Tools and methods Series

Guidelines No 2

EuropeAid

Support to Sector Programmes

Covering the three financing modalities: Sector Budget Support, Pool Funding and EC project procedures

July 2007

EUROPEAN COMMISSION

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These Guidelines have been prepared by EuropeAid drawing upon regular consultation and inputs from the Inter-services Working Group on Sector Approaches and Sector Budget Support.

The core editing group included staff from the following units in EuropeAid : Social and Human Development (E3), Coordination and Organisation Strategies (ex 01), Macro-economic Support (E1) as well as the Economic Governance and Budget Support unit in DG Development (C3).

Following EuropeAid reorganisation of June 2007, Unit E5 on "Quality monitoring systems and methodologies" is in charge of these Guidelines.

In light of the experience in using these Guidelines, it is planned to make modifications and adaptations as and when necessary. To help on this work, comments, questions and suggestions are welcomed and should be sent to EuropeAid-E5-Quality-Monitor-Method@ec.europa.eu.

ABBREVIATIONS

AF : Action Fiche

CD : Capacity Development

DAC : Development Assistance Committee

EC : European Commission

FP : Financing Proposal

IF : Identification Fiche

IMF : International Monetary Fund

MOU : Memorandum Of Understanding

MTEF : Medium Term Expenditure Framework

PAF : Performance Assessment Framework

PEFA : Public Expenditure and Financial Accountability

PFM : Public Financial Management

PBA : Programme Based Approach

PRSP : Poverty Reduction Strategy Paper

SBS : Sector Budget Support

SP : Sector Programme

SPSP : Sector Policy Support Programme

SWAp : Sector Wide Approach

TA : Technical Assistance

CONTENTS

BOXES

CHAPTER 1
INTRODUCTION

THIS CHAPTER EXPLAINS:

- the purpose of these guidelines
- the target audiences
- what the guidelines cover and how they are organised
- what is new since the first (2003) version

1.1 Purpose of the Guidelines

The European Commission is committed to delivering "more and better aid". The Paris Declaration of March 2005 set international guidelines and targets for raising the quality of aid, and the EC's commitment was reinforced by the European Consensus statement of November 2005.

This is not a new concern for the EC. It has been for many years at the forefront of efforts to make aid more effective by harmonising its efforts with other donors, and by aligning aid with partner country strategies and systems. It is EC policy to use general and sector budget support as the financial modality for its assistance whenever conditions are favourable. This is part of a broader commitment to the principles of Programme Based Approaches (PBAs): one of the Paris Declaration targets is to increase the proportion of all aid delivered as PBAs to 66% by 2010.

The same basic principles of aid effectiveness are reflected in the EC's guidelines for all types of aid – for project aid, for general budget support, and for support to sector approaches. The present guidelines address sector approaches. They revise and update the first (2003) version of the guidelines. In so doing they take account of international lessons of good practice, drawn from the EC's own experience, from the results of joint donor evaluation work, and from international guidelines, especially those propagated by the OECD's Development Assistance Committee. Sector approaches are now being applied more widely, and these guidelines take account of experience in various "non-traditional" settings[1].

Sector approaches or sector-wide approaches (SWAps) are processes aimed at the development of coherent sector policies and strategies. They involve governments, donors and other sector stakeholders in a unified process and framework. The Guidelines describe the key characteristics of these processes and outline how the Commission believes they may best be supported. They deal in particular with the EC's instrument for supporting a sector programme, which is called a sector policy support programme (SPSP) – see Chapter 2 for more explanation of terminology.

1.2 Target Audiences

The guidelines are aimed primarily at the EC staff responsible for designing, implementing or evaluating support by the European Commission to the implementation of sector programmes by partner governments. However, they should also be useful to partner country staff to fellow-donors and to others involved in development work, both by outlining general principles and by explaining EC policies and procedures.

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1 Initially sector approaches have been applied to sectors where government is main provider of services (health, education but also transport). By contrast to this "tradition", sectors where multiple institutions are involved and for which the sector approach is being applied (water, justice, social inclusion and protection etc) are jointly referred to as "non-traditional".

1.3 Contents and Organisation of the Guidelines

Structure Of These Guidelines	
Chapter 2 The Basics of Sector Approaches	Presents key concepts and working definitions, it deals with the rationale for sector approaches, it describes the key components of a sector programme.
Chapter 3 The Dynamics of Sector Approaches	Deals with the different contexts in which a sector approach may be relevant, the process of developing a sector programme, the implications of decentralisation and governance, the importance of capacity development, and the involvement of non-state actors.
Chapter 4 About Sector Policy Support Programmes (SPSP)	Describes how the EC can support the initial stages of a sector programme. Provides operational guidelines for the preparation and management of an SPSP : it explains the key stages of the design process of an SPSP and introduces main decision points; it deals with SPSPs objectives, outputs and inputs. It addresses issues determining the choice between the three financing modalities: sector budget support, pool funding and EC project procedures and then goes deeply into their characteristics and implications.
Chapter 5 The Seven Key Areas of Assessments	Provides more details on seven assessment areas, corresponding to the key elements of a sector programme. For each area, it gives insights into the basic concepts and proposes key issues to be dealt with. This material is intended to assist programme managers throughout the cycle of operations of EC support, including reviewing the quality of a sector programme, designing the SPSP and deciding upon its appropriate implementation modalities and on any support to capacity development.
Annexe 1 The Cycle of Operations for a Sector Policy Support Programme	Details the actions to be taken at each stage of the cycle of operations for a sector policy support programme. In particular, it shows how the standard cycle of operations needs to take into account the characteristics of sector approaches and sector programmes

Each section in chapters 1 to 3 explains general concepts, identifies good practice principles and describes the specific policies and procedures of the EC. Throughout the guidelines there are links to more detailed advice and examples, including cross-references to related Commission manuals and guidelines.

An important point to remember is that sector approaches and sector programmes must, a priori, reflect the particular circumstances of individual sectors and countries. There can therefore be no blueprint and these Guidelines seek only to provide guidance on how to proceed. They should be used in close conjunction with relevant sectoral and thematic guidelines.

1.4 What's New in these Guidelines

These revised Guidelines replace the original version which was published in February 2003.

The original version was well received within the Commission services and also among partner governments and other donors. Since 2003 many programmes supporting sector approaches have been developed, including in sectors and regions where this approach is new. This revision is intended to take into account the new policy and legal framework, the commitments made by partner governments and donors in signing the Paris Declaration on aid effectiveness, as well as lessons learned in working with sector approaches in the past few years, including in new regions and sectors.

The revised Guidelines incorporate the following new features:

Harmonising terminology and approaches with other donors:

- Update concepts and definitions in order to ensure consistency with the terminology used by other donors and within the aid effectiveness agenda. Give adequate attention to institutions and their capacity
- Make broad use of the DAC Guidelines on Sector-Wide Approaches "Harmonising Donor Practices for Effective Aid Delivery Vol. 2" with a view to promoting internationally recognised principles and good practices.
- Make reference to the EC policy documents issued in 2006, such as the communications on "European Consensus on Development" and "EU AID: Delivering more, better and faster" as well as to the Paris Declaration on Aid Effectiveness.

Refinements of EC policy and design criteria:

- Focus on the SPSP's design process and the main decision points, including identifying its objectives, outputs and inputs and align its implementation modalities accordingly.
- Strengthen and clarify the message on sector budget support (SBS) as the preferred modality for EC support to sector programmes; make the eligibility criteria for SBS explicit and ensure coherence with the revised guidelines for general budget support (mainly chapters 4 and 5 as well as annex 1).
- Put the concept of Medium-Term Expenditure Framework (MTEF) in a process perspective; placing emphasis on the sector budget and its multi-annual perspective rather than seeing the MTEF as an entry point for EC support to sector programmes (mainly chapters 2 and 5 as well as annex 1). The sector programme definition has been revised accordingly.

Incorporating new insights in the seven assessment areas:

- Development of new material on each of the seven key areas of assessment, incorporating lessons learned, recent thinking and updated references.

Widening the scope of the guidelines:

- Ensure that statements take into account the fact that many of the newly developed support programmes are developed in non-ACP countries, in emerging sectors or in decentralised environments.

Updates of EC procedures:

- Make reference to the new Financial Regulation and the new legal bases when discussing financing modalities (mainly chapter 4).
- Update the section on pooled funding according to the new Financial Regulation (chapter 4).
- Refer to the newly developed "identification fiche" and "action fiche" for SPSP (mainly annex 1).

CHAPTER 2
THE BASICS OF SECTOR APPROACHES

THIS CHAPTER IDENTIFIES:

- the basic concepts and provides working definitions of a sector approach, a sector programme and a sector policy support programme (SPSP)
- the rationale and objectives for sector approaches and sector programmes
- the key elements of a sector programme

2.1 Basic Concepts

2.1.1 Definitions

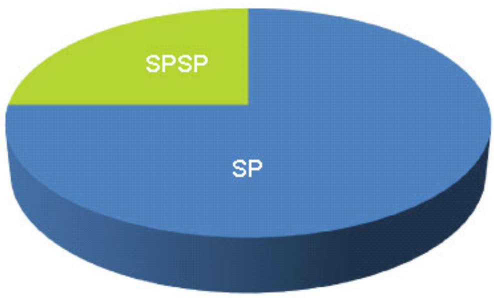
This chapter starts by providing key definitions in order to ensure a clear and shared understanding of the rationale for and elements of sector programmes.

Sector approach

A **sector approach** (or SWAp) is a way of working together between government, development partners and other key sector stakeholders. It is a process aiming at broadening government and national ownership over public sector policy and resource allocation decisions within the sector, increasing the coherence between policy, spending and results, and reducing transaction costs.

Sector programme (SP)

As a result of following a Sector Approach, a government progressively develops a **sector programme**[2]. Sector programmes are based on three core elements: the sector policy and strategy; the sector budget and its medium term expenditure perspective and the sector coordination framework through which the sector strategy, action plans and budget are reviewed and updated. A sector programme may be set out in a set of actions and activities to implement the sector strategy.



Sector Policy Support Programme (SPSP)

The EC's aid instrument for supporting a sector programme is known as a **Sector Policy Support Programme** (SPSP)[3].

2 *Equivalent to a* ***sector development programme*** *in the DAC terminology (ibid.)*

3 *The DAC Guidelines refer to a* ***sector support programme*** *as the instrument through which an aid agency supports a sector programme*

Sector Approaches are Programme Based Approaches at the level of a given sector

Sector Approaches (also known as Sector Wide Approaches – SWAps) are usually seen as programme-based approaches operating at the level of a sector. PBA is defined as follows [4] :

A programme-based approach (PBA) is a way of engaging in development cooperation based on the principle of coordinated 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 have the following features:

- leadership by the host country
- a single comprehensive programme and budget framework
- a formalised process of donor coordination 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.

As a sector approach is a PBA at a sector level, all the features of PBAs apply to Sector Approaches. In the case of Sector Approaches the "locally owned programme" coincides with "the sector programme".

2.1.2 Common principles

In spite of the varied terminology used by different agencies, there are key principles on which there is agreement in the international donor community. First, it is accepted that sector approaches (under their various labels) should be led by partner governments, in close interaction with national stakeholders. Second, they have the common goal of improving public sector performance in terms of service delivery as well as the efficiency and effectiveness with which internal and external resources are utilised. Third, there is general agreement that the sector approach is a process. The sector approach itself should be strengthened over time, while promoting continuing improvements in sector performance.

2.2 Rationale for Sector Approaches

2.2.1 Origins and objectives of sector approaches

All PBAs aim to apply basic principles of aid effectiveness – to promote national ownership, strengthen results orientation, and coordinate donor inputs with other resources.

The sector approach promotes the national ownership of sector policies and strategies, first by supporting a government-owned policy and strategy, second by promoting coherence between policy, budgeting and actual results, and third by reducing (in the medium to long run) the transaction costs of utilising external finance. The approach broadens the notion of impact beyond the scope of one specific donor and focuses on the combined impact of the interventions of Government, all donors within a sector and other important private sector and NGO stakeholders. As a result, donors evolve from supporting specific activities to co-financing a sector strategy with the partner country and other donors. These coordinated efforts are made on the basis of objectives set by the government and in the framework of a coherent public sector expenditure programme.

The sector approach aims also to strengthen links between sector and national plans and the integration between recurrent and capital expenditures as well as the coherence between aid and domestic resources. One of the features of the approach is that it brings the sector budget back to the centre of policy making and uni-

4 *DAC Guidelines and Reference Series: Harmonizing Donor Practices for Effective Aid Delivery Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management*

fies expenditure programming and management, regardless of the source of funding. In this respect, it initially has been a response to the breakdown of budgetary, organisational and management structures in aid-dependent countries. The deterioration of government systems, while partly the result of political and fiscal crises, has been significantly worsened by the multiplication of stand-alone donor projects, working outside of government systems, often with their own project implementation units (PIUs) and dedicated technical assistance (see Box 2.1 below).

Box 2.1: Potential Weaknesses of a Project Approach

The justification for the focus on projects as the main vehicle of aid before the mid-1990s was the belief that the principal constraint to development was a lack of investment and that projects were the most efficient way to deliver capital investment. Alongside this lay a conviction that projects provided the best structure for minimising the risk of financial malfeasance and thus for guaranteeing to tax payers that their aid was producing concrete results.

The project may be a good framework for managing a government's discrete investments, but it became apparent during the 1990s that there were serious drawbacks to the proliferation of separate aid-funded projects in aid dependent countries. Among the weaknesses noted:

- ➔ The ability of donors to force their own priorities upon governments and to insist on specific management requirements and implementation procedures undermined the ownership of policies and programmes by national authorities.
- ➔ Multiple projects did not favour the development of a coherent national sector policy and led to fragmentation, duplication of efforts and loss of coherence between actions funded by local and external resources.
- ➔ Funding of multiple investments by donors lacking an overall vision and priorities led to unbalanced sectoral development (at geographical and sub-sectoral level), and tended to generate imbalances between recurrent and investment budgets.
- ➔ For countries with a large number of aid projects and a multitude of donors, each with their own reporting schedules and accounting requirements, the transaction costs of delivering aid through projects were becoming unacceptably high.
- ➔ The extensive reliance on parallel, non-government project management structures and special staffing arrangements was seriously undermining the effectiveness of government systems, with negative effects right across government.
- ➔ The use of donor-specific mechanisms of accountability was corroding the normal structures of democratic accountability.

By working outside normal government systems (especially the systems of budget planning and execution, accounting, procurement and performance management), aid projects not only missed the opportunity to assist in the strengthening of government systems, but actually ended up undermining their credibility and reducing their effectiveness, even in areas of government activity completely untouched by aid. Simultaneously, the primacy given to donor demands for accountability was increasingly forcing governments to be accountable to donors rather than to parliaments and their people. At the same time, insulating projects from government weaknesses did not make them effective in the long run.

> *"Aid agencies have a long history of trying to 'cocoon' their projects using free-standing technical assistance, independent project implementation units, and foreign experts - rather than trying to improve the institutional environment for service provision…They have neither improved services in the short run nor led to institutional changes in the long run".*

Source: World Bank, Assessing Aid: what works, what doesn't and why. Oxford University Press, 1998

The trend towards PBAs and SWAps reflected the frustrations experienced with uncoordinated projects in support of the public sector. The DAC guidelines highlight the contrast between the sector approach and uncoordinated project approaches as shown in Box 2.2. However, the sector approach is not a panacea. The right hand column of Box 2.2 shows aspirations that require a lot of work in practice. SWAps are not a simple alternative to projects – there is scope for improving the way that projects operate, both by applying PBA principles to their internal design, and also by linking them to a coherent sector framework. The sector programme can be seen as a framework that can help to make projects more effective at the same time as encouraging other forms of aid finance, including pooled funding and sector budget support. Projects can be a valuable modality to support starting sector programme in various circumstances including especially in fragile states and post conflict situations.

Box 2.2: Contrast between Sector Approach and Conventional Project Approach

Uncoordinated Project Approach	*Sector Wide Approach*
➔ narrow focus on projects & narrowly defined objectives	➔ country holistic view on entire sector
➔ bilateral negotiations and agreements	➔ external partners' coordination and collective dialogue
➔ donor-recipient relationships with unbalanced power	➔ partnerships with mutual trust and shared accountability
➔ parallel implementation arrangements	➔ increased use of local procedures
➔ short-term disbursement and success of projects	➔ long term capacity/system development in sector
➔ blueprint approach	➔ process-oriented approach through learning by doing.

Source: DAC guidelines, Table 3.1.

Sector approaches were pioneered most often in the social sectors (education, health) where government is a major service provider. But they have increasingly been extended to a wider range of sectors, where the institutional setting is more complex – see discussion in Chapter 3.

2.2.2 Good practice principles

In line with the Paris Declaration, there is broad agreement on a set of guiding principles to be followed in working with sector approaches. They are stated in the DAC guidelines on SWAps as follows:

1. **Support government ownership and leadership**. Donors must leave the initiative with the partner country government, while offering flexible support, information and guidance. Aid coordination at the national level is a government responsibility, while the government-donor partnership should be based on mutual accountability. Donors should be knowledgeable and sensitive about the country context and its institutions. They should seek areas of broad agreement and avoid micro-management.
2. **Work with government to strengthen institutional capacity and accountability**. Setting up parallel systems tends to undermine the regular systems of government and confuses accountabilities. Donors should therefore work as much as possible through partner systems and procedures while collaborating with partner country governments to address identified weaknesses. Both donors and partner governments should think in terms of national capacity, not just government capacity.
3. **Set the sector programme in context.** Donors need to be aware of the SWAp's implications for overall coherence across government, including the sector programme's consistency with the Poverty Reduction Strategy, and its effect on the role of the central coordinating ministries, and on the relationship between central and local governments. Address cross-cutting issues, including gender equality, the environment, HIV/AIDS, and public service reform.
4. **Take a long-term, strategic view.** Recognise the dynamic nature of SWAps and accept that it will take time to realise all the potential benefits of a sector partnership. Sector development programmes take a long time to mature and usually imply long-term institutional change and organisational development.

They are typically implemented over at least a ten-year time frame, implemented in three- or five-year tranches. Donors must have similar time horizons, and must be prepared to commit long-term predictable resources. Address all stages of the planning and budgeting cycle for the programme, and build in a strong “results” orientation.

5. **Be pragmatic and flexible.** Design processes which economise on management, planning and policy skills within government, while progressively developing capacity. Assess the costs as well as the benefits of proposed innovations. Recognise that there are competing interests on both government and donor sides which need to be sensitively managed; undertake a proper institutional and incentive analysis. Recognise and manage risks. Look for some “quick wins” that can help to build support for the programme (amongst both government and donor constituencies) in its early stages. Be realistic and learn from experience (including comparative international experience).

2.2.3 EC perspective

The policy orientation in favour of the sector approach and sector budget support was formally taken by the EU in November 2000, when the European Parliament and the Council of Ministers approved the communication[5] of the Commission on the policy of the European Community for development cooperation. This policy was thus adopted not only by the European Commission itself but also by the Member States.

Since then a more comprehensive policy framework has progressively been developed, including a set of EC policy documents, regulations on new financing instruments and EU commitments concerning the aid effectiveness agenda.

The “European Consensus on Development”, a Joint Statement by the Council, the European Parliament and the Commission adopted in December 2005 states a clear commitment towards “delivering more and better aid”. It confirms that “where circumstances permit, the use of general or sector budget support should increase as a means to strengthen ownership, to support partners’ national accountability and procedures, to finance national poverty reduction strategies (PRS) (including operating costs of health and education budgets) and to promote sound and transparent management of public finances” [6].

Sector support is well integrated into the provisions of the new financing instruments. The "Regulation of the European Parliament and of the Council establishing a financing instrument for development cooperation" confirms key principles underlying sector approaches and indicates that the Community shall promote "effective cooperation modalities in line with OECD/DAC best practices, adapted to the particular circumstances of each partner country or region, with a focus on programme-based approaches, delivery of predictable aid funding, the development and use of country systems and result-based approaches…" (Art.3). It also includes "sectoral support" as one of the main types of financing (Art. 25). The European Neighbourhood Policy confirms the choice in favour of sector and budget support.

EU policy is perfectly consistent with the Paris Declaration on aid effectiveness, adopted in March 2005. This Declaration strongly engages partner governments and donors around the principles of ownership, alignment and harmonisation. A clear commitment has been taken towards an increased use of common arrangements at country level for planning, funding, disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows. Indicator 9 of the Declaration focuses on this dimension and measures the percentage of aid provided as programme-based approaches (PBAs). The target is to increase the proportion of aid delivered as PBAs to 66% by 2010.

The EU has committed to take a lead role in implementing the Paris Declaration and has in this context made four additional commitments that are supportive of established good practices in the area of sector approaches: i) to provide all capacity-building assistance through coordinated programmes with an increasing use of multi-donor arrangements; ii) to channel 50% of government-to-government assistance through country systems, including 50% of EC assistance to be provided through budget support or sector wide approaches; iii) to avoid the establishment of any new project implementation unit; iv) to reduce the number of uncoordinated missions by 50%.

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5 *COM (2000) 212 of 26 April, 2000.*

6 *Section 26 of the Joint Statement, page 9.*

The Commission believes that sector approaches and programmes should be pursued in particular to support three principal objectives:

- To broaden **ownership** of partner countries (government and key national stakeholders) with respect to sectoral policies, strategies and spending, and to increase the alignment of external interventions to national policies and priorities.
- To increase **coherence** between sectoral policy, spending and results (regardless of the source of funding) through greater transparency, wider dialogue and a comprehensive view of the sector.
- To **minimise** as far as possible the **transaction costs** associated with the provision of external financing, either by direct adoption of government procedures or through progressive harmonisation of individual donor procedures. (See Chapter 3 for more discussion of transaction costs.)

Ironically, it is only by placing reliance on weak government structures that a real demand for their improvement can be generated. Sector approaches seek to do exactly this. Where the minimum conditions for success exist, they can create a virtuous circle whereby a clearer sector policy creates greater coherence, permitting governments to assert ownership, while a reduction in the number of projects and in their transaction costs stops the dissipation in administrative capacity and allows budgetary and planning systems to become stronger. If the channels of democratic accountability are simultaneously strengthened – by enhancing the roles of Parliament and civil society – then this can reinforce the pressure to improve the efficiency and effectiveness of the public service and hence to strengthen planning, budgeting and management structures.

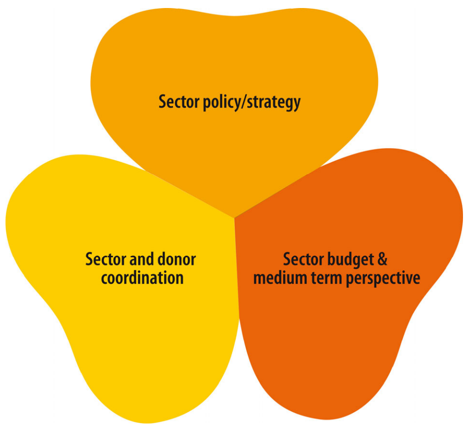
2.3 The Main Elements of a Sector Programme

As already discussed, SPs build up progressively along complex and iterative processes, for which no rigid blueprint model can be used. However, SPs always develop a set of interconnected elements covering both the policy framework and the management/monitoring system. This section provides an overview of these elements and gives basic insights into the three core elements or “building blocks”.

2.3.1 Core elements

As already emphasised, a sector approach is a process through which the sector programme is continually refined, rolled forward and improved. There is no rigid blueprint. However, **three core elements** are always at the centre of a sector approach and form the essential building blocks of a sector programme:

1. A **sector policy and strategy**, specifying what government aims to achieve in the sector and how – distinguishing government’s regulatory role from its service delivery role, specifying the roles of non-government agents and outlining any necessary institutional reforms. The policy/strategy can usefully be set out in annual action plans where priority activities are agreed. See as well section 5.1.
2. The **sector budget and its medium term perspective**; the annual sector budget should increasingly reflect sector priorities and strategies. The sector approach works towards policy based budgeting, embracing all resources for the sector, with realistic medium-term sector expenditure plans, which, ideally, will form part of a coherent national approach to medium-term expenditure planning. See as well section 5.2.



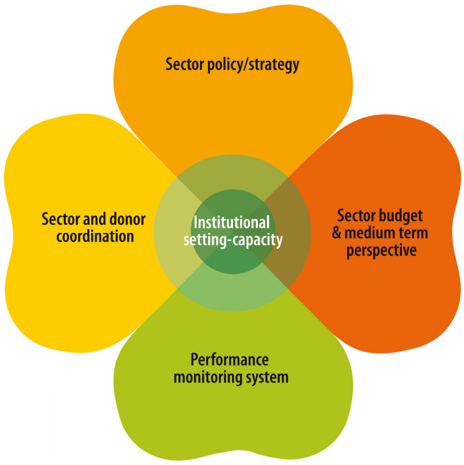
3. A **sector coordination framework**, under the government’s leadership comprising i) coordination of national stakeholders including governmental (central agencies and other concerned ministries and agencies) and non-governmental actors; ii) coordination with and among donors. See as well section 5.3.

2.3.2 Other key elements

Sector programmes include other two key elements:

4. The **institutional setting and existing capacities** linked to a pro-active capacity development strategy led by the government.

   Concern for government capacity has always been one of the driving forces behind sector approaches, which aim to reinforce national systems by using them. The need for pro-active capacity development strategies is also recognised. There is growing appreciation that sector programmes are heavily influenced by the broader institutional setting, and that capacity development needs to be a more central concern. The present guidelines give these aspects a fuller treatment (see sections 3.5 and 5.4).



5. 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, outcome and possibly impact 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. See section 5.5.

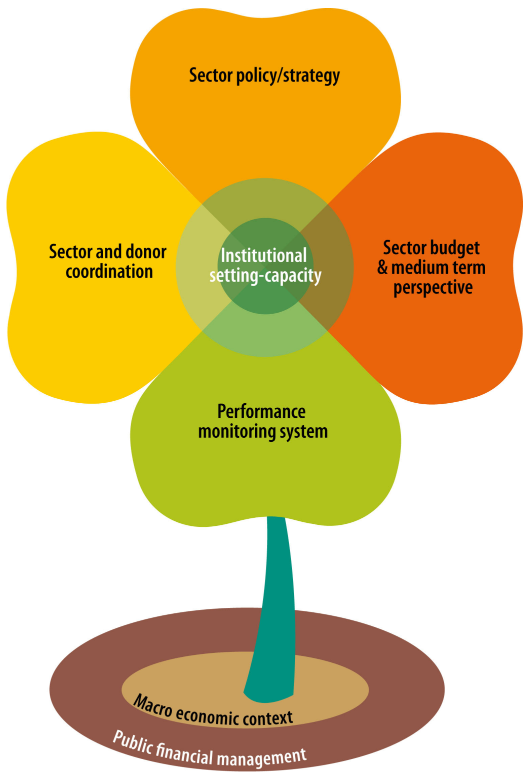
There are **two additional elements** related to the overall context influencing performance of a sector programme:

6. The **macroeconomic policy** which provides a stable environment for the sector, along with predictable resource levels. See section 5.6.

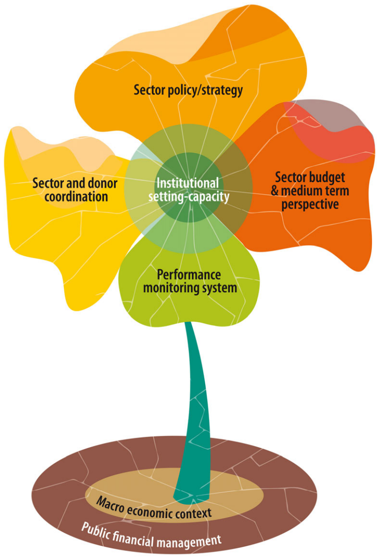
7. The systems of **public finance management (PFM).** A good PFM system ensures that policy priorities have a chance to be reflected in budget allocations; it promotes efficiency ("value for money") in public spending; and it protects aggregate fiscal discipline, i.e. ensures that actual expenditure is in line with the approved budget and does not exceed what the government can afford to spend in view of available resources. See section 5.7.

In conclusion a sector programme includes five elements and its strongly influenced by two additional contextual elements. We have therefore a flower with, at its heart, institutions and capacity issues. The flower needs to be rooted in favourable macro and PFM context.

Box 2.3: Elements of a Sector Programme



Since each sector programme develops along complex and specific processes, it makes a flower with uneven and often imperfect petals, needing care and support from national stakeholders and donors to blossom. It will not be rare to face imperfect flowers as the one depicted here. Focusing attention from the start on its heart with a realistic and pragmatic approach, will support balanced growth throughout all the petals acknowledging the many linkages and connections.



2.3.3 EC perspective

Taken together, these seven elements constitute the seven areas of assessment that are analysed/monitored throughout the cycle of operations of an SPSP. They are depicted in Box 2.3 above and addressed in detail in the Chapter 5 of the guidelines. These guidelines emphasise the many interconnections between different elements of a sector programme, and their relevance not only to the initial design of an SPSP but also to its ongoing management.

2.4 Sector Policy and Strategy

2.4.1 Basics

The **sector policy** (Box 2.4) is the first building block of a sector programme. It is a statement of government's objectives within a sector and a summary of how they will be achieved. (In practice, key sector policies are not always consolidated in a single document, though this can help transparency and strategy formulation.)

The **sector strategy**, often presented in the form of a strategic plan or similar document, describes how the government intends to implement the sector policy over a medium-term perspective (usually 3-5 years). It may set intermediate targets and objectives if (as is usually the case) some policy objectives are not achievable over a short period – or set priorities among policy objectives, if resource constraints prevent pursuing all of them simultaneously. The sector strategy provides a high-level "blueprint" or action plan for implementing the sector policy. It should be directly reflected in annual sector budgets.

Box 2.4: What is a Sector Policy?

A sector policy is a statement of government's objectives within a sector and a summary of how they will be achieved.

Sector policies usually emerge from a range of consultative processes between the executive and legislative branches of government and other national stakeholders. They may result in various decisions by government - some legal, some administrative, some budgetary. In order to determine what the sector policy is, it is often necessary to refer to several documents. Over time the clarity of objectives and strategy may be lost and duplications and inconsistencies arise. Issuing a single sectoral policy document makes policy more transparent so that a coherent, unified approach may be re-established.

A good sector policy explains the proposed role of government and non-government agents within the sector. It distinguishes activities to regulate provision of services by the market from direct financing or delivery of services by government. Often it will include a set of objectives relating to the intended level of access to government services, the minimum acceptable quality for those services and the charges which might be levied for them, if any.

2.4.2 Good Practice

As the DAC guidelines on SWAp 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, as highlighted by the DAC guidelines:

> *"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 and rolling it forward. A transparent process for review and revision helps to establish a cycle that strikes a balance between planning and implementation".*

2.4.3 EC perspective

Ownership and consensus in sector programmes

The sector approach requires a basic policy consensus between the government and its aid partners in the sector, both about the objectives for the sector and, in broad terms, how they should be achieved. However, it is important that donors should not try to micro-manage the sector by specifying its activities in detail. The EC puts special emphasis on the results that are sought. If these are agreed and jointly monitored, the government can decide how best to achieve them (See Box 2.5).

This does not mean that the Commission should support every sector programme over which there is agreement on objectives and basic principles. Chapter 5 presents seven areas of assessment which should be reviewed to judge whether a sector programme is likely to succeed and to be sustainable. It permits a judgement on whether a Programme is fundamentally sound and whether the direction of policy is right. The level and nature of funding by the Commission is dependent upon this judgement, which must be made explicitly and transparently and must cover the key issues considered in Chapter 5.

Box 2.5: Government Ownership vs. Consensus on Policies

There is no question of the Commission supporting any sector programme (however strong the leadership of government) if it is inconsistent with the objectives and principles of the Community's cooperation and development policies, and with the common values and cross-cutting principles which the Commission has adopted for its cooperation.

Thus, it is important at the outset that there should be full agreement with partner governments over objectives and fundamental principles. This will still leave much room for disagreement over how a policy is to be implemented; over what is the most appropriate composition of public spending and which are the most effective interventions to achieve given objectives.

In supporting sector programmes, the Commission will avoid excessive attention to the details of the implementation strategy. Instead, the Commission will focus on securing mutual agreement over:

- The objectives to be pursued.
- The basic principles of (development) cooperation to be respected.
- The coherence between these objectives and principles and the actual allocation of resources within the sector programme.
- The proper management of public funds, in line with the agreed budget and the requirements of good governance and accountability.

The expected results of the sector programme and the means of measuring progress towards those results.

Sector programmes and poverty reduction objectives

Commission support for sector programmes is granted in support of national and sectoral development strategies that are consistent with the Community's development and other policy objectives. Sector programmes reflect a mutual concern of the Commission and partner governments to improve the results of government and donor spending. When poverty reduction is the priority for EC cooperation in a given country, the focus will be on allocating resources on the priorities stated in national poverty reduction strategies or similar documents, and by improving the quality of spending.

Two principles follow from this:

- ➔ The sector programme must be consistent with the poverty reduction strategy or its equivalent.
- ➔ The planned composition of expenditure within the sector programme, the target beneficiaries and the proposed modes of implementation should also be consistent with the objectives of poverty reduction.

The first implication is that the sector in question should normally be part of the Poverty Reduction Strategy (PRS). The purpose of an overall strategic framework such as a poverty reduction strategy paper (PRSP) is to identify overriding priorities so that resources (and managerial efforts) can be focused on these areas and results achieved. Conceivably, a sector approach could be developed for each priority sector identified in the PRSP.

Also, it is necessary also to look at the detailed aspects of the programme to confirm consistency with poverty reduction objectives. For example, it is the case in most partner countries that a disproportionate number of poor people are women and that the unequal access to assets, credit and basic services suffered by women is a major obstacle to reducing poverty. It should therefore be expected that policies and strategies would seek to address this issue.

In general, the details of the sector strategy and policy should be consistent with poverty reduction objectives at three levels:

- ➔ Sector strategy and policy (and the resulting composition of spending) should seek wherever possible to address the major constraints to poverty reduction.
- ➔ Those groups in society which are most highly represented amongst the poor – such as people from remote geographical areas, disadvantaged ethnic groups, women and children – should wherever relevant feature prominently amongst the targeted beneficiaries of the sector strategy.
- ➔ Where avenues exist or can easily be created to give a voice to the poor with regard to the design of sector policy and strategy and relevant aspects of programme implementation, these should be incorporated into the structures for the design, management, monitoring and evaluation of the sector programme.

2.5 Sector Budget and its Medium Term Perspective

2.5.1 Basics

A credible, comprehensive and transparent sector budget is essential for the proper implementation of the sector policy. Such a budget should be elaborated taking into consideration all resources made available to the sector (including external resources) and list all expenditures (capital as well as recurrent expenditures) necessary for the achievement of the sector policy's expected achievements. Its credibility should be judged against past sector financial performance (actual budgetary outturns), and the composition of expenditure outturns. A clear budget classification is key to the proper elaboration of a sector budget.

2.5.2 Good practices

Sector policies/plans and sector budgets are the two faces of the same coin. The government budget, with or without donor assistance, is/should be the main vehicle to provide the inputs needed by government agencies to implement the sector policy and obtain the agreed results and outcomes. Thus it is – or should be – a critical policy tool.

In order to obtain the desired sector outcomes, policies and strategies have to be relevant: budgets well aligned with weak strategies will not bring better sector results. At the same time, relevant policies and strategies will be helpless if they are not reflected truly and clearly in the budget.

When a sector budget is coherent with the sector policy and meets these basic requirements, the attention would then go to policy based budgeting with a view to improving the allocative efficiency of internal and external resources over the medium term.

2.5.3 EC perspective

Within Sector approaches the EC promotes the link between policy and budget. Sector budgets need to fit into disciplined aggregate government expenditure plans, and annual spending needs to be conditioned by a medium-term perspective on resource availability, priorities and the balance between recurrent and capital expenditures, as well as between different sub-sectors. Ideally, and eventually, this would take the form of a Medium Term Expenditure Framework, strongly rooted in the political and budgetary process of the government. However, it does not make sense to demand a "sector MTEF" prematurely. The development of a sector MTEF is a gradual process that should focus first on building sound bases, such as a credible annual budget, mechanisms to ensure that all expenditure programmes are prioritised within the existing resource envelope, agreed national and sectoral policies and the definition of aggregate fiscal objectives.

Taking stock from experience[7] it is recommended to adopt a process and systemic perspective on the development of a sector MTEF, rather than making it a pre-requisite for supporting a sector programme. This approach recognises the complexity of developing such a process, the importance of its full integration in the overall public management budget system, and the need for an overall medium term fiscal framework (MTFF) to be initially in place. A formal sector MTEF makes sense if a number of conditions are met, as explained in section 5.2. Nevertheless the MTEF is a key instrument in the development of a solid sector policy, and is in many countries high in the policy dialogue agenda as well as in the PFM reform process.

2.6 Sector and Donor Coordination

2.6.1 Basics

Sector approaches require formal, government-led mechanisms for coordination and dialogue at the sector level. As said in the DAC Guidelines on SWAp:

> *"It is generally possible to address weaknesses in any of the other components as long as the coordination system is strong and there is adequate government leadership of the sector. Conversely, where coordination is weak, problems in other areas tend to become intractable"*

Coordination processes comprise two basic mechanisms: coordination of governmental actors and other national stakeholders, and coordination of donors active in the sector. In practice, on many occasions, these two dimensions overlap, but it is important to keep them conceptually separate in order to protect domestic accountability and ownership. Connected to these two processes, a special attention is to be given to the **“sector programme management system“**, corresponding broadly to the steering and decision-making arrangements set up of each sector programme, including the sector review process and its calendar (see section 5.3.3).

2.6.2 Good practices

A basic principle 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.

