

Budget Support Guidelines

Executive Guide

A modern approach to Budget support

EuropeAid Development and Cooperation Directorate-General
European Commission

Brussels, September 2012

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In light of the experience in using these Guidelines, it is planned to make modifications and adaptations as and when necessary. To help in this work, comments, questions and suggestions are welcomed and should be sent to unit DEVCO/A2 at: EuropeAid-A2@ec.europa.eu until the 31/12/2012 and to unit DEVCO/A4 at europaaid-a4@ec.europa.eu starting from the 01/01/2013.

Structure of the Guidelines

The Guidelines are structured in three parts as follows:

Part I: Executive Guide

Part II: Programming, Design and Management of Budget Support

Part III: Annexes - Thematic topics and procedural requirements

The Executive Guide is designed to provide an overview for the decision makers of how the new policy will be implemented. Each section of the Executive Guide corresponds to a companion chapter of the second part “Programming, Design and Management of Budget Support” of the guidelines, where further policy and technical guidance can be found for a wider audience: EU staff, EU Member States, partner countries, other donors, parliaments, civil society organizations. A number of Annexes provide guidance on thematic topics and procedural requirements, including annotated templates for programme preparation and implementation, for the EU staff dealing directly with budget support operations.

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1. INTRODUCTION

The Guidelines reflect the new policy on budget support spelled out in the Communication “The Future Approach to EU Budget Support to Third Countries” (October 2011) and corresponding Council Conclusions (May 2012)⁽¹⁾, and replace the previous Guidelines on General Budget Support of January 2007 as well as the previous Guidelines on Support to Sector Programmes of July 2007 as regards to Sector Budget Support. The following main principles and elements will be applied within the new policy framework that aims at strengthening the contractual partnership on EU budget support between the EU and partner countries:

- Stronger link with the fundamental values of human rights, democracy and rule of law
- Greater differentiation of budget support contracts, allowing the EU to respond better to the political, economic and social context of the partner country
- Strengthened eligibility criteria and more structured assessment
- Stronger focus on accountability and transparency
- Strengthened decision-making process and structures, as well as risk management framework for EU budget support
- Stronger emphasis on results, performance, predictability and ownership
- Strengthened EU coordination

2. RATIONALE FOR BUDGET SUPPORT AND POLICY CONTEXT

2.1. What is Budget Support?

Budget support is an aid modality. It should not be seen as an end in itself, but as a means of delivering better aid and achieving sustainable development results. It involves i) dialogue, ii) financial transfers to the national treasury account of the partner country, iii) performance assessment and iv) capacity development, based on partnership and mutual accountability. The new policy provides an enhanced and comprehensive framework to deal with the four elements of the package in order to maximise the impact and value for money of budget support on the ground.

2.2. Policy Context

Budget support is provided as a “**vector of change**” to address five key development challenges:

- Promoting human rights and democratic values;
- Improving public financial management, macroeconomic stability, inclusive growth and the fight against corruption and fraud;
- Promoting sector reforms and improving sector service delivery;
- State building in fragile states, and addressing the specific development challenges of small island development states (SIDS) and overseas countries and territories (OCTs);
- Improving domestic revenue mobilisation and reducing dependency on aid.

The EU and its Member States should strengthen efforts to coordinate their approach to budget support. The overall objective of an EU coordinated approach should be to increase the effectiveness of this modality for developments results and reforms, and to provide coordinated and consistent EU responses.

⁽¹⁾ COM(2011) 638; 13 October 2011. Council of the European Union Doc. 9371/12, 14 May 2012.

2.3. Objectives of EU Budget Support

The **general objective** of budget support is to contribute to **eradicate poverty**, pursue **sustainable economic growth** and build and **consolidate democracies**.

The **specific objectives** of budget support programmes should be defined in line with two important principles: (i) Alignment with partner countries own development policies, priorities and objectives (and thus harmonised and coordinated with other aligned donors) and (ii) Consistency with EU development policy, particularly the “Agenda for Change”. The specific objectives should also reflect the five development challenges, the relative importance of which will vary according to country context and the form of budget support.

Three different categories of budget support programmes will be provided **with differentiation introduced at the level of their specific objectives** allowing the EU to respond better to the political, economic and social context of the partner country.

