

Capacity Development Workshop
“Country Leadership and Implementation for Results in the
EFA FTI Partnership”

Cape Town, South Africa, July 16-19, 2007

Options for SWAPs

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Options for SWAps

One of the aims of the EFA-FTI is to mobilize additional funds for the education sector plan of the country. The Expanded Catalytic Fund has now been created with pooled donor funding at the global level which can provide up to 3 years interim grant funding for the financing gap of the sector plan. This support can be given as direct budget support, program support through special account, or project funding. The ECF funding supplements bilateral and multilateral funding, as well as domestic funding for the country's sector plan, all of which is included in the financing of the plan. FTI aims at creating a process for donors to support countries' education plans with emphasis on alignment, coordination and harmonization, in conformity with the Paris Declaration on aid effectiveness. Therefore the modalities for delivering the FTI support should take into account both the country context, including existing technical capacities and the robustness of the public financial management (PFM) systems, and the principles of Paris Declaration. This note presents briefly the principles of Paris Declaration, discusses the inconveniences and advantages of the different aid modalities, and reviews in more detail the sector wide approaches (SWAp).

A. The Paris declaration

The Paris declaration of March 2005¹, endorsed by the international organisations and more than one hundred developed and developing countries, set international guidelines and targets for raising the quality of aid. The partnership commitments are organised around the five key principles:

- *Ownership.* 75% of countries should have developed operational development strategies by 2010
- *Alignment.* Partner countries commit to strengthen their procurement and public financial management systems and donors commit to use increasingly partner countries system. Setting up parallel systems tends to undermine the regular systems of government and confuses accountabilities.
- *Harmonisation.* Donors commit to strengthen their coordination. 66% of aid flows should be provided in the context of program based approaches (PBA), which are presented in box 1. Shared analyses should be encouraged.
- *Managing for results.* Develop results-oriented reporting and assessment frameworks that monitor progress against key dimensions of the national and sector development strategies and strengthen the budget policy-link.
- *Mutual Accountability.* Mutual assessment of progress in implementing agreed commitments on aid effectiveness including those in this Declaration will be carried out.

¹ <http://www.oecd.org/dataoecd/11/41/34428351.pdf>

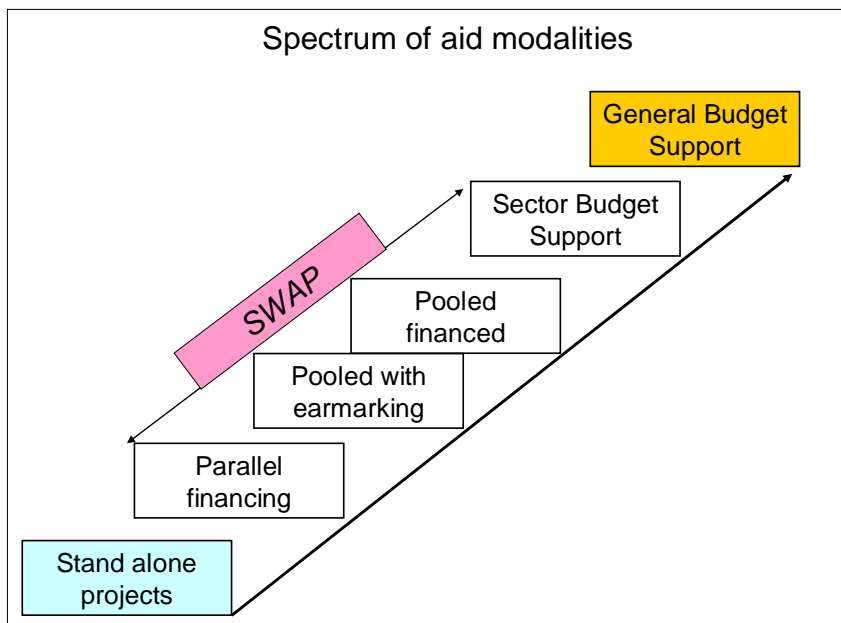
B. Overview of the different aid modalities

Enforcing the Paris declaration principles will require switching from the traditional project based approach to policy and program based approach and using increasingly the aid recipient countries financial systems, provided that actions are undertaken to strengthen them. Such changes will generally be progressive, and their magnitude must take into account the country context. To help in defining the different steps for improving aid management, this section reviews the different aid modalities and discusses briefly their advantages and inconveniences.

1. The spectrum of aid modalities

Aid modalities form a spectrum from, at one extreme, stand alone projects to, at the other extreme, general budget support. Apart from general budget support and stand alone project support, donors may assist the development of specific sector, through SWAPs. The SWAPs include a wide range of aid instruments such as parallel financing consisting of coordinated projects, pooled financing arrangements, or sector budget support. Pooled financing arrangements may include earmarking certain budget lines, when some donors participating in a pooled fund want to identify the activities they finance. Figure 1 illustrates schematically the spectrum of aid modalities, which are reviewed below.

Figure 1



2. Traditional project aid

a) *The project*

A project is generally defined as a specific set of activities, with a specific starting point and a specific ending point, intended to accomplish specific objectives. Specific arrangements are often set up to manage a project, such as appointing a project leader and project staff and defining special planning and reporting requirements. Whatever the source of financing (domestic or foreign), the project management model is suitable to the administration of activities such as preparing and implementing IT systems and large investments in the infrastructure sector.

The larger share of donor support has been traditionally provided through projects. Different forms of management of aid financed projects can be singled out, depending on the extent the project is managed through government systems or through parallel systems. For example, is the project included in the budget and financial reports? Are national procurement procedures used? Are national payment procedures used? Etc. Only, in a very few countries, externally financed projects are managed entirely through the national procedures. In these countries, a reimbursement procedure is often set up for the project-aid: the government commits and pays the aid financed expenditures through its national systems, the donors reimbursing the government after the payments are made.

However, in most countries projects are managed, at least partly, through using parallel financial management systems, while, according to the Paris declaration, the efforts should be aimed at making an increased use of the national systems².

b) *Advantages and inconveniences of project aid*

In project aid using parallel systems, the donor often takes the lead in project design and appraisal, has decided the inputs which will be provided, and uses its own disbursement and accountability procedures. The donor project operates as an enclave not fully integrated in the budget. Parallel financial management systems have received much criticism for being fragmented and donor-driven. Project management and supervision entail transaction costs and put the focus on short-term results, micro-management issues, not on major policy issues.

