

To the President of the House of Representatives  
of the States General  
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Den Haag

Ministry of Foreign Affairs Netherlands  
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C.c.

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I am pleased to present you with the report *From project aid to sectoral support. Evaluation of the sector-wide approach 1998-2005*, and my response to it.

This report by the Policy and Operations Evaluation Department (IOB) of the Ministry of Foreign Affairs examines changes in Dutch bilateral aid to the 22 (19+3) countries selected as structural development partners in 1999. It does not therefore cover all 36 partner countries.

The second part of the report discusses the effects of the sector-wide approach in the 19+3 countries, based on subsidiary studies in Bangladesh, Bolivia, Burkina Faso, Uganda and Zambia. The results of these studies are issued on CD-Rom as appendices to the report, and will be sent to you shortly.

Agnes van Ardenne-van der Hoeven  
Minister for Development Cooperation

## **Response to the IOB evaluation on the sector-wide approach**

### **Introduction**

The sector-wide approach was introduced as the organising principle for Dutch bilateral aid in 1998-1999, as a carefully considered step to improve the quality and effectiveness of Dutch development cooperation. Both IOB's own evaluations and numerous international studies in the 1980s had shown that stand-alone projects funded by donors were making no contribution to sustainable poverty reduction. Results achieved with these projects often evaporated as soon as donors withdrew. What is more, these uncoordinated and overlapping activities were undermining rather than strengthening local capacity. The macroeconomic conditions imposed by donors in the context of structural adjustment programmes were also having too little effect. It was therefore decided that, as a matter of principle, partner countries needed to be given more responsibility for their own development and a greater say in the spending of aid. This meant aligning aid more closely to these countries' national policies and financial management systems, and ensuring that donor funding was coordinated, predictable and provided on a multiannual basis. Rather than implementing projects ourselves, we now focus on the quality of our partner countries' own Poverty Reduction Strategy Papers (PRSPs) and sector plans. After all, major investments in education, health care or drinking water will not result in lasting improvements if the recipient country fails to maintain the infrastructure or ensure that these services reach the poor.

In the policy memorandum *Mutual interests, mutual responsibilities* (October 2003), I opted for continuity of the sector-wide approach and policy coherence for development as essential prerequisites for more effective aid. At the same time, I decided to broaden and deepen bilateral development cooperation. First, by encouraging good governance, a better business climate and political

dialogue in our 36 partner countries. This includes a dialogue on sensitive issues like human rights, income distribution and corruption. Second, by pursuing an integrated approach to peace, security and development, especially in regions affected by conflict. Third, by stressing the need for public-private partnerships and a greater role for civil society organisations, the private sector and other players, to persuade governments to adopt more inclusive and sustainable poverty reduction policies. One of the objectives of the new cofinancing system for Dutch non-governmental development organisations is to improve the complementarity of government-to-government interventions and the work of civil society organisations in the partner countries. And finally, by making the work of the Dutch government, the UN and other organisations more results-driven. In 2005, the Paris Declaration on Aid Effectiveness, to which the Netherlands provided active inputs, gave the effectiveness agenda an added boost.

## **Context**

The Netherlands was one of the first donors to adapt its aid management to internationally agreed principles. It is therefore vital that we evaluate the progress we have made so far and learn from our experiences to make sure we are proceeding in the right direction. That is why I asked IOB to compile its report.

IOB examined whether the Netherlands implemented the sector-wide approach policies between 1998 and 2005, whether this had the desired effect of increasing ownership of the partner countries and whether it improved conditions for poverty reduction. Chapters 1 to 4, which discuss adjustments made to Dutch policy, conclude that the Netherlands has made a consistent effort to apply the key principles of the sector-wide approach, such as less earmarking of aid and a more hands-off approach to its role as donor. The

report does not, however, reflect much appreciation of the caution with which the strategy was applied in countries where the basic conditions for development are less favourable.

Chapters 5 to 8 discuss the changes that have occurred in the five case study countries. They present an accurate picture of the practical difficulties and dilemmas confronting the Dutch embassies, such as limited implementing capacity in the partner countries, and of the results achieved in spite of these. Since IOB made only brief field visits to these countries, it was not possible to compile in-depth analyses of the processes of change. As a result, the subsidiary reports sometimes make conclusive statements which are not backed by solid evidence. Unsubstantiated causal links are also made in some cases, especially in the report on Uganda.