As well as being government-led, the sector coordination arrangements need to be consistent with the structure and responsibilities of the national government. This means, in particular, that: i) the line Ministry is the

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7 *In the first version of these Guidelines on EC Support to sector programmes (February 2003), a sector MTEF was considered as a basic component of a SP, as well as a requirement for SPSP identification. Taking stock of experiences and on the basic of a critical analysis of a number of SPSPs, designed since 2003, it has appeared that a context sensitive perspective has to be adopted in this complex area and the existence of a “sector MTEF” is no longer a pre-requisite for SPSP. See also the document on "Policy Based Budgeting, the MTEF and sector support" to be issued before end 2007. See http://www.cc.cec/dgintranet/europeaid/activities/adm/index_en.htm*

main responsible for the implementation of the sector programme; ii) the Ministry of Finance (and the Ministry of Planning, where separate) must be involved and have a clear role; iii) the responsibility assignments and lines of accountability defined in the country's decentralisation system should be respected and iv) when practical, the sector coordination mechanisms should be connected to the wider framework of coordination and dialogue around the PRS. (See as well sections 3.1 and 5.3).

2.6.3 EC perspective

EC experiences endorse the importance of a clear government-led management and coordination framework for the sector. Donor coordination is essentially a means of achieving improved ownership and coherence and reduced transaction costs rather than an objective in itself. However, it is central to the whole sector approach and may be an area where the Commission is especially well-placed to make a contribution. Indeed, the EC is often perceived as 'a neutral but influential broker that is not involved with narrow issues and perceived national agendas'. Potentially, this gives the Commission the possibility to act as a catalyst of donor support and a promoter of government ownership for sector approaches. Attention should be given as well to appropriate involvement of non state actors in the coordination framework as developed in section 3.6.

CHAPTER 3
THE DYNAMICS OF SECTOR APPROACHES

THIS CHAPTER REVIEWS ISSUES CONCERNING:

- Developing and strengthening sector programmes
- When can sector approaches be successfully applied?
- Sector approaches and governance
- Sector approaches and decentralisation
- Focusing on capacity development
- Involving different stakeholders

3.1 Developing and Strengthening a Sector Programme

3.1.1 Overall Approach

Chapter 2 identified the five main elements of a sector programme (see Box 2.3). It also emphasised that the sector approach is a process in which the sector programme is continually refined and improved. In a few cases the EC may be involved in the development of a completely new sector programme. Much more commonly, EC staff will face questions about whether to support, and how to strengthen, a process that has already begun.

Many of the same principles apply to the initial development and to the subsequent strengthening of a sector approach. There is no fixed recipe for a sector approach, and no fixed sequence of steps to follow, but experience suggests some general orientations.

The main challenges revolve around the need to balance three requirements:

- The requirement for technical improvements in all the components, which take account of their interrelationship and the need for coherence.
- The necessity for these improvements and changes to be adopted (and respected) by all major stakeholders – hence the requirement for continual consultation.
- The imperative to continue to run government activities and to deliver services: in other words to avoid devoting so much attention to system reform that day-to-day operations suffer significantly.

3.1.2 General principles

The DAC's five main good practice principles *have already been explained (see section 2.2 above), viz.:*

1. Support government ownership and leadership.
2. Work with government to strengthen institutional capacity and accountability.
3. Set the sector programme in context.
4. Take a long-term, strategic view.
5. Be pragmatic and flexible.

The DAC guidelines draw attention to the following additional elements:

- **Ensure high-level political support.** Encourage senior officials in the sector to seek political input, to brief Cabinet and Parliament when appropriate, and to have a communication strategy for the Programme. The objectives of sector policy must be consistent with political concerns if they are to receive consistent support. Moreover, the sector strategy is likely to require attention to issues of government-wide concern (such as public sector reform), where political support will be needed.
- **Plan for some "quick wins" in the implementation of the sector programme.** These should include both tangible gains perceived by the users of services – such as improved maintenance of selected, high-use roads or increased supplies of medicines or reduced user charges, and improvements perceived by sector staff and their managers, such as simplified budget preparation processes, improved information, cleaner and better equipped offices, etc.
- **Design processes which economise on management, planning and policy skills within government, while progressively building up capacity.** Most sector programmes hugely increase the contact time demanded of senior government managers by donors. Be aware of this and find ways of reducing the transactions costs associated with aid management.
- **Move cautiously and realistically on developing pooled funding arrangements** – this requires careful preparation and capacity building, and may not be necessary (or cost-effective) to achieve the goal of unified planning and resource allocation. Greater priority should be placed on establishing common review processes and timetables.

3.1.3 Early stages

Government ownership and leadership over the sector programme being key, care needs to be taken in the early stages to foster this leadership and adapt the level of complexity of the sector programme to the national capacity.

Donor coordination will normally begin with relatively informal meetings where problems are analysed and information shared. Over time they develop into increasingly structured arrangements where respective donor and Government commitments and agreed codes of behaviour are written down in formal Memoranda of Understanding (MoU). These Memoranda themselves evolve over time. They might initially comprise general "Statements of Intent", becoming more detailed as the areas of agreement become broader and donors more willing to utilise common funding systems and to rely on government mechanisms. The documentation of these agreements helps to create a type of "ratchet effect", whereby agreements once reached are consolidated through the drafting process and become less subject to reversal if circumstances or personalities should change. In order for a large sector programme to operate sustainably over time, quite a high level of detail is required in the MoU, including for example agreed dispute resolution mechanisms.

For these processes to work effectively and to generate progressive improvements, frequent government-donor and donor-donor dialogue is needed. Often this will be facilitated by a "lead donor" or lead group of donors.

In a mature sector programme, these coordination mechanisms would embrace all stakeholders (see section 3.6 below) but better government-donor and donor-donor coordination would normally be the first step. It is crucial that systems of sector coordination should be established and chaired by Government. It is also essential that they should involve participation from the Ministry of Finance in addition to the relevant sectoral ministry.

Once basic processes of coordination are in place, the sector policy is normally the next area for attention, although in some cases existing policy may be perfectly clear and acceptable to all. It is advisable to give attention to the sector budget and its medium-term perspective (which, if conditions allow for it, may develop into a medium-term expenditure framework for the sector) in conjunction with the policy because policy ambitions will necessarily need to be limited by the level of resources available[8]. Conversely, policy objectives will never be achieved if the pattern of spending is not based upon an action plan consistent with that policy. Again, the in-

8 Ensuring the consistency of sector policies with overall financing capacity is likely to require a variety of scenarios. In the education sector, for instance, strategic objectives usually need to be matched against a 10- or 15-year resource projection. The medium-term expenditure framework then becomes a more detailed sub-set of this long-term plan.

volvement of the Ministry of Finance in these processes is crucial – first, to ensure that the aggregate resource envelope is realistic and subject to some degree of protection by the Ministry of Finance in case of revenue shortfalls and, second, to be certain that sectoral priorities are consistent with wider national priorities, as expressed in the PRSP or its equivalent.

Insofar as pre-existing systems of consultation with beneficiaries and with non-state actors exist, it is important that these should be involved in developing the sector policy and expenditure framework. In this way, there is an early input into policy by clients, beneficiaries and non-government service providers. However, one should avoid overloading the reform process: the approach should be to employ whatever consultation mechanisms exist and to seek improvements later.

With sector coordination processes established around the sector policy and budget, a basic sector programme may be said to be in place. Experience suggests very strongly that only once these three building blocks of a sector programme are sufficiently developed, does it become feasible to address the quality of the performance monitoring system and of wider consultation mechanisms.

All of the above steps are iterative. In other words, each of the components of the sector programme will need to be produced in a basic form first before being refined later. The key maxim is ‘to avoid the pursuit of the best becoming the enemy of the good’. Rather than aiming from the beginning for a high level of sophistication, it is better to start, for example, with a simple policy document which lays out objectives and broad approaches and to seek improvement later as information systems develop and consultation processes are strengthened.

Section 4.1.2 of the Guidelines outlines how the Commission may promote sector approaches and support the initial stages of the development of sector programmes.

3.1.4 Being realistic about harmonisation and transaction costs

Harmonisation of reporting, budgeting, accounting and procurement systems is a key aspect of any sector programme. In many cases this is what partner governments place the most emphasis on. In practice, harmonisation often proves problematic, demanding of government time and costly in terms of technical assistance and preparatory costs. Donors, as well as governments, have often been disappointed at not achieving more dramatic reductions in transaction costs.

Box 3.1 draws from the recent Joint Evaluation of General Budget Support. Its observations on transaction costs can apply to sector approaches generally as well as to the specific case of GBS. It is important always to consider which part of the aid management cycle is affected by transaction costs and to consider who bears them. For example, coordinating a sector programme is likely to increase the burden on a sector ministry HQ (perhaps especially its planning section), even if it results in savings elsewhere. Costs may also be redistributed between donors and government and, as Box 3.1 points out, the meetings and reviews that give rise to transaction costs should also have positive benefits. It is not helpful to see transaction costs as a pure loss (though some have no value). Rather, there needs to be a careful analysis of the distribution of costs, the fit between transaction costs and capacity, and opportunities for increasing the benefits from transactions.

Disappointments with harmonisation often result because “ideal solutions” have been sought from the outset, which bring together all aspects of harmonisation into one unified process, typically structured around the establishment of a single pool fund for the financing of the programme. Experience suggests that this is not the most effective way to achieve progress towards harmonisation. Rather it is important to ask:

- ➔ Which aspects of harmonisation are likely to bring the greatest benefits?
- ➔ How will the costs of introducing different aspects of harmonisation compare?
- ➔ In the light of costs and benefits, what is the most appropriate sequencing of harmonisation processes?

Box 3.1: Transaction Costs

Understanding transaction costs

Transaction costs occur at all stages of the aid management cycle, from the initial negotiation of aid through to disbursement, implementation (including procurement, construction, etc), and monitoring of the activities it finances. There may also be conversion costs in moving from one financing instrument to another and different elements of risk for different types of transaction.

Different ways of doing business may distribute transaction costs differently (e.g. between international partners and government, between country offices and HQs, between finance ministries and sector ministries).

Transaction costs are not a pure efficiency loss: the same activities that embody transaction costs may also have positive benefits (e.g. learning from working groups, mitigating risks through fiduciary safeguards).

Transaction costs are difficult to quantify, and there is much observer bias in their assessment. Much of the debate about transaction costs in relation to budget support has focused on the negotiation and monitoring costs experienced by the principals in the relationship, neglecting the balance of downstream transaction costs during programme implementation.

The GBS evaluation's findings

- Even where budget support is well established, the up-front transaction costs are not perceived to have fallen as much as some had expected.
- Partner governments' transaction costs at implementation stage have been significantly reduced, by virtue of being able to follow standard government procedures rather than a multiplicity of donor ones.
- The scale of the resulting benefits is diminished by the persistence of project aid and sector baskets that are implemented using parallel systems to those of the government.

Source: Joint Evaluation of General Budget Support

In order to answer these questions, it is important to "unbundle" exactly which objectives are being pursued through harmonisation. In general, harmonisation can contribute to all three of the main objectives of the sector approach, namely 1) increased ownership; 2) increased coherence in planning and resource allocation and 3) reduced transaction costs. Different initiatives can have different implications for these objectives. For example, the establishment of shared information systems, common reporting and common planning and budgeting processes, may primarily improve ownership and coherence; on the other hand, the creation of common disbursement and accounting systems and common procurement processes may be intended mainly to reduce transaction costs. As already noted, increased coherence in planning and resource allocation may involve higher transaction costs in the early ("upstream") stages of the planning cycle, even if there are transaction cost savings (for government at least) in the "downstream" stages of implementation and disbursement.

Harmonisation should strengthen and not undermine alignment: the use and improvement of country systems should remain the overarching goal.

3.1.5 Priorities and sequencing

In summary, there are a number of points which need to be borne in mind in managing the process of harmonisation of procedures:

- The priorities for harmonisation and the approaches adopted should be based on a realistic assessment of the likely costs and benefits.
- Greater priority should be placed on establishing common review processes and timetables, than on common accounting and disbursement procedures. Unified expenditure programming and reporting systems can quite feasibly be established while continuing to utilise existing project accounting and disbursement procedures.
- In assessing the benefits of reduced transaction costs, **the primary concern is the reduction in transaction costs borne by government.** Gains in this area may in the short term entail increased transactions costs for donors.

- Government systems should be used wherever possible, strengthened if necessary through small adaptations and modifications.
- The development of common procurement systems can be pursued in parallel to harmonisation of other management systems. In particular, it should be noted that common procurement systems can be established quite independently of the existence of a pool fund.
- The potential for making a direct move to budget support and the use of government procedures should be carefully assessed before embarking on the development of a pool fund.

Where the use of budget procedures is not possible, pool funds can represent a major saving in transaction costs if a critical mass of donors commit to their use. When properly structured, they can also serve to reinforce gains already made in the harmonisation of planning, budgeting and reporting systems. However, these benefits are not automatic, and pool funds may have serious drawbacks in undermining government systems and ownership (see Chapter 4). Therefore each case needs to be examined on its merits.

3.2 Where Can Sector Approaches Be Successfully Applied?

3.2.1 Some lessons of experience

Sector approaches developed earliest and remain most common in education and health sectors. These sectors tended to have a number of favourable features, as highlighted by the DAC review of experiences:

- **Broad consensus between Government and donors** on key policy and management issues for the sector.
- **A single dominant sector ministry and manageable institutional relationships.** Strong and effective leadership at sector ministry has been an important factor in most successful SWAps. Sector programmes have worked most effectively where they are defined in terms of the area of budget responsibility of a single sector ministry. SPs are also often easier to manage where there is a relatively small group of significant donors in the sector.
- **An experienced "lead donor" or lead group of donors.** Sector programmes usually need a lead donor and preferably a lead group of donors[9] willing to support government in managing donor and stakeholder coordination through good advice and through bringing other donors "into line" when necessary.
- **Incentives that are compatible with the objectives of a sector approach.** A sector approach is more likely to be successful if there are civil service and other government-wide reforms in place to create incentives and performance-related rewards for the stakeholders. This makes it easier to attract staff and to counteract the incentives to retain project bureaucracies. Conversely, problems are likely to occur if the sector strategy involves cutting the budget or cutting staff in the ministry which is to take the lead role in implementing it.

When some of these factors are absent or weak, more care is needed in the design and management of a sector approach, along with adjustments in how much the approach is expected to achieve and how quickly. As experience is gained, however, the scope of sector approaches (and of more narrow PBAs) is being extended, as discussed below.

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9 Working with a lead group of donors helps to keep the institutional memory and is often perceived as more democratic and participative, especially to donors that are a bit hesitant to join the sector approach.

3.2.2 Definition of the scope of a sector or-sub-sector

Similar points apply when considering how broadly a "sector" should be defined. It makes sense to be pragmatic, and also not to regard the definition of a sector as too rigid and exclusive. There is scope to apply the principles of a programmatic approach at several different levels at once. (e.g. programme-based support to agricultural research may be nested within a wider agricultural sector approach).

The need for coherence would appear to argue for a broad conception of the sector. A sector approach should make it easier to identify and plan for policy and resource implications across the sub-sectors of a sector. For example, the rate of expansion of primary schooling has implications for teacher training capacity, for investment in school inspection services and, of course, for the provision of secondary education and of vocational training. Similarly, there are linkages between primary health services and hospital referral services or between trunk roads and feeder roads. The justice sector should preferably be considered in terms of the "justice chain" including all stakeholders to avoid "bottlenecks". Sector programmes can provide a powerful framework for managing these linkages in a constructive and coherent manner. However, it should be noted that such linkages might be equally well addressed through one broad sector programme or through two or three parallel sub-sector programmes where inter-linkages are addressed by appointing a lead sector ministry or at the level of the central agencies (Ministry of Finance, Planning Commission, etc.) or Cabinet.

Moreover, such linkages go much further than the sector in a narrow sense. For example, the success of agriculture support services is intimately linked to the existence of rural infrastructure; basic health requires good water and sanitation. The question, then, is whether complementarities and trade-offs in policy and resource allocation decisions are best addressed at the level of the sector or through political decisions taken at higher levels (central bodies and agencies, Cabinet or Parliament). This requires a case-by-case approach where country organisational set-ups and budgeting procedures are among the factors that need to be taken into account.

3.2.3 Sector approaches in "non-traditional sectors"

As already noted, sector programmes have worked most effectively where they are defined in terms of the area of budget responsibility of a single sector ministry. As indicated in the DAC guidelines, " the effort of setting up a formal sector partnership is more likely to be worthwhile when i) donors are an important part of sector financing and ii) the sector is one in which public expenditure and service delivery play substantial roles.".

However the sector approach rationale – taking a holistic view, coherence between policy resources and results, and bypassing fragmented financing – applies to good public policy management in general, and sector approaches are being adapted to a wider range of sectors and contexts. "Non-traditional" sectors include agriculture and rural development, water and sanitation, governance and the rule of law. Sector approaches are under way also in a number of non aid-dependent countries.

It is important not to assume that mechanisms that have worked well for the simpler sector cases can be easily transferred [10]. In deciding what is appropriate in these wider cases it may be useful to take a "programmatic" rather than organisational view of the terrain, and also to disaggregate the different objectives associated with sector approaches. Particularly in non-traditional sectors, not all the conventional objectives will be equally relevant or equally easy to achieve, and it is useful to consider which are the most relevant. Finally, it is important to consider the articulation between different programmes both within and across sectors. Box 3.2 presents some of the first lessons learned in promoting sector approaches in “non traditional sectors” by the EC.

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10 This section draws on Alison Evans, Lidia Cabral and Dan Vadnjal. Sector-Wide Approaches in Agriculture and Rural Development: Phase I – A Desk Review of Experience, Issues and Challenges, April 2006 and Réal Laverne and Jacqueline Wood, Aid Effectiveness and Non-State Partnerships: Analytical Considerations, Working Paper, December 6, 2006.

Box 3.2: First Lessons on Promoting Sector Approaches in Multi-Institutions Areas

Developing and implementing sector programmes in areas where several ministries and non-state actors are involved is challenging. Examples include rural development, integrated water resource management, employment, social inclusion and protection, justice system reform and decentralisation and to a lesser extent trade and private sector development.

In these areas, more attention is needed on setting up the *right policy and management framework*. Flexibility is also needed in adapting the concepts and lessons of sector approaches in traditional sectors where government and public expenditure are dominant. However promising experiences are being developed and deserve attention: learning by doing is particularly valuable in this area where "pre-cooked recipes" do not apply.

The classical concepts of *sector policy and sector budget/MTEF* may not fit well with these (essentially multi-sectoral and cross-cutting) areas and should be interpreted with flexibility. A "policy" will in any case be needed, supported by an "income and expenditure programme" that outlines its medium-term perspectives. This latter component helps to ensure that actions are prioritised against a realistic estimate of government and external resources. It also serves as a framework that can facilitate the alignment of donor resources against agreed policy priorities, which in turn, helps prevent the fragmentation of development assistance.

A wider *forum* that includes not only government but also local authorities, private sector and other non-state actors will be crucial in the sectors where these actors have important roles to play in policy making as well as implementation. This helps ensure a broad national/country ownership rather than a strictly governmental one. This broad ownership is crucial as the success of such multi-stakeholder programmes is largely dependent on the effective participation of non-state actors such as trade unions, chambers of industry and commerce, commodity associations and employers unions, associations or federations.

Solid mechanisms for *sector and donor coordination* are of key importance in areas that involve government, local authorities, private sector and other non-state actors, as well as a possibly relatively wider range of donors in support of these state and non-state actors. Due to the many actors involved, both within and outside government and operating at national and sub-national levels, the coordination is very time-consuming and labour intensive, which needs to be recognised and allowed for from the start of the process. In this coordination process the government has a leading role.

Given the multiplicity of actors participating in the definition of priorities for the sector, the assessment of institutions and organisations benefiting from capacity development programmes, should be done tactically, focusing on key actors and including a historical perspective. Support to capacity development should be balanced between state and non-state actors in order to strengthen local accountability processes.

Where the various governmental partners may not have the same priorities, or even experience a conflict of interest, the institutional mandate for overall coordination of the programme has to be well thought through. Often, a central ministry (e.g. Finance, or Planning) or a Minister with more general responsibility may play that role; otherwise, one of the line ministries involved should be allocated such a mandate to enable it to act as a focal point for key decisions.

The policy process should aim to have key actors and organisations on board. The resulting policy should allow for sufficient flexibility to respond to local (sub-national) needs. Standardisation is difficult in areas that deal with natural resources (e.g. rural development, water management) where solutions have to be based on local circumstances. Similarly, 'good governance' is heavily dependent on effective action at sub-national levels and in support of decentralisation initiatives.

Source: Report of the Interservice working group on applying sector approaches to "multi-institution sectors" – 2006

Sector approaches may seek changes in number of complementary ways:

- Improved aid management through harmonisation and alignment
- Improved policy coordination and implementation
- Stronger institutional capacity and government leadership
- Improved expenditure management and more equitable service delivery
- Enhanced public-private interface.

Not all of these objectives will be equally relevant or achievable in all cases. For example, a sector approach may be sought in agriculture in order to achieve greater policy coherence and better links between public and private sector interests. The same factors that make it difficult to operate in terms of a single "sector budget" (because there are multiple public agencies involved, while many services are provided through the private sector) may make it more important to find a way of bringing diverse stakeholders together, and to address issues that are controversial.

On the other hand, sector approaches are dynamic processes. (It is important not to define them in terms of a static set of policy and budget documents, or fixed structures for management and consultation.) As a sector programme gains in maturity and management systems are strengthened, it is plausible to envisage an expansion in the relative coverage of the programme.

In this vein, it is often useful to view a complex programme as a set of pillars (sometimes but not always "sub-sectors") which contribute to the overall objectives of the programme. Thus agricultural research, extension, and rural infrastructure may all be treated as pillars within an agriculture/rural development programme. For some purposes it may be more practical for individual donors to provide support at he level of an individual pillar, as long as the sector's overall governance framework ensures adequate coherence between different components.

Linking sector programmes to national strategies

The question of coherence also applies at the level of national strategies. No sector approach is fully self-contained. There are many interlocking issues across sectors, and addressing systemic issues (e.g. in capacity or public finance management) will often require coordinated action across government.

On the articulation between sector programmes and the PRSP, the DAC guidelines note:

> *"The context for SWAps has become more favourable, but also more complex, with the advance of poverty reduction strategies, and coordinated action on a national scale to address systemic issues (including PFM and national capacities) that have previously been addressed within sectors. SWAps and sector development programmes are often prominent in the areas that are stressed in PRSs: education, health, transport and agriculture. Ideally, a PRS should incorporate a coordinated and coherent set of sector development programmes. Governments and donors can draw on their experience at the sector level as they develop a collaborative framework for the PRS, while this may provide a helpful framework for addressing some of the "difficult" areas where challenges more often arise."*

3.2.4 EC perspective

It is very important to respect government ownership, and not to impose external preferences about how sector programmes are configured. At the same time, the Commission may be able to advise governments and partner donors over the relative advantages and disadvantages of a broad as opposed to a narrow conception of a sector. Essentially, it is a weighing of the potential advantage of increased coherence by expanding the coverage of the sector versus the potential disadvantage of the resulting increased managerial and organisational complexity. In all cases the EC will coordinate closely with other donors, and will also seek to ensure coherence between its SPSPs and its other operations that may be relevant within and across sectors.

3.3 Sector Approaches and Governance

3.3.1 Basics

Governance has moved to the forefront of the agenda the last ten years and most development partners have expanded their work in the field. The EC Communication on Governance and Development [11] adopted the following definition of governance which is broadly in line with definition adopted by other agencies:

Box 3.3: What is Governance?

"Governance refers to the rules, processes and behaviour by which interests are articulated, resources are managed and power is exercised in a society and the state's capacity and will to serve its citizens. The way public functions are carried out, public resources are managed and public regulatory powers are exercised is the major issues to be addressed in that context.

….Governance is a basic measure if the stability and performance of a society. As the concepts of human rights, democratisation and democracy, the rule of law, civil society, decentralised power sharing and a sound public administration gain importance and relevance, a society develops into a more sophisticated political system and governance evolves into good governance."

The move towards sector-wide approaches (SWAps) and budget support financing modalities has given an additional impetus to governance issues, as they are of utmost importance not only for aid effectiveness, but more broadly for sustainable sector development. It is therefore increasingly acknowledged that governance *should be addressed in all sectors*: Articulation of interests, management of resources and the way power and authority is exercised will determine which services are delivered to whom, and how regulatory functions are carried out. Transparency, accountability, adequate oversight and broader participation of non-state actors will ultimately ensure that sector authorities remain responsive to citizens' needs and demands.

3.3.2 EC Perspective

Governance is on the top of the political agenda of the EC and over the last five years the concepts and approaches to governance have evolved considerably. Efforts have been strengthened to address governance in development cooperation both as an area of activity and as a mainstreaming issue underlining the need to analyse and enhance governance at sector level. The European Consensus on Development states[12]:

"In all activities, the Community will apply a strengthened approach to mainstreaming the following cross-cutting issues: human rights, gender equality, democracy, good governance, children's' rights and indigenous peoples…… These cross-cutting issues are at once objectives in themselves and vital factors in strengthening the impact and sustainability of cooperation"

The EC Thematic Evaluation on Governance, concluded in 2006 [13], indicated that governance is not addressed in a systematic way at sector level. Yet over the last years the EC has put growing emphasis on governance in sectors. In the process, valuable experiences and lessons have been learnt, on which future programmes should build.

Addressing governance at sector level can be quite a challenge, particularly in difficult environments. The EC is recognising that working to achieve good governance is a long term, primarily domestic process which donors can support with a pragmatic and realistic approach.

Sector programmes have a strong governance dimension that cut across all their key elements. Governance is reflected in how sector coordination actually works including participation of sector stakeholders. Sector policy

11 *COM (2003) 615*

12 *part II par 101*

13 *Thematic Evaluation of EC Support to Good Governance, final version March 2006, page 2ff.*

processes will be more or less inclusive depending on whether governance is top-down or also bottom-up, and sector budgeting and more generally public financial management is a crucial articulation of both the governance and accountability situation in a sector. Governance is reflected in the wider domestic accountability processes and the performance monitoring systems. It strongly influences institutional and capacity issues, providing key drivers of and constraints to performance. Development partners are also influencing governance, particularly in aid dependent countries and sectors and their “governance and accountability behaviour” may strengthen or weaken the domestic sector governance.

Box 3.4: Addressing Governance in the Forestry Sector

The Forest Law Enforcement, Governance and Trade (FLEGT) process provides a good example of how the EU managed to promote good governance in sector development by addressing the "core issues" of governance and using the "governance principles" of participation, accountability, non discrimination/inclusion and transparency.

In many countries, the forestry sector is characterized by illegal logging, driven by a strong demand from consumer countries. In 2003, the EU presented the EU FLEGT action plan, with the intention to combat illegal logging in producing countries by improving the governance framework within the sector.

Countries can conclude a Voluntary Partnership Agreement and benefit from EC-funding for FLEGT supporting projects. A participatory approach is undertaken: consultations with key actors (public agencies, civil society, private sector, judiciary…) lead to the identification of gaps in the regulatory framework and subsequently to a roadmap of issues to be addressed.

The process is still young, but FLEGT has a potential for improving both the demand and supply-side of governance in the forestry sector. On the demand side, advocacy and external monitoring capacities of civil society can be enhanced, and independent forest monitoring systems established. On the supply-side, internal checks and balances mechanisms (verification systems) will be reinforced and/or created. In addition, the regulatory capacities of the government and core public agencies are strengthened and private sector initiatives are supported.

Currently, partnership negotiations are ongoing in Indonesia, Malaysia and Ghana. Informal discussions and preparatory work are also taking place in Cameroon, Congo, Central African Republic, Liberia, Gabon, Vietnam, Cote d’Ivoire, and Ecuador.

Governance and accountability aspects should thus be considered and addressed in each of the seven areas of assessment as well as across the components of a sector programme, because governance aspects in one area (e.g. participation in policy processes) may be intimately connected to governance aspects in another area (e.g. accountability for results according to the policy).

Within this perspective governance related concerns need to be identified and addressed throughout the SPSP cycle's (from identification, and formulation to implementation), including in terms of analysis, dialogue, and monitoring[14].

14 A Reference Document under preparation on "mainstreaming governance at sector level" will propose a practical approach, consistent with these Guidelines, on how to analyse and address governance at sector level. It will be published under the Europeaid “Tools and Methods Series” (see section Web References).

3.4 Sector Approaches and Decentralisation

3.4.1 Basics

The majority of sector programmes are developed in the sectors of health, education and water, as well as agriculture and roads. Each of these sectors tends to include significant service delivery responsibilities for government, which of necessity need to be geographically dispersed in order to reach the target population. This often involves local governments as well as the sector ministries of the central governments. Exact arrangements vary greatly between countries, and are likely to be more elaborate in federal states. The distribution of responsibilities (devolved or decentralised) between different levels of government is a crucial factor in considering the scope of a sector approach and who should participate in its coordination arrangements. Getting the right balance between accountability at central and local levels is a major challenge for SWAp processes.

Donors need to be careful that they do not inadvertently reinforce centralising tendencies by working too narrowly with the central agencies of government. Experience suggests that this is a real danger:

> *"Whereas preparatory SWAp activities tend to take place at the central level, the focus of implementation almost inevitably moves to the periphery where implementation constraints and unforeseen events can often radically reshape the process originally envisioned during the planning phase. This can be a major source of frustration for SWAp designers and can undermine widespread acceptance of the approach and its potential value-added. This relates to the observation that SWAps often represent a re-centralisation of power and decision-making within national administrations, while capacity building at the local level is often overlooked. Centrally driven processes tend to encourage top-down planning that, often for efficiency reasons, circumvents local political processes (Shepherd 2001). The resulting danger is a dynamic in which SWAps and decentralisation processes end up pulling against one another precisely in those sectors where local government participation is so critical (ECDPM 2003)".*

Careful mapping of institutional responsibilities is crucial (cf. section 5.4), as is taking into account any ongoing process of decentralisation (which may itself be supported in a programmatic way).

3.4.2 Good practices

Factoring decentralisation into sector programme design

Decentralisation is one of the aspects in which it is important for sector programmes to be carefully tailored to fit local institutions. This potentially affects all areas of the programme, not least its budget. If budgetary responsibilities for the sector are themselves decentralised, there will not be one sector budget but many at different levels. Decentralisation may take very different forms: Box 3.5 illustrates the importance of adapting to specific national systems. Take care that support to the sector does not inadvertently undermine the role and capacity of the decentralised bodies responsible for service delivery.

Links to decentralisation reforms

Decentralisation is often itself a focus of reform, in which case sector programmes take place in a context of changing institutional arrangements. Again the question arises whether the sector approach and the decentralisation reforms are likely to reinforce or to undermine each other. At the same time, some of the principles of a sector approach may be relevant to the management and coordination of support to the decentralisation process.

In principle, there is a strong consistency between the underlying goals of sector programmes and of decentralisation reforms. Both seek to improve the effectiveness and efficiency of resource use in the pursuit of poverty reduction and other established national objectives. Equally, both give emphasis to the voice of local stakeholders and beneficiaries in dictating how resources are utilised.

However, both are complex processes which are highly demanding of managerial and administrative capacity so their simultaneous implementation will certainly present particular risks and challenges. In general these will derive from three sources:

- The logistical and practical problems of coordinating two parallel reform processes.
- The short-term transitional problems common in the early stages of decentralisation.
- The short-term transitional problems common in the early stages of implementing a sector programme.

Box 3.5: Decentralisation – The Importance of Adapting to National Systems

Ethiopia and Uganda illustrate the importance of the local government dimension for sector programmes. Although both countries have embarked on serious decentralisation programmes, their very different institutional cultures and approaches also illustrate the importance of donors' adapting in detail, not just in principle, to the institutional circumstances of the country.

Uganda has funded local government services through a series of tightly-controlled specific purpose grants, which make it easy to identify sector budgets for health, education, etc. across all tiers of government, and allow donor funds to be tightly earmarked to sectors. Ethiopia, however, has a federal system with unearmarked block grants which give regions and districts more discretion. Strictly speaking, this means that aggregate sector budgets are not known until the individual budgets of 11 regions and several hundred districts are consolidated with the federal budget.

Donors strongly support decentralisation in both countries, but need to adopt different mechanisms for channelling funds to support local services, so as to reflect and support the two countries' different approaches to decentralisation. There are implications both for the way funds are disbursed and for reporting requirements: donor earmarking of funds should not undermine local government discretion and accountability; and reporting requirements and schedules should be realistic about the time required for reporting from local levels to the centre. Where a policy role, and not just service delivery, is devolved – as in Ethiopia – regional governments are themselves key players in the SWAp.

Source: DAC guidelines.

Logistical and practical problems in coordinating parallel reform processes

It is exceedingly unlikely that the government agencies leading the sector programme and leading decentralisation will be the same. Ideally, there would be a strong involvement by the Ministry of Finance in both processes and this would help to ensure coherence and coordination. However, the relevant sector ministry would always lead the sector programme whilst decentralisation would normally be led by a Ministry of Local Government or by a specially appointed Decentralisation Commission. Apart from the simple problems of information exchange which this might cause, the interests of these bodies will inevitably be different:

- A sector ministry would have an over-riding concern for service delivery, whereas the decentralisation programme may initially be more concerned with the institutional aspects of the reform and issues of governance and democracy.
- In judging the quality of a decentralised body, the sector ministry is likely to put a higher premium on technical efficiency whereas a Ministry of Local Government may perhaps look for evidence of good democratic, participatory and consultative processes.

How should these problems be addressed? At the very least, it is important to maximise consultation and interaction, for example by ensuring that the sector ministry is represented in policy discussions on decentralisation. Also, where both programmes are considering piloting reforms, efforts should be made to ensure coherence in the selection of pilot areas. In some cases where decentralisation processes are at an early stage, it may prove necessary to proceed more slowly with implementation of the sector programme. And in any case the pace of the two processes should match in order to ensure mutual reinforcement. This underlines the crucial importance of undertaking a proper institutional analysis as part of the identification, formulation and ongoing monitoring of a sector programme (see section 5.4).

Transitional problems common in the early stages of decentralisation

The implementation of decentralisation reforms will commonly hit transitional problems at an early stage, in particular:

- Reliance on local government bodies may expose weaknesses in technical or managerial capacity, leading to an initial decline in the quality of services provided.
- Reliance on untried structures of local accountability may expose weaknesses in the accountability system, for example with local elites exerting undue influence over resource allocation.
- The design of new funding formulae may require refinement to ensure a proper balance between funding and service delivery responsibilities.

Problems of this kind will inevitably create frustration amongst the stakeholders of the sector programme and may create pressures to stop or reverse decentralisation measures. Where the "transitional problems" are extreme and widespread, there may possibly be a case for this. However, in most circumstances, the appropriate response would be a) to slow the pace of implementation of the sector programme, and b) to enhance the attention given to capacity development within the programme while ensuring coherence with similar activities introduced through decentralisation initiatives.

Transitional problems common in early stages of sector programme implementation

In the early stages of implementation of a sector programme, a number of centralising influences are likely to be at play which may also create problems in terms of coherence with decentralisation reforms:

- First, as attempts are made to reduce the number of off-budget projects, it may be that the number of district and provincial level project initiatives will be reduced. Moreover, corresponding financing from other sources may not start up sufficiently quickly to avoid reduced funding for geographically peripheral structures.
- Second, local governments and district and peripheral level organisations may initially find themselves under-represented within the new (or newly enlarged) sector-level policy forums introduced with the sector programme.
- Systematic client and beneficiary consultation systems, which might be expected to give greater attention to rural and geographically peripheral areas, may by contrast take rather longer to establish.

These short-term transitional effects are difficult to avoid. Typically, the best that can be hoped is to be aware of them and to minimise their impact. In the medium to long term, there is no reason to doubt that sector programmes and decentralisation initiatives can be complementary and mutually reinforcing, but underlying tensions between sector interests and local government concerns are likely to persist and to require continuing management.

3.4.3 EC perspective

So far, EC experience to support sector programmes in a decentralisation context points to the importance of focusing on the inter-linkage between decentralisation and sector reforms so as to maximise opportunities and minimise risks:

- **Opportunities for synergies:** SPSPs can facilitate the participation of different stakeholders/actors, including non-state actors (thus including social partners, i.e. unions and private sector representatives) at different levels, under national leadership in the design, implementation and review of policies relating to service delivery and local governance. They can also provide entry points for capacity-development support that meets the needs of sector programmes as well as those of decentralised institutions and actors.
- **Mutually reinforcing dynamics:** if properly coordinated, SPSPs and decentralisation processes can help consolidating centre-local relations by delivering services more effectively and promoting decentralisation at the same time, thus complementing each other in tackling poverty and striving for social cohesion. SPSPs can also contribute to raising awareness among local actors of the importance of ensuring delivery of services at appropriate local level. They can also contribute to making increased and more predictable resources available at local level.
- **Risks:** It is often argued that, if not properly harmonised, SPSPs and decentralisation supports may be pulling into different directions. On the one hand, some point to the risk that SPSPs can sometimes be

treated as instruments for sector ministries seeking "easy and fast" solutions to ensure performance targets to be met, thus overlooking the implications and interactions with the decentralisation process in the country. On the other hand, the main concern of decentralisation agents and supporters can at times be that SPSPs may entail a recentralisation of powers and responsibilities to the detriment of strengthening of local governance. However, these risks are not inherent to the nature of SPSPs or decentralisation processes, which are generally part of wider poverty reduction strategies and public administration reforms. The way in which the two different policies (decentralisation and sector reforms) coexist within the same government and whether there is a unity of vision as to their implementation will largely determine the extent to which the two processes can be complementary or conflicting.

Further elements are developed in the EuropeAid Reference Document "Supporting Decentralisation and Local Governance in Third Countries" posted on EuropeAid's website.

3.5 A New Focus on Capacity Development

3.5.1 Basics

Systemic capacity development (see Box 3.6 for definitions) has always been an important theme of sector approaches, but this theme is now receiving even more attention. The debate on aid effectiveness and the Paris Declaration highlight the need for a strategic and coordinated approach in assessing and supporting capacity, under firm leadership of the partner government. Support to capacity development is now seen as a pillar of the aid effectiveness agenda, in particular in the area of PBAs.

