

## Implementing DFID's strengthened approach to budget support: Technical Note

### 1. Introduction

1.1. The Secretary of State has approved measures to:

- **Strengthen the basis of our decisions** on the countries we should give budget support to and the type of budget support we should give; and
- **Make budget support more effective**

This paper presents the measures with some guidance on how they are to be implemented.

### 2. Decision on whether to provide budget support and what kind of budget support to provide – a two-step approach

#### 2.1 Assessing partnership commitments: Step 1

2.1.1. In considering whether to give budget support, we will continue to assess governments against the three commitments, and we will place more emphasis on domestic accountability by making partner country commitment to strengthening domestic accountability a specific commitment, separating it out from the other commitments, so the commitments will be to:

1. poverty reduction and the Millennium Development Goals;
2. respecting human rights and other international obligations;
3. improving public financial management, promoting good governance and transparency and fighting corruption; and
4. strengthening domestic accountability.

#### Separate partnership commitment on domestic accountability

2.1.2 Domestic accountability is about people in developing countries holding governments and public authorities to account for delivering on their commitments and responsibilities. This requires:

- **transparency** – government makes available and accessible to citizens relevant information (e.g. government policies, budgets and accounts);
- **citizen engagement** – government provides opportunities for citizens and those representing them to engage with government on the development of policy and the way in which public resources are used (including planning, implementation and monitoring); and

- **answerability and enforceability** – where appropriate, Ministers and government officials are called upon to justify their actions and sanctions are applied (e.g. where responsibilities have not been carried out or where public resources have been badly used or misused). This requires effective scrutiny and enforcement mechanisms within government (including Ministers and senior government officials holding each other to account and taking action in response to any misuse of power or resources) rather than a culture of impunity. It also requires mechanisms which can be applied by external entities, such as Parliament or the Judiciary.

2.1.3 These requirements may be met by a variety of institutions, including the media, Parliament, the judiciary and civil society organisations. Elections provide a periodic sanction mechanism. The effectiveness of domestic accountability depends on formal and informal systems and on capacity, within government and within civil society. Civil society's capacity will be affected by the enabling environment (including the laws governing civil society organisations, which will reflect government policy). The way in which domestic accountability is provided and evolves will vary from country to country.

2.1.4 We will not require partner countries to meet a minimum standard of domestic accountability; rather we will be looking for commitment to strengthen domestic accountability. Our assessment of this commitment will be based on an understanding of current domestic accountability arrangements, and how they work in practice, the overall trajectory of change and plans for improvements. The scale of ambition we will expect in plans for improvements will depend on the range and severity of the problems. In assessing plans for improvements we will consider not only the scale of ambition and the extent to which major problems are addressed, but also the credibility of the plans (the confidence we have that they will be successfully implemented) taking into account the country context.

2.1.5 The partnership commitment is a commitment on the part of the partner government to strengthen domestic accountability. We will assess this commitment, drawing on data from DFID's Country Governance Analysis and from joint monitoring frameworks with partner governments. We will draw on international indicators, such as the Open Budget Index, the World-wide Governance Indicators and Freedom House Indicators. Where possible we will complement these data sets with information gathered at the country level. Where mechanisms to generate data do not exist or are not sufficiently robust, we will seek to support their establishment / improvement.

2.1.6 As part of a wider agenda on empowerment and accountability, DFID has made a commitment to spend an amount equivalent to 5% of Budget Support to enable people in budget support countries to hold their governments to account for the use that is made of public resources, including aid. Progress made and experience gained in meeting this commitment should help to inform the assessment of the partnership commitment on strengthening domestic accountability.

2.1.7 In all cases, our assessment will be of the domestic accountability across government. However, where we are considering sector budget support, we will give particular emphasis to arrangements in the chosen sector.

2.1.8 The effectiveness of domestic accountability will depend in part on government and in part on how Parliament, the judiciary, the media, civil society organisations and citizens engage. This engagement will reflect their capacity and the political, cultural, social and economic context. Aid agreements are with partner

governments and the underlying partnership commitments are commitments by partner governments. Therefore our focus in assessing commitment to strengthening domestic accountability is on those actions which are within the control of government.