I appreciate the report's overall findings on the effects of the sector-wide approach, but feel it places too much emphasis on what has not yet been achieved. I believe this is because IOB has evaluated policy practice against the high level of ambition which the Netherlands adopted in 1998 and 1999 with a view to effectuating a radical change in our own way of working. Yet in our policy papers, it was always recognised that institutional change in our partner countries would be a lengthy process. We are talking about radical reforms that require a fundamental change of behaviour, breaking through existing power relations and spending patterns. We cannot expect this to be fully achieved after only seven years. As an interim assessment, the report contains many valuable observations and recommendations. However, in reaching its conclusions, IOB does not take sufficient account of the longer-term outlook and this makes the report less useful as a learning tool. Interim adjustments made to policy in response to lessons learned, such as the recently introduced multi-year strategic planning, are also largely ignored.

I am pleased to read that at macro-level the sector-wide approach has produced several positive outcomes. And I welcome IOB's constructive advice on improving policy implementation, especially the need to ensure that sector policy filters down more effectively to lower levels. I will now discuss the report's main findings and recommendations in more detail.

### **Changes in the Netherlands' approach**

#### *Country selection and transition to less earmarked aid modalities*

The aim of the country selection processes in 1999 and 2003 was to improve the efficiency of Dutch bilateral aid by concentrating manpower and resources on a smaller group of poor countries, where basic conditions for the provision of aid through the sector-wide approach were deemed to be in place. IOB concludes that concentration has now largely been achieved. The number of countries with which the Netherlands has a structural development relationship has been reduced by a third. The exit strategy has been completed in most of the countries no longer eligible for an aid relationship.

The IOB report criticises the way the 1999 selection was made, claiming that half the 19+3 countries selected for a structural development relationship, including Bolivia, Mali and Mozambique, did not satisfy the criterion of good governance, so that one of the main pillars of the sector-wide approach was lacking. However, the report itself gives a much more qualified picture. It concludes, for example, that good progress has been made in the education sector in Bolivia and that the share of budget support in total aid to Mozambique has considerably increased.

Both the primary and secondary criteria governing the country selection, and the indicators used, were discussed in detail with parliament in 1999 and 2003.

Partly at the latter's request, it was decided that selection should not be a mechanical process based on a purely quantitative analysis, but a transparent one based on considered judgements and consultations with parliament and civil society. The secondary criteria, such as the need for continuity and the added value provided by the Netherlands, were also intended to improve quality, and did not detract from the results. This is confirmed in chapter 2, where IOB concludes that the poverty criterion was applied correctly to the 19 partner countries and that they achieved much higher scores for good governance and socioeconomic policy than countries that were not selected. In 2003, I decided to concentrate aid even further by discontinuing the Netherlands' structural development relationship with 13 of the 24 former "thematic" partner countries, seven of which had experienced a relative rise in prosperity. IOB concludes that this selection process was transparent. I grouped the remaining countries into a single list of 36 partner countries.

With respect to the good governance criterion, it has always been clearly understood that any measurement of good governance will inevitably be relative. Almost all poor countries have comparatively weak institutions. We therefore decided to look not just at the existing quality of policy and governance, but also at the multi-year trends: are countries showing sufficient political will to improve governance, have they made tangible progress, and can the Netherlands make a substantial contribution to processes of improvement? The objective remains to provide joint, unearmarked aid for the sector policies of these countries. The roadmap towards this goal will depend on the country-specific situation. Even in countries like Yemen and Bangladesh, where it is not yet possible to provide budget support, coordinated donor funding of public programmes in education, health care and the water sector has helped to strengthen the focus of government policy on women and marginalised groups.

Commenting on the transition to the sector-wide approach, IOB concludes that: (i) the government employed a swift, standardised approach which exceeded the capacity of Dutch missions and partner countries alike; (ii) the objective to reduce the share of earmarked aid has been achieved in nine of the 22 priority countries, while project aid is still the dominant form of support in over half these countries; (iii) the Netherlands has been a pioneer in harmonising and aligning aid and consistently performs better in this respect than most other bilateral donors.

I am pleased with the third conclusion, and will continue the Netherlands' work in this area, which has attracted international recognition. The first two findings, however, reflect an obvious discrepancy. The country studies clearly show that the Netherlands exercises caution in countries where it is not yet possible to fully align with national (budget) systems in view of existing policy, governance or capacity. In *Mutual interests, mutual responsibilities*, I deliberately abandoned the notion of a linear progression from project aid to budget support, preferring instead to select the most appropriate mix of aid modalities for each country and sector.