Under the project approach, the efforts to improve public management focus often on a few insulated projects, which have a limited time life, instead of addressing the weaknesses of the existing public management systems. Often, project implementation arrangements thwart the basic principles for sound budgeting, such as, among others, comprehensiveness and unity of the budget, which are, on the other hand, advocated by the donor community, notably through exercises such as the PEFA public finance performance assessments. In addition, while the project management model suits the management of activities such as large IT projects, it often leads to create a parallel administration when it is used to manage recurrent expenditures in the social sectors.

² According to an OECD DAC survey, which covered 14 countries, in average 30% of projects use national procedures for procurement, 32% for disbursement, 30% for reporting, and 28% for audit. Survey on harmonization and alignment. OECD DAC. 2005

Nevertheless, in post conflict countries the project approach may be the more feasible way to deliver assistance, quickly and efficiently. Similarly in a highly corrupted environment the project is seen by the donors as the only mean to ensure that their aid will not be diverted from its purpose. However, in such countries project management is affected by its environment. Recruitment of project staff may be governed by patronage and the project design subject to pressure for unneeded expenditures (project cars, excessive travel expenses, etc.).

Providing aid through parallel projects may be also aimed by the donors at bypassing cumbersome national procedures for budget management. It may be the more appropriate way to achieve quick and measurable results at local level, because frequently government presence is missing, due to the lack of a well-functioning decentralization. It is also seen by the donors as being an interim approach before an agreement between the government and the donors on the sector policy.

3. Direct budget support

a) What is direct budget support?

Direct budget support refers to the channelling of donor funds to a partner government using its own allocation, procurement and accounting systems. The transfer is 'direct', in the sense that it is provided as foreign exchange to government (concretely the Central Bank, who then credit the central government or Treasury account), with no controls over the process of conversion into local currency.

Direct budget support includes:

- General budget support, which is defined as a general contribution to the overall budget covers financial assistance with any conditionality focused on policy measures related to overall budget priorities. General budget support includes instruments such as the World Bank's Poverty Reduction Support Credit (PRSC) or the European Commission General Budget Support.
- Sector budget support, which is defined as financial aid earmarked to a discrete sector, with any conditionality relating to these sectors. Sector budget support include instruments such as the European Commission Sector Budget Support

The main difference between these budget supports is that assessments, dialogue and conditionalities are linked either to overall or sector issues.

Some donors when providing direct budget support may want to identify the budget lines that they will finance. Under general budget support, earmarking, if used, is "virtual" or "notional". The budget support is made available to the budget according to a fixed disbursement schedule, with the use of these resources being "justified" ex-post against pre-agreed budget lines. Under sector budget support "real" earmarking is sometimes used, which means that expenditures on agreed budget lines are committed before the release of budget support funds.

b) Advantage and inconveniences of direct budget support

Direct budget support strengthens country ownership. This may contribute to ensure the sustainability of reforms. Through direct support a policy dialogue may be developed both between the government and the donors and within the government. It encourages a greater orientation to medium-term results by focusing on national policy objectives rather than on donor-driven priorities, and individual projects.

Direct support eliminates the administrative costs of managing numerous stand alone projects. It reduces the fragmentation of public expenditure management, and, therefore, may contribute to increased efficiency of resource allocation. It encourages strengthening the public financial

management systems, notably because actions in this area are included in the dialogue between the donors and the government.

However such a support raises donors' concerns concerning fiduciary risks in countries with weak financial management systems. It may increase the volatility of aid flows in cases the country performance is poor. It, therefore, may decrease predictability in funding, recurrent expenditures financing being increasingly dependent on aid disbursement, despite the fact that its objective is the opposite.

Direct budget support provides limited scope for sector policy dialogue between the donors and the government and for capacity building in sector ministries. Even when it is accompanied with sectoral policy conditionalities, it may reduce the incentives for line ministries to make progress in their respective areas. Line ministries are not encouraged to meet specific conditions for the release of donor funds that will augment the general budget but will not necessarily provide additional funding for their sector. It may strain the capacity of the ministry of finance as the main interlocutor and coordinator of cross-cutting development priorities, and may over-centralise the policy debate.

An argument developed in the late 1990s for budget support is the fact that aid is fungible, or at least partly fungible. If donor support is increased in one sector, the government will redirect its own resources towards other sectors. Actually, evidence shows that the fungible nature of aid depends on the sector and the country (see box 1). According to Mick Foster and Jennifer Leavy: "It requires strong assumptions regarding the efficiency of the budget process and the relative power of the finance ministry before donor earmarking is rendered entirely impotent³." The fungible nature of aid is probably only partial, but fungibility issues should be kept in mind, when reviewing the impact of aid on resource allocation.

³ Mick Foster and Jennifer Leavy. The choice of aid financial instruments. ODI. 2001.

Box 1
Is aid fungible?

Aid is said to be fungible when Government offsets donor spending on a particular purpose by reducing its own expenditure on the same purpose. For example, donor funding earmarked to education will not increase total education spending if Government reduces its own education spending, and uses the funds thus released for some other purpose. Fungibility means that total public spending is adjusted to reflect the priorities of the national Government rather than the uncoordinated preferences which emerge from large numbers of donor projects.

According to Tarhan Feyzioglu, Vinaya Swaroop, and Min Zhu: "Developing-country governments receiving earmarked concessionary loans for agriculture, education, and energy reduce their own resources going to these sectors and use them elsewhere; only loans to the transport and communication sector are fully spent on the purposes intended by donors. Because most aid appears to be fungible, the rate of return on a specific donor-funded project tells little about the impact of that assistance; a better approach may be to tie foreign aid to an overall public expenditure program that provides adequate resources to crucial sectors".

However, for the education sector in Africa, Shantayanan Devarajan, Andrew Sunil Rajkumar, Vinaya Swaroop note: "aid to the education sector— which had no discernible effect on education spending in the global sample— has an almost one-for-one effect on education sector spending in Africa".

Sources:

Tarhan Feyzioglu, Vinaya Swaroop, and Min Zhu. The World Bank Economic Review No 12, 1998.