## **Assessments of the other partnership commitments**

2.1.9. We will continue to draw on existing guidance in assessing partnership commitments. In addition, we will:

- **Strengthen our assessment of the commitment to poverty reduction**, by: including indicators on trends in budget allocations and outturns for (social and productive) sectors and sub-sectors and whether spending is allocated to address inequalities (geographical and demographic). Off-budget funding of sector programmes will be considered. We will monitor progress on headline poverty indicators and the performance of macroeconomic and other policies (appropriate indicators to be determined by Country Offices).
- **Strengthen our assessment of the commitment to upholding human rights and international obligations**, by more robust use of data, both local and international;
- **Strengthen our assessment of the commitment to improving public financial management, promoting good governance and transparency and fighting corruption**, by:
  - Increasing the focus on formal accountability mechanisms, within our Fiduciary Risk Assessment (FRA) and making a credible programme to improve Supreme Audit Institutions and related parliamentary scrutiny a requirement for a positive assessment (in addition to the requirement for a credible overall programme to improve public financial management).
  - Making a commitment to undertake regular Public Expenditure and Financial Accountability (PEFA) assessments (at least once every five years) a requirement for a positive assessment.

2.1.10. For all the partnership commitments, the assessments will give greater weight to recent progress actually achieved in judging the credibility of future plans or undertakings. So where past progress has been poor, but country offices feel that future plans or undertakings given by the partner government are credible, the budget support submission would need to make a convincing case as to why better progress is expected in future.

## **2.2 Assessment of whether budget support can achieve better results and value for money than other instruments: Step 2**

2.2.1. All budget support submissions will explain how the choice of budget support instrument was made taking into account:

- the results Country Offices are committed to deliver;
- a diagnosis of opportunities and constraints to their achievement;
- the relative merits of the different types of instrument in tackling these constraints and exploiting opportunities.

2.2.2. In making this assessment, we need to consider the range of possible aid instruments, including financial aid instruments, of which budget support instruments

are a sub-set. Choices will depend on the country context and our appetite for leverage, control and risks (both fiduciary and political).

2.2.3. Table 1 compares general and sector budget support and non-budget support financial aid. As we move from general budget support to sector programmes, our ability to *leverage* other funding decreases as does development effectiveness; whereas *control* increases. Sector programmes have the advantage of an increased control over *how* donor resources are allocated and some reduction of political risks.

2.2.4. Studies<sup>1</sup> and evidence<sup>2</sup> have suggested that choice of financial aid instrument need not be an “either or” decision, but that financial aid instruments (both budget support and non-budget support) can complement one another to achieve more results and better value for money.

2.2.5. The Secretary of State will make decisions on the provision of budget support on a case by case basis. Budget support submissions will use the framework presented in Table 1 to inform decisions on the provision of budget support and the choice of budget support instrument.

2.2.6. Individual budget support programmes could be re-named to reflect the results we want to achieve (rather than to the nature of the instrument). Thus:

- General Budget Support could be re named: “*Growth and Poverty Reduction Grant*”
- Sector Budget Support could be re-named: “[name of sector] *Service Delivery Grant*” (e.g. “*Education Service Delivery Grant*”).
- General Budget Support in post-conflict States, where the objective is state-building could be renamed: “*State Building Grant*”
- Earmarked budget support to finance cash transfers and other social protection schemes, could be labelled: “*Social Protection Grant*”.

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<sup>1</sup> ODI and Mokoro, “Sector Budget Support In Practice: Good Practice Note – Making Sector Budget Support work for Service Delivery”, November 2009, page 3.