Box 3.6: Capacity and Capacity Development

Capacity can be defined as the ability to perform tasks and produce outputs, to define and solve problems and make informed choices

Capacity development is the process by which organisations create and strengthen their capacity overtime

Support to capacity development is the inputs and processes that external actors can deliver to catalyse or support capacity development.

The Paris Declaration states that:

"Capacity development is the responsibility of partner countries with donor playing a support role".

It includes the following commitments of particular relevance for Sector Approaches:

"Partner countries commit to integrate specific capacity strengthening objectives in national development strategies and pursue their implementation through country-led capacity development strategies where needed.

Donors commit to align their analytical and financial support with partners' capacity development objectives, make effective use of existing capacities and harmonise support for capacity development accordingly".

3.5.2 Good practices

Experience has confirmed that capacity development has to be mainly a domestic affair, owned and led by those wishing to develop their capacity. Supply-driven and fragmented support to capacity development has proved to be mostly only marginally effective. Support to capacity development therefore has to respond to a clear demand and be designed and implemented under partner government leadership. In order to better approach this key area – essential for successful sector programme design and implementation – a new approach is needed, including solid assessment and strategic design.

These guidelines include an enhanced treatment of institutional analysis and capacity development (see section 5.4). This emphasises the need for a contextual analysis of institutions and capacity, focusing on underlying incentives and performance, and avoiding the superficial "gap" analysis which has often led to futile supply-driven prescriptions of technical assistance.

Good practices in this area include:

Capacity development is a central part of the sector programme, not an add-on

In line with the Paris Declaration, capacity development should be a central part of a sector programme. That is, the national partners should have capacity development as part of their objective for sector development. If this is not the case, external partners can do little to "add on" capacity development and capacity development support later in the process. If capacity development has not been factored in from the beginning, then it has to be tabled for gradual inclusion as the sector programme develops into subsequent phases. New capacity development demands would normally emerge during sector programme implementation. They would be captured through the management system and regular reviews, and factored into capacity development strategies.

Assuming that capacity development is part of the sector programme, how can external partners support capacity development? It is important to note first, that the discussion here is not about how capacity development support can ensure the timely implementation of donor support. This has been a traditional perspective, and often led to the creation of temporary implementation structures which had no sustainable capacity impact once the donor support finished. The perspective on capacity development in sector programmes is not linked to the donors' support, but to the demands emerging from the national sector setting. Of course the national capacity to address donor requirements in terms of reporting needs to be factored in when designing support.

Capacity development must be driven by results, not by donor-funded inputs

Sector programmes will often focus on outcomes at sector level – e.g. reduction of HIV infection rate, improved immunisation rates or primary education completion rates. Capacity development efforts are best served with a focus on the changes in the concrete services or results (quality and/or quantity) of the organisations. This can in the short run be intermediate results from units in bigger organisations – e.g. accounts being available not later than 30 days after the close of the quarter. By focusing on results rather than capacity development activities or inputs, donors can also keep an arms length distance to the nitty-gritty processes taking place inside the organisations, and thereby they can better avoid undermining the essential ownership of the capacity development process.

Seek joint approaches to capacity development support with other donors

If capacity development considerations are occupying centre-stage in the sector programme, then it should follow that pursuing a joint approach for capacity development will essentially be through the same processes applied to foster a joint approach to the support to the entire sector programme. This implies that alignment and harmonisation can be sought at different levels and around different processes:

- In terms of levels, alignment can centre on broader capacity development objectives, or more specifically, on specific organisational outputs to be delivered as a result of capacity development processes, as agreed in PAFs or other joint instruments.
- Full or partial alignment of inputs – inclusion of capacity development activities as part and parcel of what is funded through sector budget support, or pooling of funds for capacity development support from various donors, is a more developed joint approach. If funding through the budget is not feasible, and pooling too complex to establish, then donors can usefully consider abstaining from funding capacity development activities, leaving this to a donor with adequate flexibility and untied procurement processes. Since capacity development support is rarely very expensive, this solution may be preferable to elaborate joint arrangement.
- Finally, pushing among other donors to abandon practices which undermine capacity – poaching of staff, payment of salary topping-up or training allowances, establishing parallel units – can effectively strengthen country ownership of capacity development.

Consider as well support to non state actors

Action to support capacities should also benefit non state actors, promoting their critical and constructive role in the various phases of a sector programme, including implementation, monitoring and review of performances.

Rethinking Technical Assistance

Overall Technical Cooperation and/or Technical Assistance (broadly seen as the "provision of know-how") have been criticised for being ineffective and costly, for being donor-driven and for suffering from an "accountability vacuum". These criticisms are even more severe in the area of capacity development where donor-driven TA has given especially poor results. Linked to the new consensus around the promising practices in the area of capacity development, the way TA is delivered should ensure that TA responds to a clear demand, and that TA is managed by and reports to the national partners whose capacity the TA will assist developing. How to integrate the new consensus about TA when designing SPSPs is discussed in section 4.3.4 (see Box 4.3).

3.5.3 EC Perspective

The EC is placing capacity development at the centre of its thinking about aid delivery, including its approach to sector programmes (as illustrated in Box 2.3). This begins with the revised approach to capacity assessment which is set out in section 5.4.

The EU has taken in April 2006 the additional commitment to provide "all capacity building assistance through coordinated programmes with an increasing use of multi-donor arrangements" and is working on an overall policy on technical cooperation in line with aid effectiveness principles (section 2.3.3).

3.6 Roles of Different Stakeholders

3.6.1 Basics

As stated in the DAC Guidelines, sector programmes require inclusive consultation mechanisms, extending to civil society and service users. It may take time to extend participation in the governance mechanisms of sector programmes, but a key point – stressed by the Commission and other agencies – is that the concerns of the recipients of government services, and those of the alternative providers of services (profit and non-profit making), should be understood and factored into the design of sector policy and strategy, and into mechanisms for performance and policy review.

3.6.2 Good practices

There are no simple formulas for consultative processes and management arrangements, because these need to be adapted to different country contexts, and the different characteristics of different sectors (see section 3.2). Consultation should not be limited to the design stage of sector programmes: wide stakeholder involvement is also important during implementation, monitoring and review. It is important to recognise the different roles that different stakeholders may play, and that these roles will vary according to the characteristics of the sector. A recent review of the roles of non-state actors has noted:

> *"The choice of partnership and delivery models depends to ta large extent o the nature of the activities being pursued. Not all activities are best pursued in a centralised. joined-up fashion. The complexity of development and the ambitiousness of development goals require some division of labour among different actors, depending on whether the activities are programmable and amenable to centralised planning, or are better implemented in ways that are decentralised, participatory and iterative and thus might include a greater role for decentralised level of government and non-state actors".*[15]

15 *Réal Laverne and Jacqueline Wood, Aid Effectiveness and Non-State Partnerships: Analytical Considerations, Working Paper, December 6, 2006.*

Box 3.7 highlights the OECD DAC good practice on this topic.

Box 3.7: Good Practices in Stakeholders Involvement

Inclusive consultation mechanisms and involving all stakeholders

SWAps have at times been criticised for being too focused on government's role as a service provider and on the relationship between the central government and external donors, while taking insufficient account of the interests of other stakeholders. Other national stakeholders are important for a number of reasons:

- Most obviously, the interests of the clients for services should be central, as part of the general accountability relationship of government to its constituency.
- It is also important to take account of, and consult with, non-governmental service providers in the sector. These may include NGOs, community-based organisations and the private sector.
- Adequate involvement of local government stakeholders is also important.

In a number of countries with relatively successful SWAps (often in the health and education sectors), civil society organisations have been active partners in every stage of the sector development for many years. Often such organisations (e.g. mission hospitals and schools) have been financially supported by governments and donors for decades and are naturally part and parcel of the SWAp, active members of the steering committees, and involved in planning, implementation and M&E at various levels. Whether or not non-government service provision is already a major factor, the sector strategy should review the scope for contracting activities out to the most cost-effective partners, while maintaining adequate quality assurance, co-ordination, oversight, and policy development.

Inclusive consultation should be a consideration at all stages of the SDP cycle: not only during its initial planning and policy stage, but also as part of subsequent monitoring, evaluation, and accountability.

Even when seeking to involve other stakeholders, consultation may be thought of too narrowly in terms of participation in various formal sector/partnership bodies, e.g. annual reviews or technical committees. Such participatory mechanisms play an important role, but they can be onerous for the participants, and are not always the most effective way of engaging clients and other stakeholders, or of representing their interests. Complementary approaches may include using client surveys, tracking studies, focus groups and evidence from independent research.

Civil society groups, research institutions, NGOs and the private sector may be involved in the provision of independent policy advice, supervisory monitoring or independent watchdog roles, as well as in national and local policy forums. Furthermore, there may be ways to encourage a higher level of participation locally, through such mechanisms as parent-teacher associations in the education sector, or consultations with community organisations. The key point is that the concerns of the recipients of government services and other alternative providers of services should be understood and factored into the design of sector policy and strategy (and hence also into performance monitoring). Careful attention to gender issues is essential if these systems are to work well.

An inclusive approach to consultation and the involvement of a wide range of national stakeholders has significant implications – both in promoting increased accountability to the ultimate beneficiaries of sector programmes and for the development of national, not just government, capacities. This will be facilitated by general transparency in the operation of the SWAp. Systematic follow-up is important in order to maintain the credibility of the consultation process.

Source: DAC Guideline on SWAp.

3.6.3 EC perspective

The EC recognises the importance of broad stakeholder involvement in development processes. This needs to be approached realistically, recognising the different roles and capacities of different stakeholders. EC support to civil society organisations may be a valuable complement to its SPSPs.

Three points deserve emphasis:

- First, it will be key to adapt the approach to the country and sector. Traditionally the sector approach has been developed in public sector contexts with significant aid financing. A new generation of sector approaches in emerging sectors and non-aid-dependent contexts requires a flexible approach, defined on a case-by-case basis.
- Second, decisions on public service provision and regulation need to be informed by the concerns and demands of users and by an understanding of the services being provided by the non-government sector.[16] The sector programme therefore needs to include appropriate consultation and decision-making structures.
- Third, it is key to consider the appropriate roles for different stakeholders within the sector programme. And linked to that, to consider which are likely to be the most appropriate mechanisms or consultation forums for exercising these different roles.

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16 *For example, where private-sector training institutions supply a high proportion of the teachers in the public sector (as in many parts of South Asia), this must be recognised in planning teacher training. Where the private sector has a well-developed capacity for agricultural research (as in most MEDA countries, Latin America and parts of Asia), then it may be advisable to contract out research rather than building public sector capacity. Where 30-50% of health care services are provided by NGOs or the private sector (as is the case in most partner countries), these must have some influence on public sector policy.*

CHAPTER 4
ABOUT SECTOR POLICY SUPPORT PROGRAMMES

THIS CHAPTER DESCRIBES:

- How support can be provided to a sector approach in its initial stages
- What a sector policy support programme (SPSP) is
- The key steps in the design of the SPSP
- SPSP objectives, outputs and inputs
- The three financing modalities available for the Commission to implement an SPSP. It focuses on SBS, detailing its eligibility criteria, discussing key design issues. It provides guidance in working with pool funding and EC procedures

This chapter focuses on key characteristics, design and management of a sector policy support programme (SPSP), the EC instrument for providing financial support to a sector programme. The SPSP supports the objectives and action plan of the sector programme and utilises its planning, monitoring and overall management and coordination structures. As such, it depends for its design on the specific features of the sector programme it aims to support.

The Commission also places importance on supporting governments in the initial stages of development of a sector programme. The intention is to support the process of dialogue and policy development which characterises a sector approach to actually produce a sector programme so that concrete policy actions and service delivery activities can be undertaken. We consider first how this support should be provided before examining the detailed requirements for an SPSP.

4.1 Providing Support before a Viable Sector Programme is in Place

There will often be situations when the circumstances will not be right for an SPSP. However, this does not mean that the Commission will revert to “business as usual”, based upon the traditional project approach. The Community and Council have made a policy decision to move towards the use of budget support and sector approaches whenever possible. There has also been a commitment to maximise ownership in all programme delivery. Therefore, in the absence of a sector programme, the Commission will provide support to the sector approach during the initial stages of development of a sector programme. More specifically, support will be provided in three ways:

- By restructuring ongoing EC projects and adopting a revised approach to new projects so as to make them more consistent with government policies and systems.
- By engaging in dialogue with government and non-government agents, as well as with other donors, with a view to promoting the adoption of the sector approach.
- By responding to government requests for assistance in establishing the three building blocks of a sector programme (the sector policy, budget and coordination framework).

4.1.1 Re-thinking projects

The shift to sector programmes and to budget support can only occur where the conditions are right. There may often be situations where the conditions are not right and yet where there is a development imperative to support poverty reduction through projects.

In these situations, the Commission will be mindful of the broader objectives of the sector approach and will aim to achieve these in the process of designing and implementing a project intervention. This would require:

- ➔ Ensuring that the project is consistent with sector policy objectives.
- ➔ Relying as far as possible on the use of government/ national structures for implementation of the project.
- ➔ Taking account of other expenditures within the sector by government and other donors, so as to maximise complementarities wherever possible and minimise future recurrent cost implications.
- ➔ Providing full information to government on project budgets and expenditures, ideally in line with the same format and timetable utilised for reporting on government expenditures.
- ➔ Minimising transaction costs wherever possible, through coordination with government and donors and, if appropriate, through co-financing of projects.
- ➔ Engaging in capacity development in a coherent and coordinated manner.

In many cases, the Commission's support to sector programme development begins from a situation of project support to the sector. Over time, project design and management systems for ongoing projects are adjusted in line with the above principles. Simultaneously, the Commission engages in the coordination and policy review processes which form the genesis of the sector approach. Once this has developed successfully into a sector programme, then the Commission may alter its mode of support to provide financing to the sector programme through an SPSP.

4.1.2 Promoting sector programmes

It is the explicit policy of the Commission to support governments in moving towards sector programmes. Hence, it is expected that Delegation and Headquarters staff should actively engage in the policy dialogue leading to the development of a sector programme. This dialogue would focus at first upon the sector policy, the budget and sector medium-term expenditure perspective and the donor coordination mechanisms, which are the three basic components of a sector programme. Such dialogue would normally be initiated alongside ongoing projects financed by the Commission. Therefore, the decision to initiate an SPSP may follow upon a period of project involvement in the sector and probably many months of participation in the sector approach. When the decision to initiate an SPSP follows upon a period of project involvement in the sector, the Commission can integrate lessons learned and its knowledge of the sector into the dialogue and eventually in the design of the future SPSP.

During this preparatory period, there are a number of ways in which the Commission might be able to provide support. The intensity of involvement will depend upon the extent of progress in working with a sector approach. In particular, there should be a clearly expressed interest in the development of a sector programme and an increasingly stronger leadership over the process by Government.

Three broad types of support might be envisaged:

- ➔ Direct engagement by the Commission in an advocacy function with other donors and with Government to explain the benefits of the sector approach and to provide advice on "how to get started".
- ➔ Internal analysis by the Delegation of working documents produced by Government and other partners, providing comments and specialist inputs into policy dialogue with Government.
- ➔ The engagement of technical assistance in response to requests by Government to provide advisory and training services so as to assist in the development of the different elements of the sector programme.

These efforts will always be demanding of staff time – in particular at Delegation level. There is therefore a need to ensure that provision is made in recruitment and staff utilisation plans to have available appropriate expertise in sector approaches.

4.2 What is an SPSP?

Once a Government has started the development of its sector programme, an SPSP is the contribution that the Commission makes to the implementation of that Programme. Of necessity, it must have approval processes which are specific to the Commission. However, it differs substantially from a classic EC project. It is part of a sector programme designed by Government and following procedures and management systems specific to that sector programme. Ideally, these procedures would be the normal systems and procedures of the government in question, although in some cases, such as with the use of pool funding, they might be unique to the sector programme itself. Whatever the degree of alignment to national processes, the planning and monitoring procedures will not be those of the "project entity" but those of the sector programme.

The main characteristics of an SPSP are as follows:

- ➔ An SPSP contributes to the funding of the sector programme, and consequently shares its objectives. Regardless of the financing modality chosen, no activities outside of the sector programme may be financed through an SPSP.
- ➔ The financial contribution made through an SPSP should be included within the envelope of available financing with a medium-term perspective for the sector.
- ➔ The monitoring system for the SPSP should be the same as that for the sector programme as a whole.
- ➔ An SPSP should add value to a sector programme by supporting its objective and its reform-agenda. As such it should be a flexible instrument which can accompany processes.

An SPSP can be financed using three types of financing modalities:

- ➔ **Budget support,** using the systems and procedures of the partner country – in this case it is known as sector budget support (SBS).
- ➔ **A pool fund**, or basket fund, using ad hoc procedures agreed by government and donors to finance all, or part, of the sector programme.
- ➔ **EC project procedures (procurement and grant award procedures)** relevant to the region to finance particular activities defined in the sector programme.

It is also possible to provide financing through some combination of these modalities. Indeed, in certain circumstances, the option of mixed financing may be the most appropriate and flexible. However, wherever the circumstances are right and eligibility criteria are satisfied, the use of untargeted sector budget support is the favoured financing modality of the Commission. More details on the respective merits of these modalities are highlighted in sections 4.4, 4.5 and 4.6.

The SPSP has a determined set of implementation modalities; these spell out the way in which the Commission will:

- ➔ **Participate in the sector programme's management system:** the process of sector coordination, policy dialogue, planning, budgeting and performance review.
- ➔ **Provide funding:** the channelling of funds, including conditions and modalities for funds disbursement, where relevant procedures for procurement as well as organisation of financial audits;
- ➔ **Mobilise support for capacity development** including technical assistance.

Supporting a sector programme implies much more than simply providing funding. It requires a consistent and informed engagement with processes within the sector. For these reasons, the commitment to support a sector programme through an SPSP is not a commitment which can be entered into lightly.

4.3 Designing an SPSP

This section presents the conceptual elements in the design of SPSPs, while annex 1 details the design process through the different phases of the Commission's cycle of operations.

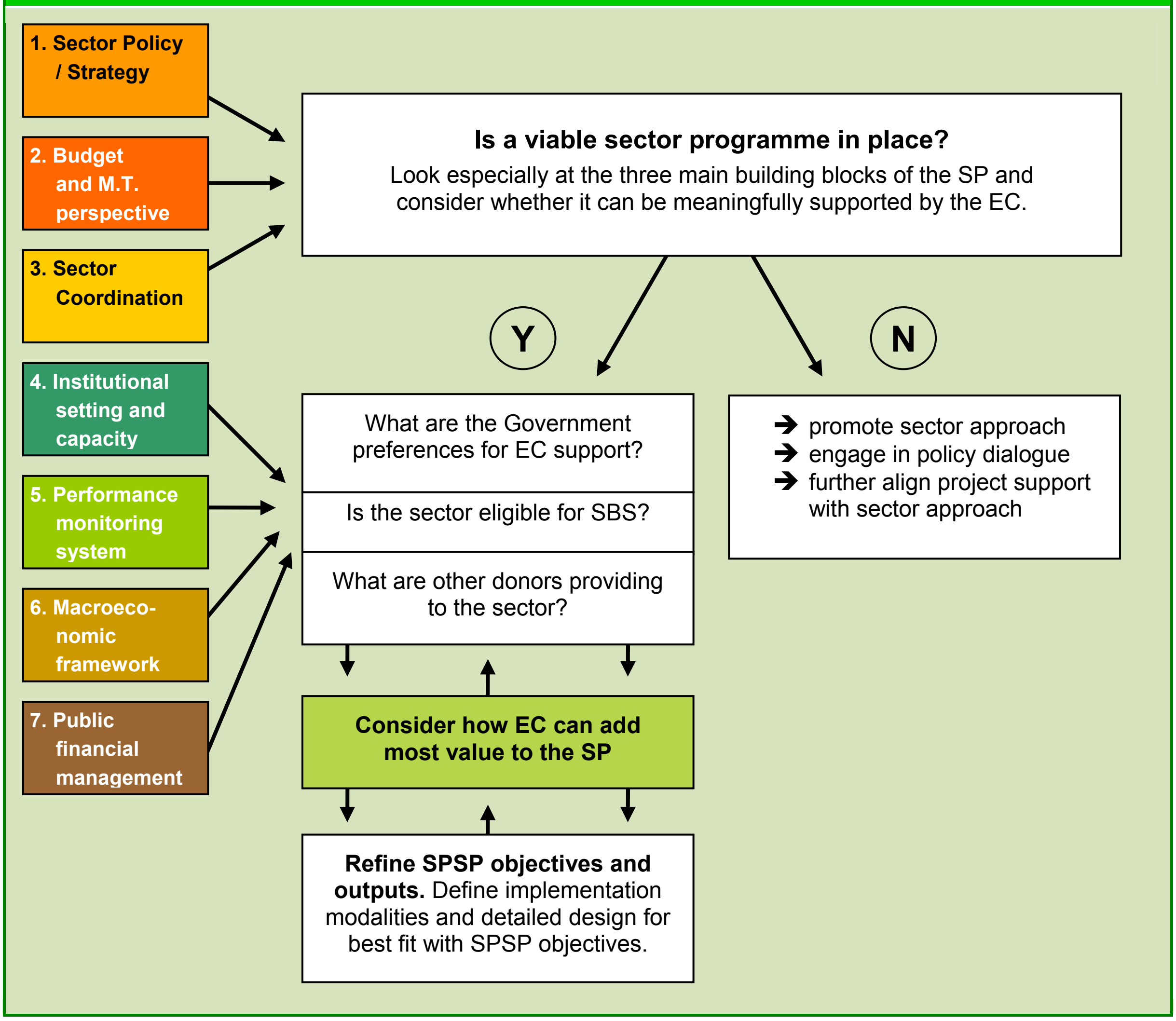
4.3.1 Overview

The design of an SPSP, its objectives and implementation modalities, takes into account and depends on the stage of development of the sector programme as assessed through its key elements. All of the Key Assessment Areas (cf. Box 2.3 in Chapter 2) are relevant. It also takes into account the support that other donors are providing to the sector programme, and reflects the Government's preferences concerning the focus and the implementation modalities of EC support.

The Country Strategy Paper provides a framework for decisions about which sectors to support and how. In some cases the EC's first support to a sector takes place when sector programme has already been developed. More often, if the EC has been supporting the sector for some time, the move to an SPSP will come at a natural point, to replace a phase of project support that is being completed.

Designing an SPSP is a process as illustrated in Box 4.1. The assessment of the three building blocks of the sector programme (sector policy, sector budget, sector coordination and management) will determine whether there is already a viable sector programme in place. If there is not (yet) a viable sector programme, the EC would engage in policy dialogue, promote the development of a sector approach, and seek to align EC project support with the developing sector approach (as discussed in section 4.1). If it is judged to be a viable sector programme, the design of the SPSP proceeds.

Box 4.1: The Process of Designing an SPSP



If an SPSP is judged appropriate, it should be designed in a way that adds most value to the sector programme as a whole, taking account of the contributions from other donors as well as the governments own inputs. The EC always aims to maximise the overall effectiveness of aid. This requires good awareness of what other donors are doing, and planning to do, and consultation with the government about the best ways in which the EC can assist. A very important consideration is whether the EC is able to use SBS (are the eligibility criteria met?). Often the EC's ability to provide SBS will be a source of comparative advantage, enabling the EC to complement, and mitigate any disadvantages of, project support to the sector from other donors. Detailed design of the SPSP is then an iterative process throughout the identification and formulation phase: the implementation modalities and other details of the SPSP design are chosen to fit with the specific SPSP objectives so as to maximise the SPSP's contribution to the sector programme as a whole.

4.3.2 Defining SPSP's objectives, outputs and inputs

SPSP objectives

As said before the overarching goal of EC support to a sector programme is to achieve sector goals, in terms of improved access to and quality of sector services, and better living conditions for the target population. This means that the goals of the SPSP are those of the sector programme itself.

In particular, the SPSP objectives focus on enhancing sector programme’s outcomes, in particular better use of service delivered. In order to achieve its outcomes, a sector programme must deliver several outputs, such as a comprehensive reform of the sector, a better link between policies and public expenditure, and more effective planning, implementation, monitoring and evaluation systems.

Although all these areas matter and may be supported as part of the sector programme, the SPSP objectives will be defined in dialogue with the partner government with a view to best contribute to the achievement of the sector outcomes.

It's important to base the identification of SPSP objectives on a careful analysis of the sector programme: the initial assessment of the three building blocks to establish whether a viable sector programme is in place, supplemented by the analysis of the other assessment areas, will provide a comprehensive picture and is likely to point to strengths and opportunities, possible threats to achieve its goals but also weaknesses to be addressed. EC support should add value to the sector programme on this basis.

The financing modality is critical in determining the ambition of the SPSP. The scope and depth of policy dialogue depends on the degree of alignment with national financial management procedures of EC support. Indeed, when financing a sector programme through SBS, external resources are transferred to the national treasury to support the implementation of the sector programme. The issues of overall sector policy implementation, budget preparation and execution and development of the financial and administrative management systems can therefore very legitimately be brought into the sector dialogue. This is much less the case when the sector programme is supported through project financing.

As already mentioned, SPSP's objectives should be defined considering where EC support can add the most value and contribute most to the sector programme outputs. Depending on the status of the sector programme and the overall context, value can be added in different ways: by promoting and supporting policy and institutional reforms; accelerating the implementation of policy and institutional measures key for the sector policy; reinforcing monitoring of sector outputs/outcomes; strengthening sector coordination mechanisms. EC support can also help improve domestic accountability and external scrutiny of sector performance. Furthermore, especially if sector budget support is used as the financing modality, EC support can add value in supporting allocative efficiency in the use of sector resources (appropriate balance between different components of sector expenditure), in strengthening sector public financial management and the efficiency with which inputs are translated into outputs and outcomes.

Defining SPSP objectives should also take into consideration sector characteristics, in particular when working in multi-institutions areas such as Rural Development and in the Water sector.

SPSP outputs and their link with the objectives

To achieve its objectives, an SPSP is expected to deliver a number of outputs, that reflect the priorities identified. Possible outputs may be classified as follows:

➔ **Improved sector partnership**

- strengthening the process of dialogue and review itself, in relation to its focus and procedures, participants involved, its use of evidence in further developing the programme, etc…
- focusing the dialogue on key results of the sector programme (reflected in sector targets and performance indicators); this will influence the design of conditions and performance indicators for the SPSP itself – see section 4.4 and section 5.5.

➔ **Improved delivery of funds:**

- improving the quality of financing for the sector, e.g. by:
  - improving predictability of funding for budget holders in the sector
  - bringing more funds on budget, and increasing government discretion over finance,

➔ **Coordinated support for capacity development in place**

as mentioned in chapter 3, capacity development is not "bolted on" to the sector programme – it should be an integral consideration in the whole sector programme design, through use and strengthening of government systems etc; support should also benefit non state actors and key national stakeholders at centralised and decentralised level in order to promote broad and effective ownership of the sector programme and domestic accountability.

➔ **Strengthened harmonisation and alignment:**

- reducing transaction costs for the government
- increasing aid effectiveness.

SPSP inputs

The SPSP may contain different categories of inputs, of a financial and non-financial nature, and the same input may have more than one effect (e.g. supporting capacity development at the same time as channelling more funds through government systems). However, it is important not to overload the SPSP with unrealistic expectations and to think carefully about what effects can be reasonably expected, what they will depend on, and how the SPSP can be monitored to see if the anticipated effects do happen.

EC support is a part of the whole sector programme (government resources plus the inputs of all donors). An SPSP does not need to include within itself all the different inputs and elements that are needed for the implementation of the sector programme. Other inputs may be best taken care of by the government itself or as part of the support programmes of other donors. But in designing, and explaining the rationale for an SPSP, it will be important to think through what key complementary inputs are necessary for the successful implementation of the sector programme and to explain (a) why the EC is best placed to provide certain inputs included in the SPSP, and (b) which complementary inputs that are part of the sector programme but not included in the SPSP, will be important in maximising the SPSPs effectiveness.

SPSP designers need also to think about how different types of improvements/progress will be monitored (relevant indicators? is the baseline known? is there a process in place to accomplish the monitoring and to act upon its findings?). Also, what are the specific risks to the SPSP and how will they be mitigated (again the seven key assessment areas are all relevant)?

It's also key to look systematically for the "best fit" between SPSP objectives and inputs (i.e. the ways EC expects to add value to the sector programme) and its implementation modalities (as discussed in 4.3.4 below).

Box 4.2 shows how SPSPs inputs and outputs feed a "simplified intervention logic" for a sector programme contributing to the achievement of its results. See as well the "Indicator Framework" presented in chapter 5.5.2.

SPSP designers need also to think about how different types of improvement will be monitored (relevant indicators? is the baseline known? is there a process in place to accomplish the monitoring and to act upon its findings?). Also, what are the specific risks to the SPSP and how will they be mitigated? (Again the seven key assessment areas are all relevant.)

It's also key to look systematically for the "best fit" between SPSP objectives and inputs (i.e. the ways EC expects to add value to the sector programme) and its implementation modalities (as discussed in 4.3.4).

Box 4.2: Simplified Intervention Logic of an SPSP

Goal/Impacts of the Sector Programme

Impact of sector policy and strategy contributes to national development & poverty reduction.

Outcomes/Results of the Sector Programme

Results at the level of beneficiaries: better access to and use of public services.

Outputs of the Sector Programme

Improved supply of sector goods and services, including government services effectively delivered; PFM systems and sector institutions strengthened; sector reforms implemented; better monitoring systems; domestic political accountability improved.

SPSP Outputs

Improved Partnership

Improved delivery of funds

Coordinated support to Capacity Development

Harmonisation and alignment

SPSP Inputs

Financial resources and expertise

- Funds for projects, pool funding or budget support
- Policy Dialogue
- Support to Capacity Development and TA in a co-ordinated framework
- Support for specific studies, advisory services

Inputs from Partner Country

Financial resources and expertise

- Government 'own' resources for the sector
- Measures/actions/policy in the sector

4.3.3 Deciding on financing and implementation modalities

As discussed before (section 4.3.3), the level of ambition of an SPSP and its objectives depends on the chosen financing modality. When using SBS, the issues that can legitimately be brought to the table for discussion cover a wider spectrum. This is less the case when using project modality.

SBS is the preferred financing modality as indicated in the European Consensus on Development.

Whether the use of SBS is possible, depends on the outcome of the assessment of three eligibility criteria: a well defined sector sectoral policy, a credible and relevant programme to improve public financial management and a stability-oriented macroeconomic policy in place or under implementation. SBS and its eligibility criteria are further detailed in section 4.4. If SBS is not possible the two other options, pool funding or EC procurement and grant award procedures will need to be explored. Sections 4.4 and 4.6 present these options and their respective merits in further detail.

The precise way in which the Commission, using the chosen financing modality, will provide its funds in support of a given sector programme is spelled out in the implementation modalities.

The successful contribution of an SPSP to a sector programme is strongly dependent on these. They determine the way in which the Commission will intervene in practice and form the backbone of the contractual engagement with partner government and possibly other partners.

The implementation modalities should in particular clarify which management structures of the sector programme the Commission will participate in, how its financial support to the sector programme is organised (reflecting the chosen financing modality) and how it will mobilise complementary support for capacity development.

1. Participation in the sector programme management system including donor coordination mechanisms

The aim of these structures (see Box 4.3) is to ensure (i) a continuous sector dialogue; (ii) a harmonised system for sector performance monitoring; (iii) a clear division of responsibilities amongst donors.

2. Organisation of EC financial support to the sector programme

The following should be made explicit: (i) the overall duration of implementation; (ii) the way funds are channelled: the overall volume as well as the proposed schedule, modalities and conditions for disbursement; (iii) the conditions and modalities for procurement, (iv) the timing and modality for financial audit. These elements are determined in function of the chosen financing modality as well as the legal bases and are further detailed in section 4.4, 4.5 and 4.6 below. The way the financial support to government is structured, notably in the case of SBS or pool funding, is key. Amounts and timing of tranche releases influence the allocative efficiency of sector resources as well as their predictability.

3. Mobilisation of support to Capacity Development

The Paris Declaration asks for a coordinated approach to capacity development, aligned around a government led capacity development plan. Although capacity development is not synonymous with technical assistance and training (see the discussion of institutional analysis and capacity development in section 5.4), the organisation and the coordination of the provision of TA in a capacity development effort should be made explicit. A basic principle is that TA should be implemented only where there is a clear demand and political

Box 4.3: Management and Coordination Arrangements

While organisational structures of the sector programme and the donor coordination mechanisms are country-, context- and sector-specific, the following mechanisms are often used:

- Establishing a sector working group, chaired by the line ministry and including important other national stakeholders as well as all donors to the sector supports continuous and coordinated sector dialogue. It is important that real policy debate takes place in this type of forum and not just exchange of information. Often therefore more technical sub-groups will need to be formed.
- Agreeing on joint annual reviews will help harmonise sector performance monitoring, so does the agreement on a common monitoring framework. It is important though that the policy dialogue as such is not restricted to the time of the review only.
- Silent partnerships, the agreement that one donor will represent the interests of another donor in sector dialogue, are a useful way to capitalise on the available expertise of one donor while decreasing the number of interlocutors for government.
- Memoranda of Understandings or Joint Collaboration Arrangements are often useful to make explicit roles and responsibilities between different partners and clarify the decision-making process.

ownership for it. It should be seen as an input to achieve CD outputs, focusing on the reinforcement of national capacities and skill transfers.

Box 4.4 highlights a few good practices in mobilising technical assistance, helping avoid tensions or inefficiencies in the implementation of a sector programme.

Box 4.4: Good Practices in the Provision of TA

Some good practices in the provision of TA in sector programmes include the following:

- A rigorous and joint design phase of the TA is key and should be conducted under government leadership.
- Terms of References for TA should be drafted by the partner authorities and explicitly endorsed by the national manager to whom the TA will report. TA should report in the first instance to government managers.
- The possibility of "pooling" TA should be explored so that technical resources are made available through a unified set of procedures, under joint management arrangements in which government takes the lead.
- A performance assessment system should be developed, so as to regularly assess achievement of outputs, the effectiveness and efficiency of relations, etc. In monitoring, donors should largely confine themselves to verifying through the national partner that this system is in active use.
- Exit strategies for when and how TA will no longer be required should be considered ex ante. Local and regional consultancy expertise should be utilised wherever possible and explicit efforts should be made to develop local consulting capabilities.

4.4 Sector Budget Support: the Preferred Modality

Sector Budget Support is the transfer of financial resources from an external financing agency to the National Treasury of a partner country in support of a sector programme, following the respect by the latter of agreed conditions for payment. The financial resources thus received are part of the global resources of the partner country, and are consequently used in accordance with the public financial management system of the partner country. The transfer of resources will take place in the context of dialogue, harmonisation, alignment, and capacity development.

The EC favours the use of SBS when conditions are right. In recent years the European Commission and other donors have pointed to a series of potential benefits of using budget support as a financing modality. A summary of these potential benefits are presented in Box 4.5 (see the Guide on GBS for further details). Supporting a sector programme, or the implementation of a sector policy, is a process that involves promoting coherence between policy, budgeting, institutional reforms and sector results. SBS is an appropriate tool to support these processes, which are complex and tend to evolve in the long term.

This preference for the use of budget support is reflected in The European Consensus (Art 26) which states that "Where circumstances permit, the use of general or sectoral budget support should increase as a mean to strengthen owner-

Box 4.5: What are the Potential Benefits of Budget Support?

Budget support used in the context of sector programmes has a number of potential benefits including:

- **Strengthened ownership**, as it supports the implementation of the partner government sector programme
- **Better framework for public policy and public expenditure**, by integrating donor support into the budget of a country
- **Increased coherence**, by bringing "on-budget" what was often "off-budget" it increases the potential for achieving a more coherent mix between sectors, between different types of expenditure (capital/recurrent, wage/non-wage)
- **Lower transaction costs**, by using national systems, the transaction costs of delivering aid as budget support are potentially lower than other forms of aid.
- **Greater harmonisation of donor practices and alignment** around national systems.
- **Strengthening domestic accountability** – donor funds are integrated in the national budget and therefore subject to the same scrutiny as domestic resources.
- **Improved efficiency and sustainability** - by using national systems donors contribute to improving them and the possibility of lasting effects is greater.

ship, support partner's national accountability and procedures…" and also that (Art 113) "Where conditions allow, the preferred modality for support to economic and fiscal reforms and implementation of PRS will be budget support for specific sectors or for the general public spending programme."

However, SBS is not always the most appropriate modality. When the objective of a development initiative is not to support a sector programme but is more focused, as can be the case of support to discrete activities, stand alone investments or ad hoc technical support, project modalities or pooled funding can be more appropriate. In these cases the costs in terms of foregone use of country systems and foregone support to the entire sector, may be compensated by benefits in terms of faster delivery, lower unit costs or easier procurement of international resources. A case by case assessment of costs and benefits is relevant.

Realising the potential benefits of budget support requires minimising its risks. The risks attached to any aid modality can be defined as "anything that may stand in the way of achieving its objectives" [17]. Budget support is not a priori associated to greater or smaller risk than other aid instruments. Rather budget support has a different risk profile than other modalities, as risk depends on stated objectives, aims and ambitions. The Commission manages the risks associate with budget support by having conditions associated with the preparation and implementation of its programmes. "Eligibility criteria" specified in legal provisions are key to dealing with these risks and ensuring that they are properly managed at all stages of the cycle of operations.

4.4.1 Eligibility criteria: legal bases, rationale and interpretation

Box 4.6: The Legal Bases of Eligibility Criteria for Sector Budget Support

Cotonou Agreement states that direct budgetary assistance in support of macroeconomic or sectoral reforms shall be granted where: (i) public expenditure management is sufficiently transparent, accountable and effective; (ii) well defined macroeconomic or sectoral policies established by the country itself and agreed to by its main donors are in place; and (iii) public procurement is open and transparent (Art 61/2)

Regulation of the European Parliament and the Council establishing a financing instrument for development cooperation (DCI) (Art 25 (1) b) and European Neighbourhood and Partnership Instrument (ENPI) (Art 15 (2)(e)) states that Community financing will take the form of budget support "if the partner country's management of public spending is sufficiently transparent, reliable and effective, and where it has put in place well defined sectoral or macroeconomic policies positively assessed by its principal donors; including, where relevant, the international financial institutions". Art 25 (1) b of DCI adds "Disbursements of budgetary support shall be conditional on satisfactory progress towards achieving the objectives in terms of impact and results".