Shantayanan Devarajan, Andrew Sunil Rajkumar, Vinaya Swaroop. What Does Aid to Africa Finance?. World Bank. 1999

4. SWAps

a) What are SWAps?

A part from general budget support and stand alone project, donors may assist the development of specific sectors or subsectors/programs. Program based approaches (PBA) and sector wide approaches (SWAps) lie within the framework of Paris declaration principles. The SWAp is a mechanism by which government and donors can support the development of a sector in an integrated fashion through a single sector policy. It is expected to progress towards the use of government procurement and payment procedures.

Box 2 gives the OECD-DAC definition of PBAs and SWAPs and their main features. The description of the features deals with the intended direction of change rather than just the current attainment.

The sequencing of the implementation of the building blocks of a SWAp will depend on the country context, but there are some common broad directions. Thus, figure 2, which details slightly some of the SWAp features presented in Box 2, illustrates the gradual process in implementing the key elements of a SWAp. First, government ownership and leadership is required to develop a SWAp. Subsequently, partnership with the donors' community should be built; a policy framework should be developed; and an expenditure programme defined. Then, efforts should be directed to coordinate the different financial management systems and to use the national systems, but full use of these systems may be not attainable at short notice.

Box 2
What are sector-wide and program based approaches?

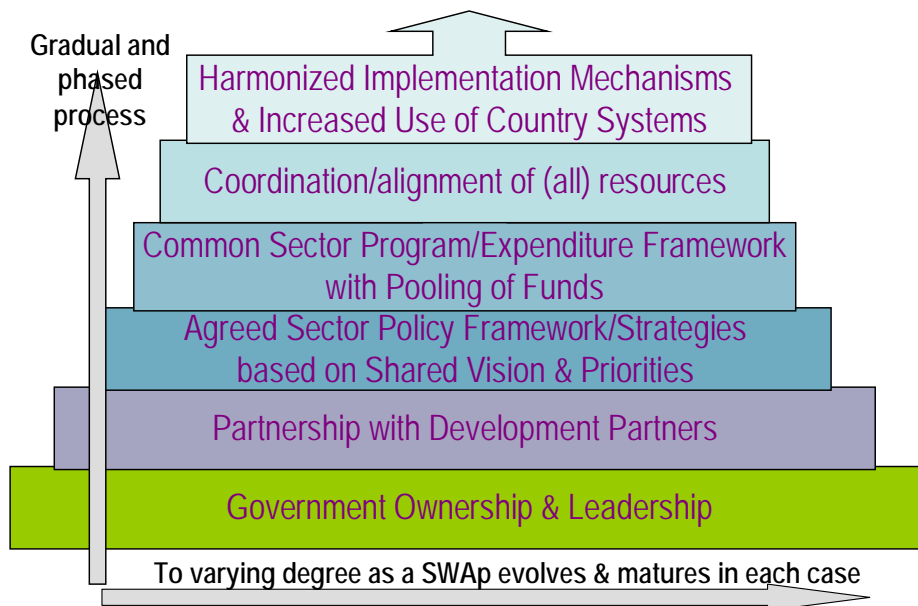
A sector-wide approach (SWAp) is a program-based approach (PBA) operating at the level of an entire sector. PBA is a way of engaging in development co-operation based on the principle of co-ordinated support for a locally owned programme of development, such as a national poverty reduction strategy, a sector programme, a thematic programme or a programme of a specific organisation.

PBAs and SWAps share the following features:

- Leadership by the host country or organisation.
- A single comprehensive programme and budget framework.
- A formalised process for donor co-ordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement.
- Efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation.

Source: DAC guidelines. Harmonizing donor practices for effective aid delivery. Volume 2. OECD, 2006.

Figure 2. Key Elements of SWAps
Intent and Directions, not "Pre-requisites"



Source: www1.worldbank.org/harmonization/paris/AfricaWorkshop/SWApsAfrNov2004Final-Tony%20HL.ppt

A SWAp is not a financing arrangement, several financing modalities may be considered under a SWAp (see figure 1):

- Sector budget support
- Pooled or basket funding.
- Pooled with earmarking.
- Parallel, but coordinated, funding for activities or projects in the SWAP program:
- Mixed, some donors doing different form of financing

Pooled funding refers to an arrangement whereby the government and/or development partners participating in the SWAp deposit their funds into and disburse from a common account rather than using their own special-purpose accounts. Pooling of funds requires that all participants use common procurement, financial management and disbursement procedures. Harmonization of procedures in pooled funding is carried out in two ways:

- The first and preferable way is for the government, itself, to manage the expenditures financed pooled account, using its own procurement and financial management procedures, with funds reimbursed, or an advance payment made to the government budget disbursed, based on expenditure reports from government.
- The second way is to use common procedures agreed by all parties, one donor managing the account on behalf of the others. This arrangement is adopted in cases when the fiduciary risk of using country procedures is deemed by the donors very high.

As noted, pool with earmarking refers to situation where some donors want to finance specific budget lines within the sector budget.

b) Advantages of SWAps and concerns

The SWAps are seen to bring significant advantages. Making the government the SWAp leader favours the effectiveness and the sustainability of the sector policies under implementation. A SWAp may reduce the aid transaction costs in the medium-term, but some dispute this point (aid transaction costs are further discussed in section C6)

A SWAp may increase predictability of funding, both the government and the donors being committed to a certain level of funding. It may improve the effectiveness of resource allocation through unifying fragmented financing arrangements and providing a uniform “code of conduct” for all sector development partners. It favors prioritization at the sector level. A SWAp provides a framework for financial and performance monitoring and, therefore, contributes to improved transparency and accountability.

However, the SWApS raise a number of concerns. They may put an unbearable strain on the government weak capacities. Wide stakeholders group, involving several donors, may be difficult to coordinate. In practice the government leadership may be weak, the SWAp being de facto led by a donor. It can be questioned whether SWApS are suitable to decentralized systems. Financing arrangements such as pooled financing are by nature centralizing, and may enter in conflict with the decentralization process. Also, within a SWAp well-functioning programs risk being undermined by poorer ones. Unpredictable nature of some donor financing may hamper the SWAp credibility. Some donors may be reluctant, or unable because their own regulations to use common procedures. Parallel projects from these donors may be difficult to coordinate.

Success of a SWAp depends on a number of conditions, which are reviewed in section C8, after discussing some SWAp design issues.

