Investissement Sectoriel (PDIS) was launched, based on the new Plan National De Developpement Sanitaire et Social de Senegal (PNDS).

### **Progress towards a Sector Wide Approach**

In 2004, the second phase of the PDIS was launched, running to 2008 – with 2003 as the transitional year to complete projects started under phase 1, which a donor financed evaluation had described as unsatisfactory. The PDIS is now described by several donors

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<sup>9</sup> UNDP. 2003. Senegal Human Development Report.

<sup>10</sup> Johansson, R. 2000. Education and Health in sub-Saharan Africa: A review of Sector Wide Approaches. World Bank.

<sup>11</sup> SPA Mission Note to Senegal, November 2002.

as a Sector Wide Approach, and is intended to coordinate donor interventions and funding in line with nationally designed objectives and work plans.

The PDIS is nominally linked to Senegal's Poverty Reduction Strategy Paper, approved in early 2003. However, the status of the PRSP remains unclear – with many government officials seeing it as a donor document – and the health goals in it are not widely disseminated. Senegal also lacks a Medium Term Expenditure Framework, and ongoing donor concerns about the quality of the budget planning process are cited as a reason for holding back a more programmatic approach to aid.

Reports differ as to whether a separate coordination mechanism for donors exists in the health sector. The WHO has reportedly taken over this function from the EC, although the fact it is not a party to the PDIS raises questions about its relevance to the sector plan. It is also unclear how often this group meets. There is also a wider donor coordination group. However, this reportedly only meets occasionally, donor participation is patchy, and there's little interaction between this group and government.<sup>12</sup> The three principal mechanisms for monitoring and planning the PDIS are Follow up Internal Committee Meetings, Joint Supervision Missions, and Annual Reviews. The Follow Up Committee is a joint MoH-donor group that meets once every three months to review plan implementation, approve activity reports from the technical directorates and regional education offices, and liaise with the procurement branch of the ministry on TA expenditures. Joint supervision missions have now been agreed between the programmatic donors and the MoH, with a different region selected for each mission visit.

The PDIS review is undertaken annually by the Ministry of Health and relevant donors, who discuss the forward-looking budget proposals and the progress for the past year. Annual Work Plans are drawn from the regional and district health plans, since the system is heavily decentralised, with most budget and management decisions devolved to the local level, where elected health committees oversee the operation of facilities. There is no basket funding under the PDIS (there's currently no budget support for Senegal), although there's some limited pooling into a current account at the district level for recurrent expenditures, with disbursements recorded separately. Most donor funding, however, is projectised and provided in parallel to government processes, and except for small expenditures must be signed off by the Ministry of Finance before being released to cover their individual programme costs in the PDIS. Donor-financed consultants, together with government officials in the Ministry of Health General Administration and Equipment Directorate (GAED) are responsible for SWAp finances. This cumbersome process, together with co-financing arrangements that ignore different budget cycles for government and donors, have been cited as key reasons for widespread delays in aid releases, with actual disbursements for the period 1998-2002 at 45% of total donor commitments. Slow and partial disbursement into PDIS has been given as the main reason for postponement of the last national immunisation campaign, against a backdrop of falling child immunisation in Senegal.<sup>13</sup>

Although donors cite a lack of transparency and weak budget systems as obstacles to more aid and fewer strings attached, donor commitments to the sector have increased steadily over the life time of the PDIS, from \$67m in 1998 to \$137m in 2001. The most

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<sup>12</sup> OECD-DAC. Senegal Survey on Progress in Harmonisation and Alignment. November 2004.

<sup>13</sup> IHSD. 2003.

active donors have also committed to moving towards pooled funding over the course of the second phase to 2008. Aid predictability remains weak, with only the World Bank and UNICEF making multi-year commitments to the health sector. Audits have been carried out by individual donors on their commitments to the PDIS, rather than of the overall programme. The World Bank spent \$100,000 on audits over the course of the first phase, and the African Development Bank over \$30,000. More recently, an internal control unit has been established in the GAED to manage audit requests from donors.

**Table 1: Donor Participation in the PDIS**

<b>Active</b>	<b>Nominally engaged</b>	<b>Non-participating</b>
World Bank African Development Bank UNICEF Denmark	EU	Belgium France KfW (Germany) JICA Taiwan UNFPA USAID

Source: IHSD 2003

The number of donors supporting the Senegal health SWAp varies, depending on who is asked. According to the World Bank, 12 donors are engaged, whereas other evaluations suggest just four donors including the Bank consider themselves fully on board (see table 1). In the absence of any formal agreement such as a Memorandum of Understanding between government and donors, the parameters of the SWAp, and what that demands of donors, are necessarily vague.