The EC interprets the three eligibility criteria as follows:

i. **A well defined sectoral policy is in place or under implementation.**

Rationale – The main purpose of any SBS is to support a sector programme which stems from a sector policy. The eligibility criterion requires that this sector policy is assessed and that the result of the assessment is positive: principal donors have to share the objectives and approaches of a sector policy in order to engage as reliable partners for its implementation.

Interpretation – The assessment of this eligibility criterion relies on the elements set out in section 5.1 focusing on: features of a good policy document; policy processes; quality and consistency of sector policy with development objectives including the role of the government; coherence with the budget.

For the use of budget support the assessment of this area should conclude with a statement on whether this eligibility criterion has or has not been met.

ii. **A credible and relevant programme to improve public financial management is in place or under implementation.**

Rationale – Resources transferred with SBS become part of the global resources of the partner country and are managed according to the partner country's own public financial management system. Public financial management is concerned with the planning, spending, reporting and auditing of public money as

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17 *On main risks related to Budget Support see Guidelines on the Programming, Design and Management of General Budget Support (ch2.7, page 21) and the Commission Working Paper: Outline of Risks linked to External Aid, 12 March 2004, SEC(2004)318*

well as assessing the extent to which plans are implemented and whether a budget is comprehensive and transparently prepared and executed. As a result the country's public financial management system is a key factor in determining the efficiency and effectiveness with which budget resources contribute to achieving the objectives of the sector policy.

Interpretation – The assessment of this eligibility criterion relies on the elements set out in section 5.7 focusing on: an assessment of the quality of the Public Financial Management system; an assessment of the PFM reform process.

An assessment of the quality of the PFM system, is carried out using as the EC's favoured tool of choice the "Public Financial Management – Performance Measurement Framework" (PFM-PMF) of the PEFA (Public Expenditure and Financial Accountability) initiative.

For the assessment of the PFM reform process, the EC will pay particular attention to the national authorities political will to improve PFM performance relevance of reforms in correcting identified weaknesses; the relevance and implementation of a reform strategy; and the relevance and implementation of capacity development programmes in this area.

An assessment of the quality of overall PFM systems and an assessment of the PFM reform process is sufficient to establish eligibility. However certain sectors may follow specific public financial management rules that depart from overall public financial management systems: this is the case, for example, of Road Funds, public agencies, parastatals or local governments (see also section 5.7). When specific systems and mechanisms are in place at the sector level, assessments of sector public financial management are then necessary in addition to the assessment of overall PFM systems in order to establish eligibility.

Apart from these special cases, any sector PFM assessment should not be used to establish eligibility for the use of budget support, but rather be used to identify weaknesses, inform support to be provided and where appropriate used to help establish disbursement conditions associated with the programme.

For the use of budget support the assessment of this area should conclude with a statement on whether this eligibility criterion has or has not been met.

iii. **A stability-oriented macroeconomic policy is in place or under implementation.**

Rationale – Although stability oriented macro-economic reform is not an objective of SBS, short and medium term macro stability is necessary for the successful execution of sector budgets and to ensure predictable and sustained sector funding.

Interpretation – The assessment of this eligibility criterion relies on the elements set out in section 5.6 focusing on a summary of the main past and expected trends in macroeconomic variables; a description of the relationship between the partner country and the IMF; and any special topic of macroeconomic interest.

- ➔ A summary of the main past and expected trends in macroeconomic variables. The partner country's track record on macroeconomic management, as well as the prospects for a good track record being maintained or a poor track record being improved should be mentioned. In examining these issues, in all but exceptional cases, it is not expected that a separate macroeconomic analysis be carried out, but that a judgement be made on the basis of existing documentation, using as starting point information from the IMF.
- ➔ Description of the relationship between the partner country and the IMF. In looking at the macroeconomic eligibility criteria above, one of the key issues will be the relationship between the partner country and the IMF.[18]
- ➔ Are there any special topics of macroeconomic interest that might need to be addressed? Depending on the country context, there may be particular areas that deserve special attention.

For the use of budget support the assessment of this area should conclude with a statement on whether this eligibility criterion has or has not been met.

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18 A country has a programme with the IMF when it has an agreement between the IMF on a set of macroeconomic and structural policies whose implementation may either be financially supported by the IMF (such as a PRGF or stand-by agreement); or a non-financial programme with the IMF (SMP, PSI); or a country's policies may not be agreed together with the IMF, but may simply assessed by the IMF under an Article IV cycle of consultations.

4.4.2 How to apply the eligibility criteria

The EC gives a **dynamic and rigorous interpretation** of eligibility criteria. Whenever looking at the eligibility criteria, it is always important to take into account the direction of change. In the use of budget support there are no absolute “thresholds” in the sense that certain static minimum conditions in the area of national policy and strategy, macroeconomic policy, and public financial management have to be met. Instead, the key factor in deciding whether eligibility criteria are met is the direction and magnitude of change against the background of the initial quality of the national development or reform policy and strategy, the macroeconomic framework, and public financial management. It is this dynamic interpretation of the eligibility criteria, the case-by-case approach to which it leads, and the rigour of the diagnostic assessments used, that helps ensure that budget support can contribute to wider development objectives.

Furthermore, the three eligibility criteria should be seen as part of a coherent and interdependent whole. It would be inappropriate to judge non-performance in one area as being offset by good performance in another area. Instead, performance in all areas is seen as key to ensuring eligibility for budget support.

During implementation it should be recalled that Delegations using budget support are to produce an Annual Report on Public Financial Management that should be valid at the time disbursement takes place. In those countries that have GBS this report should already be prepared, and it would be sufficient to add to this report and any "sector specific PFM" issues that should be mentioned. In those countries without GBS the obligation to produce an Annual Report on Public Financial Management still remains in force (for further information the content and timing of this report see section 7 of the Guidelines on General Budget Support).

4.4.3 Eligibility criteria in the programme cycle

Because of their crucial role, eligibility criteria matter at all stages of the cycle of operations, from programming through to implementation.

Programming

For sectors already identified in the country strategy, during programming a decision will be made to indicate if a sector programme is likely to receive budget support based on the expected **benefits** of using SBS, prospective eligibility, and the **risk** of difficulty during implementation.

As a result of this assessment countries are likely to be divided into:

- **Strong candidates**: these are countries that have a robust sector programme and have received and successfully managed SBS or GBS under the previous programming cycle and whose prospects to remain eligible are good. The risk of non-utilisation of budget support is very limited.
- **Potential candidates:** these are countries that would benefit from applying SBS to a sector programme, but for which there is some risk of non-utilisation of budget support. These would typically be countries whose prospects to become or remain eligible are fair but somewhat uncertain, such as for instance countries that have received GBS or SBS in the past but encountered some difficulties in implementation or countries that have not yet received GBS or SBS and whose eligibility needs to be assessed. The country strategy in these cases could indicate that SBS would be the preferred financing modality but also identify the steps that would need to be taken in order to ensure eligibility in the future (for example, improvements in particular aspects of the country’s sector programme).
- **Weak candidates**: these are countries that have received GBS and/or SBS but suffered from suspensions of disbursement or countries that have not yet received GBS and/or SBS and whose prospects to become eligible in the period covered by the programming document are poor. In this case referring to SBS as the preferred financing modality is highly risky; unless the expected benefits would justify such high level of risk, other financing modalities might be considered more appropriate to support the sector.

Assessing prospective eligibility to SBS at the programming stage is useful to identify possible weaknesses and pave the way towards future successful implementation of a given SBS operation by preparing and strengthening the dialogue and identifying possible support measures that can ensure future eligibility.

Identification/Formulation

For all sectors that indicate SBS as the preferred financing modality of a sector programme in the country strategy, eligibility will be re-assessed and confirmed by a more in-depth analysis during the identification and formulation phase. If a serious deterioration of country conditions undermines eligibility, other financing modalities will have to be preferred.

For each eligibility criterion the identification/formulation phase will include and clearly capture in the Identification Fiche and the Action Fiche/Financing Proposal (FP):

- the bases for the assessment of the eligibility criteria, which includes a description of the main elements taken into consideration;
- the conclusion of the assessment and a statement confirming eligibility;
- the general conditions that will be monitored to ensure that the eligibility criteria will remain satisfied during implementation and prior to each disbursement of funds.

Box 4.7: Capturing Eligibility Criteria in the General Conditions

In the Identification Fiche and Action Fiche/FP for each of the eligibility criteria it is important to be able to make a clear statement about whether the specific area examined provides a sufficient basis for providing sector budget support. In the Action Fiche/FP such statement should be completed by the general condition that will be monitored prior to each disbursement of funds. In this respect, some standard terms are suggested below.

On sectoral policy: "The analysis of the sector policy and strategy set out above and in more detail in […specify the annex…] confirms that a well defined sector policy and strategy that responds to the challenges and problems faced by the partner country is in place/under implementation. As a result this sector policy is considered an appropriate basis for the provision of EC sector budget support".

A related *general condition* could require " satisfactory progress in the implementation of the sector policy drawing on […provide details of the information to be supplied by the partner country in their tranche release request, such as Joint annual sector reviews…]

On public financial management: "The analysis of PFM set out above and in more detail in […specify annex…], shows that the partner country has established a credible and relevant programme of improvement of PFM and that the evidence from the PFM assessment and the PFM reform process shows that trends in PFM justify the allocation of budget support with respect to the legal requirements concerning the eligibility criteria for budget support [the appropriate reference to the legal basis may be included here, for example, Article Article 61(2) of the Cotonou Agreement, Article 25(1)(b) of the DCI, and Article 15(2)(e) of the ENPI)

A related *general condition* could require "satisfactory progress in the implementation of the programme to improve public financial management as evidenced inter alia by [provide details of information to be supplied by the partner country in their request for tranche release…] For example, the Joint annual government-donor review of PFM reform programmes or annual sector audits carried out by Supreme Audit Institutions could provide the basis for the assessment of this general condition.

On the macroeconomic framework: "The analysis of the macroeconomic framework [and in particular the support provided by the IMF through its […state the programme…] set out above and in more detail in […specify the annex…] shows that the macroeconomic policy is conducive to maintaining macroeconomic and is not expected to put at risk sector objectives. As a result this stability-oriented macroeconomic policy is an appropriate basis for providing sector budget support".

A related *general condition* could require "satisfactory progress in the maintenance of a stability-oriented macroeconomic policy as evidenced by […provide details of information to be supplied by the partner country in their request for tranche release…for example, "continued implementation of a macroeconomic programmes supported by the IMF"…"where the review of an IMF programmes is delayed, temporarily suspended, or lapses, the EC may sill take the decision to disburse budget support if it judges that the situation does not unduly place at risk the achievement of sector objectives". The Commission will make an informed assessment of the latter following consultation with the partner country and the IMF.

Implementation

Compliance with general conditions, which capture the eligibility criteria, is to be verified prior to each disbursement of funds during the implementation of an SPSP using SBS as the financing modality.

4.4.4 Specific issues in designing Sector Budget Support

There are several levels at which SBS can add value and contribute to achieving sector objectives. Among the most frequent are: improving allocative efficiency in the use of sector resources (appropriate balance between different components of sector expenditure); strengthening sector public financial management and the efficiency with which inputs are translated into outputs and outcomes; increasing the level of sector resources; reinforcing monitoring of sector outcomes and thereby contributing to improving domestic accountability and external scrutiny of sector performance.

During the identification/formulation, a given SPSP using SBS as the financing modality will be designed to ensure that the expected objectives will be achieved and the risks will be managed and minimised. In SBS decisions have to be made on the allocation of the total level of funding in fixed and variable tranches (including the timing of disbursements) ; the wording of the general conditions on eligibility criteria, as well as other special conditions; promoting a results/outcome oriented approach All this work needs to be carried forward in the context of sector dialogue (including the timing of assessment of performance, scope and frequency of sector reviews, structure and scale of sector dialogue) alignment and harmonisation, and possible separate allocations for capacity development. The practical issues related to general and specific conditions; fixed and variable tranches; and the results/outcome oriented approach are mentioned below.

Fixed and variable tranches

A key choice is about the allocation of funds between fixed and variable tranches :

- ➔ **Fixed tranches** have a fixed value, specified in advance within the Financing Agreement. They are either disbursed in full (if all conditions are met) or not at all (if one or more conditions are not met). In other words, partial disbursement is not possible.
- ➔ **Variable tranches** have a maximum value, specified in advance within the Financing Agreement. They are either disbursed in full or in part, with the amount being disbursed being based on performance achieved in relation to pre-specified targets or designated performance criteria and indicators (provided that at the same time the general conditions are all met).

Fixed tranches are often the most predictable components of SBS as they are typically linked only to eligibility and can be released provided general conditions are satisfied. In some cases non-eligibility conditions are attached to fixed tranches.

Variable tranches are typically linked to specific performance indicators. The benefits of using variable tranches is the possibility of partial payment for partial performance which avoids damaging “stop-go” in aid disbursement and therefore enhances the credibility of disbursement conditions. “Such a mechanism can reduce the volatility of budget support by establishing an intermediate option between withholding all funds and releasing them” (OECD-DAC Harmonising Donor Practices for Effective Aid Delivery, vol 2). Variable tranches are more apt to promote a focus on performance and results.

General and Specific Conditions

SBS disbursements are made after verification that certain conditions for payment are met. These conditions are usually classified as general or specific.

- ➔ **General conditions.** These are conditions that apply to the disbursement of all tranches. These conditions will be those related to the eligibility criteria for receiving SBS mentioned above in section 4.4.1. There may be additional general conditions, but these should be kept to a minimum, as this reduces the predictability of support and as such the general conditions should be drafted in a way that ensures verifying the conditions without introducing formalistic rigidities that may lead to unnecessary "stop and go" during programme implementation.
- ➔ **Specific conditions**. These are conditions that apply to the disbursement of individual tranches, whether fixed or variable. These conditions will normally be those related to performance criteria and indicators established in each of the areas of focus of the SBS programme In setting these performance criteria and indicators attention will normally be given to ensuring that they are “result/outcome-oriented”, particularly in the case of variable tranches.

Implementing a results/outcome oriented approach

The European Consensus mandates that "The Community will consistently use an approach based on results and performance indicators" (art. 115) while the Regulation establishing a DCI in art. 25(1)b underlines that "The Commission shall consistently use an approach based on results and performance indicators and shall clearly define and monitor its conditionality and support efforts of partner countries to develop parliamentary control and audit capacities and to increase transparency and public access to information. Disbursement of budgetary support shall be conditional on satisfactory progress towards achieving the objectives in terms of impact and results". These recent mandates confirm and reinforce the EC approach that links the disbursement of variable tranches to the achievement of targets for agreed outcome indicators

In the Commission's "Input-Output-Outcome-Impact" typology, a result corresponds to the "outcome" level where typically access to, use of, and satisfaction with public service provision is measured (see Box 4.8 and section 5.5.1).

Box 4.8: Results: What are they and why use them?

What do we mean by "Results"?

There is a potential for confusion over what is meant by a "result". In the Commission's "input-output-outcome-impact" typology, it would correspond to an "outcome", such as primary school enrolment. The amount spent on primary education would be classified as an "input"; the number of primary teachers trained would be an "output", and literacy rates would be an "impact". It is for this reason that the terms "results" and "outcomes" should be treated as synonymous. In this text you will find the reference "results/outcomes" frequently used.

However, it should be noted that others sometimes give a different definition to what is meant by a result. For example, the OECD-DAC refers to a result as being the "output, outcome, or impact…of a development intervention" (see Glossary of Key Terms in Evaluation and Results Based Management", OECD, 2002).

Why focus on results/outcomes?

In the "Input-Output-Outcome-Impact" typology mentioned above, inputs and outputs correspond to what can be more or less ***"controlled directly";*** outcomes correspond to what can be *"influenced directly"*; and impacts refer to what can be "influenced indirectly". Thus, outcomes may not be fully controlled, but governments can have a very strong direct influence on what can happen, often over a short time period (for example vaccination rates and school enrolment). Although it is impact that we may wish to change, it would be unrealistic to seek short-term changes at this level; in contrast focusing on outcomes ensures that changes can take place in those areas where governments can have a direct influence. In addition outcomes are crucial as they capture not only the provision of services but also the use of these services by beneficiaries.

Encouraging the use of results/outcome indicators is expected to be beneficial for a number of reasons which are summarised in Box 4.9.

Box 4.9: The Potential Benefits of a Result Based Approach

An outcome-based budget support has additional potential benefits such as:

i. **Results matter:** Input and output may be necessary but not sufficient to achieve outcomes. What really matters is not only whether services are provided but whether they are used by beneficiaries.

ii. **Encourage "evidence-based" policy making:** By linking disbursement of its variable tranches, the EC promotes a focus on outcomes in the dialogue that can then inform useful adjustments in outputs, inputs and sector policies. The causality chain, and its management by sector stakeholders, can be strengthened.

iii. **Protect political space of partner countries.** A focus on results protects the political space for governments to define their policies. Interference with domestic policy making processes is limited when donors focus on outcomes, while dialogue allows to constructively contribute to, rather than enforce, policies.

iv. **Strengthen domestic accountability:** Using results/outcome-based indicators has the potential to encourage greater transparency over the use of public funds.

v. **Stimulate demand for high-quality data**: Linking the disbursement of funds to concrete improvements in sector outcomes is a tangible way to stimulate demand for data and to demonstrate the value added of budget support.

Although result/outcome indicators are in general more appropriate, output indicators could be used in some sectors where there is limited experience with and availability of outcome indicators where or outcome indicators respond with long time lag. In certain cases output indicators could be used in addition to outcome indicators. In these cases it is important to clearly state the reasons for using output indicators.

Indicators should be drawn as much as possible from national and sectoral policy documents.

In addition to outcome indicators, the EC typically links the disbursement of its variable tranches to other indicators such as measures to improve public financial management in the sector or sector financing targets. Among these, the most frequently used include: increases in the sector and, where relevant, sub-sector allocations and rates of execution. Measures to strengthen statistical and measurement systems at sector level can also be used. ENPI country indicators will often be related to objectives as described in the action plans approved by both parties.

Additionality in Sector Budget Support

Additionality of an SPSP is defined as the extent to which something happens or changes as a result of the SPSP which would not otherwise have occurred**.** It therefore compares the "with" picture with the "without" picture.

The idea of additionality, using the EC terminology on indicators may be applied to inputs (for example financial additionality), output, outcomes, or impacts. For example, we might consider the additional finance for a given sector, or the additional results taking place within a sector. Care also needs to be taken to focus on outturn figures, rather than budgeted or planned figures.

The concept of additionality is simple. However in practice it may be very difficult to measure additionality and is often elusive and difficult to pin it down thereby giving rise to much debate and discussion. Ex ante, it is either not possible, or at best very difficult, to establish the future scenario of what could plausibly happen in the absence of the SPSP. Ex-post it is difficult to establish the counterfactual – what would have happened in the absence of the SPSP.

Financial additionality may be a key feature of many SBS operations – as it is of other external support – but it is not a defining element of all SBS. Applying a rigid requirement for financial additionality in the use of SPSPs overlooks many of the practical issues that need to be addressed when examining a sector. Additionality should be defined in relation to the plausibility of the sector expenditure path[19]. Here we can consider two main scenario – first, where an increase in sector expenditure is not the prime objective of the SPSP; and second, where it is an important objective of the SPSP.

- **When an increase in sector expenditure is not the prime objective of Sector Budget Support.** In providing SBS, the concern is to see an impact at sector level but not necessarily in the level of sector spending. In this context, SBS will be expected to add value in other ways and *will not have increasing levels of sector expenditure as an objective.* For example effectiveness and efficiency of a given level of sector expenditure could be raised with a reallocation of resources from capital to recurrent expenditure, from tertiary to primary level of service delivery or from central to decentralised entities. Or improving rates of execution of existing sector budgets can have a significant positive impact on sector outcomes. The value added of SBS could also be in supporting an acceleration of reforms, in knowledge sharing or capacity development.
- **When an increase in sector expenditure is an important objective of Sector Budget Support.** The assessment of the sector policy, the budget allocated, and its implementation may reveal that the main constraint to achieving the sector goals is that the sector is under-funded. In these cases *increases in the levels of sector spending are desirable and among the main objectives* of SPSP, especially in underfunded social sectors. It is preferable to focus on realistic expenditure projections that should underpin any

19 The term "sector expenditure path" refers to current and projected sector expenditures. When the time horizon for projected expenditures covers a period of two or more years, this will require the development of a medium term perspective on resource availability, and indeed in ideal form a medium term expenditure framework integrated into the budgetary process (see section 2.5).

sector programme. It is also important to start early to prepare for dialogue on the sector expenditure path. To build a picture for looking at the sector expenditure path the following steps are proposed:

- **Focus on historical trends to identify a meaningful baseline.** The starting point of any process looking at the sector expenditure path should be a thorough analysis of past trends of sector financing, both from domestic resources and donor project aid. A focus on actual levels of sector financing has several advantages: it reduces the impact of variations in government financing that respond to changes in project aid and it promotes a more complete and realistic picture of current and past levels of sector expenditure. It is crucial that this exercise involves all members of the sector coordination, the minister of finance in addition to the concerned line minister and all donors involved in the sector.
- **Choose how to express the baseline.** Current and past levels of actual sector expenditure constitute a baseline that could usefully be presented in per capita terms. Other options are to express current and past levels of sector expenditure as percentage of GDP, government overall expenditure or domestic revenue. (However, great care is needed in using such percentages as targets, since they may be affected by factors outside the control of the sector.) Whichever indicator is chosen, it is recommended to develop two baselines, the first based on overall sector expenditure and the second on domestically financed sector expenditure.
- **Discuss expected increases in sector spending.** It is recommended to review with government the magnitude of desirable levels in sector spending. In certain cases maintaining real per capita expenditure can be sufficiently ambitious. In others the objective will be positive increase in real per capita expenditure. A medium term perspective is important as it links SBS commitments to agreed projections of total and sector expenditure. This can be a useful subject of dialogue between government and the entire donor group.
- **Assess the fiscal sustainability of expected increases in sector spending.** The expected increases in sector spending should take into account the results of preliminary assessments and be consistent with the government medium-term fiscal framework. Crucial in this process is the role of the Minister of Finance and, where appropriate, the IMF. The consistency of spending shifts between sectors with the partner country national policy should also be assessed.
- **Centre the sector expenditure path on domestically financed spending but within the framework of overall sector financing.** Discuss an increase in domestically financed sector spending that could be expressed in percentage increases over the baseline. It is important to ensure that an increase in donor financing to the sector is not accompanied by a reduction in government resources such that that overall sector expenditure decreases. Both domestically financed sector expenditure and total sector expenditure (which includes project aid by donors) will be monitored although any conditionality will focus mainly on the first area.
- **Where appropriate translate any requirement into disbursement conditions.** Where appropriate the financial implications of non-compliance with the agreed sector expenditure path could be clearly and transparently stated in the Action Fiche/FP. Different approaches are currently being piloted: additionality as a special condition on the fixed tranche, triggering an “all or nothing” response in case of non compliance; the amount of a variable tranche that is reduced proportionally in case the actual increase in government per capita sector spending is only a percentage of the agreed increase; variable tranches specifically linked to compliance with the agreed expenditure path alongside traditional outcome variable tranches. In certain cases the agreed sector expenditure path requirement might be split into an allocation (percentage increase in the per capita government resources allocated to the sector) and a sector budget execution requirement, each having financial implications on a different tranche in case of non compliance. Graduated response mechanisms to the realised expenditure path seem more appropriate than "all or nothing" approaches

Delegations are encouraged to explore and propose other approaches that take into account the specificities of local contexts. Frequent exchanges and close cooperation between Delegations and Headquarter services will facilitate monitoring of design and implementation of additionality requirements, knowledge building and the gradual refinement of the approach proposed here.

4.4.5 SBS in countries already implementing GBS

Choosing to support a sector programme with SBS can be relevant even when the partner country is already implementing General Budget Support (GBS). Although both GBS and SBS finance the same budget and sector policies are part of broader development strategies, GBS contributes only indirectly to individual sector's objectives, while SBS aims specifically to support progress towards the country's sector goals. For this reason in SBS dialogue and conditions, focus mainly on sector related issues and SBS facilitates a deeper technical engagement with sector policy and implementation issues in a focused dialogue with a broad range of sector stakeholders than is possible through GBS. These stakeholders may be national actors (local governments, NGOs, private sector organisations) and international partners who may not be involved in GBS. Some typical features of GBS and SBS are shown in the table below.

General Budget Support and Sector Budget Support

<table>
<tr><th>Area</th><th>General Budget Support</th><th>Sector Budget Support</th></tr>
<tr><td>Financing Modality</td><td colspan="2">Budget support: the transfer of resources to the National Treasury, where these financial resources are used in accordance with the public financial management system of the partner country.</td></tr>
<tr><td>Objectives</td><td>Support to the national development or reform policy and strategy</td><td>Support to a sector programme policy an strategy</td></tr>
<tr><td>Policy Dialogue</td><td>Focus on the national development or reform policy and strategy. For example, support to an Association Agreement, or a PRSP</td><td>Focus on the sectoral development and reform policy and strategy. For example, support to an education sector programme</td></tr>
<tr><td>Typical features</td><td>Focus on:
i. national objectives which can cover key sectoral objectives in so far as they are fundamental to the national development or reform policy and strategy;
ii. improving or maintaining macro-economic stability;
iii. improving overall public financial management;
iv. improving the budgetary framework to address national policy and strategy objectives
v. oriented to the use of "results/outcome based" performance indicators</td><td>Focus on:
i. improving sector performance;
ii. improving overall public financial management, but paying particular attention to sector specific issues
iii. macroeconomic framework in so far as it is important for the achievement of sectoral objectives;
iv. improving the budgetary framework for the sector
v. the use of "results/outcome" based performance indicators, but also paying attention to the results chain from "inputs" to "outputs" to "results/outcome"</td></tr>
</table>

GBS aims to support the partner country national development policy, its macroeconomic stability, and overall PFM improvement. It provides a unique opportunity to have a dialogue and to support the overall policy priorities of the partner country, and should not be overloaded with a multiplicity of objectives, including at sector level.

SBS can benefit from a concomitant GBS, mainly by deferring to GBS the assessment of the macroeconomic policies and PFM reforms. The sector will benefit from the implementation of global systemic reforms supported by GBS, while SBS will be able to focus more on strengthening sector processes.

SBS can contribute to GBS. A national development policy articulated in strong sector policies is more likely to be effectively implemented. And sector reviews are an increasingly important element of annual performance reviews that are carried out in the context of GBS. Sector reviews also provide a reality check on the impact of global reforms at the sector level.

SBS can complement GBS by providing more predictable finance to the budget. Provided eligibility conditions are satisfied, disbursement of SBS funds can continue even if the implementation of a GBS programme is delayed or temporarily suspended. This could happen for example in case of a deterioration of the macroeconomic framework, which may constitute a breach of GBS general condition, but assessed by the EC as not putting at risk sector objectives and therefore not requiring the interruption of SBS.

GBS operations in the ACP countries tend to use indicators on access and use of social services as proxies for poverty reduction in the measurement of country performance. As the same indicators are relevant also SBS to health and education, the articulation between GBS and SBS may appear more demanding. The idea is that GBS should only capture the sector main targets, the ones that more directly contribute to the country development objectives (the ones more closely related to poverty in countries with PRSP), while SBS could include a wider range of sector indicators, reflecting different dimensions of a sector programme. The fact that a sector is supported with SBS should not be a reason to exclude all indicators relating to this sector from a GBS programme in the same country. In the same way the fact that an indicator is already included in GBS should not be a reason to exclude it from SBS.

When the same indicators are considered relevant for both GBS and SBS, different options are possible. SBS could reinforce GBS by increasing the resources, and the incentive, attached to achieving targets on outcome indicators already selected for the GBS variable tranche. As the expenditure capacity of the sector could increase with SBS, targets for the same indicators should become more ambitious, although resources are not automatically transformed in outcomes and if they are maybe only with a delay. Or SBS could complement GBS by including targets for the same outcome indicators at a more disaggregated level. SBS performance tranches could also be linked to the production and dissemination of agreed key input, output and outcome indicator at lower levels of service provision (for example at the school level).

4.5 Pool Funding

Box 4.10: Definition of a Pool Fund

A Pool fund is a fund that receives contributions from different external agencies, and in certain cases from Governments, to finance a set of budget lines or activities agreed as eligible in support to a sector programme.

Financial contributions to pool funds, or basket funds, represent another form of financing of a sector programme. These are specially designed systems for financing expenditures within a sector programme, in which the resources of the Commission are "pooled" (joint co-financing) with allocations from other external financing agencies and potentially from Government. The primary purpose is to reduce the transaction costs to government that would otherwise arise from the use of the systems of several external financing agencies. In addition, pool funds, if properly structured and if sufficiently wide in their coverage, can also promote coherence in sector planning and budgeting and facilitate government ownership of donor-financed expenditure in the sector[20].

The use of pooled funds is determined by the set of budget lines or activities agreed with Government and other partners as eligible for financing through the pool fund. In certain circumstances, all activities included within the agreed sector programme might be covered but more usually the pool fund would be focused upon a sub-set of activities and expenditure items included within the programme. The methods for transferring resources into the pool fund, for disbursing common funds and for accounting for expenditures are specific to each Fund and would need to be formally agreed with Government and other participating donors.

At its core a pool fund entails a bank account into which donor resources are channelled together. These funds are then spent directly on eligible activities. Hybrid cases, where a pool fund is just a holding account before onward transmission to the government budget, should be avoided. In these cases it would be preferable to consider SBS as the most appropriate modality subject to compliance with the eligibility criteria.

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20 *See 3.1.4 for a discussion of issues arising from the harmonisation of reporting, budgeting, accounting & procurement processes within a sector programme.*

4.5.1 When is pool funding appropriate for an SPSP?

The choice between pool funding and project modalities should be based on a case-by-case assessment of what is appropriate given both the intervention objectives of the SPSP and the country circumstances.

This will entail a detailed assessment of how costs and benefits vary under each modality. Against this background, the following basic elements can be considered in such an assessment.

Pool Funding Versus Projects: Elements for Assessing Costs and Benefits	
Potential costs	***Potential benefits***
➔ Preparation costs: government and donors	➔ Ownership
➔ Transactions costs: government and donors	➔ Flexibility
➔ Fiduciary risk	➔ Allocative efficiency
	➔ Economies of scale (reporting etc.)

These costs and benefits will vary depending on the financing modality chosen. In addition, the incidence of the costs will also vary between donors and beneficiaries. In general, the choice of modality should be based on the most favourable outcome for the beneficiary. At the same time, however, it is important for donors to consider the implications of the choices for their own resource management.

Under a project, preparation costs are usually predictable and manageable for both donors and government as the appraisal process is typically well established. In the case of pool funds, however, the need to adapt known procedures to a less familiar common approach tends to increase the up-front preparation costs for interventions under this modality. This increased burden of preparation under pool funds can also continue into the initial stages of the implementation of a pool fund, where joint approaches to annual work plans and reporting formats etc. might require close attention.

Balanced against this, the transactions costs under a pool fund approach can be significantly lower provided that the design has adopted procedures and arrangements that allow for increased management efficiency. The corollary of these reduced transactions costs is the potential economies of scale in reporting etc on the benefits side.

A further important consideration on the potential costs side of the assessment is the different exposure to fiduciary risk under the pool fund and the project approach. This is of particular importance in cases where the pool fund is managed by the beneficiary. In the sense of the Financial Regulations, such cases entail a greater degree of decentralised management than the standard project approach (see Box 4.11). Consequently, greater attention needs to be paid to the assessment of the financial circuits at the appraisal stage of pool funds. This in itself implies an increased burden of preparation costs, as discussed above. Moreover, the risk profile will most likely be different under each modality and this should be explicitly considered as a potential direct cost when assessing the choice of modalities.

On the benefits side, the potential for a pool approach to enhance ownership, allow a more flexible response to progress in implementation and enhance allocative efficiency in sectoral budgeting needs to be considered.

Against this background, it should be clear that a proposal to proceed on the basis of a joint/pooled approach needs to show that the relationship between expected benefits and potential costs is significantly more favourable when compared to the standard project approach.

In addition to these technical judgements, one would also need to have a detailed awareness of what other donors might be doing. Possibly the most powerful argument for the utilisation of a Pool Fund would be the presence of a pre-existing, well-tested pool fund open to new donors. Alternatively, there might be a situation where small groups of donors had already had successful experiences with co-financing of projects and felt sufficiently confident to move towards greater harmonisation. At the very least, there would need to be a critical mass of donors, who were willing to engage in a new common fund with Government.

4.5.2 Different types of pool funding

Pool funds may be distinguished in terms of three criteria:

- Whether they are managed by government or by donors.
- Whether the pooled funds finance the whole sector programme or, as is more common, are earmarked to specific items of expenditure (e.g. medicines), or to specified sets of activities (e.g. the primary education sub-programme).
- Whether the accounting and reporting procedures are modelled on government accounting systems, on the accounting systems of a particular donor or international organisation, or custom-designed for the particular sector programme.

In general, it is desirable that the government should manage the common pool fund, in order to ensure that responsibility for proper use of funds rests firmly with government and that there is clear ownership. Ideally, the input from government would be not only at the sector ministry level but also from the Ministry of Finance. However, where capacity limitations are severe, it may not prove possible to have a pool fund directly managed by government and it may be necessary for a specific donor or international organisation to play this role.

Many pool funds are set up with a limited scope of operation. For example, they may be designed simply to pool resources used for the purchase of pharmaceuticals or the provision of technical assistance or the construction of school building. Clearly, the extent to which pool fund can make an impact on transaction costs will be limited by the breadth of their coverage. On the other hand, the creation and agreement of a pool fund carries transaction costs of its own, which will tend to rise with the breadth of coverage and the number of donors involved. In the early stages of a sector programme, when management systems are not well developed and there is not yet sufficient confidence between stakeholders for coordination to operate easily, there may be advantages in developing small, relatively simple common pool funds. Experience can then be gained before attempting to initiate funds with wider coverage.

The choice of accounting and reporting procedures to utilise in the common fund is of course a key determinant of how time-intensive and costly the start-up will be. International experience with sector programmes suggests that it is advisable to avoid unique “tailor-made systems”, which are specially designed for the sector programme in question. In general, it is preferable to take an existing chart of accounts and an established set of procedures with which local accounting staff are likely to be familiar and then to make small adaptations as necessary. The ideal would be to use government procedures and accounting systems, limiting adaptations to procurement rules, the structure of reporting and to the disbursement process. This has the great advantage of facilitating a subsequent transfer to the full use of government procedures once there is sufficient confidence with procurement systems and with the public finance management system.

An alternative approach is to use the established procedures of one donor or of an international organisation for the whole fund. In this respect, it should be noted that for the moment the financial regulations of the Commission do not permit the transfer of EC resources to a pool fund managed directly by a bilateral donor.[21] This will change under the new financial regulation and the basic acts 2007-2013. They do however permit transfers to Funds managed by multi-lateral agencies (most commonly, the World Bank and UN agencies) or to Funds managed by partner governments, so long as the accounting financial management and procurement procedures have been judged to be acceptable (see Box 4.11).

It is worth noting that the World Bank, in conjunction with the Commission and UNDP, has developed a set of model trust fund procedures which are readily adaptable to the requirements of most sector programmes. In November 2001, the Commission and the World Bank signed a “Trust Funds and Co-Financing Framework Agreement”, which defines the various types of trust funds and sets out common rules and principles applicable to all of them.[22] This agreement was renewed in 2005.

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21 *Article 54 of the Financial Regulations leaves this possibility open in principle but only where the “basic act of the programme concerned” provides for the possibility of delegation. At present, none of the acts regulating external cooperation in the different geographical areas allow for delegation.*

22 *Information on this agreement, the text agreed and models to be used are available in the internet (http://europa.eu.int/comm/europeaid/tender/usedoc/cont_typ/wb_index_en.htm)*

4.5.3 Pool funding: how to proceed

The position of the Commission, in line with the recommendations of the OECD Development Assistance Committee, is that one should proceed cautiously with the introduction of pool funds. As outlined in section 4.5.1, a realistic assessment of the costs and benefits of pooled funding should be made before proceeding, with careful attention given to the coverage and degree of sophistication being contemplated.

It should also be recalled that unified programming and reporting systems can feasibly be established while continuing to utilise project modalities (see section 3.1.5). This may permit a direct move to budget support at a later stage, if the necessary conditions can be met. Thus, the option of continuing to use Commission procurement and grant award procedures should be considered, if there appears to be a good prospect over the medium term to move to budget support.

Box 4.11: EC Regulations on Pool Funding (Co-Financing)

In terms of EC rules and procedures the new Financial Regulation for the Budget and the new legal bases -notably the Development Cooperation Instrument (DCI) - applicable from May 2007 onwards, recognise four options for the management of pool funds (co-financing):

- ➔ A pool fund managed by a partner country/Beneficiary State and Overseas Countries and Territories (OCT)-(EDF) - *decentralised management* (art 56.2 FR Budget - art. 13.4 FR 9th EDF)
- ➔ A pool fund managed by an international organisation - *joint management* (art 53d FR Budget - art. 12 and 16 FR 9th EDF)
- ➔ Management of the pool by international and national public sector bodies such as bodies of EU member states and of third countries governed by public or private law with a public service mission and executive agencies created by Community decision – *indirect decentralised management* (art 54.2 and 56.1 FR Budget -art. 14.3.b FR 9th EDF)
- ➔ Management of the pool by the Commission on behalf (and with resources) of the Member States, a partner country or even an international organisation -art 18 FR Budget.

The first three options are also stipulated in the Financial Regulation of the 9th EDF.