5. Choosing between aid modalities

For choosing between budget support, SWAp, and stand alone projects, a World Bank study⁴ suggests, on the donor point of view, the following approach, which is illustrated by the decision tree presented in figure 3:

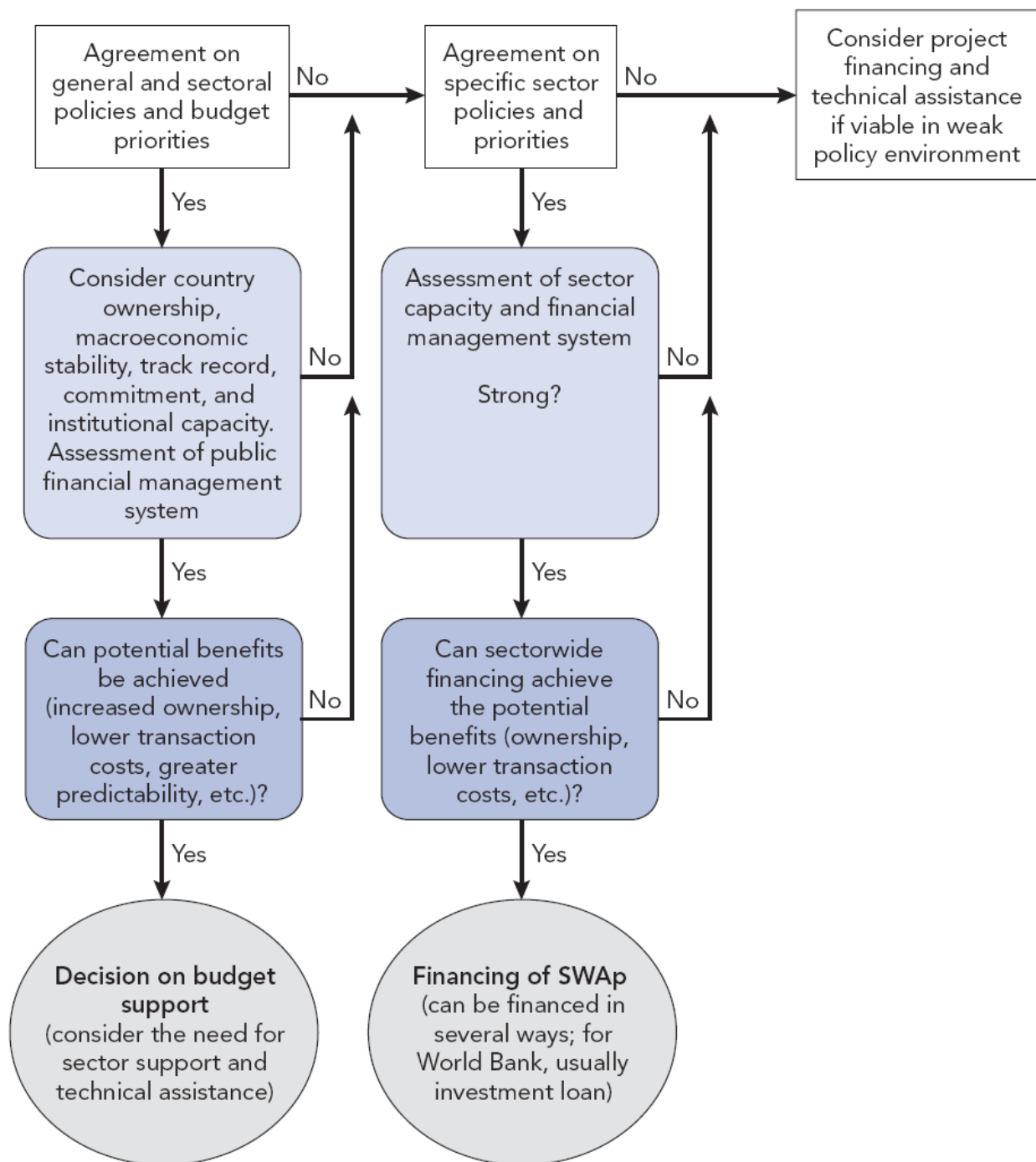
- *Budget support.* Budget support would be the main aid instrument for countries with a reasonably sound policy and institutional framework, including transparent budget management and adequate financial management arrangements. The PEFA performance measurement framework, CFAA (country financial accountability assessment), PER (public expenditure review) and CPAR (country procurement assessment report) help in assessing the degree of robustness of the financial management systems.
- *SWApS.* If donors feel that a greater degree of control may be required, a financial support at a sector level could be considered through a sectorwide approach (SWAp), provided that there is an agreement on the sectoral strategy and priorities. Similarly, a decision whether to provide SWApS should be based on a careful assessment of the sector's institutional capacity to implement the expenditure program and to achieve the program objectives.
- *Stand alone projects.* Where a policy consensus between donors and recipient government cannot be achieved at reasonable costs or within a realistic time frame, traditional investment projects may have an important role.

Governments will have to take into account the impact of these different aid modalities on their public expenditure management system, and their priorities in budget management. For fiscal control, budget support is probably the most effective and less costly approach. On the other

⁴ Stefan Koeberle, Zoran Stavreski, Jan Wallister. Budget support as more effective aid? Recent experiences and emerging lessons. World Bank. 2006

hand, sector ministries may find that SWAp arrangements will help them in protecting their budget. SWAp arrangements may help them also to better supervising the activities in their sector than stand alone projects, because; sometimes, project managers report more to the donors than to their supervisory authorities. However, managing a SWAp may put an excessive strain on scarce human resources (see section C 7 below).

Figure 3.
Decision Tree for Choosing Aid Instruments: A Donor Point of View



Source: Stefan Koeberle, Zoran Stavreski, Jan Wallister. *Budget support as more effective aid? Recent experiences and emerging lessons.* World Bank. 2006

C. SWApS: design and implementation issues

This section discusses the key design features of a SWAp, which include: (i) the definition of the "sector"; (ii) a sector strategy or policy; (iii) a sector budget and expenditure program; (iv) the financing modalities; (v) the fiduciary processes; (vi) the organizational arrangements; and (vii) a memorandum of understanding. Then, the issues related to transaction costs are briefly reviewed and some conditions for success are enumerated.