The Ministry of Health staffs the implementation unit for the PDIS – although this is heavily donor-funded and operates in many respects as a traditional Project Implementation Unit – and is responsible for implementing the plan and coordinating donor interventions. Each donor with a ‘programmatically’ relation with the MoH (World Bank, African Development Bank, EU and Denmark) has its own representative inside the PDIS unit, responsible for regular coordination between the PDIS and the donor – mirroring the projectised approach used by donors outside the SWAp. This group of donor-dedicated consultants, the ‘Support and Follow Up Team’, has seen its annual costs almost quadruple over the course of the PDIS to \$1.5m, as it has taken on a key analytical role in driving the reforms.

The PDIS unit drafts sector budgets and agrees individual donor contributions, although these tend to be re-statements of what each donor has already decided to do in the sector. Where the MoH has attempted to direct donor activities more strongly, donors have often objected, thereby delaying implementation.<sup>14</sup> This is cited as one reason for programme overrun in the first phase to 2002. The ability of government to take a more directive role in relation to the donors is expected to increase if a new budget financing system, including a Medium Term Expenditure Framework, is adopted. A new Performance Management System is also expected to be operational in early 2005, although it has not proved possible to get donor agreement on common procurement and reporting procedures. As a result, the Programme Management Manual contains only very general targets and indicators, for which several donors criticised it in interviews. Until or unless some common financial and reporting systems can be agreed, harmonisation efforts seem to be limited largely to inter-agency communication, with

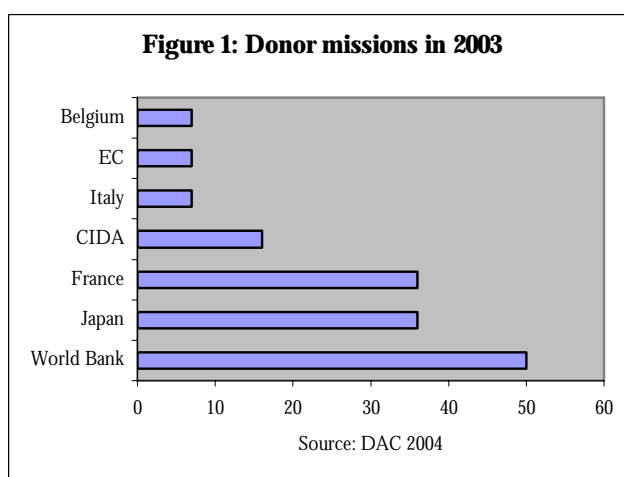
<sup>14</sup> IHSD. 2003. Mapping of SWAps in Health. Report for SIDA.

donors avoiding outright duplication of one another's activities, rather than any meaningful coordination.

### **Wider harmonisation efforts**

Senegal is a Strategic Partnership with Africa (SPA) country pilot, part of donor efforts through the OECD-DAC to accelerate harmonisation in 13 major aid recipients. The SPA countries are expected to benefit from changes in donor practice aimed at increasing donor alignment, reducing recipient transaction costs and enhancing national capacity in public financial management. However, the slow progress in the health sector since 1997 is reflected more widely in donor practices. A recent DAC survey of progress showed that donors have yet to start routinely sharing information among themselves and with government, which is a necessary condition of progress towards coordination. For example, over half of all donors in Senegal are currently failing to disclose information on actual disbursements, or providing indicative aid commitments beyond the current financial year. Just one donor, the World Bank, is sharing country analytical work.

There are clearly weaknesses in both the government and donor approach to tackling aid transaction costs. Despite widespread complaints in government about onerous donor procedures, late disbursements and operational fragmentation, and demands from the Ministry of Finance for more pooled support, Senegal has so far failed to draft any plan for harmonisation, as happened in Zambia with the Memoranda of Understanding. Some principles for increasing aid effectiveness have been articulated in PRS-related documents, such as the Country Financial Accountability Assessment, although this was commissioned and authored by the World Bank and African Development Bank, raising questions about the depth of country ownership of this agenda. The Poverty Reduction Strategy itself is seen by most donors as an inadequate basis for alignment, since it is short on specific objectives and goals, lacks measurable progress indicators, and is not well linked to the budget.



As in Zambia, donor and government perceptions about the extent to which aid goes through country systems differs widely. Whereas government respondents to the DAC survey claimed that approximately 10% of aid used country systems, donors cited between 30-40%, depending on the activity. Monitoring, evaluations and missions continue to be carried out individually by donors, with the exception of some joint

supervision missions in health. In 2003, Senegal received 150 missions, excluding the UN agencies, IMF, African Development Bank and several of the smaller bilateral donors - with the World Bank alone accounting for almost one mission a week (see figure 1).

### **Conclusions**

Over the past seven years, progress towards more effective aid for health, with lower transaction costs for Senegal, has been exceptionally slow. At present, 'Sector Wide Approach' is a misnomer for donor practices in the health sector, as they continue to pursue a piecemeal and administratively cumbersome approach to funding. There are a number of likely reasons for this, including the government's failure to make clear demands of the donors, and the failure of donors to create the skills and incentives needed to communicate and coordinate better. The upshot of this failure is seen in the weak response to health challenges, exemplified by delays to the national child immunisation campaign because of slow donor disbursements.