In terms of procurement procedures, for a pool fund managed by a partner country (Budget) / Beneficiary State and (OCT) (EDF), falling under the notion of decentralised management, it will be possible to use national procurement procedures or procurement procedures agreed upon between donors on the basis of a case-by-case preliminary analysis. This after compliance with art 56.2 (for the Budget) or consistency with art. 13.4 (for 9th EDF) has been demonstrated.

For more information on procurement procedures for the implementation of pool funds reference is made to section 7 of the Practical guide to contract procedures for EC external actions.

Before proceeding with pool funding, it would be necessary to make an assessment of compliance with the relevant articles of the FR of the Budget and EDF, giving special attention to the contracting and financial procedures envisaged for the pool fund. Guidance for these specific assessments will be provided by the relevant Commission services, starting with the geographical coordination units and the corresponding Finance and Contract units.

In the case of pool funds managed by partner governments, the Commission proceeds to these assessments on a case-by-case basis. Commission Services are working towards establishing a methodology for assessment of compliance or consistency, in the form of terms of reference and a questionnaire; a standard "Part 4: Implementation Issues" in the Technical and Administrative Provisions (TAPs); and some guidance to ensure that relevant articles of the Financial Regulation and the assessment's results are sufficiently taken into account in the (donors-partner government) Memorandum of Understanding.

Apart from the specific requirements of the Financial Regulations, a broader evaluation of the proposed operating procedures for pool funds must always be undertaken, whether these are managed by partner governments or by international organisations. This evaluation would need to be undertaken during the formulation phase of an SPSP but would also need to be repeated during implementation either on an annual or two-yearly basis. Such evaluation in the case of pool funds managed by partner governments is to be covered by the above-mentioned, but still work in progress, methodology for assessment.

Box 4.12: Guidelines for Evaluation of the Operating Procedures of Pool Funds

In addition to fulfilling the financial requirements of the Commission as specified in Box 4.11, the operating procedures proposed need to be examined with respect to the following aspects:

- The consistency between the activities funded through the Pool and the agreed sector programme: in general an annual disbursement schedule or an annual plan for the use of the pool fund would need to be prepared in parallel with the government budget, based upon the medium-term sector budget projections.
- A reporting mechanism relating expenditures to actual outputs and completed activities would need to be pre-agreed and judged satisfactory. This would need to cover both the government budget and pool funding.
- The means of justifying and accounting for expenditures and verifying their consistency with the pre-agreed budget would need to be assessed and judged satisfactory by comparison with the requirements of the Commission.
- A financial management and accounting manual would need to be prepared and assessed for completeness and quality by reference to the Commission's requirements, for instance in the context of the assessment exercise
- The mechanisms for maintenance of bank accounts and management of disbursements (including applicable conditions for the release of funds) would also need to be assessed as satisfactory.
- An assessment of the personnel responsible for managing the fund would need to be made, considering the adequacy of their training, their experience and the framework of reporting and supervision in which they would be working. Often, supplementary training would be required for their induction into the new system.
- The Memorandum of Understanding or Joint Collaboration Agreement between government and donors to the pool or between donors themselves should be examined in order to establish whether it :

  (i) Clarifies the management responsibilities for the pool fund.

  (ii) Defines the role and mandates of the supervisory and steering committees, including the respective responsibilities of the beneficiary State and the donors.

  (iii) Establishes systems and obligations for reporting, monitoring, evaluation, and auditing.

  (iv) Clarifies the decision-making process, especially for transfers of funds, and the conflict resolution mechanisms, especially in case of violations of its conditions and/or principles (e.g. recovery of funds, suspension or reduction of payments).

  (v) Provides conditions and procedures for donors' withdrawal (and accession), and for allowing any substantial review of its conditions and/or principles.

  (vi) Generally pays adequate attention to the criteria laid down in the relevant Budget and EDF Financial Regulations' articles.

This detailed examination should, where appropriate, generate proposals for improvement of the procedures of the Fund. If necessary, implementation of these recommendations might be included as a condition for EC participation.

4.6 Funding through EC Procedures

The third financing modality for an SPSP is through the EC project procedures (procurement and award grant procedures). Here the specific EC procedures relevant to the region in question are utilised to finance earmarked activities defined in the sector programme. Such project procedures are appropriate where:

i. the conditions for SBS are not in place, and

ii. a comparison of the costs and benefits of pool funds versus the project approach favours implementation by EC procedures.

4.6.1 Where would Commission procedures be appropriate?

As outlined in section 4.5.1 and 4.6 above, once SBS is ruled out, the choice between pool funding and project modalities should be based on a case-by-case basis. This entails a detailed assessment of how costs and benefits vary under each option. In general, project procedures will tend to be favoured where the up-front preparation costs of a pool arrangement are considered prohibitive; or the potential benefits from harmonising procedures are limited; or the fiduciary risks in pool funding are considered to be too high, or a combination of all of these factors.

In addition to these general considerations, we can also envisage a priori, three specific situations in which the use of project procedures might be appropriate for an SPSP, despite the inherent drawbacks of using this modality. These are as follows:

- **As an interim measure**, where the conditions necessary for the use of sector budget support are not yet in place and the eligibility criteria are not met. In this context, specific procedures could be used to finance preparatory activities (including surveys, public expenditure reviews and expenditure tracking surveys) or to support capacity building through technical assistance. Such capacity building would focus upon areas essential to the successful implementation of the sector programme as a whole. There might also be a case for using Commission procurement and grant award procedures for priority investment activities within the sector programme, where there would be benefits from quick implementation.
- **To address a transaction costs problem**, where activities planned in the sector programme have inherently high transaction costs, which the EC could carry to reduce the burden on government. Examples might be 1) technical assistance contracts; 2) large infrastructure contracts, involving international competitive bidding and/or complicated contract supervision issues; 3) contracts with non-government agents contracted out to provide services foreseen within the sector programme. Contracting out systems would probably be new to government and difficult to establish: the Commission could carry these transaction costs while contract management capacity is created.
- **To accommodate government or legal requirements**, in situations where sector budget support is not possible due to legal restrictions, neither is favoured by the partner government.

4.6.2 How to proceed

At first sight, it might appear that there is little to distinguish the use of specific procedures in support of an SPSP from their use in normal project activities. In terms of financial procedures and obligations, there is no difference but in objectives and mode of operation there are fundamental distinctions:

- The objectives of promoting ownership, coherence and harmonisation should figure prominently in the design of the SPSP and must be reflected in the mode of implementation and monitoring.
- The focus of the SPSP must be on the sector as a whole and on the results achieved at the level of the sector.
- The activities financed through an SPSP must be an identifiable part of the sector programme designed by government.
- The SPSP must follow the sector programme management system.

This requires that the sector programme should have reached a certain minimum level of readiness. Therefore, as with any SPSP, the seven assessments would need to be undertaken.

4.7 Implementing an SPSP

Implementation of the SPSP involves simultaneous attention to ensuring that a) the sector programme progresses as planned, and b) that, subject to adjustments in the light of the evolution of the programme, the SPSP is executed as planned, with the commitments made in the financing agreement fulfilled by Government and the Commission.

The SPSP will utilise the planning and monitoring procedures of the sector programme and as far as possible the detailed implementation requirements for the SPSP (the disbursement calendar, the review process, audit requirements, etc) will be integrated within the implementation modalities for the sector programme as a whole.

From a procedural perspective, the specific implementation requirements of an SPSP will depend upon the financing modality chosen and upon the precise source of funding. Annex 1 provides the procedural requirements in designing and implementing SPSPs. Reference should also be made to relevant documentation as appropriate, in particular the Practical Guide to EC external aid contract procedures should also be consulted.

4.7.1 SPSP start-up

When supporting a sector programme it is especially important to avoid delays in start-up. Not only can delays have knock-on effects on other components of the sector programme but the credibility of the Commission as a partner in the sector programme might also be negatively affected. Therefore, every care should be taken to ensure that requirements for start-up are in place as early as possible and ideally at the moment of signature of the financing agreement (see annex 1).

In all cases it is important that the Commission remains involved in the policy dialogue in the interval between end of formulation and the signature of the financing agreement. It allows to keep abreast of developments within the sector while smoothening start-up of EC support.

4.7.2 Ensuring continuous policy dialogue and effective sector coordination

It is essential to the success of EC support to a sector programme to get the sector policy dialogue right from the start, maintaining this engagement throughout. Sector dialogue is a complex process and takes place at political economy, strategic and technical levels. Reforms and change processes towards more pro-poor policies are likely to include measures that will touch upon established interests and that might cause stakeholders to intervene to protect them. These interventions and their underlying causes are not always easy to recognise and require continuous sector observation and sector assessment. While it is important to be flexible and responsive to opportunities, a well planned approach can ensure that joint undertakings are better understood, more feasible and will result in better programme design, implementation and monitoring.

Support to the implementation of sector programmes is a dynamic process. Indeed, sector programmes are about reform, about changing the way of doing things. Change processes are by nature erratic as change is conditioned by the willingness and ability of stakeholders to change once convinced that change is needed. Stakeholders may move at different speed and at different points in time around a reform agenda, and they might want to move in different and adverse directions. Support to sector programmes is therefore not only engaging in a dynamic process, it is engaging in a process of a high political nature. Furthermore, engaging in policy dialogue around such issues can often be new ground for partners, and it is essential to take the time to build trust and mutual understanding over shared objectives.

While dialogue between government and donors is important in the design phase of the sector programme, it is even more important in the implementation phase. Disappointing results of performance review, personnel changes within the lead ministry, start of a decentralisation process, civil society groups mobilising themselves, interest groups diverting the agenda, new donors supporting the sector are all unpredictable events that have the potential to affect the sector programme. It is only by maintaining an open line of communication between government, donors and other relevant stakeholders that the effect of such events can be addressed. Dialogue therefore needs to be regular but it needs also to be effective, meaning that the debate spreads from the broader development strategy down through to service delivery levels and community participation section 4.3.3 describes some of the implementation modalities that can be put in place to facilitate an effective policy dialogue.

Policy dialogue cannot be contracted out. EC Delegation staff is responsible for active participation in the dialogue, supported by technical assistants where relevant. Teamwork within the delegation is important as well, as at different points in time dialogue may extend to issues beyond a specific sector, such as broader governance and economic reforms. The Delegation needs to capitalise on its diverse in house expertise to participate in the debate, to ensure these links are made, and ensure that policy dialogue is prioritised in human resource management and work planning within the EC Delegation. In this way it will be possible to identify the most appropriate entry points to the dialogue, being responsive to opportunities as well as focusing strategically on those areas where our contribution to the dialogue will have most impact. With this in mind, it may also be necessary to further develop our own skills and capacities, as well as national partners, to effectively engage in the sector dialogue.

4.7.3 Monitoring of the sector programme

The progress of the SPSP is monitored through the overall performance measurement and monitoring mechanism established for the sector programme. This implies active participation in all of the agreed monitoring mechanisms. The main requirements are as follows:

- Reviewing progress with the achievement of sector goals
- Monitoring of the implementation of the eventual action plan for the sector programme, in line with the agreed structure of activities, outputs and outcomes
- Reviewing progress with the development of the sector programme, utilising the milestones agreed within the Programme
- Tracking development and implementation of the sector budget as well as it medium-term perspective, comparing actual expenditures with those foreseen and assessing the evolution of overall spending in the light of planned shares of expenditure.
- Verifying compliance with any conditions agreed within the sector programme, including specific audit requirements
- Verifying amounts and timing of disbursement of funds
- Monitoring progress in alignment to country systems
- Participating in half-yearly or annual review meetings for the sector programme as well as in mid-term reviews, and contributing to the drafting and negotiation of the resulting aide-memoires between stakeholders. This also refers to indicators 9 and 10 of the Paris Declaration asking respectively for common arrangements for monitoring and reduction of the number of separate diagnostic reviews
- Also in line with the commitment to the implementation of the Paris Declaration on aid effectiveness "integrate diagnostic reviews and performance assessment frameworks"

CHAPTER 5
THE SEVEN KEY AREAS OF ASSESSMENT

THIS CHAPTER PROVIDES INSIGHTS INTO THE 7 KEY AREAS OF ASSESSMENT:

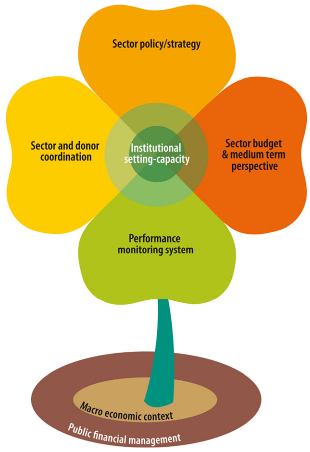
the five elements of a sector programme

- ➔ The sector policy and strategy
- ➔ The budget and it medium-term perspectives
- ➔ Sector and donor coordination
- ➔ Institutional setting and capacity issues
- ➔ Performance monitoring systems

and the two additional elements influencing the sector programme's performance

- ➔ The macroeconomic framework
- ➔ Public financial management (PFM) systems

This chapter makes further reference to other background materials.



Assessment would start during the programming and identification phases of the SPSP cycle, with the analysis then being completed during formulation. During implementation, these assessments would also need to be updated regularly in order to keep abreast of developments in each of the areas.

Depending on the stage in the SPSP cycle of operations and on country context, the assessment will have different objectives and focus. These objectives may include:

- ➔ exploring if a viable sector programme is in place, focusing on its three building blocks;
- ➔ analysing strengths and weaknesses of the sector programme, looking at its five elements in order to identify priorities in, and potential added value of, EC support;
- ➔ checking eligibility criteria for SBS, looking in particular at the sector policy; the macro economic context and PFM;
- ➔ defining objectives, expected results and implementation modalities for the SPSP;
- ➔ during implementation, reviewing the overall performance of the sector programme through all the seven areas and, in case of SBS, check whether eligibility criteria are still met.

It is not necessary for these assessments to be carried out or commissioned directly by the EC. Indeed, they should be carried out jointly with government, with partner donors and with other sector stakeholders and can of course be merged or sub-divided to fit in with the wider arrangements for the sector programme. Wherever there are relevant pre-existing studies and materials, these should be drawn upon. In several cases, those preparing an SPSP would be able to draw on assessments conducted to inform the Country Strategy or as part of GBS preparation. The intention is to build an increasingly richer understanding which is shared and discussed with government and donor partners so that joint responses to challenges can be developed through the evolving sector programme.

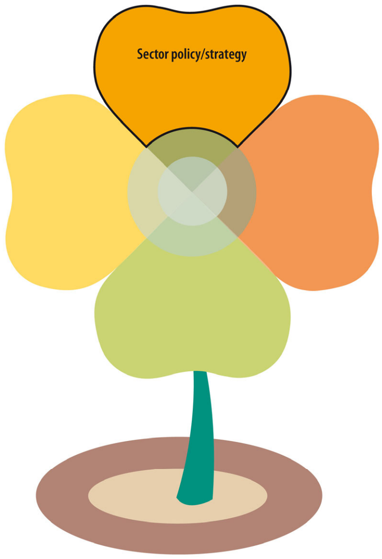
For each of these areas this chapter proposes issues to be assessed - in particular on the three areas corresponding to the eligibility criteria for sector budget support - and includes additional material that may be relevant for policy dialogue and self learning. It does not aim to cover all the issues that may arise, and staff working on the preparation of an SPSP should therefore consult suggested sources of reference and seek complementary advice from headquarters.

Professional judgement has to be used in applying the seven assessments, in a way that is tailored to the specific country context.

In addition, the training programme which will accompany the dissemination of these Guidelines will also give access to a wider range of materials and references in these areas.

5.1 The Sector Policy

A coherent and consistently applied sector policy is the heart engine of any successful sector programme. This must derive from, and be consistent with, the overall strategic objectives of government and the overall strategic framework (for example, the PRSP). In addition, it must also be linked to a robust medium-term projection of resources and their planned use, endorsed at the political level. Issues to be assessed include the policy processes, the quality of the policy and its consistency with government's own national strategic objectives and with the Commission's objectives of development co-operation.



It is important that the analysis of these issues should be undertaken in full collaboration with the government and as relevant other national stakeholders. Different perspectives need to be discussed, and agreement must be reached over which are the principal strengths and areas of weakness and if and how the latter might be addressed. While policies must be nationally owned to be effective, the EC and other donors must be able to endorse overall policy directions, and a shared understanding of strength and weaknesses is an important foundation for such an endorsement.

Donors are actors in the domestic policy processes around an sector programme. In assessing sector policies the ownership dilemma may arise (see section 2.4). Donors are of course expected to respect national prerogatives to design and decide on policies. And on the other side they are as well expected to have viewpoints about what they consider to be good policies. They participate in policy dialogue and they decide if and how to fund a national policy. This may cause tensions particularly between process and content aspects: Should donor support a policy they consider relatively poor but which is strongly owned by national stakeholders or push for what they perceive to be a better policy which count on less domestic commitment? In line with the Paris Declaration and good practices in the sector approach, the trend is clearly towards adopting the first position, keeping a long term perspective on getting to what donors consider to be good policies. But the line between the two positions is in practice delicate. Being open about this dilemma in the dialogue with partners is one way of addressing it, while any heavy-handed approach by donors to promote their policy concerns is likely not only to be ineffective, but also to backfire by jeopardising the climate of trust which is fundamental to the success of the sector approach.

The DAC Guidelines on SWAp give attention to policy assessment as synthesised in Box 5.1.

Box 5.1: Features of a Good Policy Document

A good policy document will:

- Be authored by the government (not the donors) and fit clearly into the government's policy and plan-ning system; it will be aligned with the national PRS and endorsed at a high political level.
- Explicitly address the role of government in the sector – distinguishing regulatory functions from service delivery and noting the complementary roles to be played by communities, non-governmental organisa-tions (NGOs) and the private sector.
- Define the allocation of responsibilities across government between: i) the main sector ministry, other line ministries that may be involved, and the central planning and finance ministries; ii) the different tiers of central and local government); focus on implementation capacity constraints, and identify the principal requirements for institutional reform and capacity development.
- Focus on the whole sector's resource requirements, including recurrent as well as capital expenditures, and demonstrating the sustainability of proposed public expenditures; it will address the effectiveness of existing policies and expenditures, and not simply submit a subset ("a shopping list") of additional activi-ties for donor finance.
- Have a strong results orientation, providing the essential framework for subsequent monitoring, with a focus on poverty reduction and attention also to key cross-cutting issues (including gender equality, the environment, HIV/AIDS and the strengthening of public institutions and their accountability).
- Set out clear mechanisms for monitoring, review and updating of the policy document, and identify the principal areas where further research and analysis may be required.

Source : DAC Guidelines on SWAp

5.1.1 Policy processes

In developing a sector programme, the ability of national partners to reach consensus and address problems is almost more important than the production of high quality policy documents. If policy documents are not the result of solid nationally owned processes ensuring sufficient power behind the policy, then they will end collecting dust on the shelf or being changed at any moment.

Policy processes are intimately linked to political processes, since they essentially aim at deciding how different interests in society should be considered or not, given limited resources. For example, an education policy may give priority and preference to educating the rural poor – but if this is at the visible expense of urban middle class children, then it would be important to know if the urban middle class has actively endorsed that policy – otherwise quite fierce open resistance or active subversion of the policy should be expected. A pro-poor policy promoted by donors but only formally accepted by a government will also stand little chance of success.

Being political, policy development is not a linear, technical-rational process. Though evidence should ideally inform policy ("evidence-based policy"), the relationship also works the other way around ("policy-based evidence"). Policies may be as significant in what they do not address as in what they address, and asking "who are behind this" may be as important as asking "what does it say?" Finally, policy processes do not end with a document – formal policies are transformed through the whole implementation chain so that in the end, what front line workers do when serving clients is effectively the real policy expressed in actions on the ground.

Depending on the context, issues that may be considered concerning the policy process include the following:

- Are policies authored and endorsed by domestic actors, and made public? Policy documents prepared by consultants may read nicely – but detailed domestic ownership over the content may easily disappear in the process. Assessing concretely how the policy has been formulated, whether it has been approved by parliament and consulted broadly with other stakeholders is therefore important. Public availability of policies, and public announcements stating that a policy will now be implemented is also a signal of commitment.
- Which stakeholders are part of the process? In addition to the executive and legislative, it is important to consider whether different groups in civil society have a meaningful voice in policy processes, including

representatives of the poor and of the political and economic elite with interests in the sector outcomes. Without the participation and endorsement of the latter, the policy is less likely to be implemented. Participation of regional and local government representatives may also be important for a policy process to be robust.

- Are policies evidence-based? Good policies are informed by evidence of what works and what does not work, and about information about the reality on the ground. They should draw upon quantitative or qualitative survey data about the demands and concerns of the main users of government services in the sector.
- Do policies matter? Policies may fail to achieve their goals. A setting where policy failure has political consequences for those who stood up for the policy, indicates that policies matter, and that political leaders are held accountable for the policies they promote. If ministers and senior civil servants (or donor agencies) just continue unaffected launching the next policy in line, then it is an indication that policy-making may be more ritual than real.
- Are policies implemented as intended? Linked to the question about whether policies matter, the assessment should consider whether policies are likely to be implemented largely as they were designed? This cuts across all 7 assessment areas – but if capacity to implement any policy is limited, then building that minimal capacity (the resource-result chain) may by default have to be the core of the very first policy – because something more sophisticated would not work anyway.

5.1.2 Quality and consistency with development objectives

The issues under this heading relate to the clarity and realism of policy as well as the underlying principles on which it is based. If policies are confused, then policy actions are exceedingly unlikely to be effective. If policies are not realistic then they cannot be an effective guide to strategy and actions. If fundamental principles are not clearly shared, then there is no basis for partnership. On the other hand, even over these fundamental issues, judgements are unlikely to be so clear-cut. There will be many “grey areas” and hence the crucial importance of assessing the direction of change as well as the current status of policy.

The key issues that could be addressed include:

- ➔ Are the stated sector policy objectives reasonably clear? Is the strategy for achieving them coherent and readily understandable?
- ➔ In particular, is the sector policy sufficiently precise to form an adequate basis for planning resource allocations? For example, do policies on service delivery include specific targets for access, defined quality norms and a clear statement of the intended level of public subsidy?
- ➔ In the context of an overall administrative, political and/or fiscal decentralisation process, does the policy take the effects of this overall decentralisation policy sufficiently into account?
- ➔ Is the policy affordable (in terms of projected available resources over the medium term) and feasible, in terms of managerial and organisational capacity at all levels involved in implementation?
- ➔ Are the objectives of the sector policy consistent with the government’s wider national policy objectives, as reflected in the PRSP [23], for example?
- ➔ Are the objectives and underlying principles of the policy consistent with the development objectives of the Commission?
- ➔ Is there proper attention to the issue of gender equality, and to the other cross-cutting issues of development policy such as good governance and human rights but also environment?

5.1.3 The role of government in the sector

The definition of the role of government in the sector is a crucial aspect of a sound sector policy. It is also an area where approaches vary a great deal across countries and sectors, also in OECD countries. Hence, there

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23 *See section 2.4.3.*

are no standardised approaches. Nevertheless, the dialogue about and assessment of the appropriate role of government is essential because the failure of governments to regulate effectively or to deliver services efficiently is so often the result of inappropriate roles or policies ascribing functions to government which exceed implementation capacity.

This is not an area where clear-cut judgements can be made and consensus easily reached. The assessment therefore needs to evaluate whether the right questions are being asked, whether these are being debated openly and whether a process for moving to a consensus appears to be in place.

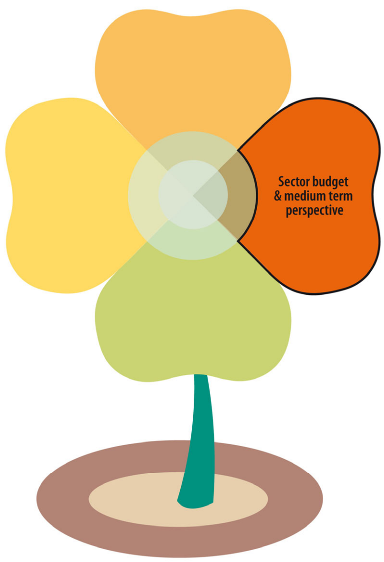
Some of the basic questions that could be addressed include:

- Is the intended role of government in the sector well defined?
- Is the rationale for the intended role clearly presented? For example, is there a distinction drawn between a market management (or regulatory) role, intervention to correct for market failure and intervention for social objectives?
- In developing a sector policy has attention been given to the different options available for government action, specifically – regulation of private sector providers, taxes and/or subsidies to redirect private behaviour as well as direct provision of services by government?
- Where the role of government is perceived primarily in terms of social objectives, such as direct alleviation of poverty or hunger, have the target groups been clearly specified and has a feasible strategy for reaching them been defined?
- In terms of the planned provision of services by government has a distinction been drawn between the financing and delivery of public services?
- Does the approach to the delivery of public services consider the possible efficiency gains by contracting out government services to NGOs or the private sector?
- Does it also take account of the complications of contract definition, management and supervision when considering if specific delivery functions should be contracted out?
- Taken as a whole is the sector policy based upon an appropriate, affordable and feasible vision of the role of government?

5.2 Sector Budgeting and its Medium-Term Perspective

This section introduces key issues on sector budgeting which are relevant for an informed policy dialogue. Attention should be paid to reinforce the budget-policy link at the sector level and to develop processes and instruments to improve allocative efficiency of internal and external resources. The sector budget and its multi-year perspective are important for achieving these objectives.

5.2.1 Assessing the sector annual budget



To assess whether sector policies are being implemented, the first step in any context should be to focus attention on the sector budget, because expenditures are authorised through the budget. The budget should show that the sector policy priorities are being implemented. It should be executed accordingly.

Different aspects of the sector budget require attention including:

- **What is the nature and scope of the "sector budget"?** The budget should be presented by line ministry or main agencies, the ministers being responsible and accountable for budget formulation and execution in their area of responsibility (see Box 5.2 for an overview of different budget classification systems). Ideally the government should be organized along functional lines, each sector being supervised by one ministry. In many countries the responsibilities for managing one sector are split between different line ministries. Such a fragmentation poses problem and calls for setting up coordination mechanisms within the sector. In certain cases it may be necessary to assess and monitor the different components of the budget that are relevant for a sector policy. In other cases it may be preferable to focus the SPSP on a (sub)-sector that is financed by a single component of the budget.

- **Are budget allocations and budget outturn consistent with the sector policy?** The overall level of sector financing and its recent evolution can give an idea of the importance of the sector in the overall development policy of the partner country. Is the share of the sector in total government expenditures increasing? How is the ratio of sector expenditures to GDP changing over time? For some sectors it may be useful to look at changes in public expenditures per capita. The composition of the sector budget should reflect the sector policy priorities: the allocation of funds between capital and recurrent expenditure, the percentage of sector budget allocated to salaries and to other recurrent expenditures, the level of resources budgeted for primary, secondary and tertiary sector delivery should be coherent with the sector policy objectives. In cases where service delivery is decentralised, the level of resources transferred to local government would also be of interest. If there appear to be inconsistencies between policies and budget allocations and outturns, what reasons explain these differences? For example, is there lack of clarity in defining strategic objectives to guide budget allocations? What main areas need to be addressed to bring allocations into line with national policy and strategy?

  The budget preparation procedure should be designed properly in order to ensure that programmes will be prioritised within the financial constraints. Giving a hard budget constraint to line ministries at an early stage of the budget preparation cycle favours a shift away from a “wish-list” mentality and encourages line ministries to prioritise their programmes and activities. To translate strategic choices and policies into programmes, line ministries require clear indications on available resources. A "top-down" procedure is aimed at allocating resources among sectors and/or ministries according to the strategic, or inter-sectoral, priorities, before prioritising individual programs and activities. Because policy changes need several years to be implemented such a procedure is, in principle, more effective within a multi-year framework than for the annual budget only (see section 5.2.2 below). However, starting the implementation of such a procedure for the annual budget will give some immediate benefits and will contribute to ensuring discipline in the budgeting process, which is a perquisite for developing a multi-year approach in budgeting.

- **What sector budget strategy is being pursued by the partner country?** In examining the evolution of the sector budget over time, and the forecasts for the future, it should be possible to describe the sector budget strategy of the country. Issues include: the sector budget financing strategy: does the sector budget rely on domestic or external budget revenues? Is there a cost-recovery (partial or total) approach to sector finance? Does it appear that capital expenditure is dependent on external finance? Examining these issues on the basis of past performance and future plans often gives a guide as to where priorities and constraints lie within the sector budget and where support can be most effective.

- **Is any work being undertaken to examine whether the sector budget is providing value for money?** It would also be useful to comment on any work that is being undertaken to look at whether the sector budget is providing value for money. For example, are there any audits by the Supreme Audit Institution examining this issue? Are there comparisons between regions on value for money? Are steps being taken to examine this issue, and does the government have a strategy for ensuring value for money in the use of public funds?

- **What is the size of support in relation to the budget?** It is important to describe the size of support in relation to key budget figures. For example, the size of forecast annual support as a percentage of the sector budget. The size of the SPSP support should also be placed in context in relation to the size of support from other international partners.

Box 5.2: Budget Classification Systems

A budget classification system is an instrument for administering the budget, policy analysis and accountability. There are four main ways in which a budget may be classified:

An **administrative classification**, which links budget allocations to the administrative structures responsible for expenditure, such as ministries, directorates and spending units. It is therefore aligned with the responsibilities for budget management. A good budget should always preserve this form of structure so that responsibility for budget implementation is clear. The traditional line-item budget classification system consists of a line-item (object) classification and an administrative classification

An **economic classification** which links the budget to economic categories such as recurrent expenditure and capital expenditure, and within recurrent expenditure the amount allocated to wages and non-wage expenditure. For fiscal analyses it is useful if a country's economic classification can be mapped to the international standards set out in the IMF's Government Finance Statistics Manual (GFSM 2001).

A **functional classification**, which classifies expenditures according to their socio-economic purposes such as defence, pre-primary and primary education, and hospital services. These categories will often be close to but rarely equivalent to the administrative structure of government. A functional classification is useful to prepare analytical reports for policy analysis, and historical and international comparison, and for these reasons it is useful if a country's budget classification can be mapped to the international standards in this areas set up in the UN's Classification of the Functions of Government (COFOG)

A **programme classification**, classifies expenditure according to "programmes" that are designed to meet a particular objective. In its purest form a programme classification will cut across the administrative structure of government (for example, health objectives rely on the work of a Ministry of Health, Education, and Water and Sewerage) and will depend on a country's specific policy objectives. However, in practice this form of programme is extremely complex and programmes are as a result much more closely linked to the administrative structure of government.

A budget classification system should cover the whole budget. It would be confusing to present and manage the budget under classification systems that would vary from one ministry to another. A budget classification system may be supplemented with additional segments (or sub-classifications) of the budget classification system. As noted above a mapping – or bridge table – between programmes and the budget can be prepared, and attached to these documents for transparency.

➔ **Are budget classification changes being made?** In many countries changes to the budget classification system are being made or being encouraged by donors. For example, ensuring that any economic classification is in conformity with GFSM 2001 standard; or that a functional classification consistent with the COFOG is introduced. A further step in modernising the budget classification may consist of implementing a programme classification that will group expenditures according to both their objectives and the responsibilities in budget management. Establishing a programme classification is often seen as a way to strenghthen the budget-policy link. However, a programme classification is not a panacea and is demanding. Where responsibilities in budgeting are fragmented (for example where personnel, goods and services and investment expenditures are managed by different directorates) or where adequate accounting systems are not in place, setting up a programme classification may prove difficult and will not lead to effective results. Thus grouping under the same programme expenditures that fulfil the same function, whatever their economic category and financing source, may require first reorganising the concerned ministry along functional lines, or reviewing the distribution of responsibilities between the ministry of finance, the ministry of planning and the line ministries. Some developing countries have attempted to classify expenditures in the budget according to cross-sector objectives that do not take into account responsibilities in budget management. As a result, responsibilities in budgeting are not well identified and the grouping of activities into programmes is often arbitrary, since an activity may contribute to several objectives. Consequently, in all these areas – introducing economic classifications in line with GFSM 2001, adopting a functional classification in line with COFOG, or introducing a programme classification – great care must be taken in ensuring that the integrity of a budget classification which clearly identifies responsibilities in budgeting is not undermined.In fact an administrative classification will often support policy decision making better than a poorly designed programme classification.

Examining the issues mentioned above should normally be carried out together with looking at public financial management issues, because of the close linkage between the "processes" of public financial management and the "content" of the budget examined here.

5.2.2 Placing the budget within a multi-year perspective

Placing the budget in a multiyear perspective has a number of objectives:

- **Reallocation role** (allocative efficiency). Ensuring that policy choices within a budget constraint can be made and allowing those policy choices to be gradually implemented over time as, through making it possible to devise a path toward gradually achieving policy objectives. Changes in budget allocations and expenditure frequently require a sustained multiyear effort in order to be attained since much of a budget is non-discretionary in nature.
- **Better implementation** (operational efficiency). Contributing to improving operational performance, through providing managers with greater predictability for managing their programmes.

Different elements of a multi-year perspective exist in practice. There are long-term perspectives (say 10-20 years ahead) where some countries describe their "vision" of the future. There are shorter-term perspectives often enshrined in Medium Term Frameworks (of say 3-5 years). The time period of the multi-year perspective will vary from country to country depending upon the challenges faced; a requirement to prepare plans over different time periods may also be established by law in some countries.

The use of Medium Term Frameworks as a tool for strengthening the budget-policy link has been popularised in recent years. Medium Term Frameworks go by many different names – Medium Term Macroeconomic Frameworks, Medium Term Fiscal Frameworks, Medium Term Budget Frameworks, and Medium Term Expenditure Frameworks. Box 5.3 provides some definitions of these terms, recognising that there is no universally accepted definition.

Box 5.3: Medium Term Frameworks: Glossary of Key Terms

Medium Term Framework: a macroeconomic, fiscal, budgetary, or expenditure framework typically covering a period of three to five years. The use of the word "framework" implies that it is not detailed, and certainly not as detailed as the information you would find in a budget.

Medium Term Macroeconomic Framework: a macroeconomic framework usually covering a coherent set of macroeconomic accounts – the national accounts (real sector), balance of payments, fiscal accounts, and the monetary survey.

Medium Term Fiscal Framework: the fiscal accounts covering revenue, expenditure, and financing elements of the fiscal situation of a country.

Medium Term Budgetary Framework: the budgetary framework of a country covering the revenue and expenditure, and financing elements that would be included in a budget. It may differ from the fiscal accounts to the extend that some financial operations of the government do not pass through the budget Information would normally be presented by the major headings used in the budget format.

Medium Term Expenditure Framework: the expenditure framework of a country covering the expenditure items. Normally expenditure items would be presented by the major headings used in the budget format.

It should be noted that there is no widely accepted definition of the terms used here. Some take the view that a Medium Term Expenditure Framework should include output and outcome indicators. Depending on the country such documents are called Medium Term Budget Framework (MTBF), "global MTEF", or merely MTEF.

Medium-term fiscal framework (MTFF)

The first stage or starting point in developing a multiyear perspective to budgeting must be the preparation of a medium-term fiscal framework (MTFF), which is a basic requirement for sound budgeting and a key instrument for controlling total expenditure. A MTFF provides revenue forecasts, expenditure forecast and financing forecasts (to cover any fiscal balance), It should cover a three to five year period.

The MTFF is a component of the medium term macroeconomic framework, which typically includes besides the MTFF projections of the balance of payments, the production sector (real sector) and the monetary sector. The macro-economic framework is a tool for checking the consistency of assumptions or projections concerning economic and financial development (for example, economic growth, fiscal balance, current account balance, exchange rate, inflation, credit growth, and external borrowing policies). Macro-economic scenarios should include sensitivity analysis (e.g. analysis of the impact of oil prices increases). Debt sustainability analyses and reviews of contingent liabilities should also be carried out. In many countries this work is often carried out in close collaboration with the IMF.

The MTFF should cover the financial operations of all government entities, and distinguish central government operations from sub-national government operations. In practice, however, in many developing countries, the coverage of the MTFF is not fully comprehensive, notably because of data availability problems.

In most developing countries an MTFF is prepared, either by the national authorities or by the IMF staff. Nevertheless, in many countries it is needed to: (i) reinforce national capacities to prepare the MTFF; and (ii) make the MTFF a more effective instrument for fiscal control, through budgeting under hard constraints, along the lines suggested below.

Medium Term Expenditure Framework (MTEF) – inter sectoral resource allocation

A second stage in developing a multi-year perspective to budgeting consists in preparing a Medium Term Expenditure Framework (MTEF), with a view to improving the allocation of resources between sectors. An initial step in developing an MTEF may consist of focusing on intersectoral resource allocation. Countries, with a disciplined budgeting process, including an MTEF will normally divide the annual budget process into two stages: (i) a "framework" or "strategic" top-down stage, during which the fiscal aggregates are set, indicative sectoral allocations are made for a multi-year period, and expenditure ceilings established for the annual budget under preparation; and (ii) a bottom-up stage, during which line ministries draft budgets and programmes are prepared.

At the first (framework) phase of budget preparation, an MTEF document that includes expenditure estimates by line ministry, or by sector, and a budget policies statement is prepared. This document should be reviewed at a high political level (e.g. the Cabinet or an inter-ministerial committee). Expenditure ceilings will set the framework for the annual budget preparation and multi-year expenditure programmes will be derived from this document.

Such a framework is necessary if some sectoral or multiyear expenditure programming exercise is to be carried out. It helps prevent inconsistencies between the sectoral programme and the MTFF, or the crowding out of expenditure in sectors or areas not covered by a sectoral programme. Thus, the so-called sectoral MTEFs must imperatively be established within the framework of a MTEF, which should in its turn be based on a MTBF or macroeconomic framework.

Generally, an MTEF covers a period of three to five years and is prepared and rolled over annually[24]. Its first year should be in line with the budget, while subsequent years are indicative. An MTEF does not replace the budget, but does shed light on the future budgetary impact of current policies. In principle, it encompasses all expenditures whatever their financing source and their economic nature. The preparation of an MTEF should be integrated in the procedure for budgeting under hard constraints discussed above.