I will give an example of what I mean. In 2005, the Netherlands started providing sector budget support for the environment sector in Senegal following several years of thorough preparation and capacity building in the environment and finance ministries. The improvements in multi-year planning and budgeting also led the Government of Senegal to increase its own contribution to the sector. In parallel, the Dutch embassy, partly in conjunction with other donors, is helping to strengthen the capacity of a number of NGOs, the media and parliament to call the government to account for its spending. The Netherlands is also using project aid to support two regional programmes on rivers and marine ecosystems, for which there is as yet no provision in the

national budget. Finally, a public-private project which will contribute to the environmental agenda in Senegal is being prepared with ORET funding.

The sector-wide approach reflects a deliberate choice for a process of learning by doing. In other words, organisations in the partner countries will have to gradually build up the necessary capacity. This means that we must have the courage to take acceptable risks. Giving our partner countries more say in how they spend the aid we give them is the best incentive we can provide for improving the efficiency and effectiveness of their own work processes. A great deal of new knowledge and experience has already been acquired by all the players, including within our own embassies, in just a few years. Problems that come to light, such as weak budgeting procedures, are tackled en route through targeted support for capacity building. Since 2003, the Netherlands and other donors have been systematically addressing the need to strengthen capacity for financial management. More recently, the influence of informal institutions, such as nepotism, and the importance of political dimensions have also gained increasing recognition. This year, the government will be launching a new, broad-based support programme for the missions (Support Programme for Institutional and Capacity Development, SPICAD), to increase knowledge and awareness of these factors and to boost the effectiveness of Dutch support for capacity building.

#### *Concentration of aid in the social sectors*

IOB maintains that in all the former 22 structural partner countries the introduction of the sector-wide approach has led to a concentration of aid in the social sectors and less support for productive and economic activities. As a result, the economic dimension of poverty is now taking second place in policy according to IOB. It therefore feels that the decision to prioritise aid for the social sectors is in need of review.



When I took office, I underscored the importance of productive development and a favourable business climate, and these are spearheads of my policy in all partner countries. Based on my observation that the sector-wide approach in practice was becoming more and more a matter of government-to-government support only, I consistently emphasised the importance and role of the private sector. Given the specific characteristics of the productive sectors – the many actors involved, a less hands-on role for the government and limited public funding – I opted for a strategy aimed at strengthening economic governance, which would help the private sector to invest more of its own money. This included support for a better delineation of responsibilities between public and private players, as recommended by IOB. I have been setting aside extra funding for this purpose since 2003 and will be committing a further EUR 30 million this year.

The Netherlands also makes an active contribution to public-private partnerships in various areas, such as the agricultural sector in Zambia and Bolivia, and to strengthening small and medium-sized enterprises and the financial sector. The ORET/PSOM private sector development programmes have also been streamlined and PSOM has now been opened up to a total of 41 countries. As a result, the budget for 2005 and 2006 was not only increased but almost completely exhausted. I have also taken steps to improve the coherence of policy on aid and trade and to ensure favourable conditions for developing countries on the global market, for instance in the context of the World Trade Organisation.

I do not believe that we need to review our decision to prioritise funding for the social sectors. We are sometimes in danger of forgetting that it was not until the late 1990s that the importance of the social sectors for poverty reduction – including for the income dimension of poverty and economic growth – was

internationally recognised. This was not behind the decision to introduce the sector-wide approach. However, education and health are areas in which the public sector plays a key role in formulating, implementing and financing policy. Hence, the social sectors will obviously account for a larger share of government funding. Moreover, there is still a large worldwide funding deficit, which means that many countries will fail to meet the Millennium Development Goals for education and health care.

### **Effects of the sector-wide approach in the partner countries**

#### *Ownership*

The IOB report concludes that the Netherlands has helped to create better conditions for national ownership in the chosen sectors. It also finds that, within the context of sectoral programmes, aid flows have become much more predictable, allowing governments to draft multi-year budgets for both capital and recurrent expenditure. The nature of the policy dialogue is changing and donors are gradually becoming less involved in the direct implementation of policy. In general, however, ownership by recipient countries has not come about to the extent that was hoped for. I agree with the explanations put forward by IOB. Chapter 6 provides an interesting overview of the dilemmas. On the one hand, donors are reluctant to adapt their procedures and to reduce their influence on policy. On the other, partner countries lack the capacity – and in some cases the will – to exercise effective leadership and assume more ownership. If we are to break through this vicious circle, we must give these countries more responsibility, even if the conditions for doing so are not optimal. If we do not strengthen the capacity of our partner countries to tackle their problems as they see fit, then they will fail to achieve sustainable results.