1. Defining the sector

What is a "sector" varies from one SWAp to another. Thus it may be distinguished⁵:

- Conventional sector. For example: Health including population & nutrition (Ghana, Uganda, Tanzania, Bangladesh, Nepal); Agriculture (Zambia, Mozambique); Roads (Tanzania, Uganda)
- Large sub-sector. For example: Primary Education (Zambia, Nepal, Bangladesh); Rural Water & Sanitation (Uganda)
- Non conventional sector (Multi-sector, cross-cutting issue or a program –the SWAp being a PBA). For example: Multi-sectoral AIDS program (Malawi); Public Sector Reform Program (Tanzania, Ethiopia); India SSA (National Elementary Education Program)

For accountability and transparency, the budget lines covered by the SWAp should be clearly identified. When a SWAp covers cross-cutting issues, risks of confused distribution of responsibilities should be assessed.

2. Sector strategy and expenditure planning/budgeting

As the DAC guidelines indicate: *A coherent and consistently applied sector policy is at the heart of any successful SWAp and focuses the partner government, donors and other stakeholders on achieving collective results. It must be derived from, and consistent with, the partner government's overall strategic objectives and strategic framework (including the poverty reduction strategy).*

It is important to keep a process perspective on sector policy. Strive for a good sector policy and strategy, rather than a perfect one. The sector policy document will not be a rigid blueprint. It will establish basic principles, objectives and strategies for the sector. It will acknowledge that detailed policies and resource allocations will continue to evolve. Accordingly, there should be a defined process and schedule for regularly updating the document.

A credible, comprehensive and transparent sector budget is essential for the proper implementation of the sector policy. The budget should be placed in a medium-term perspective to ensure the sustainability of the fiscal policy and plan policy changes. Therefore the

⁵ Source: www1.worldbank.org/harmonization/paris/AfricaWorkshop/SWApS Afr Nov 2004 Final-Tony%20HL.ppt

development of a sector MTEF may be desirable, but as discussed in the session on budgeting experience shows that some pre-conditions must be met, before considering implementing a sector MTEF.

A performance monitoring system with a focus on results and feedback into management and policy. This frequently involves a sectoral performance assessment framework (PAF) consisting of a set of input, output, and outcome indicators. The evolution of the PAF is periodically monitored to assess progress towards the achievement of the sector's policy and strategic objectives. The monitoring system provides key elements to steer policy dialogue and is part and parcel of the overall policy process. The choice of indicators must reflect all the important dimensions of the sector being monitored.

The sector strategy and the instruments and procedures to place the budget within a multi-year perspective are further discussed in the session on budgeting and expenditure planning.

3. Comparison of financing modalities

As noted the SWAp may cover different financing mechanism from parallel financing dealing with projects to sector budget support. Table 1 below summarizes the main advantages and challenges of the SWAps financing modalities. Parallel project financing can accommodate some donors constraints or concerns, but may present the same inconveniences than stand alone projects, when coordination between parallel projects and other SWAp activities appears to be difficult. Direct budget support has been discussed earlier. Pooled funding arrangements may be a practical and realistic step in moving from project to budget support, but they require an intensive work to design and implement coordination mechanisms.

Table 1. SWAp Comparison of Financing Modalities

Financing modalities	Advantages	Challenges
Parallel and coordinated financing	Useful when pooling of funds difficult or outweigh costs Can accommodate donors with constraints to pool Still possible to harmonize processes	Extra efforts to harmonize processes Incentives to harmonize weaker Higher coordination transaction costs Could easily go back to stand alone project mode
Pooled funding	More streamlined, faster disbursement Single implementation and reporting mechanisms Loss of attribution helps focus on higher-level outputs and outcomes.	Intensive upfront work to assess and agree on implementation mechanisms Risk of over-complexity in design or micro-management
Direct budget support	Simple disbursement mechanism Fully integrated into government Budget cycle Greater focus on result	Defining realistic and appropriate policy milestones Adequate public finance management systems necessary

Adapted from: Chiyo Kanda. Development support modalities for greater effectiveness. OPCS. World Bank. 2004

4. SWAp fiduciary processes

a) The approach

A principle, following from the Paris declaration, is that sector coordination mechanisms should not substitute for, or override, the general structures and responsibilities of the partner government. Thus, the national budgetary process should be the principal mechanism for allocating public resources (including aid), and the national parliament should be the source of authority for approving national policies, plans and budgets. Where weak governments and high levels of aid dependency have eroded this principle, a key objective of sector approaches and other aid coordination arrangements should be that they help to restore appropriate lines of national accountability. These considerations should exclude SWAp management such as those that entrust the management of pooled funds to a donor, except under special circumstances.

However, the SWAp management arrangements must also take into account the donors' concerns, notably the following:

- What are the fiduciary risks related to the current arrangements?. Are there actions planned to address them?
- Do the current arrangements allow smooth and efficient budget implementation? Are there actions planned to improve the efficiency of budget implementation?

- Are the existing monitoring and reporting systems satisfactory? Are there actions planned to improve them.

The design of fiduciary processes should be based on a joint donors-government ex ante assessments of procurement and financial management rules, procedures and practices. Reviews such as CFAA, CPAR and PER, and the PEFA assessments which are being carried out in most developing countries will help in undertaking this assessment. More than the level of a PEFA score or the list of current weaknesses, what is important is to identify whether the public financial management systems are moving in the good direction. Government and donors should agree measures to mitigate identified risks and strengthen capacity in financial management.

b) Procurement

Generally, the government prepares an annual procurement plan, which is reviewed with the donors participating in the pooled fund. If needed, national procurement procedures should be streamlined to allow alignment of procurement procedures as soon as possible. It would be not very meaningful to implement special procurement procedures for only a few sectors or programs, while the majority of government purchases are made under questionable procedures. An action plan to implement the recommendations of reviews such as CPARs should be established and implemented.

Special procurement procedures for pooled fund may be set up, as interim arrangements before national procedures are satisfactory. For example, for the health pooled fund in Ghana the following arrangements have been set up in 2002: (i) all procurement above US\$ 2 million or equivalent for civil works, US\$ 400 000 for goods and US\$ 200 000 for consultants shall be conducted using procedures set forth in the guidelines for procurement under IBRD loans and IDA credit; and (ii) other goods and services will be procured according to procedures set forth in a procurement procedures manual jointly agreed by the government and co-operating partners.