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24 According to the "Budget Practices and Procedures" OECD and World Bank survey, half of the OECD countries include "formal rolling medium-term (3-5 years) estimates of expenditure" in the budget documents. http://www.oecd.org/document/3/0,2340,en_2649_34119_2494461_1_1_1_1,00.html

MTEF – intra sectoral resource allocation

In the second (bottom-up) phase, line ministries formulate and cost their spending programmes, and prepare their budgets within the ceilings. Sufficient time needs to be granted for reconciliation mechanisms and for allowing line ministries to prioritise their programmes and identify measures to comply with the ceilings. Depending on the severity of the fiscal constraint and the organisation of the budget preparation process, additional requests from line ministries could be allowed for a few new programmes, above the ceilings. However, the principal request should be consistent with the notified ceilings or guidelines, and the cost of programmes included in this principal request should be sufficient for full implementation of the programmes concerned.

Detailed costs analysis should focus on key points. For example, as noted earlier the forward annual costs of investment projects of a certain size must be always assessed, with or without MTEF. On the other hand, the cost-effectiveness of preparing detailed forward expenditure estimates for each recurrent activity must be always assessed before launching such an exercise.

Box 5.4: MTEF and Budget Preparation in South Africa

In South Africa, the MoF (the "National Treasury") started to work on a MTEF in 1994, but this ex-perience did not last two years, because of a lack of political involvement and no clear linkage with the budget process. Taking into account this initial experience, the MTEF and budget processes were merged in 1997. They include currently the following co-ordinated activities:

Initial policy review (May-September –the fiscal year starts April 1st), which includes the following critical steps:

- June-July, the Ministers' Committee on the Budget (MinComBud) considers the MTEF baseline, ex-penditure reports, policy and funding issues;
- July: national, provincial and local government technical committees meetings;
- July-September, revision of the macro-economic framework, revenue projections, and the fiscal pol-icy.
- October: An extended Cabinet meeting considers the fiscal framework and revenue projections.

Preparation of MTEF/budget submissions (April-August). Line ministries MTEF/budget preparation starts at the beginning of the fiscal year. Line ministries proposals must be submitted to the MoF by August 16th. Their proposals should be structured in order to ensure that proposed policy changes are clearly identified. They should include:

- A baseline medium term allocation. The resource envelope used to determine this base line consists of the two outer forecast years of the MTEF prepared the previous year.
- Identified savings and reprioritisation, within the baseline.
- Policy options which propose changes to the medium-term baseline allocation (e.g. new policy, change in the level of output, change in the implementation plan of a program). These options should be related to the strategic priorities of the line ministry. For non recurrent expenditures estimates should cover five years (two years beyond the MTEF period).
- Various documents and statements (e.g. personnel numbers, analysis of risks and contingent liabili-ties, etc.)

Review of MTEF submission, MTBS, and allocation process (August-November). Provincial and na-tional Medium Term Expenditure Committee (MTEC), comprising senior officials from the MoF and other ministries, evaluate in August-September the MTEF/budget submissions of line ministries and make recommendations to the MoF.

The MoF submits to the Cabinet in October a draft Medium Term Budget Policy Statement (MTBPS) and "adjustments estimates". The MTBS, the "adjustments estimates" and a budget execution report are presented to Parliament at the end of October.

The MTPBS is aimed at developing the policy debate, but it is not a binding document. It includes: (i) an economic outlook and three-year macro-economic projections.; (ii) a medium-term fiscal frame-work.; (iii) a report on taxation; (iv) a report on priorities over the medium-term, which includes an MTEF aggregated by broad sectors; (v) a report on the intergovernmental financial relationships.

Finalisation

Early November the Cabinet approves MTEF allocations to ministries and for conditional grants to subnational government. These financial envelopes are communicated through "allocation letters" by the MoF to line ministries.

Line ministries prepare their draft MTEF/Budget in November-December. The budget includes under the same format both projections for the budget year and indicative estimates for the second and the third years of the MTEF. It is tabled in parliament in February.

Sources adapted from Medium Term Expenditure Framework Treasury Guidelines. Republic of South Africa 2004 and 2007

"Operationalising the MTEF as a tool for Poverty Reduction": South Africa, Albert van Zyl. Overseas Development Institute. London. May 2003.

5.2.3 Options and features of MTEFs

Although a view of the MTEF has been presented above, in practice what is an MTEF varies from one country to another. Some features and options are discussed below.

The coverage of the MTEF. For efficient resource allocation the MTEF should encompass all central government expenditures, whatever their financing source and their economic nature. It should include a resource section to identify all resources, including own revenues of spending agencies and project-aids. For efficient resource allocation, the coverage of the MTEF should be extended, at least progressively, to the revenues and expenditures of extra-budgetary funds.

In some countries preparing an MTEF may be a means to overcome the fragmentation of budgeting processes faced in many developing countries, notably the separation between the recurrent and the investment budget. Thus, in several countries, the public investment programmes (PIP) that were prepared in the 1980s and the 1990s have been abandoned to be replaced by some form of MTEF, which in principle covers both recurrent and capital expenditures.

The MTEF as part of a budget process. In some countries, the budget and MTEF process includes, half way through the fiscal year, the presentation, for information, to the legislature of an MTEF presenting policy directions by function, together with a budget execution report and a revised budget bill (see, in Box 5.4, the MTEF-budget process in South Africa). This procedure, reinforce the role of the MTEF in framing resource allocation.

The MTEF as part of fiscal discipline. In OECD countries, multi-year expenditure projections are prepared under prudent resource projections. They focus on the approved policies and do not include new programmes or programme extensions not yet agreed. The MTEF is a mean of planning policy changes, which may consist of both new policies and savings. Actually, taking into account the current fiscal strains, MTEFs in developed countries are more aimed at stabilizing expenditures or planning savings than at planning additional programmes.

Further steps in the development of an MTEF will be aimed at improving the effectiveness of intra-sectoral resource allocation and providing managers with increased predictability, in order to improve performance in programme management. Therefore, for each ministry, or sector, the expenditure projections will be detailed at least by broad programmes. A few developing countries (e.g. Ghana) have implemented MTEFs detailing programmes activities and outputs, but results from such experiences are not yet satisfactory. In a few countries (e.g. Australia, South Africa), detailed forward expenditure estimates are presented in the budget under the same format and with the same degree of detail than the annual budget outlays.

A sector MTEF should preferably be a line ministry MTEF. However, in some cases, depending on the organization of the government and on the sector, it may be desirable to carry out a public expenditure programming exercise for the whole sector. In such cases, it will be important to identify clearly the responsibilities in preparing and implementing the components of the sector MTEF. The budget being managed by line ministries, to make the sector MTEFs effective, line ministries MTEFs should be derived from the sector MTEF. The sector should be clearly identified in the MTBF (or global MTEF) and a procedure should be in place to ensure that the sector MTEF complies with the financial constraints given by the MTFF and the MTBF. This approach may be relevant for our so-called "multi-institutions sectors" involving different line ministries.

Sub-national government. Depending on the distribution of responsibilities between the different levels of government, it may be desirable to prepare MTEFs both at the central government and at the subnational government levels, and to set up coordination mechanism between these different MTEFs. However, except for large federal states, preparing local government MTEFs requires first a mature MTEF at the central government level.

Degree of detail of the expenditure estimates. Different degrees of detail can be considered for an MTEF. An MTEF that would detail expenditures only by broad programmes (e.g. primary education, secondary education, etc.) has the advantage to put less strain on scarce human resources than more detailed MTEF. However, aggregate estimates risk being arbitrary, if they are not justified by more detailed cost estimates, notably concerning the multi-year investment projects. A balance should be found between two extremes approaches, which will consist of either presenting aggregate expenditure projections by ministry or detailing the expenditure projections by activity or output. The optimal balance will depend on the country technical capacity. It will depend also on government commitment to fiscal discipline. Specifying future new activities and projects in a multi-year programme could overload the future budgets, if the budgeting processes are governed by bargaining. At the same time forward estimates should be indicative avoiding detailed expenditure estimates which may be interpreted as promises for specific future activities (an MTEF should be true to its name – it is a "framework" and not a detailed list of activities). If the processes are not disciplined, detailed MTEFs risk becoming wish lists of activities. The MTEF should focus budgeting on policy choices, if budgeting is used to control the details of spending, the MTEF will not be of much value

Introducing performance elements. In theory, detailing the multi-year expenditure estimates by programme, subprogram and activity or output could facilitate the development of a performance budgeting approach and increase predictability at the programme management level. However, such exercises may be demanding in term of technical capacity.[25]

5.2.4 Limitations of the MTEF

The use of a MTEF has a number of limitations that should be taken into account when promoting the use of this instrument. Some issues are summarised below.

Avoid promotion of an MTEF when circumstances are not right: The reviews of the MTEF experience in African countries show that the results are uneven and sometimes disappointing[26]. According to the IMF[27], "developing comprehensive medium-term expenditure frameworks can be effective when circumstances and capacities permit. Otherwise, it can be a great consumer of time and resources and might distract attention from the immediate needs for improving the annual budget and budget execution processes… Before introducing an MTEF, one should raise a question: is the country ready for such an exercise in the sense of having adequate support for the above preconditions? When this support was not adequate in a number of African countries, the MTEF was introduced prematurely, and is turning out to be merely a paper exercise".

There is very often a need to get the "basics" of budget preparation, execution, reporting and auditing functioning in a satisfactory manner before moving on to more ambitious plans embodied in the preparation of an MTEF. It can often be possible to ensure a reasonable policy-budget link within the annual budget cycle if it is functioning reasonably well. On the whole these reviews suggest that to be an effective instrument for improving budgeting, the MTEF requires the following:

- reliable macroeconomic projections, linked to fiscal targets in a stable economic environment;
- establishing an explicit strategic phase at the outset of the MTEF/budget process to engage ministers collectively on policy priorities, and practicing top-down budgeting that reflects both aggregate resource realities and policy priorities;
- satisfactory budget classification and accurate and timely accounting;
- disciplined policy decision-making and political discipline for fiscal management;
- linking consideration of recurrent and capital spending and integration donor instrument such as programmatic approaches to aid delivery;
- technical capacity.

The use of sector or "partial" MTEFs. In several Commission partner countries, MTEFs were prepared only for a few priority sectors, without being properly framed by an MTFF. Focusing on priority sectors may be more cost-effective than covering all sectors, but it can be questioned whether such partial and open-ended MTEFs are effective in achieving the objectives of fiscal discipline and efficient intersectoral resource allocation, mentioned earlier. In addition, such sector MTEFs are often seen as being expansionary plans, unlike the MTEFs of industrialized countries.

Political support. An MTEF should not be a mere technocratic document or a mere set of spreadsheets. As noted, it should be based on a sector strategy. It should if well prepared include a budget policy statement, which will show the links between the budget, the MTEF and the sector and national strategies.

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25 Full costing of activities and outputs, which is sometimes considered, would required the development of costs accounting methods (such as activity based costing), which are beyond the capacity of most countries, including industrialised countries.

26 Malcom Holmes and Alison Evans "A review of Experience in implementing MTEFs in a PRSP context : a synthesis of eight country studies". ODI. 2003. Philippe Le Houerou and Robert Taliercio "Medium Term Expenditure Frameworks: From Concept to Practice. Preliminary Lessons from Africa". World Bank. 2002.

27 Selected African Countries: IMF Technical Assistance Evaluation—Public Expenditure Management Reform. IMF. 2006.

As noted, the financial envelopes for the annual tranches of an MTEF should be agreed at a high political level. Once finalised, the MTEF or the sector section of the MTEF should be reviewed and approved by the Cabinet or a Cabinet committee.

In the same way as the budget, a sector MTEF should be prepared by the relevant line ministry, but the ministry responsible for finance and economic management and the Prime Minister office should be regularly consulted at the different stages of its preparation.

If the MTEF is well prepared, in conformity with the MTFF, it could be made public and transmitted for information to Parliament, in order to show the commitment of the government. On the other hand, it will be counterproductive to publish a non-credible MTEF, and this issue should be reviewed in the wider context of the definition of the fiscal reporting policy.

Mechanisms to promote consultation and debates with the legislature and the civil society are required to ensure that all policy options are considered before choosing the most cost-effective option. Such policy consultations will be preferably undertaken at an early stage when the strategies are formulated or revised.

Donors' involvement. An MTEF is primarily an instrument to support government budget management and improve resource allocation. In addition it may be an instrument to coordinate donors' aid. It can contribute to improved transparency and predictability in funding, provided that the donors "play the game". To this end, donors' consultation and coordination mechanisms should be set up. For each sector, such mechanisms should be led by the relevant sector ministry.

Increased predictability in funding is one of the aims of a MTEF. In aid-dependent countries the MTEF will be credible only if the aid flows are predictable. Commitment of the donor community to fund in timely manner the government budget will be a key element for making the MTEF exercise successful.

5.2.5 Assessing the MTEF processes

If some form of MTEF is in place, some of the issues that could be examined include:

- Is the MTEF being prepared against the backdrop of a functioning annual budget cycle? Are the "basics" of budget preaparation, execution, reporting, and auditing of a statisfactory standard?
- The linkages with the macro-economic and intersectoral resource allocation should be assessed: does the MTEF complies with the financial constraints defined in the MTFF?
- If the MTEF documents cover only a few sectors, is there an MTBF (or global MTEF), which frames these documents in conformity with the MTFF?
- If certain "sector MTEFs" cover the areas of responsibility of several ministries, are the responsibilities of each ministry clearly identified? Is this "sector MTEF" framed by a global MTEF? What are the mechanisms to ensure coordination at the sector level?
- How are sub-national government's programmes taken into account? What are the coordination mechanisms between the central government's MTEF and sub-national government's MTEFs, if any.?
- What is the degree of detail of MTEF expenditure projections (e.g. by programme or by activity)? Are there improvements in their degree of detail and costing methods planned? Is the degree of detail relevant, or does it obscure major policy issues?
- Is the MTEF published? Is it transmitted to Parliament?

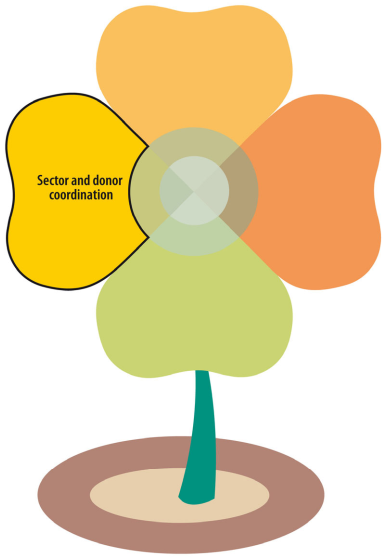
The analysis of the MTEF document will help in assessing whether the government policy is being implemented. Issues to be reviewed include, among others: Does the MTEF include a well developed budget policy statement? Does the planned changes in the volume and the composition of the sector budget are in conformity with the sector strategy? Are the forward costs estimates reliable?

The credibility of the MTEF can be assessed ex-post through reviewing the gap between the MTEF estimates, the budget and actual budget execution. Is the first annual tranche of the sector MTEF consistent with the budget? What is the gap between year t budget and the year t tranche of the previous MTEFs (e.g. MTEF t-1 to t+1)? The realism of cost estimates and projections can be also judged through comparing of the current programme with trends in the recent past and reviewing the internal coherence of the MTEF projections.

These reviews should not be aimed at benchmarking the MTEF against a best practice. Its objective should be to assess whether the country is making progress in building a sound budgeting and placing the budget within a multi-year perspective, taking into account its current situation and technical capacity. At the outset, the most significant issues to assess are whether there is a commitment to strengthen public expenditure management. Some form of action plan for strengthening expenditure programming could be prepared. Theses actions should not be defined in isolation for only one sector. They should be closely coordinated with the other actions aimed at strengthening government expenditure management.

5.3 Sector and Donor Co-ordination

An effective government-led system of sector and donor co-ordination is one of the defining features of a sector programme. It is often the starting point for a sector programme and in many ways, the centre-piece which enables the dialogue about other components.



Sector coordination is here used to denote national coordination mechanisms between government and non-state actors on all relevant sector issues. The sector policy is the result of consultation, coordination and decision mechanisms which can involve economic and civil society stakeholders, the parliament, cabinet, cross-cutting ministries and local governments. Annual and medium-term budgeting processes, performance monitoring, domestic accountability and strengthening of the demand for public service and capacity are also arenas for sector coordination involving different stakeholders. The sector coordination mechanisms as considered here are thus a key element of the sector governance (see section 3.3), together with other elements (the legal framework, the formal authority of organisations etc.)[28]. As a key component of the overall sector programme process, national sector coordination deserves special attention and is discussed separately here.

Aid coordination, on the other hand, covers the narrower efforts to align and harmonise donor support to the sector. While donors have a keen and legitimate interest in the efficiency, effectiveness and robustness of the sector coordination mechanisms, it is important to separate the two coordination arenas: donor coordination is a means to achieve increased aid effectiveness and reduction of transaction costs, and while it should aim at strengthening sector coordination, it should not replace it. Care should be taken to avoid the risk that sector stakeholders are included in donor coordination mechanisms to accommodate donors' needs – this may weaken rather than strengthen the permanent sector coordination mechanisms which have to be strengthened.

An effective sector and donor coordination system is important not only because it increases effectiveness in implementation of the sector programme and reduces transaction costs but also because the dialogue that is part and parcel of a coordination process can be a means to institutional development and capacity building.

In this section, we first present some issues in relation to sector coordination, followed by the latest thinking on good practice in donor coordination. Since some coordination challenges are similar at sector level and in relation to donor coordination, some of the considerations presented are relevant for both sector and donor coordination.

5.3.1 Focus on sector coordination

There is no right model for how sector stakeholders best coordinate, participate, consult and are consulted. Some countries have developed well with rather centralised schemes of sector development and governance,

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28 *Parallel to the revision of these guidelines, and consistent with them, Europeaid is preparing methodological guidance to assist delegation staff and partners to mainstream and specify governance issues at sector level.*

with a strong hand of central ministries of e.g. finance and planning. Others have had more autonomy for line ministries, which again may use a more or less "vertical" approach vis-à-vis other agencies and decentralised units. Involvement of non state actors also varies considerably, from more corporative systems where government and key organised sector groups negotiate policies with little democratic oversight, over systems where parliament is brokering interests, to systems where the executive plays a very dominating role.

When assessing sector coordination mechanisms, there is therefore no checklist to consult, but rather a number of questions which have to be discussed between the partners to a sector programme.

Issues to be considered may include:

- First, however, **a warning particularly to donors**: From the outside, it is often relatively easy to observe phenomena which seem to indicate what is then broadly labelled "poor coordination" between actors and organisations. Next apparent logical step is then to suggest improved "coordination mechanisms", often resulting in commissions, councils, steering committees, task forces, working groups, programme implementation units, regular monthly meetings, in some cases supported by specially recruited or seconded staff or consultants.

  This may all be relevant at certain stages. However, it may address symptoms rather than causes: Lack of leadership, of incentives and/or capacity to scout and network efficiently cannot be substituted by coordination mechanisms. Barriers against e.g. sharing of information are not likely to disappear by declarations of good intents. In short, incentives to coordinate have to be right in the first place – then coordination mechanisms are likely to be effective. Not the other way around.

  Therefore, in assessing sector coordination, the **incentives to coordinate** (and the costs of doing so) should be carefully considered.

  It should also be recalled that the government as such is essentially a vehicle for coordination: the cabinet is the highest level coordination mechanism across sectors, ministries of finance are supposed to coordinate allocations, ministries may formally be in charge of coordinating sector agencies and deconcentrated units, and regular intra-governmental mechanisms should coordinate between local governments and line ministries. This means that a core task for civil servants – not least in central ministries - is, in fact, coordination. When this coordination is less than effective, the first thing might be to strengthen it and develop the capacity to coordinate, rather than to establish parallel, often donor-driven coordination units.

- Second, the **substantive purpose** of coordination should be clarified. This helps to assess whether coordination mechanisms are effectively put in place or strengthened from the perspective of making the national system work better. Coordination for the sake of increased aid effectiveness may also be required, but it is important that the narrower concern of aid effectiveness does not distort or replace the broader concern of effectiveness of the sector as such.

- Third, the **immediate objectives** of coordination processes should be made clear to enable assessment of the effectiveness of alternative mechanisms: is it network building (in which case events with a social dimension might be effective), information sharing (in which case big meetings are ineffective), joint analysis (formal and big meetings are poor for that), negotiation or bargaining (informal processes and small meetings may be good), advice and consultation (where bigger meetings may work) or decision-making (in which case the decision mode should be clear).

- Fourth, the clarification of purposes and immediate objectives would allow delimiting the **actors to be involved** in different coordination mechanisms. Frugality should often be observed: the fewer involved, the more effective is coordination likely to be.

- Finally, developing capacity to coordinate in a sector is a long term endeavour, and shorter term pressures to ensure implementation of the sector programme may pose dilemmas and force second-best choices in terms of the long-term perspective. This being so, the long term development of sustainable coordination capacity should be kept explicit so that choices between long and short term objectives are explicit and underpinned by good assessments.

5.3.2 Development of stakeholder consultation mechanisms

It is important not to leave out important stakeholders, notably citizens, out of the coordination and policy making process. Feedback from citizens on performance for example is important to feed the policy debate. There are different types of consultation mechanisms to achieve this involvement.

The key issues that may be addressed include:

- ➔ Is there a mechanism in place for a structured process of consultation with beneficiaries and and, if not, does there exist a concrete plan to create one?
- ➔ Does the plan differentiate between the different functions which stakeholders may play and the types of information which may therefore be needed? In particular, is there a clear distinction between mechanisms of consultation, where opinions are sought, from inputs into decision-making where stakeholders are party to resource allocation or service management decisions?
- ➔ Is the structure of consultation mechanisms properly integrated with the framework for service delivery? Are local beneficiaries consulted and involved as appropriate?
- ➔ Is there an adequate linkage with local government?
- ➔ Are the difficulties of obtaining representative inputs properly addressed - in particular the difficulties normally associated with obtaining an adequate representation of women?
- ➔ Is there an adequate balance between quantitative surveys and more qualitative, participatory processes?

5.3.3 Good practices in aid coordination

A good framework for aid co-ordination in sector-wide approaches spans partner government -donor relations, intra-donor relations, and individual donor systems including:

- ➔ An agreement on the information, fora, rules and timetables to manage dialogue between partner and donors.
- ➔ Arrangements between different donors to enhance co-ordination and to simplify procedures where it is not possible to use partner government systems.
- ➔ Internal donor rules, incentives and culture that promote the ability to form effective partnerships with partner governments and other donors.

Partner-donor relationships

In assessing partner-donor relations, it is important to appreciate that government must take the lead in improving donor co-ordination but that their ability to do this may be limited by the history of relations between individual donors and the government. The sector authorities may therefore need the support of a “lead donor” or small lead group of donors for this process to work effectively.

A sector approach will initially not reduce transaction costs. Over a considerable period of time, coordination of an sector programme will require more efforts rather than less. Existing bilateral projects on the margin of the sector programme may continue to demand attention, and the mixture of modalities used by different donors to support the sector programme will demand bilateral consultations on top of the joint coordination mechanism. Finally, in any Sector Approach donors will be accompanying the development of policies, public finance management, accountability and monitoring of processes and results, all of which requires dialogue, support through joint analytical work, ad hoc working groups etc.

The partner-donor relationship is concretely shaped by four elements: information/documents, forums, rules and a calendar as presented in Box 5.5.

Box 5.5: Elements of a Sector Programme Management System

Information and documents that help to define the co-ordination system include the sector policy and/or development strategy and expenditure programme, the agreed set of periodic and annual performance, financial and audit reports as appropriate, as well as ad hoc analytical inputs in areas of joint concern.

Principal **forums** may include:

- ➔ A **high-level sector programme liaison committee** entrusted with global oversight, general policy dialogue, as well as dialogue about overall donor support to the sector programme. Neither this nor any other joint body should play a direct role in the implementation of the sector programme. The high-level body would often be fairly broad in composition (sector ministry, parliament sector committee, Ministry of Finance, local government representatives, all major donors, possibly other stakeholder representatives including civil society representatives) and only meet annually or semi-annually.
- ➔ An **ad-hoc high-level government-donor forum** for possible conflict resolution, consisting of senior civil servants and a smaller group of heads of agencies with a mandate from the rest of the donors.
- ➔ A **smaller government-donor coordination body** where operational coordination and more detailed policy dialogue take place (review of regular and analytical reports, endorsement of calendar and ToR for joint reviews, negotiation of agenda for joint analytical work etc.). A lead donor or small lead group of donors is a useful way of rationalising the set-up on the donor side.
- ➔ **Joint technical working groups** to facilitate deeper dialogue and/or analysis in particular areas (e.g. on gender aspects of the sector programme, or PFM in the sector).
- ➔ **Periodic (probably annual) joint reviews;** which examine the achievements of the last working period, assess the evolution of key sector indicators, and make recommendations to all parties to the sector programme. Such reviews can be led by the government, which fosters ownership, or by donors, which may feel that they need their own review to be able to address their accountability concerns.
- ➔ A **wider consultative forum** (again probably annual, and possibly held immediately before or after the joint annual review) that allows participation by a wider range of domestic stakeholders.

The various forums need effective **secretariat support**, but it need not be the same secretariat for all the forums. The secretariat services should be an integral part of the functions of the leading sector authorities. Responsibilities need to be clearly allocated, adequately resourced and actively empowered.

The rules governing donor coordination include agreements about the management of the sector approach (e.g. any Memoranda of Understanding, joint financing agreements, codes of conduct, mandate and terms of reference for co-ordinating committees, etc.). Often, agreements are initially well served by being informal, allowing personal relations of trust to develop and mature before formalisation.

Finally, an agreed **calendar** provides rhythm and deadlines for the work of the various management bodies and review forums. The calendar should fit with the government's fiscal calendar, and include timing for donors' funding commitments; meetings, reports, and reviews; a multi-year timetable for roll-over of the main sector programme document; and a work programme for related thematic research and reviews.

Donor-Donor relationships

Multiple inconsistent practices by donors impose burdens on partners. Where it is not possible to use partner country systems, donors can ease this burden by adopting common systems and procedures or adopting joint working arrangements that include shared decision-making. Such harmonisation can lead to stronger, more sustainable forms of aid co-ordination, provided care is taken to consult fully with partner countries.

Working arrangements, such as joint monitoring teams and joint high-level meetings, reduce burdens on partner countries. Others, such as lead donor arrangements for particular donor co-ordination bodies, can create the potential to lower the burdens on partners of administering aid.

Good practices for achieving these benefits of joint working, where donors participate in the same sector programme, are set out below.

- ➔ **Share information** – Information on relevant donor operations (consultancies, project proposals, reports etc.) should be made available to other donors and the partner government.

- **Explicit agreement on roles** – Agreements should set out the respective roles, consultation mechanisms and behaviours expected of each donor in a multi-donor activity where the benefits from an explicit understanding outweigh the costs of any negotiation.
- **Share examples of common procedures** – Sharing country-specific examples of common procedures can contribute to international good practices that can be applied more widely.
- **Global common procedures only in certain** circumstances – Negotiation of common procedures at a global level is only appropriate where this approach does not undermine the adoption of partner government systems and where the benefits of standardisation warrant the often high costs of negotiation.

5.4 The Institutional Setting and Capacity Issues

The success of any sector programme depends on the underlying institutional drivers of and constraints to development, as well as the capacity of the involved organisations and persons. These factors will largely determine the pace of implementation as well as the robustness of the sector programme. Dialogue about the institutional setting and the present capacity based on a joint assessment of the situation is therefore an essential part of the preparation of an SPSP (including support to capacity development) as well as part of the ongoing dialogue during implementation.

As discussed in section 3.5, in line with the Paris Declaration, development of sustainable capacity in the sector should be a core objective of the sector programme. This requires an assessment of the institutional setting and of the capacity. In this section, the focus is on this assessment only[29], and not on planning support to CD.

Assessing the institutional setting and present capacity in a sector may have different objectives and a different scope depending on the status and characteristics of the sector programme itself. Where the sector approach is in its early steps, the first objective would be to assess whether the sector programme can realistically be implemented under national leadership and drawing mainly on the existing capacity. The result of the assessment may influence the design of a realistic Programme and support definition of SPSPs focus and expected outputs. If the sector programme is more mature and already integrates a capacity development component, the assessment will give special attention to the soundness and quality[30] of this component. In any case, this assessment will support the definition of SPSPs focus, expected outputs and implementation modalities (see section 4.3). If the EC intends to support capacity development with specific activities, this assessment will also provide crucial inputs in their design and in the dialogue with main sector stakeholders.

5.4.1 The assessment process

The Paris Agenda calls for a harmonised approach to capacity development. This is valid for all issues dealt with in relation to capacity: capacity assessments, dialogue about capacity and capacity development options, as well as donor support to capacity development. The EC has fully endorsed the Paris Agenda also in this area, and will therefore aim at undertaking all activities in this area jointly with other development partners, supporting government leadership of all processes.

Lessons from experiences and promising practices in this area show that in dealing with institutions and capacity development, the partner government leadership is particularly key and donors can only play a supportive role. The EC and other development partners should therefore to the degree possible build their assessment in this area on existing analytical work performed by the national partners or under their leadership. A donor-driven analysis may fail to create a climate of open and trustful dialogue and to ensure a clear ownership of the analysis by the key national stakeholders. Without this ownership, even the most technically proficient and excellent capacity assessment is unlikely to be used as foundation for subsequent capacity development.

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29 *See as well the standard model TOR for Institutional and capacity assessment : http://www.cc.cec/dgintranet/europeaid/activities/adm/capacity_development/guidance_en.htm.See as well the Reference Document on "Institutional Assessment and Capacity Development" (Web Reference Section)*

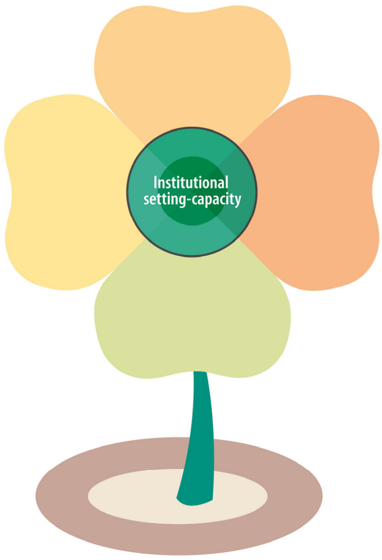
30 *http://www.cc.cec/dgintranet/europeaid/activities/adm/capacity_development/guidance_en.htm See in particular the "ADM Check list on CD support "*

It may therefore sometimes be preferable to start the SPSP based on a partial assessment, and which may build on less than full and updated information. More thorough assessment processes, led by the national partners with the aim of defining solid capacity development processes, may then be part of the agreed early actions of the sector programme, as required with support from the SPSP.

If an assessment is deemed to demand EC- or donor-contracted TA, ToR should anyhow preferably be drafted by government and endorsed by donors. The team should work under the authority of the sector organisations that they are assessing. Inclusion of local or regional specialised management consultants may often strengthen an assessment team's ability to assess context factors and informal aspects. It may also facilitate more extended processes in time, which are better adapted to foster ownership and to respect the daily priorities of the organisations. Assessment processes concentrated over 1-2 weeks and conducted mainly by international consultants are likely to create stressful relations between the parties, and may have difficulties in digging deeper into sector context.

5.4.2 How to approach capacity assessments

The key steps of a suggested approach to institutional and capacity assessment are summarised in this section. Its full development is presented in the Reference Document on "Institutional assessment and Capacity Development" (standard terms of reference and checklist)[31] and is supported by some working tools. This framework, based on good practices already shared by a number of donors, may facilitate the understanding of institutions and capacity issues, and the related policy dialogue. It may also guide the design and implementation of the assessment itself. However in this latter case, applying fully or partially this approach should be done only in respect of the principles of alignment and harmonisation outlined above and in section 3.5.



Capacity is not an area in itself. It can be seen as the heart of the flower that symbolises a sector programme as a key dimension of its different petals. The assessment may therefore be spelled out referring to these core elements (in particular the capacity to formulate and implement a sector policy and the sector budget and its medium term perspectives, the capacity to manage the coordination framework, and the capacity of the performance monitoring system).

When assessing capacity in a sector, the sector organisations can conveniently be seen as systems embedded in a context. It may require a quite comprehensive and complex assessment to come to terms with the strengths and weaknesses of the sector system, and the drivers of and constraints to its performance. In this short summary, three key issues are singled out as particularly important for the assessment: i) the present outputs (products and services) from the sector; ii) the institutional setting and context; iii) and the capacity of the key sector organisations.

i. Present outputs

Capacity results in outputs (products, services, regulations). A clear picture of present outputs is a good proxy indicator for present capacity. Possible capacity development should also result in increased and/or better products/services – and this development process will depart from and build on what is already there. Therefore, the assessment should include a clear mapping of current outputs, their quantity and quality, and the degree to which the intended users have access to the services or will respect the regulations. This will also provide a baseline for discussing capacity development, and to monitor if e.g. training and technical assistance results in improved performance.

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[31] http://www.cc.cec/dgintranet/europeaid/activities/adm/capacity_development/guidance_en.htm. *See as well section on Web Reference.*

ii. The institutional setting and wider context

With a sector approach there will be many organisations and stakeholders to consider, who together are significantly contributing to the outputs (products/services) in the sector. The performance of the sector will depend not only on the capacity of the various sector players, but also on the enabling or constraining factors in the wider context of the public sector, the political setting, the economy and the dominant norms and values which enable and constrain present performance: does money come in a timely and predicable manner; are relations to the Ministry of Finance and others effectively managed; are overall incentives for civil servants conducive to work? These and other related questions about the context factors must be assessed. Part of this may well be general for all sectors and can therefore be shared, but it is also important to detect context factors close to the sector.

The institutional setting includes both informal and formal aspects. The formal legal framework is an important part of the institutional setting of the sector: Are the mission, roles and tasks of sector ministries, deconcentrated agencies and decentralised units reasonably clearly defined? On the informal side it is necessary to assess whether legal regulations are effectively defining the rules of the game: are they observed and enforced, with sanctions against those not following them? If they are not effective, the assessment should develop an understanding of the constraints to legal effectiveness

iii. The capacity of key sector organisations

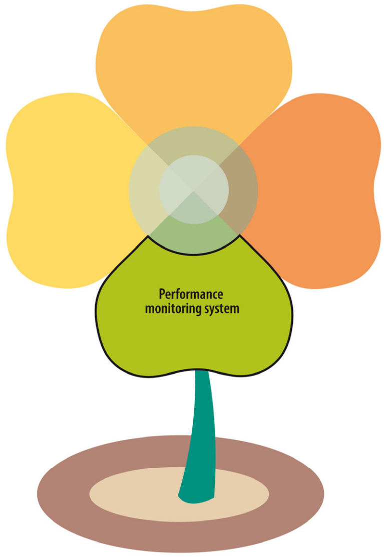
The third area of attention is about looking inside sector organisations themselves and screening their internal capacity. A number of analytical models can be used in this type of exercise, mostly referring to key classical factors influencing organisational performance such as leadership, incentives to staff, relations between staff, staff numbers and skills, structures, processes, available funds as well as the quality of the relations to other important organisations in or outside the sector.

Care has to be taken not to approach this analysis from a position where the present capacity is mainly assessed with the lenses of how the capacity should ideally be. This may lead to assessments which are full of statements of what is lacking – lack of leadership, of planning, of systems, etc. Such a gap analysis may end up explaining nothing: it would correspond to diagnosing a sick person by observing that this person cannot work well, eat normally, run etc. – which might all be very correct, but say nothing about the sickness leading to this situation and the cure which would remedy the situation.

It is also necessary to look beyond what is directly observable in organisations. Organisations and networks do not consist only of what can be seen, they are also driven by informal rules and norms. Further, organisations only function if they are driven by energy and power exercised largely for the benefit of the organisation, but such power issues – and the conflicts they also often imply - are often considered to be sensitive. A capacity assessment must therefore not stop when it has looked at the formal, visible part – organisational charts, job descriptions, mandates - it also has to come to grips with the informal aspects of organisations, and the power and loyalty issues that foster or constrain capacity.

It's important to consider as well key organisations outside the public sector whose capacity are influencing quality of the sector policy dialogue, sector coordination and are key for domestic accountability. This is particularly important in multi-actors policy areas (as rural development, private sector development where these organisations play an important role as well in service delivery.

5.5 The Performance Monitoring Systems



One of the fundamental objectives of the Commission in engaging in sector programmes and in budget support is to be able to work with governments to direct attention towards the **results** of development spending. Outside of the project paradigm, it is easier to move beyond a focus on inputs and outputs and to consider the full range of factors influencing the outcomes and impacts of development spending. It is possible through the consultative mechanisms of the sector programme to address not only the material requirements necessary to improve outcomes but also the policy and institutional constraints. Moreover, if the policy and programme implementation structures of the sector programme are working well, it is possible to disengage from the detailed management of inputs and activities so as to leave these responsibilities with government – where they properly belong, and focus the attention of the Commission and other donor partners on outcomes and results.

If such a framework developed by the line Ministry is to work well, it is crucially important that the indicators selected for monitoring performance of the sector programme should be suitable both for efficient day-to-day management and also for tracking the overall effectiveness of the Programme in producing its targeted outcomes, so able to capture short term and more long term changes. However, the quality and usefulness of indicators is necessarily constrained by the available data and by the existing mechanisms for statistical collection and performance measurement. The continuous improvement of these systems should be one of the objectives of the sector programme and the assessment of performance measurement systems should consider not only what can be done in the short term but also how the quality of indicators can be improved over time.

Furthermore, if EC financial support to sector programmes takes the form of budget support with disbursements in tranches related to achieved performance, it is equally important that the targets that are set are challenging but achievable and the resource implication for meeting that target understood by all.

The basic principle of performance monitoring is that indicators are meant to measure performance and to provide important inputs into management decision making and resource allocation. This means that the performance review needs to be synchronised with the planning, budgeting and reporting cycles. We thus consider each of these aspects of the assessment.