- **Good Governance and Development Contracts (GGDC)** is provided whenever the specific objectives are focused on strengthening core government systems and supporting broader reforms; on fostering domestic accountability and strengthening national control mechanisms (an important basis for improving governance and adherence to fundamental values of human rights, democracy and rule of law); and addressing constraints to sustained and inclusive growth. Improved government systems should lead to improved MDGs indicators and cross-cutting service delivery aspects, which may therefore also be reflected in the specific objectives of GGDC.
- **Sector Reform Contracts (SRC)** is provided whenever specific objectives are more narrowly focused on supporting sector policies and reforms, improving governance and service delivery to populations. When providing SRC, emphasis should be on the equitable access to and quality of public service delivery, particularly to the poor, women and children as well as creating conditions at sector level for inclusive and sustainable growth. Improved governance and service delivery in a specific sector should lead to concrete and measurable results.
- **State Building Contracts (SBC)** is provided when situations of fragility or transition require action to support transition processes towards development and democratic governance, including sustainable changes in transition societies, to help partner countries to ensure vital state functions and to deliver basic services to the populations.

3. GOVERNANCE FOR EU BUDGET SUPPORT

The governance structure will include new/strengthened structures both at Headquarters and in Delegations. The objectives are to:

- Strengthen continuous policy steering at Senior Management and Commissioner level.
- Enhance and ensure coherence of the EU budget support dialogue with partner countries, as agreed in the Communication.
- Ensure policy coherence across countries and regions.
- Reinforce the risk management and risk mitigation mechanisms
- Support EU Delegations and HQ in the programming, designing and implementation of Budget support programmes.

3.1. Headquarters

The Geographic Directors in DEVCO are directly responsible, in their role of Sub-Delegated Authorising Officer, for the management of all budget support programmes in their region.

There will be no change in the current financial circuits, neither in HQs nor in EU Delegations. Relevant DEVCO services, including thematic experts, will continue to provide technical advice and support to the Geographical Directorates through the quality support group or upon request.

A **Budget Support Steering Committee (BSSC)** chaired by the Director General of DEVCO, with representatives of DEVCO, EEAS and ECFIN at management level has been created to strengthen continuous steering and enhance

political and policy scrutiny and ensure coherence of EU budget support operations. All GGDCs and SBCs should be submitted to the BSSC, as well as all SRCs with high or substantial political and policy risk or sensitivity, including disbursement files. The BSSC may refer to the Commissioners for Development, Neighbourhood, and the HR/VP as appropriate to seek for strategic guidance.

3.2. EU delegations in the regions

The Heads of Delegation and Delegation staff are directly responsible, in their respective Sub-Delegated roles, for the management of all budget support programmes in their Delegation.

Regional teams/hubs will be created to have an advisory and support role to Geographical Directorates, HoD and Delegations in the region, in close cooperation with the relevant thematic experts, under the instructions of the Geographic Director (SDAO) and in full cooperation with the Heads of Delegations in the region.

4. FUNDAMENTAL VALUES AND BUDGET SUPPORT

In addition to the primary objective of poverty reduction, there is the general EU commitment and adherence to the fundamental values of human rights, democracy and rule of law, which are essential elements of all the EU's partnerships and cooperation agreements with third countries.

The GGDC is an instrument to support broad reforms that lead to poverty reduction, improved governance, while signalling a mutual and shared commitment to universal fundamental values. Therefore, the commitment to fundamental values needs to be assessed as a **pre-condition for any GGDCs**, and subsequently monitored during implementation (to identify slippage, policy reversals and deterioration).

When Sector Reform Contract is selected as the most appropriate support modality, adherence to fundamental values should be taken into account. However assessment of political governance in connexion with EU Sector Reform Contract needs to be carefully balanced against the need to provide and protect the provision of vital basic services to the population, in particular to the poor, women and children.

In case of **State Building Contracts**, the assessment of the government's commitment to fundamental values as well as the political response to address them in a comprehensive way are aspects to be considered, inter alia, when deciding to engage with these countries. In the context of a fragile or conflict affected situation, the EU should adopt a forward looking approach accompanied by reinforced political and policy dialogue. The risk of inaction should be balanced with the development and basic needs implications of not engaging in fragile states.