#### *Conditions for effective poverty reduction*

IOB points out that in most of the sectors supported by the Netherlands, governments are finding it very difficult to reach the poor. This is true, and it is precisely our aim to change that. While direct provision of donor aid to target groups – to compensate for government failure – may initially achieve a strong poverty focus, this approach will not achieve sustainable results in the longer run. The sector-wide approach, by contrast, *can* deliver sustainable results because it encourages the partner country to assume responsibility for its own development. While shifting to the sector-wide approach, we have not abandoned our focus on poverty. The report concludes that the Netherlands has successfully encouraged a stronger focus on poverty within the partner governments' own policies, for example, a higher priority for primary health care in rural areas and more attention to the position of women and girls.

IOB points out that the Netherlands has reduced direct aid to the poorest districts. While this is true, the embassies have successfully promoted preferential treatment for poor districts within the government programmes at large. Examples include the ten-year sector plan for basic education in Burkina Faso and the Local Government Development Fund in Uganda. It is initiatives like these that can make the difference. IOB concludes that the sector-wide approach has produced the envisaged economies of scale, with a substantial increase in public services, especially in education. At the same time – contrary to what IOB suggests – we are also supporting supplementary activities, such as education for special target groups, in all the partner countries. Here, too, we are striving to achieve harmonisation and coordination wherever possible. Mechanisms to encourage feedback from users of government services, such as parent-teacher committees in schools, have also been built into the sector programmes.

IOB recognises that the sector-wide approach has created more scope for an effective, integrated approach to structural problems than was possible with project aid. For the first time, bottlenecks at supra-sectoral level such as personnel and salary policies in the civil service are being addressed. This month, precisely because we give sectoral and general budget support, we have been able to discuss with the Nicaraguan government and the IMF the underlying causes of the current crisis in the country's health sector and the reasons for the mass strikes by medical personnel. After all, without medical personnel, the poor will receive no care and the Millennium Development Goals will not be attained.

I have put political dialogue at the centre of my policy and made good governance, along with poverty reduction, an important subsidiary goal in all partner countries. This requires an integrated approach by the embassies and a strategic vision. Since 2005, the missions in all the partner countries have drawn up multi-year strategic plans bringing together all elements of foreign and development policy. Fundamental sector reforms may take ten to fifteen years to achieve. For decades, we have worked mainly at the local level. Now our staff at the missions are using our expertise and knowledge of the field in the dialogue at national level on sector management, the broader poverty agenda, budget management and the international debate.

Given that we have spent the last few years mainly addressing problems at higher levels of government, it is now time to ensure that these improvements filter down to the regional and local levels. I endorse IOB's view that the delivery of macro policy in the form of better local services can and must be strengthened. These lessons in the IOB report are the ones I take most to heart. I will discuss this more fully below.

I agree with IOB that initially too much emphasis was put on the role and ownership of central government. We cannot bypass the government, and an enabling government policy is vital in almost every policy area. But the government is not the only player, nor is it always equally effective. As I advocated in *Mutual interests, mutual responsibilities*, we need to forge wider partnerships and view the private sector and civil society much more as independent development partners. This requires a clearer delineation of tasks and responsibilities in the partner countries. In the context of sector coordination, private service providers and civil society organisations must be given a role that has been agreed sector-wide, and is preferably financed from central funds instead of directly by donors. In Burkina Faso, for example, part of a schools building programme which the government is unable to implement has been contracted out to two leading civil society organisations using funding from the sector programme. We must therefore step up our efforts to ensure that we achieve a genuinely sector-wide approach in which the role of each player is acknowledged and subject to local accountability mechanisms.

### **IOB recommendations and follow-up**

In the summary in chapter 8 and in its main findings, IOB maintains that on introducing the sector-wide approach, the Netherlands paid too little systematic attention to instruments and mechanisms which could increase the poverty focus of service provision. I believe that this should be the main focus of our work over the coming years, in addition to making the results achieved more visible.

#### *Country policy and aid modalities*

IOB recommends that when aligning aid to the management and policy frameworks of recipient governments, the Netherlands should apply a more

differentiated approach to take account of the situation in each country, and use project aid more strategically. I have already pointed out that my policy aims for the best possible mix of aid modalities for each country. As I explained in my response to the 2004 Joint Evaluation on External Support to Basic Education, it allows for innovative projects to develop policy, provided they contribute to and are embedded in broad sector development. A varied application of aid modalities also presents the opportunity to strengthen civil society demand for accountability.