<sup>2</sup> Feedback from our Country Offices

**Table 1 – Choices and trade offs across Financial Aid instruments**

	General Budget Support	Sector Budget Support	Sector programme (non-budget support financial aid)
<b>Leverage and results</b>	<ul style="list-style-type: none"> <li>• It provides an opportunity to influence partner governments on a wide range of issues.</li> <li>• The dialogue encourages better leverage of government resources to pro-poor sectors and reforms</li> <li>• Through the dialogue, funding and technical assistance, general budget support is well suited for achieving results (including essential reforms) across the whole of government expenditure</li> </ul>	<ul style="list-style-type: none"> <li>• Dialogue confined to sector wide issues. Budget allocation decisions still made by Ministry of Finance.</li> <li>• More effective than general budget support in tackling service delivery problems when these are confined at sector level.</li> <li>• But does not overcome service delivery problems originating from central government</li> </ul>	<ul style="list-style-type: none"> <li>• Dialogue is limited to programmes or activities directly funded by the sector programme.</li> <li>• Dialogue cannot leverage sector wide resources.</li> <li>• Difficult to claim attribution to outcomes.</li> </ul>
<b>Control and risks (fiduciary and political)</b>	<ul style="list-style-type: none"> <li>• Donors have less control over <i>how</i> aid funds are spent.</li> <li>• Fiduciary risk determined by the quality of national PFM system – the weaker the system the higher the fiduciary risk.</li> <li>• High political risks if partner government breaches conditionality</li> </ul>	<ul style="list-style-type: none"> <li>• Donors able to decide which sector aid is spent on.</li> <li>• Fiduciary risk determined by the quality of both <i>sector</i> and national PFM system.</li> <li>• Lower political risks than general budget support – but misuse of funds in the sector has similar political risks as general budget support</li> </ul>	<ul style="list-style-type: none"> <li>• Donors have more control over how aid is spent, but not over how public funds are spent.</li> <li>• As funds still go through government systems they are subject to same fiduciary risk as budget support but increased safeguards in the form of strict earmarking partly help overcome this.</li> </ul>
<b>Development effectiveness</b>	High level of ownership as partner government allocates budget support resources as per national strategies. Aid helps implement their priorities.	High level of ownership by sector Ministries	Low – donors have more say in the make-up of sector expenditure

### 3. Making budget support more effective

#### 3.1. Increased focus on results and value for money

3.1.1. We will do this in two ways: firstly by changing how we engage with partner governments and secondly by changing some features of the instrument.

##### Changing how we engage with partner governments:

3.1.2. We will help governments to focus more on results and improve the value for money of their expenditure, choosing, together with partner governments, areas to prioritise. We will:

- assess the adequacy of, and seek improvement in, government's management information systems and data collection mechanisms, which can have an important role to play in evaluating the impact of budget support.

- use more data generated by inclusive poverty monitoring systems which draw on evidence from civil society and other information generated by citizens on results and service delivery.

3.1.3. We will assist partner governments to get better value for money from their spending by:

- Helping them to undertake analysis to generate value for money data (economy, efficiency, effectiveness and equity). Where possible this will be done with other donors. The use of Public Expenditure Reviews and Tracking Surveys may be good ways of generating useful data.
- Helping to develop demand for value for money information within the country. For example by supporting the Supreme Audit Institution to undertake performance audit or by supporting independent analysis of government policy and expenditure.
- Giving significantly greater attention to achieving value for money from government procurement systems, given that a large percentage of government expenditure typically goes through procurement (OECD, 2006, data suggests that for Uganda and Malawi 70% and 40% of government expenditure pass through procurement systems respectively).

### **Changing the design of budget support**

3.1.4. To provide stronger signals to partner governments on results and on delivering agreed reform agendas (public financial management, service delivery etc.) we will use whenever appropriate:

- **A performance tranche** which is an amount of budget support funds linked to particular indicators in the Performance Assessment Framework related to agreed reform agendas;
- **A results compact** which makes payment of a sizeable amount of budget support conditional on the achievement of results agreed with partner governments. The results compact may follow the Cash-on-Delivery Aid model or the Millennium Development Goal (MDG) tranche of the EC MDG Contract. The results compact will be tested through the implementation of pilots.

3.1.5. The use of each of these performance-based disbursements, whenever applied, will need to be harmonised with other donors to increase effectiveness and reduce transaction costs.

## **3.2. Strengthening domestic accountability between governments and citizens**

3.2.1. Transparency and accountability are critical for delivering development results. Budget support can help increase domestic accountability over the long term, by driving greater transparency about budgets and results and by enabling civil society, parliaments, the media, and other oversight institutions to scrutinise public spending – including aid channelled through the budget.

3.2.2. With more and better information about government revenues and expenditures, including aid, citizens and their representatives are more able to ask questions and hold decision makers to account. This is why citizens' access to key fiscal and procurement information, audit reports and information on progress against results frameworks are important. Dialogue between donors and partner country governments about budget support provides an entry point for discussing partner country transparency and encouraging more openness. Greater transparency and inclusiveness by both governments and donors about budget support can provide opportunities for citizens and their representatives to engage.