5. DESIGN AND IMPLEMENTATION OF BUDGET SUPPORT

5.1. Eligibility criteria for Approval & Disbursement

Budget support programmes are subject to the following four eligibility criteria covering:

- **National/sector policies and reforms ("public policies")**
- **Stable macro-economic framework**
- **Public financial management**
- **Transparency and oversight of the budget**

The four eligibility criteria apply to all three forms of budget support contracts, although the focus may vary according to the specific objectives of the programme. The assessment of the eligibility criteria generally involves:

- 1) Assessment, during identification and formulation, of the **relevance** and **credibility** of the partner country policy and strategy related to each eligibility criterion:
 - **Relevance:** refers to extent to which key constraints and -weaknesses are being addressed by the government's strategy to reach the objectives of the policy.

- **Credibility:** refers to the quality of the reform process regarding its realism, institutional arrangements, track record and political commitment to the reforms.
- 2) Assessment, during implementation, of **progress** made in implementing the policy and strategy and achieving the objectives:
- **Satisfactory progress:** it should be based on a **dynamic approach**, looking at past and recent policy performance benchmarked against reform commitments, but allowing for shocks and corrective measures and refining the objectives and targets if necessary.

Assessments should be reasonably short (avoiding lengthy descriptions of the policy) and analytical, providing a clearly argued and justified recommendation regarding eligibility.

5.2. Budget Support Dialogue

Budget support dialogue is a core element of the package and a centre piece for mutual accountability. First, it provides a framework to take stock of the implementation of the partner country's policies and reforms as well as of donors' commitments, including the EU, and to assess progress on the basis of criteria and performance indicators as well as extensive discussions with the Government. Second, budget support dialogue can be used as a forward-looking tool to identify policy slippages and to reach a common understanding with the authorities on corrective measures to meet policy objectives and refining the objectives and targets if necessary. The risk management framework is an important tool to support this forward-looking dialogue in order to improve partner country's absorption capacity of funds, the quality of the operations and the impact on the ground.

5.3. Risk Management Framework

The proposed approach of risk management clearly responds to previous commitments in the **Communication and to the Court of Auditors recommendations** to develop a more structured framework for assessing and monitoring risks. It combines scoring risks against a selected number of questions grouped into five categories: political, macroeconomic, development, PFM and corruption/fraud, with a narrative commentary to produce an overall risk rating (low, moderate, substantial or high). Key points to note are that:

- All programmes rated as substantial or high risk (before mitigating measures are taken into account) will be presented to the BSSC for consideration;
- All programmes rated as substantial or high risk (before mitigating measures are taken into account) have to propose mitigating measures and action plans; in case of substantial or high political risk, a policy matrix and contingency plan need to be developed;
- Just one risk assessment will cover all budget support contracts in the same country, partly because risks are assessed in terms of the overall – not specific- objectives of each budget support programme and their systemic impact.

5.4. Performance, Variable Tranche Design, Ownership & Predictability

The establishment of the performance monitoring system and related disbursement criteria is at the heart of a budget support operation, providing the framework for conditionality and for policy dialogue. **Base (or fixed) tranches** are linked to eligibility criteria and **variable (or performance) tranches** are additionally linked to progress against specific indicators.

- **Variable (performance) tranches** have several advantages: i) creating incentives for improved performance through partial payment for partial performance; ii) reducing damaging "stop-go" volatility in aid disbursements; iii) enhancing the credibility of disbursement conditions by focusing on concrete and measurable performance indicators.

However a balance needs to be struck between creating incentives and avoiding excessive unpredictability or volatility in disbursements, particularly in more aid dependent contexts.

- **The variable tranche indicators** should be selected, in agreement with the authorities and in co-ordination with other budget support development partners, among the indicators from the Performance Assessment Framework (PAF) of the public policy. The following principles should be applied:
 - There should be **coherence** between the programme objectives, the diagnosis of the problem, and the selected indicators and targets;
 - A combination of **indicator types** can be selected. The greater the willingness of the partner country to be held accountable for such outcomes and the confidence in the government's ability to deliver as well as the quality of such performance data, the more emphasis should be placed on outcome indicators. In less aid-dependent countries, it may be more appropriate to focus on agreed policy actions using process/input indicators;
 - The **number of indicators should generally be limited** to a maximum of 8 per tranche (and could be much less) in order to avoid a loss of policy focus.
 - Indicators, targets, and assessment methodology should be **precisely and unambiguously defined** in the Technical and Administrative Provisions. The data source should be clearly identified and the quality of the data assessed.