5.5.1 Performance assessment frameworks for sector programmes

The impetus for developing a performance assessment framework comes from:

- the belief that performance monitoring helps to build consensus inside and outside government about priorities, making it easier to make reallocation decisions in periods of retrenchment;
- the move towards entrepreneurialism in government, measuring the performance of their agencies, focusing not on inputs but outcomes;
- as well as the recent international commitment of governments and partner countries to establish a common results framework and monitoring arrangements. Indicator 11 of the Paris Declaration

Box 5.6: Performance Assessment Framework

A Performance Assessment Framework is a set of regular performance measurements which enable managers and stakeholders to reliably assess progress in achieving a set of outcomes reflecting all key dimensions of the system being monitored.

Assessment because it can involve both monitoring and evaluation measures and processes; framework because it needs to logically hold together and reflect the whole system; both managers and stakeholders because managers are not alone in policy development and a PAF is one means of increasing accountability and transparency; outcomes rather than inputs and outputs, because impact is hard to measure and outputs do not tell us whether an objective is being met; all key dimensions but generally trying to keep the number of measures to a manageable number.

on aid effectiveness monitors the "number of countries with transparent and monitorable performance assessment frameworks to assess progress against (a) the national development strategies and (b) sector programmes".

A PAF is developed by Government with support from donors if need be. It helps to bring clarity to the goals being pursued by Government. Government often has a multitude of stated goals. But the decision to select a few indicators to publicly track at national level helps to clarify what are seen as priorities.

5.5.2 Indicators for the performance framework and the SPSP

A performance measurement framework consists of a series of indicators chosen because they are thought to best point to the desired performance or lack thereof. The choice of these indicators has both a technical and a political nature.

The figure below shows agreed definitions of the four levels of indicators in a classical result chain.

Box 5.7 : Indicators Glossary

IMPACT	Measures the consequences of the outcomes in terms of wider objectives (for example, literacy rates, health improvement). The definition covers the wider effects of the outcomes but there might also be higher level impacts, related to broader objectives – growth and income poverty, for example.
OUTCOME	Measures the results at the level of beneficiaries (for example, gross enrolment rates in primary schools, vaccination). The definition covers the outcomes (or results) from the use and satisfaction of the goods and services produced by the public sector - it is where supply comes face-to-face with demand
OUTPUT	Measures the immediate and concrete consequences of the resources used and measures taken (for example, schools built, teachers employed, nurses trained) The definition of output covers those goods and services "supplied", "produced" or "provided" by the public sector with the inputs.
INPUT	Measures the financial resources provided and the administrative and regulatory measures taken (for example, resources allocated, resources used, measures taken, laws passed). The definition of inputs can be treated as very broad, covering in some cases what is often called "process indicators".

From a technical perspective, issues to be addressed include:

- Do the performance indicators selected respect the SMART principles, in being Specific, Measurable, Affordable, Relevant and Time-bound?
- Is the indicator reliable enough to follow trends over time[32]?
- Is there a clear and unambiguous definition of the indicators so as to avoid errors and misunderstandings in interpretation at a later date?
- Is the data source for the indicators clearly identified? They should as much as possible be drawn from the data produced by the National Statistical System, avoiding ad hoc or project-related indicators
- Is there a clearly developed framework for sourcing information and for verifying its correctness?
- Is the methodology used to calculate the indicator clearly described?
- Are the timing and lead time[33] in the availability of the data to construct the indicators known?
- Are indicators disaggregated by gender, by socio-economic category or other criteria so that it is possible to assess the impact of the programme on both men and women, on the poor and the less poor, on specific vulnerable groups?
- Does the group of indicators chosen cover the necessary requirements both for short-term management information (data on inputs and outputs) and for performance measurement (outcomes and impacts)?
- Is the structure of indicators consistent with the way in which spending has been structured within the sector programme's budget? In particular, is there a consistent breakdown by sub-sector, programme and where relevant sub-programme?
- Is the structure of indicators also consistent with the wider requirements of monitoring the national development strategy or PRSP?

The political nature of the choice of the indicators reveals itself in the several tensions influencing the choice. Tensions between:

- the need to demonstrate progress in achieving international, global commitments such as the MDGs and local priority setting and ownership;
- a set of indicators that is comprehensive enough to encompass key areas of sector performance and the reform agenda while being limited in numbers;
- having indicators that are meaningful to local communities and citizens yet useful for sector management and resource allocation;
- choosing indicators that enable tracking achievement of medium- to long-term sector goals (more output/outcome) and can function as triggers for annual donor disbursements (more process/output).

Another political dimension is the issue of ownership of the framework:

- Has the performance assessment framework for the sector programme been established through the leadership of the government?
- Has the team responsible for this included senior management within the ministry as well as statisticians and data processing staff? In short, is there a sense that the issue has been taken seriously at senior levels and that adequate internal consultation has been conducted?
- Have the other major stakeholders in the sector programme been consulted? In particular have consultations involved not only donors and the core sector stakeholders but also the Ministry of Finance and, for decentralised components, the Ministry of Local Government (or equivalent)?

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32 A reliable indicator is one which would give the same value if its measurement was repeated in the same way on the same population and at almost the same time.

33 The time interval between the time data are produced in the field and the time the report is produced

The selection of indicators is closely related to the capacity of the system to produce the necessary data. Indeed certain elements of the statistical system may be so weak that the targeted information will be too unreliable or the cost of improving its quality will be unaffordable. This may necessitate changing the information requirement until that time the system is able to produce the necessary data and providing support to develop the system. The selection of indicators (and the capacity of the statistical and performance measurement system) should therefore be seen as an iterative process.

5.5.3 Supporting improvement in the systems

As mentioned above, the choice of indicators for a performance assessment framework is dependent on the capacity of the system to produce the relevant data and to do so in a reliable and timely fashion. Inevitably, the performance measurement systems for the sector programme will need to rely in the first instance on existing systems for collecting and processing statistical and performance data. In some cases, these may be more than satisfactory but typically the weakening of sector-wide performance assessment processes is a classic negative by-product of a service delivery structure based on a large number of discrete and poorly integrated projects. Hence, attention to the improvement of statistical and measurement systems is likely to be an important part of most sector programmes. It starts with the assessment of these systems.

The typical general objectives of such an assessment might include:

- Determining the level of performance of one or more sub-systems in term of the generation, use and reporting of data needed for key indicators.
- Identifying problems and inefficiencies in the system and propose activities which will result in improved performance. This will be based on a more detailed systems analysis, showing the flow of data from collection/acquisition through all the intermediate steps to its final use and long term storage. This system's description will identify all the actors and institutions involved in the system and the tasks they fulfil.
- Providing assurance to final data users that the system is capable of producing reliable data in the specified areas.

The precise requirements for strengthening the system will depend on the prevailing situation but three key questions need to be asked:

- Insofar as statistical and measurement systems are deficient, is there a clear plan of action in place for strengthening them?
- Does the plan of action look relevant, feasible and coherent with the sector programme? In particular, does it build on existing strengths and capabilities so as to ensure that long-term capacity is developed and retained?
- Does it address the potential weaknesses in the demand for information? In particular, does it consider how to make managers and decision makers better users of information?

In relation to proposals for support to further development of the statistical system, the resource implications of these should be made clear. Clarity in choices and resource requirements for a given level of reliability are an important foundation for developing a relationship of trust between the statistical service and those who fund it. It enables government and development partners that decide to support improvements in statistical and information systems to demand realistic targets in the level of performance that they expect as an outcome of their support.

5.5.4 Target setting: key issues and principles

It is probably impossible to avoid political issues in target setting. It is after all an intrinsically political process to declare that certain goals will be given prominence and that certain targets will be met by the incumbent government.

One way to reduce possible distortion by political pressures or suppression of certain aspects of the system is to develop a well balanced PAF. When all the key issues are represented in a balanced way it become more difficult for politicians to argue for rapid expansion of access to a system without accepting the need to commit commensurate resources to maintain quality.

Key principles in target setting are to base targets on operational assumptions, to take local capacities and resources enough into account when setting targets, to look at past trends in performance as a basis, drawing upon a sufficiently long time span, and to avoid introducing perverse incentives for performance. Targets should be set so as to get the balance right between being over-ambitious or excessively prudent. They should be challenging but achievable. In other words they should be the product of active engagement by the managers and stakeholders with realities of the system and its environment.

Good practices on these issues include:

- **Clarity of indicators:** if indicators are clear and simple it is easier to assess the target setting objectively.
- **Debate assumptions not forecasts**: in other words force the target setting group to think about the assumptions such as productivity increases, resource availability, which must occur if the target is to be achieved. Involvement of the Ministry of Finance is important in that respect.
- Force them to model those numbers against **real data** and **actual trends**.
- **Discuss resources early:** Targets depend crucially on resource commitment so resources need to be added to the equation early.
- **Develop execution skills:** Targets are meant to stimulate all those involved in the system to greater efforts. Targets should be accompanied by clear implementation strategies and plans which are linked to clear assumptions and ideally show how improved performance can be achieved at a stable or falling unit cost. Sector managers need to demonstrate how the targets are to be translated into operational procedures at different levels of the service or how incentives will be structured to ensure that both public and private sector service providers move in the desired direction.

Who should be involved in setting targets?

- Involve all major stakeholders at some point in the process so that the assumptions are thoroughly debated and so that there is social buy-in from key actors like unions and private service providers.
- Give the target setters some independence to increase objectivity but don't divorce target setting from the managers who have to deliver the achievement of those targets.
- Involve a professional statistician in the target-setting group. As illustrated above target setting is not purely a technical task but it has many technical complexities. Without professional involvement targets are likely to be formulated without clarity and possibly without validity.

Target setting should not be seen as a single event occurring once a year or once every few years. It should be part of an ongoing process of operational research around key aspects of systems performance informed by thorough analysis and regular research.

5.5.5 Interpreting and using indicators

The basic principle of performance monitoring is that indicators are meant to measure performance and to provide important input into management decision making and resource allocation. This means that information from indicators needs to be synchronised with the planning, budgeting and reporting cycles.

Preliminary targets for the coming year should be proposed by government during the MDA (Ministry, Department, Agency) reviews so that what is presented to the annual review involving a wider stakeholder group is already a well-considered proposal based on tentative resource allocations and a thorough understanding of the causes of indicator trends.

The sequencing of the PAF review process deliberately places the start of the review process within and between ministries. An assessment of the PAF review should check whether the following steps of a well-organised review are undertaken:

- **Management review:** Analysis of performance indicators is presented to responsible managers in sector ministry for review and comment. Where possible disaggregated data should be prepared and sent down to the responsible sub-national levels. Managers are asked to explain significant deviations from targets.
- **Management analysis:** Where deviations are major it may be appropriate to analyse the source of deviation more deeply. (Were resources available as planned? Are there possible exogenous reasons such as a natural disaster? Is the deviation derived from unexpected results in certain parts of the country?)

- **Investigation:** It may be appropriate to commission some rapid field assessment to understand the deviation better. Investigation should also be used to look at factors behind success stories and develop good practice cases studies for sharing with relevant managers across the whole system.
- **Peer Review:** Once managers have been allowed an opportunity to analyse, investigate and understand the performance data there should be an opportunity for them to present this information and its implications for future action to their peers. Such peer reviews are the best environment to encourage professional challenge and to ensure that explanations of sector performance are internally consistent. Such a review should bring in managers from the sub-national level. Often they will be in a better position to explain or challenge explanations.
- **Strategy review:** Senior managers[34] of the sector need to absorb this information and develop initial proposals for strategy change, increased efficiency, resource reallocation, adjustment of future targets. This would ideally constitute a second forum with more limited membership following up the work of the one described in the last paragraph.
- **Inter-ministerial coordination:** Most governments are organised in a manner where most service Ministries cannot implement their strategies without substantial support from other Ministries such as Finance (financial resource), Public Service (human resources and government-wide structural reforms), Local Government (coordinator of the local authorities who actually deliver the services), Legal Affairs (coordinators of any legislative programme). So once the sector Ministry has developed a robust analysis of its own performance and a set of responsive strategies to enhance future performance, it has to go out and sell its proposals to the rest of government both in Cabinet but also at a more technical level with its sister Ministries.
- **Public accountability:** The final step in the internal review process is the presentation of performance data to the appropriate public forum specified by the law or constitution. This could be a specific Senate committee or an annual parliamentary review of public expenditure.

All of the foregoing should take place before the annual review with development partners, so that the annual review can reflect on the domestic debate and enrich it where possible but not become a substitute for the constitutional organs and channels of debate.

The role of the annual review should then ideally be one of discussion and endorsement. If there is a major development partner concern regarding performance in general, targets or the appropriateness of a particular indicator this should be raised earlier in the process so that the government can respond appropriately to these issues during the process of strategy development and public accountability.

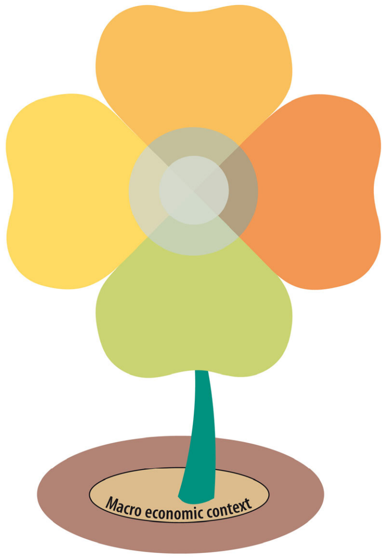
Where development partners providing budget support need to make an assessment of the adequacy of performance as one of the conditions for tranche release, this process is also best done before the review. If it is delayed to the review then there is a danger that a position of public confrontation is created with a lot of press attention. This may not be warranted if the problems of performance are technical rather than lack of commitment.

34 Note that throughout the process it is managers taking responsibility for the data. This does not mean that the statisticians should be absent from the debate but their role is technical support and challenge especially in respect of the validity of explanations of indicator results. Sometimes a performance report is prepared entirely by the Monitoring and Evaluation section of a ministry and then presented by them at an annual review without any input or ownership of managers. This almost nullifies the purpose of the whole exercise.

5.6 The Macroeconomic Framework

5.6.1 Objectives and scope

One of the important lessons emerging out of the experience of sector approaches is that a weak macro-economic environment can easily derail sector programmes, in the process destroying painstakingly negotiated agreements and undermining donor confidence. Most of the sectors in which sector programmes are commonly developed (education, health, agriculture, roads) comprise significant proportions of total public spending and hence can be significantly affected through revenue shortfalls and treasury liquidity problems. Given that Budget Support has been adopted by the Commission as the preferred form of financing for sector programmes, the analysis of the macroeconomic situation also has a special significance for the choice of SPSP financing modality. Specifically, it is one of the principal elements determining whether there exists a realistic potential for the use of Budget Support to finance an SPSP.



The purpose of the macro-economic assessment is thus two-fold:

- To assess the stability of the macroeconomic situation and the consequent potential for future public funding as well as private investment to the sector.
- To judge what potential might exist for Budget Support financing of the SPSP.

5.6.2 Assessment of macro-economic context

Here the main concern is to assess the stability of the macroeconomic situation, the potential for future public funding of the sector and for private investment. The national strategy document or PRSP would normally include some assessment of prospects but analysis of this should be supplemented by more detailed investigation of specific questions. These should be discussed in the first instance with national authorities – in particular the Ministry of Finance and the Central Bank and later with relevant think-tanks and academic authorities as well as with staff of the Bretton Woods Institutions and other donors. Much of this analysis – including detailed work on the potential for future expansion of tax revenues – would normally be done in the context of the design and implementation of budget support and, for IDA countries, Poverty Reduction & Growth Facilities.

If budget support is to be used as the financing modality, one of the eligibility criteria is that a stability-oriented macroeconomic policy is in place or under implementation. Making an assessment in this area relies on three main elements:

- **A summary of the main past and expected trends in macroeconomic variables.** Use can be made of a standard analytical framework summarising the main expected trends in key macroeconomic variables,[35] including data for the past two years and forecasts/projections for the current and following two years (see Annex 4 to the Guide on the Programming, Design and Management of General Budget Support for further details). The partner country's track record on macroeconomic management, as well as the prospects for a good track record being maintained or a poor track record being improved should be mentioned. In examining these issues, in all but exceptional cases, it is not expected that a separate macroeconomic analysis be carried out, but that a judgement on stability-oriented macroeconomic policies be made on the basis of existing documentation, using as starting point information from the IMF.

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[35] Such as the overall growth rate, the balance of payments deficit, the government deficit, the rate of inflation, the shares of the social sectors in the overall budget, employment growth, the level of reserves, the level of external indebtedness and the exchange rate

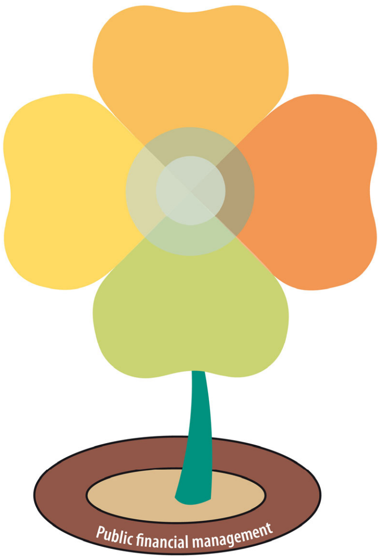
- **Description of the relationship between the partner country and the IMF.** In looking at the macroeconomic eligibility criteria above, one of the key issues will be the relationship between the partner country and the IMF.[36] For example, is there a programme? How long will it last? Is a successor programme in preparation? The nature of this relationship can serve as a tool at the disposal of the EC to assess eligibility. Indeed, satisfactory implementation of a financial or non-financial programme with the IMF will be sufficient assurance of a stability-oriented macroeconomic policy. However, the absence of a programme with the IMF is not itself reason for non-eligibility for budget support or for judging that a stability-oriented macroeconomic policy is not in place. In such a situation it is important to examine why there is no programme with the IMF. (Is it because there are difficulties with the IMF? Or does the partner country not need support from the IMF?) In some circumstances reliance can be placed on the conclusions of Article IV consultations, in particular where there is a strong track record of stability. In exceptional cases it may be necessary for the Commission to carry out its own assessment (see Annex 25 Guide on the Programming, Design and Management of General Budget Support for model terms of reference).
- **Are there any special topics of macroeconomic interest that might need to be addressed?** Depending on the country context, there may be particular areas that deserve special attention. Focus should be on those areas where the risks concerning the preservation of eligibility and a stability oriented macroeconomic policy are greatest, and where the provision of budget support may itself create a set of macroeconomic challenges. Such areas may include the challenges of "scaling-up" of external aid (to meet the MDG objectives, for example), the timing of the spending and absorption of external assistance.

5.7 Public Financial Management

5.7.1 PFM as eligibility criterion for Sector Budget Support

One of the eligibility criteria for using budget support as the financing modality for an SPSP is that a credible and relevant programme to improve public financial management (PFM) is in place or under implementation.[37] The analysis should be based on:

- An *overall assessment of PFM* using the requirements set out in the Commission's Guidelines on the Programming, Design & Management of General Budget Support (see section 5.7.2); and
- An additional assessment at the level of sector PFM where sector specific public financial management rules exist (see section 5.7.3).



5.7.2 The overall PFM Assessment

As with General Budget Support, making an overall assessment of PFM relies on two essential elements:

36 A country has a programme with the IMF when it has an agreement between the IMF on a set of macroeconomic and structural policies whose implementation may either be financially supported by the IMF (such as a PRGF or stand-by agreement); or a non-financial programme with the IMF (SMP, PSI); or a country's policies may not be agreed together with the IMF, but may simply assessed by the IMF under an Article IV cycle of consultations.

37 The Paris Declaration on Aid Effectiveness also covers issues related to PFM with indicators of progress in three areas. First, "Number of partner countries that have procurement and public financial management systems that either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these". Second, "Percent of donors and of aid flows that use partner country procurement systems which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these. Third, "Percent of donors and of aid flows that use public financial management systems in partner countries which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these". These indicators make a distinction between "public financial management" and "country procurement systems" – a distinction that is not used in this text and does not exist in the PEFA PFM-PMF, where country procurement systems are seen as part of PFM.

➔ **An assessment of the quality of the PFM system** using, as the EC's favoured tool of choice[38], the “Public Financial Management – Performance Measurement Framework” (PFM-PMF) of the PEFA (Public Expenditure and Financial Accountability) initiative. Some key features of this assessment are:

- The PFM-PMF consists of the analysis of 28 indicators covering six essential dimensions of PFM systems: (i) credibility of the budget, (ii) comprehensiveness and transparency of the budget, (iii) policy-based budgeting, (iv) predictability and control in budget execution, (v) accounting, recording and reporting, and (vi) external scrutiny and audit. It also includes three indicators on donor practices.
- This analysis is developed and synthesised in a “PFM Performance Report” which also contains additional complementary elements (for example, a statement on the legal and institutional framework) so as to provide an overall evaluation of the performance of the public financial management of the country under review.
- Delegations, in collaboration with other donors, are expected to use and promote the PFM-PMF in their work, and discourage the use of a variety of diagnostic tools[39] that have existed up to now. Indeed the PFM-PMF has been designed to ensure more effective monitoring through donor coordination around coherent and harmonised diagnostic appraisals.

The logic underlying the PFM-PMF, a description of its main elements, and guidance and practical instructions for its use are at Annex 1.5 of the Guidelines on the Programming, Design and Management of General Budget Support. An outline of terms of reference for carrying out an assessment of PFM according to the PEFA methodology is at Annex 1.20 of the same Guidelines.

➔ **An assessment of the PFM reform process.** The “PFM Performance Report” mentioned above contains a section on the government reform process which briefly summarises recent and ongoing reforms and improvements. However, in order to encourage the partner country's ownership of the reform process, the report does not include any recommendations for reforms or assumptions as to the potential impact of ongoing reforms on PFM performance. This type of appreciation is left to the stage of policy dialogue between the partner country and the donors. It is therefore necessary to complement the information provided by the PFM performance report, with an assessment of the programme designed to improve or reform public financial management. Such an assessment should focus on:

- the relevance and degree of implementation of the reform strategy (and related action plan);
- the relevance and degree of coordination and implementation of the capacity development programmes that may be financed by the donors to support the reform of public financial management; and
- evidence of the national authorities’ political will, commitment and endeavours to improve PFM performance.

Such an assessment will be based on the PFM reform reviews organised by the governments (for example in the framework of the annual reviews of the implementation of poverty reduction strategies), or on studies/evaluations/audits financed by donors and, whenever possible, on the reports of the national Parliament and Supreme Audit Institution[40].

It is important to note that the use of budget support as the financing modality for an SPSP requires an assessment of the eligibility criteria using the two elements mentioned above. If it is not possible to carry out an assessment on this basis, then the eligibility condition for budget support would not be met, and the partner country would not be eligible for the use of budget support as the financing modality for the SPSP. In countries

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38 *Taking into account that coordination with other donors is important, the Commission whilst promoting the use of the PEFA diagnostic, can accept to be part of, or contribute to, other initiatives to examine the quality of PFM systems.*

39 *In the past a wide array of different diagnostic tools for assessing PFM (CFAA, PER, HPIC tracking exercise and others) has been used. It was against this backdrop that the Commission and other Donors (World Bank, IMF, France, UK, Norway, and Switzerland) undertook to elaborate, through the PEFA initiative, a common Performance Measurement Framework which was adopted in June 2005 and approved by the OECD/DAC.*

40 *Clearly, at the start of a PFM reform process it will not be possible to address issues related to implementation of PFM reform or of capacity development issues. In this case the assessment will not cover issues related to implementation.*

receiving General Budget Support the assessment of eligibility on the basis of these two elements should be already addressed.

5.7.3 The Sector PFM Assessment

An assessment of the quality of overall PFM systems and an assessment of the PFM reform process as mentioned above is usually sufficient to establish eligibility. However certain sectors may follow specific public financial management rules that depart from overall public financial management systems: this is the case, for example, of Road Funds (see Box 5.6 below), public agencies, parastatals or local governments. When specific systems and mechanisms are in place at the sector level, an assessment of these specific public financial management issues is necessary to establish eligibility. This sector level assessments will be based upon the two elements mentioned in section 5.7.2 (only this time with the inclusion of a sector dimension), namely (i) assessment of the quality of the sector PFM system; and (ii) assessment of the sector PFM reform process.

Box 5.8: The Road Maintenance Funds

Road Maintenance Funds are special national funds mainly dedicated to providing secure and predictable revenue for road maintenance, which are financed by designated road user charges, based on user pays principle, mainly a levy on fuel.

The operation of Road Funds is the development of a business-like process to the financing and management of road maintenance by outsourcing services and works in a competitive commercial environment.

Today, 27 Road Funds are in place, in Sub Saharan Africa, with different structures and modalities, but a few common key features could be summarized as follows:

- Road Funds and their Boards have generally a sound legal basis -Act of Parliament;
- Road Funds have a Road Fund Board, in which, in many cases, the road users are represented and form the majority of the members;
- The Road Funds have the responsibility to raise and allocate revenues for road maintenance in accordance with maintenance and investment programmes approved by government;
- Procurement procedures, accounting, reporting and auditing are based on Government systems;
- A levy on fuel is the principal (90%) road user charge providing road fund revenue. The fuel levy in US cents/litre falls normally in the range 4 to 9, while 10 to 13 is normally seen as sufficient to cover road maintenance needs.
- Road Fund Agencies are mainly purchasers of services and not service providers. The separation of functions is achieved by setting up a correspondent road development agency responsible for road network maintenance and development.

Making assessments in the area of sector PFM will not be as structured and clear-cut as in the assessment of the overall PFM system because of the absence of specific tools in this area. However, steps could be taken to make use of (i) specific audit reports produced by national audit authorities who have examined sector performance; (ii) some PEFA indicators that might be applicable at the sectoral level (see below); (iii) any sector based examination of public expenditure such as public expenditure reviews, Public expenditure tracking studies, or examination of procurement practices within the sector.

Apart from the special cases of sector specific PFM systems, any sector PFM assessment should not be used to establish eligibility for the use of budget support, but rather be used to identify weaknesses, inform support to be provided and where appropriate used to help establish disbursement conditions associated with the programme.

When using sector budget support, there may be some concerns that the nature of the dialogue around the sector programme will limit the ability to assess and make an effective contribution to the overall performance of the PFM system. Concerns in this area can be addressed in a number of ways. For example: (i) by recognising the fact that since sector budget support contributes to the overall resources of a country, it is legitimate to assess the overall quality of the PFM system, and the programme for improvements. (ii) limiting dialogue on PFM to sector related issues will often be insufficient to address the issues that arise. Frequently there will be systemic issues that can only be addressed at a systemic level, and so naturally the debate will tend to lead to discussions on the overall PFM system. (iii) frequently complementarities can be sought with other programmes. Examples include GBS programmes where the overall system of PFM will be addressed and specific projects and programme to strengthen PFM systems, whether supported by the EC or other donors.

An additional assessment of public finance management at the sector level through, for example, Public Expenditure Tracking Surveys is always recommended as it can provide useful insights on how PFM reforms are implemented at the sector level and how the SBS could support this process.

5.7.4 Elements of PEFA potentially useful for looking at sector PFM

Although the PEFA methodology has not yet been adapted for sector level diagnostics, the indicators mentioned below are potentially relevant. Guidance from Headquarters should be sought when using these types of indicators in sectors contexts.

Credibility of the budget. A frequent weakness of budget systems is the fact that the budget is not implemented according to the policies stated in the budget. This may be explained by various factors such as poor decision making systems that lead to postpone hard choices from budget preparation to budget execution or various pressures from interest groups during budget execution. The PEFA indicators number 1 and 2 are used to assess the credibility of the government's budget. The PEFA indicator number 1 compares the aggregate expenditure out-turn to the original approved budget, while the indicator 2 calculates the budget variance[41], on the basis of administrative or functional classification. In the same way, concerning a sector budget, it will be desirable to review the budget execution rates both for the whole sector and for each subsector or main administrative division of the relevant line ministry. These reviews should focus on domestically financed, externally financed and total expenditures.

Comprehensiveness of the budget. It will be important to assess whether the budget is comprehensive. Issues to be reviewed include, among others: Does the budget or at least fiscal reports cover all central government expenditures in the sector (including externally financed expenditures and expenditures from extra-budgetary funds)? Are there actions planned to improve the coverage of the budget? Comprehensiveness of the budget does not mean that all expenditure programmes should be administered through the same procedures. Special arrangements may be needed for administering some particular activities, such as externally financed projects and programmes implemented by semi-autonomous agencies. Nevertheless, for efficient resource allocation, all programmes should be reviewed together, when preparing the budget. The PEFA indicators 6 and 7 look at the comprehensiveness of the budget.

Unification of the budget. The degree of unification of the budget should also be assessed. Issues to be reviewed include: Are there joint reviews of the capital and recurrent component of the budget during budget preparation? Are trade-offs between capital and recurrent expenditures made effectively? Are the forward costs of investment projects, including their recurrent costs, systematically reviewed? The PEFA indicator 12 looks at this area.

Reporting on the budget. All central government expenditures should be included in the published fiscal reports, whatever their financing source. If the budget is not comprehensive, at least, in a first step, comprehensive fiscal reports should be prepared (e.g. expenditure monitoring reports and/or documents annexed to the budget). Budget reporting provides a feedback to budget preparation and decision making. It may also reveal the "true" priorities, which may differ in countries with weak budget system from the priorities formally displayed in the budget. Reports on subnational government spending can be very relevant in sectors where delivery of services is decentralised. Therefore, establishing a robust budget reporting system is required for improving budget formulation. The stage at which expenditures are reported should be clearly indicated (commitment, payment order or payment stage). The reports should cover both cash payments and unpaid expenditures, if any. PEFA indicators 24 and 25 look at this area.

Budgeting process. Both disciplined processes and effective participation in budget formulation of the sector ministries are required. The PEFA performance indicators number 11 ("orderliness and participation in the annual budget process") provides a method to assess whether these requirements are met.

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[41] *For the PEFA-PFM assessments, the budget variance is calculated as the weighted average deviation between actual and originally budgeted expenditure calculated as a percent of budgeted expenditure on the basis of administrative or functional classification, using the absolute value of deviation*

WEB REFERENCES

EU LINKS

EU official site : http://ec.europa.eu

EU site on European Union in the World : http://ec.europa.eu/world

Official EU site on "Development and Relations with African, Caribbean and Pacific States" presenting EC policies documents: http://ec.europa.eu/development/index_en.cfm

Aid Delivery Method menu on Europe Aid intranet containing links with EuropeAid guidance documents: http://www.cc.cec/dgintranet/europeaid/activities/adm/index_en.htm

LINKS TO SPECIFIC EC DOCUMENTS :

EuropeAid internet site presenting Guidelines and Reference Documents :
http://ec.europa.eu/europeaid/multimedia/publications/index_en.htm
The documents will be posted under the "Tools and Methods Series" menu.

EU Consensus on Development

Strengthening the European Neighbourhood Policy, 4 December 2006 [67 KB]

EU AID: Delivering more, better and faster

DAC LINKS

Official DAC site on aid effectiveness: http://www.oecd.org/dac/effectiveness

DAC Guidelines on Sector Approaches : Harmonising Donor Practices for Effective Aid Delivery Vol. 2

Paris Declaration on Aid Effectiveness

OTHERS

Public Expenditure and Financial Accountability (PEFA) : www.pefa.org.

Evaluation of General Budget Support: Synthesis Report" - May 2006 IDD and Associates

ANNEXES

ANNEX 1: THE CYCLE OF OPERATIONS FOR AN SPSP

THIS ANNEX AIMS TO:

- Recall the important aspects of SPSP design process.
- Define the six phases of the Cycle for an SPSP and explain their specific requirements.
- Explain the linkages between the SPSP Cycle and the wider cycle of development of the Sector Programme.

N.B This annex focuses upon the EC cycle of operations to design and implement an SPSP, and not upon the “sector programme cycle” managed by government.

This annex explains the cycle to be followed by Commission staff in designing and managing a sector policy support programme (SPSP). The precise actions to be taken at each stage depend crucially on the country and sector context; hence much of this section is presented in the form of guidelines rather than precise instructions. In respect of sector budget support, the Guidelines on the Programming, Design & Management of General Budget Support represent an essential reference document which should be used in conjunction with these Guidelines.

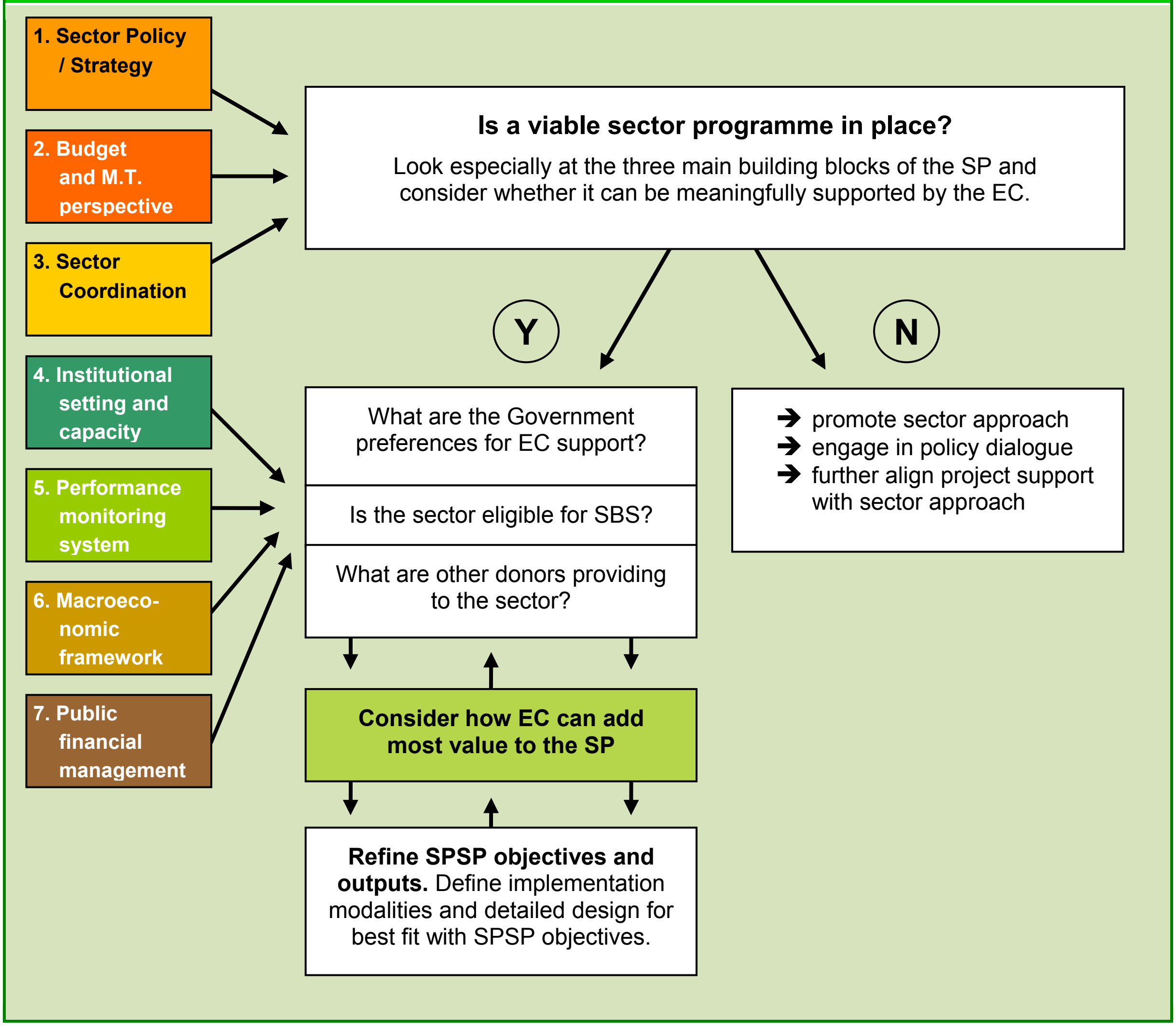
As stated in the Introduction, these Guidelines do not intend to be exhaustive in their presentation of the Commission’s procedural requirements. They specify the particular requirements for supporting a sector programme and in no way seek to replace relevant official documents and instructions (e.g. inter-service agreements, financial guide, Practical Guide to EC contract procedures for external actions).

The SPSP Design Process

The design of an SPSP, its objectives and implementation modalities, takes into account and depends on the stage of development of the sector programme as assessed through its key elements.

Designing an SPSP is a process as illustrated in the Box A. 1 The assessment of the three building blocks of the sector programme (sector policy, sector budget, sector coordination and management) will determine whether there is already a viable sector programme in place. If there is not (yet) a viable sector programme, the EC would engage in policy dialogue, promote the development of a sector approach, and seek to align EC project support with the developing sector approach (as discussed in Chapter 4, section 4.1). If there is judged to be a viable sector programme, the design of the SPSP proceeds.

Box A1: The Process of Designing an SPSP



If an SPSP is judged appropriate, it should be designed in a way that adds most value to the sector programme as a whole, taking account of the contributions from other donors as well as the governments own inputs. A very important consideration is whether the EC is able to use SBS (are the eligibility criteria met?). Detailed design of the SPSP is then an iterative process throughout the identification and formulation phase: the implementation modalities and other details of the SPSP design are chosen to fit with the specific SPSP objectives so as to maximise the SPSP's contribution to the sector programme as a whole.

During implementation, performance of the sector programme is assessed and subject, to adjustments in the light of the evolution of the programme, the Commission checks whether the SPSP is executed as planned, with the commitments made in the financing agreement by Government and the Commission.

The SPSP Cycle

The design and implementation of an SPSP follows a cycle similar, while not identical, to that of a project. For projects there is a relatively well-defined linearity in the successive phases, whereas the SPSP cycle of operations will be heavily influenced by the nature and extent of development of the sector programme. Thus, the precise content of each phase of the SPSP cycle will vary from one case to another, although the decision points are consistent.

The six phases, as stated in the Inter-services Agreement, are as follows: programming, identification, formulation, financing, implementation and evaluation. The table below summarises their content, with further details given in the subsequent sections.