I do not agree that donors should continue to implement their own projects to stay in touch with the micro level and to compensate for the shortcomings of recipient governments. My view is that we should be extremely cautious about taking such action, since it is precisely what we set out not to do. The IOB report notes that in countries where less progress has been made with programme support, there *is* a tendency to try to align project aid more closely to government policy. However, it does not indicate which types of projects and innovative hybrids have or have not been successful in countries where policy and governance are weak, or in institutionally complex sectors like water and the environment. So IOB itself provides few guidelines on achieving the differentiated policy it advocates.

I will continue to press at national and international level for a behaviour change among other donors. Many international organisations and countries still need to translate the Paris Declaration on Aid Effectiveness into their procedures and guidelines at head office level. One issue which merits specific attention is more harmonised donor support for capacity building.

*Greater impact at regional and local level*

IOB rightly calls for more interaction between the macro and micro levels. The main challenge is to help build sufficient mechanisms into the national policies of the partner countries to increase the effectiveness of national policy and national sector financing at regional and local level. Examples include the district baskets, which have been introduced in health sector programmes in various countries to guarantee sufficient funding at local level, and the Zambian programme to encourage medical staff to work in poor districts. We will increasingly be applying innovative solutions like these.

We must also take active steps to strengthen local and regional authorities and private service providers so that they can exert more influence on national policy. I will therefore actively be seeking complementarity with organisations working at the meso and macro level, including SNV, the Association of Netherlands Municipalities (VNG) and non-governmental development organisations. The latter are in a good position to strengthen local demand for higher quality services and accountability. The sector-wide approach has already led to a clearer division of tasks between official bilateral aid and civil society initiatives. The new cofinancing system (MFS) will create better conditions for encouraging complementarity between the two. A meeting will shortly be held with representatives from civil society to discuss micro-macro problems in the context of sector policy, and the issue of complementarity. A detailed actor analysis will have to be made at country level to ensure an optimum distribution of tasks. The missions will do more to learn from the knowledge and experience of other actors, and to share their own experience at national level.

The Support Programme for Institutional and Capacity Development (SPICAD) will be launched this year to help the missions and their partners to more fully understand institutional issues, including decentralisation processes, and to

make a more effective contribution to capacity building at all levels within the sector programmes.

### *Monitoring and evaluation*

I endorse IOB's view that the monitoring of country and sector policies should be less donor-centric. Again, it is chiefly a matter of strengthening national monitoring and data collection systems, in line with the Paris Declaration. Donors should begin by not overburdening these systems with their own demands.

IOB also recommends doing more to measure impact at micro level. I will therefore be asking the embassies to encourage greater use of relevant national instruments such as household surveys and service delivery surveys, and to ensure that the results obtained are discussed in the policy dialogue. We will also be improving our own monitoring instruments this year, notably the sector ratings compiled by the missions.

IOB is critical of the quality and relevance of the joint sector reviews that are used to perform evaluations in many partner countries. It is important, however, to remember that these are joint processes based on shared responsibility and joint review of results and priorities. Dutch theme experts are encouraging non-governmental actors such as trade unions and mission hospitals to take part. Dutch cofinancing organisations can help to strengthen their partner organisations so that they can also play an effective part in these review processes.



## **Conclusion**

The IOB report makes a useful contribution in drawing up an interim balance sheet on the sector-wide approach, seven years after it was introduced as part of a strategy to improve aid effectiveness. It concludes that encouraging results have been achieved in the partner countries at macro level, and that these have helped to improve conditions for sustainable poverty reduction. The report also shows that the strategy has reached different stages in the various partner countries, depending on the quality of policy and governance in each. Contrary to what IOB suggests, the Netherlands has in fact differentiated widely in its efforts to anchor aid in the policies and administrative frameworks of each partner country. Current policy is more realistic and more balanced than when the sector-wide approach was first applied. The current approach is also more results-oriented, with a greater focus on good governance and political dialogue. Dynamic processes are clearly unfolding in all the countries studied, suggesting that IOB's conclusion that there was no basis for applying the sector-wide approach in half of the Netherlands' 22 former structural development partners is premature. In the next few years, we must concentrate on strengthening the quality of service provision and on ensuring that national reforms filter down more effectively to local level. Close cooperation between recipient governments and the private sector, civil society and other actors is vital if the strategy is to be genuinely sector-wide.