Performance assessments should be an inclusive process led by the government but whereby performance results are also subject to stakeholder consultations and are made publicly available and feed into domestic accountability mechanisms.

In order to **enhance predictability** and respect the country's budgetary and planning cycles, conditions, criteria, procedures and timing for disbursement should be clear defined with and understanding by the partner country. This is a core element of the budget support contract between the EU and the partner country. Assessments and decisions regarding disbursements should take place timely to support the budget execution for the fiscal year into which the funds are to be disbursed.

As a general rule, **undisbursed funds should not be 'recycled' in later tranches** as this can reduce the initial incentive effect of variable tranches.

5.5. Domestic Revenue Mobilisation

Domestic revenue mobilisation (DRM) plays a determinant role in fostering sustainable and inclusive growth, good governance and poverty reduction. Within budget support contracts, DRM will be considered within the macroeconomic (fiscal policy) and public financial management (tax administration) eligibility criteria, and it should be given greater attention in policy dialogue and capacity development. In resource-rich countries and when appropriate, budget support should contribute to reforms promoting enhanced natural resource governance, managing natural resources wealth and promoting revenues from natural resources, and promoting a transparent, cooperative and fair international tax environment.

5.6. Accountability

The domestic and mutual accountability will be further enhanced by:

- Strengthening the openness, transparency, and accountability of the budget process, in particular through the new eligibility criterion on budget transparency;
- Supporting a participatory budget support approach;
- Integrating programmes to support national legislative and oversight bodies and CSOs ;
- Increasing transparency by publishing relevant information on budget support financing agreements and performance reviews;

5.7. Fraud & Corruption

The fight against fraud and corruption is a key element that should have greater prominence in budget support, particularly when assessing the PFM eligibility criterion. The Commission will pay particular attention to these issues and will promote a stronger use of anti-fraud and corruption provisions, as well as the cooperation between the European Anti-Fraud Office (OLAF) and the inspection and judicial authorities of the partner countries. Partner countries need to be actively engaged in the fight against fraud and corruption and be equipped with appropriate and effective mechanisms.

5.8. Capacity Development

Capacity development is a key part of the budget support package, as it supports effective and efficient organisations, enhances government's capacity to implement policies and deliver services to final beneficiaries, and promotes the active engagement of all domestic stakeholders.

Capacity development needs are assessed systematically and should be provided based on demand, ownership and commitment, be linked to results and expected outcomes, be provided through harmonized and aligned approaches, particularly in the context of the EU coordinated approach to budget support and division of labour with Member States.

6. THE PROGRAMME CYCLE

The management cycle for budget support programmes encompasses the following decisions:

6.1. Whether to provide budget support

- **First, an assessment of a country's commitment to the fundamental values of human rights, democracy and rule of law.** For any GGDC the commitment to fundamental values is a pre-condition and will be assessed during the programming phase when Good Governance and Development is selected as an equivalent to a sector, and subsequently monitored during the identification, formulation and implementation phases using the risk framework. For SRC and SBC no assessment of the pre-condition is required. The assessment of fundamental values will be done within the risk management framework (political risk category) during the identification phase and subsequently monitored during the formulation and implementation phases using the risk framework. Proposed SRC and SBC during the identification phase with substantial or high political risk will be submitted to the Budget Support Steering Committee who will balance any concerns related to the political risk with the need to provide and protect the provision of vital services, including other potential benefits, in order to decide whether a SRC or a SBC are appropriate aid modalities.
- **Second, an assessment of the eligibility against the four criteria.** This assessment will be done for all budget support contracts during the identification and formulation phases for approval and during the implementation, in addition to variable tranche performance, for disbursement.
- **Third, an assessment of the risks** and whether these are likely to be outweighed by the mitigate measures and expected benefits during the identification, formulation and implementation phases.

6.2. How Much Budget Support?

Decisions on how much budget support will be based on the following elements:

- Financing needs of the partner country;
- Commitment of the partner country to allocate national budget resources in line with development strategy and objectives;
- Effectiveness, value for money and impact of the specific added value that budget support will bring in achieving the partner country's policy objectives;
- Track record and absorption capacity of past disbursements and how effectively agreed objectives were achieved with budget support operations;

- Result orientation in the partner country's development strategy including a monitoring system.

Each factor may be judged as high, medium or low, allowing an overall but not mechanistic assessment regarding the appropriate share of a programme to be provided as budget support.

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