3.2.3. We will work with governments and other donors to make the process around budget support more transparent and inclusive. We will promote:

- the publication of Performance Assessment Frameworks, annual review reports, results, and conditionality in government/ donor budget support agreements;
- the provision of information on the national budget and budget support in ways the public can access and understand;
- the involvement of parliaments and civil society in the identification and monitoring of budget support conditions and benchmarks.

3.2.4. Each DFID country office will aim to spend around 5% of the total amount provided as budget support on measures to help improve domestic accountability, but with flexibility to respond to individual country circumstances. A guidance note will provide more detailed information and examples from DFID country offices on how to work on domestic accountability in the context of budget support. The case for country office support to domestic accountability institutions and the proposed level of spend will be set out in budget support submissions.

3.2.5. We will monitor progress on transparency, legislative scrutiny and external audit and seek to include indicators and benchmarks on this in Performance Assessment Frameworks.

### **3.3 Strengthening our management of fiduciary risks**

3.3.1. To strengthen our management of fiduciary risk, we will

- Undertake a further Fiduciary Risk Assessment (FRA) in addition to the national FRA, for all financial aid instruments above a threshold of £10 million, if the funds for that instrument are managed by a public financial management system significantly different from the national system. Where funds are managed by the national public financial management system, including most sector budget support funds, the national level FRA will continue to be our main tool for managing fiduciary risk.
- Require all budget support submissions to say how the budget support package will strengthen external audit and legislative scrutiny.
- Monitor more rigorously the implementation of the government's public financial management reform programme (e.g. by including dates and milestones from the programme as benchmarks in the PAF). Better monitoring

will enable better assessment of recent progress (which will be given greater weight when assessing the credibility of reform programmes). It will signal the importance of strengthening public financial management for continuation of budget support

## 4. Breaches of conditionality

4.1. The approach set out above of assessing governments' commitment to:

- poverty reduction and the Millennium Development Goals;
- respecting human rights and other international obligations;
- improving public financial management, promoting good governance and transparency and fighting corruption; and
- strengthening domestic accountability

is the basis for deciding whether a breach of conditionality has occurred.

4.2. Our policy has been to consider and to report as a breach of conditionality (in DFID's Annual Report), any instance where the payment of budget support was reduced from the level originally committed. The introduction of the Results Compact may change this. In the case of a Results Compact, where we attach funds to the achievement of particular results (to encourage partner governments to achieve even better results) it would not be considered a breach of the partnership commitments if they failed to achieve a higher level of results (which may be due to factors beyond their control).

4.3 If we attach money to actions which are fundamental to demonstrating a partner government's continued commitment to the partnership commitments and the partner government fails to implement those actions, it would constitute a breach of conditionality and must be reported. This is the way we often use the performance tranche, so, in such cases, a reduction in disbursements under a performance tranche would be reported as a breach of conditionality.

## 5. Disbursement schedule

5.1. Our practice has been to pay budget support (the core and the performance tranche) as a single payment during the first quarter of the partner government's financial year. The following change applies only to *general budget support* (core and performance tranches): from now on we will disburse **quarterly** at the beginning of each quarter. The quarterly disbursement is the default position, and it will mean that with the smaller amount of each individual payment, DFID will have fewer funds at risk at any one time. Also the level of criticism by the UK public which could arise if a serious problem occurs soon after a payment has been made may be lower with quarterly payments.

5.2. If there is compelling evidence that quarterly instalments would not represent value for money, Country Offices can make a case to the Secretary of State for an annual or semi annual disbursement:

- If the fiscal deficit of the partner government is such that moving to quarterly payments resulted in an increase in government's borrowing which, in cases of limited access to credit, could contribute to cash flow and macroeconomic stability problems; and/or
- If the partner government's cash management and aid flow is such that early receipt of budget support funds are essential for the partner government to manage differences between the timing of their receipts and payments for service delivery.

5.3. Under the quarterly payment schedule we will not introduce new conditions for disbursements (i.e. conditions other than those agreed at the start of the programme). Therefore the release of payments will not require additional reviews of programme performance. If no major concerns have arisen, Country Offices will release the quarterly instalment without a submission to the Secretary of State. If major event have occurred which place this in doubt, the Secretary of Sate should be involved for information or decision, as appropriate.

5.4. These changes will not affect the arrangements for the release of the results compact which should occur as a single payment once evidence of results is verified.