This lack of progress is especially disappointing given that Senegal is wealthier, more politically stable and has greater administrative and technical capacity than most of its West African neighbours. The fact that a small number of donors – comprising France, the EC and the MDBs - dominates the health sector, should make significant strides towards coordination and harmonisation feasible within this inner group. One factor in this not happening so far may be the excessively close association of the sector plan with the World Bank, which has identified and prepared many of the key initiatives in the plan, and financed much of the analysis – leaving other donors reluctant to be coordinated in order to achieve success in what's perceived as a Bank programme, and government ownership diluted.



### **Summary conclusions from two case studies**

The two case studies of aid transaction costs under Sector Wide Approaches in Zambia and Senegal highlight a large gap between donors' stated ambitions to improve aid effectiveness, and the incoherent, inefficient reality on the ground. The two examples in this paper are important because in many respects they represent the outer limits of donor progress towards implementing the harmonisation and coordination agenda that was set at the Monterrey Financing for Development summit, and through the OECD-DAC. Inevitably, this raises serious questions about whether donors are well placed to deliver far-reaching changes in aid planning and delivery, or whether a radical rethink is needed of the aid architecture that underlies many of the current inefficiencies. The key conclusions are as follows:

- Donor concerns about transaction costs are often driven more by the cost to themselves of doing business, rather than by concerns about the administrative and political impact of aid on recipients' own systems. At the very least, donors are unlikely to support an agenda that simply moves transaction costs 'upstream' from recipients to donors, which helps explain why there are so few cases of delegated cooperation, or 'silent partnership' between donors. Mutually beneficial reform options urgently need to be identified.
- Despite the promotion of Sector Wide Approaches and budget support by like-minded donors such as the UK and Nordics, there is no clear evidence that transaction costs are lowered under these more macro modalities. There is some evidence that costs are redistributed and concentrated, with an increasing burden falling on senior staff at central ministry level. This concentration of transaction costs can expose capacity constraints in recipient governments, which donors often respond to with Technical Assistance and micro-managed policy advice. Therefore what begins as an effort to enhance country ownership can end by significantly eroding it. In sum, the equation between reduced transaction costs and macro modalities needs to be revisited - at least so long as donors insist on micromanagement and heavy fiduciary safeguards in exchange for direct budget and sector support.
- Because some donors – including the two largest bilateral agencies, the US and Japan – do not support the harmonisation and sector wide agendas, recipients tend to end up managing two quite distinct sets of transaction costs at project and programme level. This also happens because even the most enthusiastic poolers tend to retain some project presence at sector level. As a general rule, recipients are managing more financial transactions per sector than there are active donors.
- The harmonisation agenda has so far failed to question the number of actors at country and sector level. In both cases, a large number of agencies – often providing small sums of money – create major obstacles to effective coordination. Recipients could be relieved of many aid transaction costs by donors agreeing to limit the number of agencies and establishing a clear division of labour across and within countries. Recipients should also be encouraged to follow the lead established by some Low-income Countries such as India, and establish minimum entry criteria for donors. The risks of this course of action would be reduced if donors acted collectively, perhaps starting with the 13 SPA countries.
- In both case studies, donor disbursements tend to be late, partial and unpredictable. This undermines effective planning for the Millennium Development Goals, and carries direct costs for people living in poverty. Donors tend to cite country shortcomings, but donors' own procedures seem to be an equal if not greater problem. Synchronising donor releases with recipient budgets, making multi-annual

- commitments, informing recipients of actual disbursements, and wherever possible channelling funds through country systems are necessary to address this problem.
- There are significantly differing donor and recipient perceptions about what is and is not a country system. This partly reflects the fact that many country systems are identified, designed and implemented with donor funds in order to satisfy donor demands. Many interventions, for example to improve financial transparency and accountability, are necessary to ensure that aid and public money is used well. However, donor dominance of institutional reform processes in many LICs undermines ownership and sustainability. Pooled technical assistance budgets and a more hands-off approach to the design of country systems are needed address this problem.
  - There has been some limited progress in both the case studies towards inter-donor and donor-government communication and coordination, especially around missions and reporting. Harmonised procurement and use of country financial systems pose a much greater challenge. Donors often cite administrative and legal obstacles to using country systems, which usually reflect tied aid policies and political concerns about demonstrating value for money and financial accountability to publics and parliaments in the North. Ultimately, progress will depend on whether poverty reduction, or commercial and political objectives drive aid programmes.
  - None of the challenges identified in this study are new, which suggests that the main barriers to progress are the structure, culture and incentives of the aid system. At present, donors are accountable mainly to themselves for delivering on the harmonisation agenda. The donor system is fragmented and inefficient, but there is also a powerful shared interest in maintaining the *status quo*, partly because of political pressures in donor countries and also because of internal interests in aid bureaucracies. The weakness and fragmentation of aid recipients further hinders reform efforts. Yet aid reform cannot be disembodied, and meaningful changes in how aid is delivered must necessarily change the aid architecture.

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