Even if national procurement procedures are satisfactory, some donors may be submitted to some special constraints that will impede alignment of procurement procedures for their aid. This will require earmarking their support within or outside the pooled fund, if any.

c) Disbursement

Pooled funding requires designing adequate disbursement of donors' funds and payment procedures. Payment procedures raise concerns related to fiduciary risks, the quality of reporting and accounting, and the efficiency of cash management. Thus, many donors, as well as line ministries, promote the use of special accounts and special payment procedures to ensure that their budget will be effectively implemented, to bypass cash rationing procedures or to diminish delays in budget implementation. On the other hand, such special procedures are criticized by other donors, the ministries of finance and the IMF because they may hamper fiscal discipline and the efficiency of intersectoral resource allocation.

Special budget management procedures can be desirable for efficient budget implementation, but multiplying special procedures may lead to fragmented budget management and different reporting and accounting systems, which diminish accountability to parliament and citizen. Some basic requirements should always be enforced:

- All government expenditure, whatever their financing source, should be included in the budget, and presented under the same budget classification system.
- All actual expenditures (commitment and payment), whatever their financing source, should be accounted for, presented in the government financial reports under the same budget classification system, and included in the end-of-year accounts.
- All government bank account should be Treasury's accounts, even when managed by line ministries.

Different type of payment systems may meet these principles, but the payment system must take into account the existing national system, with the view to avoiding increased fragmentation. For example, where a Treasury Single Account (TSA) is implemented, it will be highly desirable to use it, or to plan its use in the short/medium term.⁶

Figure 4 illustrates some possible disbursement arrangements for a SWAp:

- Donors providing sector support budget will transfer their funds to the consolidated fund (and the TSA, if any), according to the agreed conditions. However, if the donor-government agreement includes provisions for real earmarking the donor funds, a special account may need to be opened.
- Donors financing parallel, but coordinated, projects will still use special project management procedures, but at least the projects should be included in the budget tabled in Parliament and in government financial reports.
- The pooled funds are disbursed in figure 4 in the same way than in the Tanzania example given in Box 3: (i) donors funds are deposit in a special foreign currency account at the central bank; (ii) funds are transferred periodically (e.g. quarterly) to the treasury's account in domestic currency, after producing reports on both planned expenditures and payments previously made⁷; and (iii) planned payment transactions are processed made through the government financial management system, in the same way as other government payment transactions.

⁶ In all African francophone countries and about half of African Anglophone countries some form of TSA is implemented.

⁷ These reports should be cash based, or both commitment and cash based. In the Francophone budget systems, if a computerized accounting system is not in place, this will require, keeping ancillary book to monitor cash payment against appropriations, because in such systems, the budgetary expenditure is recognized at the payment order stage, not at the payment stage.

Such a mechanism for pooled funds does not exclude special procedures for ensuring smooth SWAp implementation which may include, for example, imprest accounts, notably for spending units located in remote regions, or authorizing carrying over under certain conditions. Figure 4 includes within the SWAp transfers to local government entities, transfers to semi-autonomous implementation agencies could be also considered. Implementing special budget management for some expenditure items may require amending the legal framework⁸, but it does not need to place the SWAp expenditures off-budget.

A SWAp requires a robust financial reporting system and an adequate budget classification. When implementing a SWAp the required actions to strengthen financial accounting and reporting should be identified. Financial reporting a SWAp should be preferably integrated, or aimed at being integrated within the government reporting systems. Parallel financial reporting have short life and are sometimes source of confusion. Budget classification issues are discussed in the session on budgeting and expenditure planning.

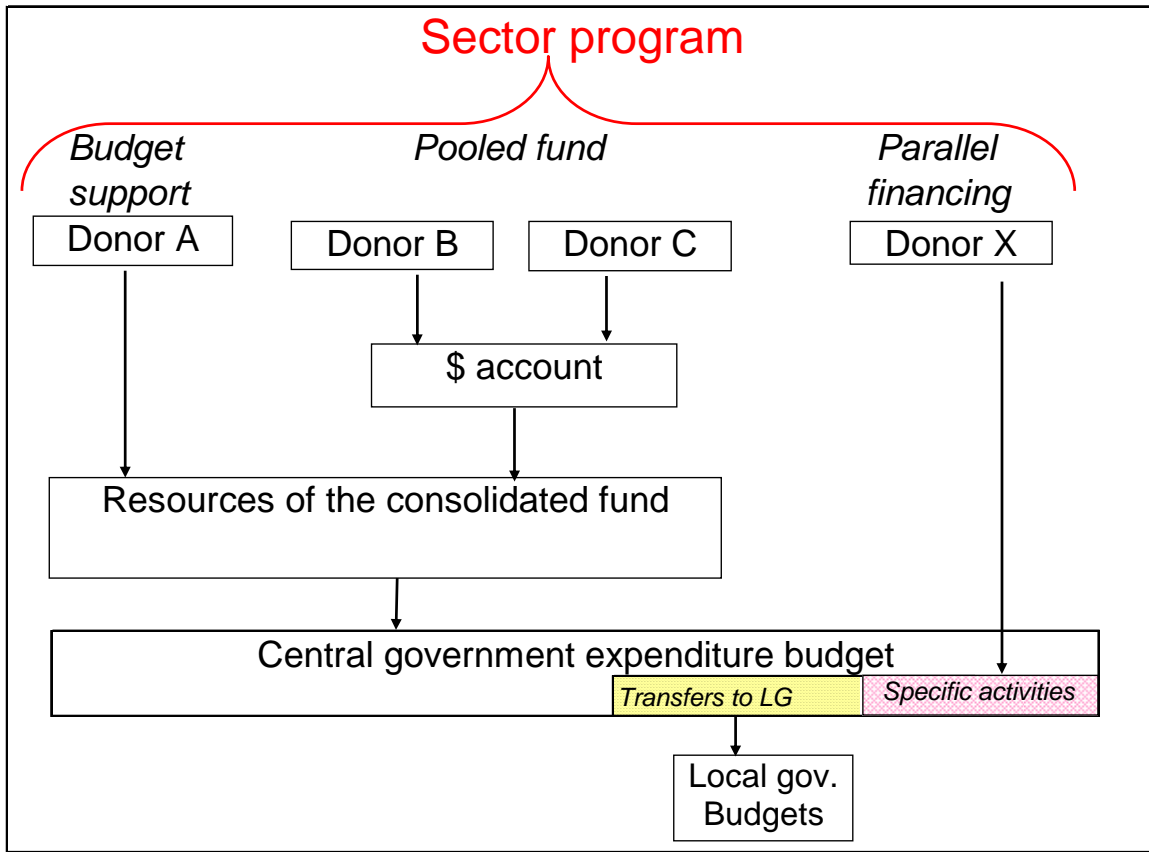
In some countries, the pooled fund is off-budget and the donors' aid does not transit through the consolidated fund. Such a procedure is assumed ensuring smooth budget implementation and limiting fiduciary risks. However, it does not encourage governments to reinforce their PFM systems. Moreover, fiduciary risks should not be significantly higher where the fund transfers to the consolidated fund⁹ are based on quarterly reports, and, eventually, additional field controls. Whether an off-budget procedure ensures smoother program implementation is unclear, as shown by delays in implementing off-budget projects or the slow disbursement pace of some off-budget pooled funds¹⁰.

⁸ Actually, even in the more centralized budget systems the legal framework include provisions that may grant some flexibility in budget management for special cases.

⁹ Or through the *budget général* and *compte unique du trésor* (TSA) in Francophone systems.

¹⁰ See the Mozambique example in Sector-wide approaches in education: issues for donor agencies arising from case studies of Zambia and Mozambique. UNESCO IIEP. 2002.

Figure 4. SWAp: Possible Disbursement Procedures



Box 3

Tanzania: Health Sector Basket Fund (HSBF) disbursement procedure (for central government)

Donors deposit funds into a USD Holding Account at the Bank of Tanzania. The Basket Financing Committee – comprising the Ministry of Health, Ministry of Regional Administration and Local Government, Ministry of Finance and donors – is responsible for overseeing operation of the HSBF. It reviews and approves annual plans and budgets; confirms donors' annual contributions; and reviews and approves quarterly reports, and the release of funds from the USD Holding Account.

Funds are transferred from the USD Holding Account to the Exchequer Account quarterly (via the development revenue account). The Basket Financing Committee's decision to transfer funds is based on an approved cash flow forecast (for the forthcoming quarter) and satisfactory financial and technical performance reports (from the previous quarter) prepared by the Ministry of Health; and clear evidence of monthly releases of government funds for the Plan of Action.

Funds are processed using the government's Integrated Financial Management System. All Warrants of funds and payments are processed using the system. Cheques are generated through the Central Payment System at Treasury. Reports for donors and government are printed from the system. Funds are accounted for as part of the Ministry of Health's voted expenditure. HSBF funds follow government financial rules and procedures (described in the HSBF accounting manual).

Annual reports and audit. The Ministry of Health must submit to the Basket Financing Committee an Annual Expenditure Report showing budgeted against actual expenditure for the activities in the Plan of Action. The Basket Financing Committee appoints external auditors to conduct an annual audit.

Source: Graham Hobbs. The health sector-wide approach and health sector basket fund. Economic and social research foundation. 2001.

5. Organisational issues

The SWAp coordination arrangements should:

- be consistent with the structure and responsibilities of the national government. This means, in particular, that: (i) the line ministry¹¹, responsible for the sector, is the main responsible for the implementation of the sector program ; (ii) the ministry of finance (and the ministry of planning, where separate) must be involved and have a clear role; and (iii) the responsibility assignments and lines of accountability defined in the country's decentralization system should be respected;
- establish co-ordination mechanisms with the view to enhancing policy dialogue, planning, co-ordination and partnership between the donors and the government.

These arrangements may comprise:

- a high level steering committee chaired by the minister responsible for the sector and comprising senior government staff, which meets about twice a year;
- a sector committee, chaired by the permanent secretary (or *secrétaire général*) of the ministry responsible for the sector, which will include technicians from the sector ministry, the ministry of finance/planning and other relevant ministries, the main educational institutions, NGOs/civil society and the private sector. The sector committee will meet regularly (e.g. every two or three months) to provide a forum for consultation regarding education policy, strategy and financing;
- technical working groups responsible for sub-sectors and cross-cutting policy issues;
- sector reviews held once or twice a year led by the sector ministry and involving the participation of all major stakeholders in the sector.

Figure 5 shows the arrangements set up in Rwanda for the education sector and highlight some of the organizational complexities of managing the process.

¹¹ or line ministries. As noted in section C8, the SWAp should be supervised preferably by a single ministry, but exceptions may be unavoidable (e.g. in some countries, SWAps are supervised by both the sector ministry and the ministry responsible for local government affairs).

Figure 5. RWANDA: SWAp MANAGEMENT

Membership

Policy team
 State Ministers (Ed),
 SG (Ed and relevant ministries),
 Donor representative (1)
 Chaired by Honourable
 Minister of Education

**Senior technical and
 planning personnel** from
 MINEDUC, MINECOFIN,
 MIJESPOC, MINALOC,
 Educational Institutions,
 Donors, NGOs, CBOs, FBOs
 Chaired by Honourable
 Minister of Education

Technical officers from
 MINEDUC, MINECOFIN,
 MIJESPOC, MINALOC,
 Educational Institutions,
 Donors, NGOs, CBOs, FBOs
 as appropriate
 Chaired by Lead Directors

Activity

Policy assurance

- Monitors education performance
- Advises ETG

[Meets at least once in each ½-year]

Sector Guidance and Supervision:

- Advises on programme planning
- Monitors sector development
- Supervises, co-ordinates and guides the Working Groups;
- Ensures Donor liaison
- Reports to ESSC

Sub Sector Strategy and Action Planning

- Makes proposals on subsector policies, targets and strategies;
- Produces planning outputs, including work plans;
- Monitors subsector progress;
- Ensures information exchange and compliance through cross-membership between the CCU and SSG;
- Reports to ETG

[Meets monthly (minimum)]

Two Cross Cutting Units (CCU)

Quality and Relevance
 Chair: IGE

Policy and Planning
 Chair: Director Planning

Four Sub Sectoral Groups (SSG)

Basic Education
 Chair: Director Primary

Secondary Education
 Chair: Director Secondary

Higher Education
 Chair: Director Higher

Science, Technology & Research (STR)
 Chair: Director STR

Abbreviations (some explained within the diagram)

- | | |
|-----------|--|
| CBOs | Community Based Organisations |
| FBOs | Faith Based Organisations |
| IGE | Inspectorate General of Education |
| MIJESPOC | Ministry of Youth, Sport and Culture |
| MINALOC | Ministry of Local Government, Social Affairs and Information |
| MINECOFIN | Ministry of Finance and Economic Planning |
| MINEDUC | Ministry of Education, Science, Technology and Scientific Research |
| SG | Secretary General |

Source: Sector wide approaches in Education. IHSD. London. 2003.

6. Memorandum of Understanding

An agreement on specific financial management and procurement procedures is imperatively required. It should be based on the results of the capacity assessments and reflected in a joint Memorandum of Understanding which will specify:

- Institutional arrangements
- Procurement arrangements, and post review of procurement actions plus technical and procurement audit
- Financial Management (including Disbursements)
- Interim and annual reporting arrangements
- Annual audit of consolidated financial statements, and follow up arrangements
Consultation, Information, Monitoring & Evaluation (joint reviews).

Manuals on financial management and procurement procedures should be annexed to the Memorandum of Understanding.

7. Transaction costs issues

Aid transaction costs can be defined as: *“The costs arising from the preparation, negotiation, implementation, monitoring and enforcement of agreements for the delivery of the aid”*¹². They may take the following forms:

- Administrative costs: They arise from inputs of resources needed for the transaction. Main costs include administrative overheads, in particular staff time.
- Indirect Costs: They result from the impact of the aid delivery mechanism on the achievement of development goals. Examples of indirect costs include disbursement delays, reduced effectiveness (as resources may go to lower priority areas), and over-financing of capital vis-à-vis recurrent expenditure.
- Opportunity costs: They measure the benefits forgone from alternative applications of the resources consumed in the transaction. For instance, senior officials need to trade off their time between aid management and policy development.

In countries which receive assistance in the form of projects, transaction costs may be high, especially where there is a large number of standalone projects managed under different

¹² Aid transactions costs in Vietnam. UNDP-DFID. 2000.

procedures. However, moving towards SWAp does not necessarily diminish, immediately the transaction costs.

The prevailing assessment is that transaction costs are higher for SWAp than for project aid, in the first few years of the sector program, but efficiency gains will largely exceed the administrative costs in cruise regime. However, transaction costs are difficult to estimate. As shown in Box 4 there are different assessments on their magnitude and on the possible savings under SWAp arrangements. These depend on the country context, the degree of mutual trust between the actors (government and donors) and the nature of SWAp arrangements, notably their degree of complexity.

Box 4

Transaction costs issues: Some different assessments

Malawi (HIV Program)

SWAp/PBAs diminish aid transaction costs:

- under conventional funding arrangements: 9 accounting, 9 progress reporting, 9 procurement, and 7 grant-making systems
- under harmonized funding arrangements: 1 accounting, 1 progress reporting, 2 grant-making, and 4 procurement systems

Source: www1.worldbank.org/harmonization/paris/AfricaWorkshop/Session5-SWAp.ppt

Cambodia (Education)

Education SWAp made a notable progress in reducing transaction costs of the government by setting up a unique process of negotiation and institutional arrangements to build consensus among donors. This enabled public officials to spend less time managing aid, and more time on substantive work, including planning, implementation and monitoring and evaluation.

It should however be noted that the reduction of transaction costs to the government has not been without cost. On the government side, there are a number of working groups to manage which increase the problem of coordination. Many donor informants reported that the transaction costs of donors have increased significantly as donors have had to spend more time and resources for negotiation with other donors. In a sense, the coordination mechanism created under Education SWAp has shifted part of the transaction costs from the government to donors.

Source: [practices and Lessons Learned in the Management of Development Cooperation: Case Studies in Cambodia](#). Council for the Development of Cambodia. 2004.

Box 4 continued

Tanzania (Education)

Despite its apparent logic, the [SWAp management] structure is dysfunctional. Donors complained of lack of senior enough government representation at the meetings of the Basic Education Development Committee, despite it being for them their main forum of engagement. Government complained of too many meetings. NGOs complained that ‘real decisions’ were made elsewhere than through this structure. The business required under the Pooled Fund Memorandum of Understanding (MoU) involves mainly planning and reporting, but these activities are now widely regarded as highly problematic for three reasons: (i) they constitute a parallel process; (ii) they are not feasible to carry out; and (iii) the purpose and use to which the various documents are put, the production of reports being seen as an end in itself, and little or no subsequent action is taken.

...

The substantive points from this discussion of pooled fund and sector support are that: (i) transaction costs, administrative and fiscal have been high; (ii) attention focussed on ensuring adherence to the MoU, might have been better spent on creating an enabling environment for some of the other issues, such as addressing capacity gaps, improving intergovernmental coordination or promoting local accountability.

Source: Kate Dyer. The Cost of Poverty”: Transaction Costs and the Struggle to Make Aid Work in the Education Sector in Tanzania. Human Development Report Office, Occasional Paper. 2005.

8. Conditions of success

As noted, the SWAp is an approach not a rigidly defined model. There is no blueprint, but experience shows that there are a number of conditions of success:

- A basic requirement is the fact that both the government has a sector policy in place.
- Donors support that policy, and both parties have enough common ground to be able to agree on how it will be developed into action plan and expenditure programs. Government is open to discuss with the donors the sector strategy and resource allocation for the sector.
- There is political commitment by government to the SWAp.
- The sector falls mainly under the remit of one line ministry, or at least responsibilities at the Cabinet level in managing the SWAp should be clearly identified without overlaps and conflicts. Where more than one line ministry is involved political sensitivities of managing the relationships can derail the program and the link between the SWAp and the budget may be weakened.

- There is a sound overall macro-economic and budget management environment. The financial constraints for the sector should be defined and the sector budget, and multi-year sector expenditure programs, if any, should be prepared under hard constraints. This is essential to ensure that sector level priority setting and planning are based on realistic, deliverable budgets.
- The government needs to be opened to independent scrutiny of its PFM management systems.
- Donors must be prepared to make a medium/long term financial commitment to the program.
- The arrangements for managing the SWAp should be designed carefully with the view to limiting transaction costs.