The cycle of operations for a sector policy support programme (SPSP)

Phases	Issues to Be Assessed	Key Questions	Output
1. **Programming**	**Assessment of the status of the sector approach and the consensus and readiness to develop a sector programme.** 1. Broadly stable macroeconomic situation; 2. Sector policy in place or a commitment by Government to elaborate/refine it; 3. Sector & donor coordination existing or commitment and steps towards it taken; 4. Adequate leadership capacity of the ministry in charge. 5. Where sector budget support is envisaged, satisfactory situation on eligibility criteria: sector policy, macroeconomic framework, public financial management systems.	Should the EC support the sector approach in one of the chosen sectors, designated in the Country Strategy Paper (CSP)?	→ If yes, definition of a process for EC engagement in the sector approach. → Order for Services.
2. **Identification**	**Preliminary assessment of the quality of the sector programme through the 7 areas of assessment.** 1. Re-assessment the sector policy and the sector & donor coordination process (reviewed in programming); 2. Quality of the budget and medium-term perspectives for the sector. 3. Institutional and management arrangements for sector programme. 4. Preliminary review of the public financial management system;	Is the sector programme reform oriented?Should the EC take a decision in principle to support to the sector programme? What would be the tentative objectives, scope and content of the proposed SPSP?	Preliminary definition of proposed objectives, scale & duration of SPSP, as well as proposed financing modality through Identification Fiche [42] IF and where relevant and ToR for formulation submitted to QSG for review

42 http://www.cc.cec/dgintranet/europeaid/activities/quality_support_groups/tools/identification_fiches_en.htm

	5. Preliminary review of Performance monitoring. 6. Re-assessment of the macro situation. Tentative definition of objectives, purpose and expected results of the proposed SPSP as well as the approximate volume of funding, preliminary choice of the financing modality.	Is it consistent with the Paris Declaration and EU commitments on the aid effectiveness agenda?	
3. **Formulation**	Preparation of an Action Fiche/Financing Proposal: Detailed (re)assessment of the 7 key areas; Based on the recommendations of the QSG review, finalisation of objectives, purpose and expected results of the SPSP; further development of implementation modalities for the SPSP.	How will the implementation modalities contribute to improved implementation of the sector programme?	SPSP Action Fiche/Financing Proposal and complementary documents
4. **Financing**	Assess the Action Fiche/Financing Proposal; Introduce and agree any necessary amendments; Confirm availability of required funding from government and other sources.	Is the proposed SPSP acceptable to EC?	➔ EC financing decision ➔ EC FA ➔ Relevant agreements for Common Pool.
5. **Implementation & Monitoring**	Execute SPSP as contribution to sector programme.; Review of progress of sector programme towards agreed objectives; Continuous assessment of the 7 areas to support ongoing improvements.	Should EC intervene to take remedial actions, or agree on modifications?	➔ Successful contribution to sector programme.
6. **Evaluation**	Assess with government and partners the relevance, efficiency, effectiveness, impact and sustainability of the sector programme, the added value of the SPSP in helping achieve the sectoral goals as well as the appropriateness of chosen implementation modalities.	Should changes be made to the SP? Should EC prepare new SPSP?	➔ Evaluation reports

The sector programme may well have deficiencies at the outset but these may be addressed through the SPSP itself. The activities undertaken during the SPSP cycle aim to assess 1) whether the sector programme is of sufficient quality to justify financial support and 2) to formulate and implement the best type of SPSP to contribute to the objectives and further development of the sector programme.

Because of their crucial role, eligibility criteria for sector budget support should be addressed explicitly in all stages of the cycle of operations, from programming through to implementation (see also Chapter 5, section 4.4).

1. The Programming Phase

The programming process is led by the staff of DG Dev or Relex, working in conjunction with Delegation and the partner government. It involves extensive consultations with Non State Actors and Member States.. The objectives of programming and the mechanisms to be utilised have been reviewed and updated as part of the ongoing reform of Commission services. A set of new reference documents has been issued, standardising procedures across the full range of geographical operations. These comprise:

- The inter-services agreement.
- The Common Framework for the preparation of Country Strategy Papers.
- The guidelines for the implementation of the Common Framework for the CSP issued by the Inter-Services Quality Support Group (IQSG).

The principles which guide the process of programming are fully consistent with the goals and objectives of the sector approach. Indeed the guidelines for the Common Framework for the CSP establish that 'wherever possible, the focus on individual projects should be gradually replaced by a sector programme or policy-based approach, providing support to coherent national policies in each sector or area for cooperation.'

The process of programming covers the following areas:

- The national development strategy of the country in question (or the PRSP if it exists).
- The country analysis, comprising a review of the political, economic and social situation of the country. This also includes an assessment of the viability of current policies, as well as an evaluation of the process of reform, of the structure of public finances and the principal sectoral policies.
- The record of Development Cooperation, including interventions by the Commission and by other donors.

On the basis of this analysis, the programming process defines a specific "response strategy" and, where applicable a National Indicative Programme (NIP). This includes the identification of "focal sectors" for future development assistance from the Commission. Within each of these sectors or areas of intervention, specific objectives and priorities are identified with corresponding results and indicators of achievement as well as indicative financing envelopes for Commission funding. The CSP also identifies reform actions to be taken by government as well as actions to incorporate cross-cutting issues. Proposals on the types of development assistance to be provided by the Commission are made as well as some indicative ideas for specific projects/ programmes. Annexed to the CSP are detailed analyses of the sector policies for the chosen focal sectors and areas of concentration.

The outputs of the programming process are a Country Strategy Paper (CSP) and an Order for Services. The review process permits an updating of the CSP and of the analysis conducted on the focal sectors. Hence, the 'programming function' for an SPSP could be undertaken either through the multi-annual programming exercise or through its subsequent review.

Purpose and content of Programming

Either the Country Strategy Paper or the review report will provide the elements necessary to assess if there is sector sufficiently organised as a programme and a potential candidate to be supported with an SPSP. To reach a decision, the following preliminary assessments of the 3 building blocks of an sector programme need to be made:

- Is there an adequate sector policy in place, consistent with Commission objectives on Development Cooperation, or at least a sufficient commitment from government to elaborate a new sector policy or to refine the existing one? (essential) Is it reform oriented?
- Is there government commitment to allocate resources for the implementation of the sector programme? Is there openness to discuss the sector budget and its medium term perspective?
- Is there a government organised donor coordination system or commitments and steps towards such a system? (desirable but could be addressed at identification stage)

A general question is whether the ministry in charge of the sector has sufficient leadership capacity to lead and steer a sector programme? Or are there good prospects for it to do so with additional support? (desirable but could be addressed at identification stage)

Eligibility conditions for Sector Budget Support during Programming.

For sectors already identified in the country strategy, during programming a decision will be made to indicate if a sector programme is likely to receive budget support based on the expected benefits of using SBS, prospective eligibility, and the risk of difficulty during implementation.

As a result of this assessment and as described in chapter 4 of the guidelines, countries are likely to be divided into:

- **Strong candidates**: these are countries that have a robust sector programme and have received and successfully managed SBS or GBS under the previous programming cycle and whose prospective to remain eligible are good. The risk of non utilisation of budget support is very limited.
- **Potential candidates**: these are countries that would benefit from applying SBS to a sector programme for which there is some risk of non utilisation of budget support. These would typically be countries for whose the prospective to become or remain eligible is fair but somewhat uncertain, such as for instance countries that have received GBS or SBS in the past but encountered some difficulties in implementation or countries that have not yet received GBS or SBS and whose eligibility needs to be assessed. The Country strategy in these cases could indicate that SBS would be the preferred financing modality but also identify the steps that would need to be taken in order to ensure eligibility in the future. For example, improvements in particular aspects of the country's sectoral approach and/or sector programme
- **Weak candidates**: countries that have received GBS and/or SBS but suffered from suspensions of disbursement or countries that have not yet received GBS and/or SBS and whose prospective to become eligible in the period covered by the programming document are poor. In this case referring to SBS as the preferred financing modality is highly risky; unless the expected benefits would justify such high level of risk, other financing modalities might be considered more appropriate to support the sector.

Assessing SBS prospective eligibility at the programming stage is useful to identify eventual weaknesses and pave the way towards future successful implementation of a given SBS operation by preparing and strengthening the dialogue and identifying eventual support measures that can ensure future eligibility.

2. The Identification Phase

Once the Order for Services is received from the programming DG's, the identification process can start. The purpose of identification is to confirm the choice for supporting the sector approach made during programming, verify that the related assumptions still hold and based upon the assessment of the sector programme and its management system, define objectives of EC support and possible financing modality.

If the basic building blocks of a sector programme are not sufficiently developed, then the most appropriate type of support to a sector approach would not be an SPSP. Instead, it would be preferable to continue to engage in the processes of coordination and policy dialogue with government and, where appropriate, to continue to finance relevant project interventions.

The decision to initiate an SPSP implies a decision to move away from a predominantly project-based approach and towards modalities which enhance ownership and coherence and promote harmonisation by moving gradually towards the use of government systems. It is a technical and a political decision based on the analysis of the features of the sector programme and the assessment of the quality of that programme which provides the basis for the shift away from project support.

2.1 Objectives and outputs of the identification phase

The purpose of the identification phase is as follows:

- To undertake a detailed assessment of the sector programme, in close collaboration with government and other partners, following the seven areas of assessment detailed in Chapter 5.

- To reach a decision in principle as to whether or not the EC should support the sector programme.
- To convey that position of principle to government and to other participants in the sector approach and agree on a timetable for further work.
- To develop and agree with government indicative proposals regarding the financial dimensions of a future SPSP. This would take account of the overall absorptive capacity and the financing requirements for the sector programme.
- To develop and agree with government on the process of formulation including, where relevant, the terms of reference for additional expertise[43].

The outputs of the identification phase would be 1) an SPSP Identification Fiche (IF) to be submitted to the Quality Support Group for approval, 2) a series of annexes to the IF, covering the different assessment areas, and 3) where relevant terms of reference for the formulation phase.

The decision in principle to provide Commission funding does not comprise a financial commitment. No formal financial commitment is made until the approval of the SPSP Action Fiche/Financing Proposal (FP)[44]. However, the decision in principle allows the Commission – both at Delegation and Headquarters levels, to plan for a future SPSP in its own work and financial programming. It also permits government to plan for such an eventuality both in terms of the development of the sector programme and in terms of medium-term financial programming both within the sector and within the Ministry of Finance.

2.2 How to manage the identification process

In order for an SPSP identification process to be launched, the sector approach itself needs to be reasonably advanced. In most cases, Delegation staff would have been participating in the process for some time. They should therefore have a close familiarity with the sector in question and its stakeholders, with the sector programme, and with the details of the relevant policy documents and analyses. The Delegation should also have established sufficient internal technical capacity to manage an SPSP. This might well require recruitment of additional staff and/ or development of consultancy framework agreements.

Delegation staffs play a central role in the process of identification. They will be supported in their work by Headquarters through back-stopping and through periodic missions. And, on a case by case basis, through external consultants recruited to provide support to the entire identification process or for specific tasks such as assessment of public financial management.. Whether or not external consultants are needed will depend on the background knowledge and structure of contacts the Delegation has, as well as the availability of adequate information produced by government staff, by technical assistance working inside the sector ministry or by other donors to the sector.

There are five 'golden rules' for Delegation staff in managing these processes:

- Take direct responsibility for managing the SPSP identification process – this cannot be contracted out.
- Construct a comprehensive inventory of all relevant studies and policy documents and use these as far as possible – new analytical studies by the Commission should build on existing work, not duplicate.
- Plan the analytical work required during identification in conjunction with government and other partners in the sector approach, distribute the results widely and ensure they are fully discussed.
- If there are possibilities for combining the SPSP identification phase with preparatory work for other donors, take full advantage of these – reducing transaction costs is a key objective of the sector approach.
- Remember that the assessment work undertaken in the identification phase should be used to assist the process of ongoing improvements to the sector programme.

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43 This would evaluate the feasibility of indicative proposals for the SPSP, investigate alternative options and develop a detailed SPSP design. See 5.4 below.

44 The outline and format of the document the EC staff prepares for the financing decision is slightly different depending on the source of funding (Budget or EDF). It is called Action Fiche for interventions financed from the budget and financing proposal is financed from EDF.

Depending on the results of the assessment and subsequent discussion, the Delegation should agree with Government and where relevant other donors on the process it will follow for the formulation of the Action Fiche/FP. These next steps, including work plan and time schedule should be described in the SPSP IF and submitted to headquarters (OQSG) for feedback.

2.3 Scope of analysis required during identification

Attention to each of the seven critical areas of assessment is expected during identification. Some of these will already have been examined during Programming and most of them will need further study during formulation so this process must necessarily be dealt with in an iterative manner. The depth of analysis at each stage will be influenced by the concerns of the government and other partners and the degree of development of the sector programme. Nevertheless, it must also correspond to the requirements of the Commission.

2.4 Quality support process

It is a requirement of the EC's quality support measures that the IF for an SPSP should be submitted to the Quality Support Group. The purpose is:

- ➔ To ensure consistency between the proposed measure and the Country Strategy Paper (CSP).
- ➔ To ensure that the Delegations are aware of comparable operations and of the lessons which may have been derived from them.
- ➔ To advise on specific issues and concerns to be addressed during formulation.
- ➔ To decide when stage two of the quality assurance process should be carried out, reviewing the draft Action Fiche/FP[45].

2.5 Completing the IF & drafting the TOR for formulation

It is recommended that the IF should be built up progressively throughout the review of the seven assessment areas.

Once completed, the IF is then submitted to the QSG and line management in Europe Aid. The review of the IF by the QSG is an opportunity to improve the design of the programme. Potential risks and problems and the proposed responses must be transparently presented. This will make the QSG process more useful. Similarly, the QSG feedback at the end of the identification phase can also significantly simplify the subsequent submission of the completed SPSP Action Fiche/FP. It is the acceptance of the IF and where relevant the ToR for formulation by the QSG and their agreement by the relevant line managers in AIDCO which provide the formal mandate to progress towards completing the design of the SPSP programme.

The model for the IF is reproduced in summary in Box A.2 The IF stresses particularly the relevance of the programme idea. It should also demonstrate that there exist the right conditions for the successful implementation of the programme. These issues as well as the options considered for the implementation of the SPSP, including the proposed implementation modalities, are addressed in section C of the IF. Section A of the IF is a summary of the "pipeline data" on the SPSP, for use within the Commission's Global Monitoring System, whereas section B provides an overview of the timetable to the Commission Decision.

45 Appraisal of the Action Fiche/FP constitutes stage two of the quality assessment process. Depending on the size and complexity of the SPSP, this may be done either by the Directorate Quality Support Group (DQSG), chaired by the Director concerned or by the OQSG, chaired by the Deputy Director-General. See 5.5.

Box A.2: The Identification Fiche (IF)

(Maximum Length – 8 pages, excluding annexes)

A – PROGRAMME DATA

- Basic data
- Financial and implementation data

B – PROVISIONAL TIMETABLE

- Dates for submission to QSG
- Inter-services consultation
- MS Committee

C – FINDINGS AT THE END OF THE IDENTIFICATION STAGE

- Summary description of the objectives, purpose and expected results of the proposed SPSP
- Consistency with EC policy, programming framework and the aid effectiveness agenda
- Eligibility
- Implementation issues: preliminary description of the proposed operating and financing modalities
- Issues and state of play in the seven key areas of assessment
  - Sector policy and strategy
  - Macroeconomic context
  - Sector budget and medium-term expenditure framework (MTEF)
  - Public financial management (PFM)
  - Sector and donor coordination
  - Performance measurement
  - Institutional assessment and capacity development
- Risks and assumptions with considered mitigating measures
- Next steps, work-plan and time schedule

It should be stressed that the IF is not an ex-ante Action Fiche/FP, but rather a "stock taking" exercise to provide the basis to move confidently into the detailed analysis of the programme. By preparing the IF, relevant information will be organised for the preparation and agreement with government of the final proposal. In this sense, the IF will not be a duplication of work

3. The Formulation Phase

The formulation phase should define all components of the SPSP in detail. The output of this phase would be an Action Fiche/FP for the SPSP, agreed with government and ready for submission to the relevant Financing Committee of the Commission. In addition to an updating of the assessment of the seven issues reviewed during programming and identification, the formulation phase should define the type of SPSP to be pursued. This will depend on the state of development of the sector programme, on the positions taken by other donors regarding the financing of the sector programme and on the seven assessments.

In common with the identification phase, formulation should be undertaken in conjunction with government and, if possible, with the other partners within the programme. As far as possible, it should draw on existing work and should contribute to the development of the sector programme. This will require careful attention to the timing of formulation activities so that the results can be factored into the planning and budgeting process for the sector programme. Although there is likely to be a higher level of external consultancy input during formulation, this process must be actively managed by Delegation staff, who should continue to follow the five 'golden rules' specified for managing the identification process. (See 5.3.2)

The formulation phase comprises an updated assessment of the sector programme, based upon the seven assessment areas, and undertaken jointly with government and other partners. It will inform:

- Final definition of objectives of the SPSP, expected results and choice of the implementation modalities for the SPSP, based upon a review with government and partners of the results of the assessment.[46]
- Detailed design of the SPSP in the light of the objectives and chosen implementation modalities and based upon the sector programme action plan established by Government

3.1 Updated assessment of the sector programme

In general, one should expect a significant period of elapsed time between the end of identification and the beginning of formulation. On the one hand, time will be required to have terms of reference for formulation fully agreed on and to contract and mobilise consultancy inputs. In addition, the start of SPSP formulation would often depend upon other activities being completed by the partner government – finalisation of the sector budget submission, for example, or conclusion of revisions to the sector policy. This is especially true if the sector programme is at an early stage of development.

During this interim period, significant improvements should have been made to the sector programme, in terms of its content, the number of partners involved and the development of systems and procedures. It is important to capture the benefit of these improvements and to be sure that the design of the SPSP is based upon an up to date assessment of the status of the sector programme. For this reason, formulation starts with an updated review of the seven assessment areas.

3.2 Confirmation of the choice of financing modality

The assessment of the seven areas provides the basis for reaching a decision on the most appropriate financing modality for the SPSP. The basis of the choice between the three modalities is the eligibility criteria for sector budget support as explained in Chapter 4. It should be remembered that this choice should be made in collaboration with government and other partners, with the implications fully discussed. Implications should also be discussed within AIDCO and relevant technical and sectoral inputs should explicitly be sought. Consultations with DG Dev and RELEX are also strongly recommended, where sector budget support is foreseen.

3.3 Detailed design of the SPSP and drafting of the Action Fiche/FP

The design and implementation arrangements for an SPSP will be summarised in the Action Fiche/FP, with further details provided through annexed attachments. In most cases, these annexed attachments would be documents produced for the sector programme itself, such as the action plan, the description of the management arrangements, and the proposed methods of performance assessment and client consultation.

The precise format of the Action Fiche/FP will vary depending on the source of funding within the Commission. Nevertheless, there is a set of recommended elements for an SPSP Action Fiche/FP which should be covered.

Box A..2 presents the outline of the Action Fiche. The overall length of the Action Fiche itself should not exceed X pages, although a number of additional documents will invariably be necessary for quality assurance purpose.

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46 In most cases, this would confirm the preliminary choice of financing modality made at Identification but changes can certainly be introduced during Formulation if the circumstances dictate. In the case of a "mixed formula" combining two financing modalities, the specific details could not expect to be considered before Formulation.

During formulation, an appreciation should be built on the quality and the added value of the SPSP including the following issues:

- **The formulation stage should confirm the relevance of the proposed SPSP**, in the light of the national strategic framework (or PRSP), the objectives of the Commission, the stated sector level objectives and the state of development of the sector programme. The Action Fiche/FP and its annexes should provide a basis for reaching a judgement on this issue.
- **The formulation stage should also confirm the feasibility of the proposed SPSP**, considering in particular whether the proposed intervention is likely to be the most efficient and effective of the available alternatives and whether it is likely to maximise impact upon development objectives. The assessment of the sector programme and the corresponding choice of operating and financing modalities will therefore need to be justified in the Action Fiche/FP.
- **Finally, the formulation stage should confirm the sustainability of the proposed SPSP**, in the light of the structure of the sector programme and the proposed medium-term financial perspectives for the sector. In particular, sustainability should refer to a) ownership and leadership of the sector programme by Government, b) financial sustainability of the sector programme, c) anticipated future development of the sector programme and d) anticipated future development of the SPSP.

The seven key assessments will be essential to support judgements on relevance, feasibility and sustainability. Chapter 6 summarises the main elements required under each of the seven areas. Further information is provided in annexe 2 and additional materials and guidelines on how to approach these assessments will be made available through the training programme on sector approaches and budget support.

During the formulation phase the following issues should be addressed:

- **Expected results of EC support** for improved implementation of the sector programme should be made explicit. These should relate to the overall expected outputs and outcomes of the sector programme. Where government has established a performance assessment framework for its sector programme or is in the process of doing so, the Commission will take care to not to select indicators outside that framework in order not to overburden an often already weak data collection system It is also an explicit commitment of donors in the Paris Declaration on aid effectiveness[47].
- **The monitoring of results** within the sector, based on a common set of indicators across the sector programme is a key feature of any sector programme and by implication of any SPSP. However, monitoring of sector performance is often one of the weakest elements of a sector programme. There is a double challenge in designing the SPSP: how best can EC support improvements the performance monitoring system over time? Which indicators to choose to monitor performance? Section 6.6 provides details on how to assess the indicators proposed and how to work with government to introduce improvements over time.
- **Indicators** presented in the Action Fiche/FP should reflect the government's sector reform agenda, while being coherent with EC development policies, notably poverty reduction. They should be gender-sensitive.
- **The approach to capacity development** should be clearly stated as are the modalities for recruitment of TA if needed.
- **The implementation schedule** for the SPSP should be consistent with the planned implementation of the overall sector programme and also fully consistent with the budget calendar of the government. The implementation schedule and corresponding disbursement schedule must be included in the Action Fiche/FP.
- In addition to the sector policy and its action plan**, the assessments of the macroeconomic situation and of public financial management** hold special importance for sector budget support as eligibility is drawn from these assessments. Chapter 4 provides details of what is required. The Guidelines on the Programming, Design & Management of General Budget Support can furthermore provide information on the

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47 *"Adopt harmonised performance assessment frameworks for country systems so as to avoid presenting partner countries with an excessive number of potentially conflicting targets"*

general framework for Commission budget support operations including eligibility criteria, and should be read in conjunction with these Guidelines.

- **Targets for achievement,** at least for the first year of implementation, should be defined in the case of sector budget support. Indeed the EC links the disbursement of variable tranches to the achievement of targets for agreed outcome indicators. Although outcome indicators are more appropriate, in some sectors, where there is limited experience with and availability of outcome indicators, or outcome indicators respond with long time lags, output indicators that capture the immediate consequences of measures taken and resources used, could be used. In addition to outcome (output) indicators, the EC typically links the disbursement of its variable tranches to some other indicators such as the level of sector funding or measures to improve public finance management or to strengthen statistical and measurement systems at sector level.
- Where relevant, **the degree and type of financial additionality** that is demanded in SBS will need to be made explicit. As stated in chapter 4 the aim of additionality of EC support to a given sector is to help reach proper level and composition of budget and public expenditures for that sector. If additionality is desirable for a specific SPSP, the Action Fiche/FP should make explicit i) the level of sector financing over and above the baseline which is expected in the context of EC financial support (additionality) ii) the condition that captures the additionality requirement. (See section 4.4.4 of the Guidelines for discussion of additionality.)
- Where **pool funding** is proposed, a prior assessment of the operating procedures for the pool including contracting and financing procedures of the fund must be completed and presented as an additional document to the Action Fiche/FP. Boxes 4.11 and 4.12 of chapter 4 provide a summary of the requirements. The draft Memorandum of Understanding between Government and partner countries or the draft administration agreement should be provided as well.
- Any **conditions placed upon disbursements** from the SPSP should ideally be drawn from the same framework agreed with the government and the other stakeholders to the sector programme and should be monitored through a joint process. Subject to the need for harmonisation with other donors, the Commission favours a conditionality framework which links directly with improvements in services to final beneficiaries. Agreed conditions must be clearly stated in the Action Fiche/FP.
- A **Logical Framework for the SPSP** may be included where Commission procurement and grant award procedures are adopted, following the Commission's Project Cycle Management Manual. The logical framework should be utilised to present the components of the SPSP, as already identified within the sector programme and to verify their consistency with the targeted results of the programme.
- **Audit requirements** for the SPSP need to be agreed and specified. Auditing arrangements have to respect the requirements of the financing modalities chosen. In the case of budgetary aid, the instructions given within the Guide must be applied. In the case of a pool fund, compliance with the Commission's regulations must be assessed (See Box 4.11 in chapter 4).
- **A communication and visibility strategy** should be developed. Guidance on communication strategies is available in the Communication and Visibility Manual for EU External Actions.

Assessing Sector Budget Support eligibility criteria during Formulation.

In the case of SBS for each eligibility criterion the formulation phase will include and clearly capture in the Action Fiche/FP:

i. The bases for the assessment of the eligibility criteria, which includes a description of the main elements taken into consideration
ii. The conclusion of the assessment and a statement confirming eligibility
iii. The general condition that will be monitored to ensure that the eligibility criteria will remain satisfied during implementation.

Box A. 3: Capturing Eligibility Criteria in the General Conditions of Action Fiche and Financing Agreement

For each of the eligibility criteria it is important that a clear statement is made in the Action Fiche about whether the specific areas provide a sufficient basis for providing sector budget support. This statement should be completed by a general condition that will be included in the Action Fiche as well as in the financing agreement. In this respect, some standard terms are suggested below.

On sectoral policy: "The analysis of the sector policy and related budget confirms that a sector policy that responds to the challenges and problems faced by the partner country is in place/under implementation. As a result this sector policy is considered an appropriate basis for the provision of EC sector budget support".

A related *general condition* could require "satisfactory progress in the implementation of the sector policy as evidenced by…." Joint annual sector reviews could provide the bases for the assessment of this general condition.

On public financial management: "The analysis of PFM diagnostics and reform programme shows that a relevant and credible programme of reform for the improvement of PFM is in place/under implementation. As a result the allocation of sector budget support is justified with respect to the legal requirements concerning the eligibility criteria for budget support (…for example quote art 61(2) of the Cotonou Agreeement).

A related *general condition* could require "satisfactory progress in the implementation of the programme to reform and improve public financial management as evidenced by…." Joint annual government-donor review of PFM reform programmes or annual sector audits carried out by Supreme Audit Istitutions could provide the bases for the assessment of this general condition.

On the macroeconomic framework: "The analysis of the macroeconomic framework shows that the macroeconomic policy is stability oriented and is not expected to put at risk sector objectives. As a result the allocation of sector budget support is justified".

A related *general condition* could require" a stability oriented macroeconomic policy demonstrated by the latest IMF assessment. In case of deterioration the EC decision will be based on whether or not sector objectives are placed at risk. The Commission will make an informed assessment of the latter following consultation with the IMF".

4. The Financing Phase

The objective of the financing phase is to reach an informed decision on whether to proceed with the SPSP and, in the light of this, to conclude a financing agreement with the partner country. To achieve that objective, the following steps need to be completed:

- Finalisation of the Action Fiche/FP, taking account of comments from Government and other partners in the sector programme;
- Appraisal by the Directorate Quality Support Group (DQSG) and inter-service consultation;
- Financing decision by the appropriate Financing Committee;
- Preparation and signature of financing agreement.

4.1 Finalisation of the Action Fiche/FP

The recommended elements for the Action Fiche/FP are shown in Box A..4 and the detailed requirements for drafting the proposal are presented in section 4.3. By the end of the formulation phase, the Action Fiche/FP should have been completed and discussed with Government and other partners in the sector programme. It is important that any feedback should be incorporated into the Action Fiche before it is forwarded for appraisal within the Commission. Often there will be a need to make small amendments to the proposed SPSP design so as to firm up aspects of its content, size and implementation arrangements.

The SPSP will always imply financing from other sources, given that it is a contribution to a sector programme, supported by government and by other donors. During the process of finalisation of the Action Fiche/FP, appropriate guarantees should be obtained that the funds from these other sources would be forthcoming. These guarantees may be relatively informal – for example through an exchange of letters at the time when the SPSP Action Fiche/FP is circulated but, in some cases, the firm availability of these other finances could constitute a condition of effectiveness of the EC financing agreement. If so, then the proposed means of verification of the availability of resources would need to be specified in the Action Fiche/FP.

In the case of pool funds, finalisation of the legal basis for the fund would normally constitute a condition of effectiveness of the financing agreement. Again the FP must specify the details of the documents and agreements necessary for this purpose.

Box A.4: Outline of an Action Fiche for an SPSP

Action Fiche
[beneficiary country/region]

1. Identification
2. Rationale and country context
   - **2.1** Economic and social situation
   - **2.2** Cooperation policy of beneficiary country
   - **2.3** Government sector programme
   - **2.4** Lessons learnt
   - **2.5** Complementary actions
   - **2.6** Donor coordination
3. Description
   - **3.1** Objectives
   - **3.2** Expected results and main activities
   - **3.3** Stakeholders
   - **3.4** Risks and assumptions
   - **3.5** Crosscutting Issues
4. Implementation issues

4.2 Appraisal by Quality Support Group and inter-service consultation

For the appraisal of the Action Fiche/FP the same process applies as for the identification fiche. It is reviewed by the Quality Support Group (QSG) chaired by the Director of the relevant operational unit.

The appraisal by the QSG focuses on three issues:

- An assessment of the proposed SPSP in relation to the criteria of relevance, viability and sustainability.
- A judgement on whether the requirements of the Guidelines for EC Support to sector programmes have been adequately fulfilled.
- Verification that the comments made during the first stage of quality assurance (at the end of identification) have been addressed during formulation.

The geographical Director, as chair of the QSG, will communicate the opinion of the QSG to the EC Delegation. The EC Delegation will finalise the Action Fiche/FP taking into account the comments of the QSG and transmit it to Headquarters. After appropriate verification, the Director will then initiate the inter-service consultation.

4.3 Opinion of the financing committee and Commission decision

Once the committee has given a positive opinion on the annual action programme and its Action Fiche/FPs AIDCO is responsible for the financing decision procedure.

The Action Fiche/FP is circulated for comments in Inter-service Consultation. Following that the commission decision procedure is launched. As a general rule, the Commission adopts financing decision by written procedure or in exceptional circumstances by habilitation procedure.

Once the Commission decision is taken,, AIDCO prepares the financing agreement and takes responsibility for ensuring complete consistency between the Action Fiche/FP and the FA. The FA is based upon a model financing agreement, prepared by AIDCO. This covers all the contractual information contained in the FP. To be deleted no? and just refer to chapter 4 of this guideline The Guidelines on the Programming, Design & Management of General Budget Support, section 4.7 specify a number of specific contractual requirements in the case of sector budget support.

As a rule, all implementation modalities for the SPSP must be specified in the financing agreement.

5. The Implementation and Monitoring Phase

Implementation of the SPSP involves simultaneous attention to ensuring that a) the sector programme progresses as planned, and b) that, subject to adjustments in the light of the evolution of the programme, the SPSP is executed as planned, with the commitments made in the financing agreement fulfilled by Government and the Commission.

The SPSP will utilise the planning and monitoring procedures of the sector programme and as far as possible the detailed implementation requirements for the SPSP (the disbursement calendar, the review process, audit requirements, etc) will be integrated within the implementation modalities for the sector programme as a whole.

From a procedural perspective, the specific implementation requirements of an SPSP will depend upon the financing modality chosen and upon the precise source of funding. The presentation in this section is not exhaustive in its coverage of procedural requirements and reference should be made to relevant documentation as appropriate. In particular, the Practical Guide to EC external aid contract procedures should be consulted.

5.1 SPSP start-up

When supporting a sector programme it is especially important to avoid delays in start-up. Not only can delays have knock-on effects on other components of the sector programme but the credibility of the Commission as a partner in the sector programme might also be negatively affected. Therefore, every care should be taken to ensure that requirements for start-up are in place as early as possible and ideally at the moment of signature of the financing agreement. For example:

- With regard to first tranche release, procedures for monitoring of preconditions need to be properly foreseen and all relevant parties need to be made aware of authorisation procedures. (For sector budget support, see the Guidelines on GBS section…? for pool funds, these details should be included in the MoU or financing convention for the Fund.)
- Where technical assistance is foreseen, the documents required to issue a call for tenders should be prepared before signature of the financing agreement, wherever possible. The recruitment of technical assistance under a suspension clause, before the financing agreement is signed, can also be envisaged in the cases foreseen under the procedures in force (see: Practical Guide to EC external aid contract procedures point 2.4.13)
- In all cases it is important that the Commission remains involved in the policy dialogue in the interval between end of formulation and the signature of the financing agreement. It allows to keep abreast of developments within the sector while smoothening start-up of EC support

5.2 Ensuring continuous policy dialogue and effective sector coordination

It is essential to the success of EC support to a sector programme to get the sector policy dialogue right from the start, maintaining this engagement throughout. Sector dialogue is a complex process and takes place at political economy, strategic and technical levels. Reforms and change processes towards more pro-poor policies are likely to include measures that will touch upon established interests and that might cause stakeholders to intervene to protect them. These interventions and their underlying causes are not always easy to recognise and require continuous sector observation and sector assessment. While it is important to be flexible and responsive to opportunities, a well planned approach can ensure that joint undertakings are better understood, more feasible and will result in better programme design, implementation and monitoring.

Support to the implementation of sector programmes is a dynamic process. Indeed, sector programmes are about reform, about changing the way of doing things Change processes are by nature erratic as change is conditioned by the willingness and ability of stakeholders to change once convinced that change is needed. Stakeholders may move at different speed and at different points in time around a reform agenda, and they might want to move in different and adverse directions. Support to sector programmes is therefore not only engaging in a dynamic process, it is engaging in a process of a high political nature. Furthermore, engaging in policy dialogue around such issues can often be new ground for partners, and it is essential to take the time to build trust and mutual understanding over shared objectives.

While dialogue between government and donors is important in the design phase of the sector programme, it is even more important in the implementation phase. Disappointing results of performance review, personnel changes within the lead ministry, start of a decentralisation process, civil society groups mobilising themselves, interest groups diverting the agenda, new donors supporting the sector are all unpredictable events that have the potential to affect the sector programme. It is only by maintaining an open line of communication between government, donors and other relevant stakeholders that the effect of such events can be addressed. Dialogue therefore needs to be regular but it needs also to be effective, meaning that real debate takes place from the broader poverty reduction strategy down through to service delivery levels and community participation section 4 describes some of the implementation modalities that can be put in place to facilitate an effective policy dialogue.

Policy dialogue cannot be contracted out. EC Delegation staff is responsible for active participation in the dialogue, supported by technical assistants where relevant. Teamwork within the delegation is be important as well, as at different points in time debate may focus on issues of a very different political and technical nature, including issues beyond a specific sector, such as broader governance and economic reforms.. The Delegation needs to capitalise on its diverse in house expertise to participate in the debate, to ensure these links are made, and ensure that policy dialogue is prioritised in human resource management and work planning within the EC Delegation. In this way it will be possible to identify the most appropriate entry points to the dialogue, being responsive to opportunities as well as focusing strategically on those areas where our contribution to the dialogue will have most impact. With this in mind, it may also be necessary to further develop our own skills and capacities, as well as national partners, to effectively engage in the sector dialogue.

5.3 Monitoring of the sector programme

The progress of the SPSP is monitored through the overall performance measurement and monitoring mechanism established for the sector programme. This implies active participation in all of the agreed monitoring mechanisms. The main requirements are as follows:

- ➔ Reviewing progress with the achievement of sector goals
- ➔ Monitoring of the implementation of the eventual action plan for the sector programme, in line with the agreed structure of activities, outputs and outcomes
- ➔ Reviewing progress with the development of the sector programme, utilising the milestones agreed within the Programme
- ➔ Tracking development and implementation of the sector budget as well as it medium-term perspective, comparing actual expenditures with those foreseen and assessing the evolution of overall spending in the light of planned shares of expenditure.
- ➔ Verifying compliance with any conditions agreed within the sector programme, including specific audit requirements
- ➔ Verifying amounts and timing of disbursement of funds
- ➔ Monitoring progress in alignment to country systems

Participating in half-yearly or annual review meetings for the sector programme as well as in mid-term reviews, and contributing to the drafting and negotiation of the resulting aide-memoires between stakeholders. This also refers to indicators 9 and 10 of the Paris Declaration asking respectively for common arrangements for monitoring and reduction of the number of separate diagnostic reviews.

Also in line with the commitment to the implementation of the Paris Declaration on aid effectiveness "integrate diagnostic reviews and performance assessment frameworks".

5.4 Specific monitoring requirements for the SPSP

Any Delegation involved in implementing an SPSP has specific monitoring requirements which need to be respected. As far as possible, these should be completed in conjunction with the process of participating in the monitoring of the sector programme.

Requirements are as follows:

- Preparing reports for headquarters (and for Delegation files) on the progress of the sector programme, summarising discussions at each review meeting and commenting on their implications. Reporting on progress in the External Assistance Management Report (EAMR) should be results oriented and highlight progress made in service delivery, institutional capacity as well government-led sector & donor coordination.
- Within this general framework, the design and implementation of the SPSP should be reviewed on a half-yearly and annual basis in the light of the progress achieved in the sector programme with changes made as appropriate.
- In the case of sector budget support is being used as the financing modality for the SPSP, the Delegation has an obligation to produce an "Annual Report on Public Financial Management"[48] which must be sent to AIDCO and DEV/RELEX. The report should respect the following features:
  - **Produced once a year.** In principle it should be produced in line with the country calendar – for example, following an annual review of programme implementation. In the absence of such a calendar the report should be produced by end-February each year.
  - **Use to monitor and ensure a structured dialogue around PFM.** This report is required because it is important that Headquarters and Delegations, after the signature of Financing Agreement, maintain a regular structured dialogue on the PFM situation in the partner country. Its main purpose is to check whether the PFM situation of the country shows a satisfactory trend so as to confirm its continued eligibility to budget support. In this respect the Delegation must take a clear position in the report.
  - **Format is based on explanatory document to the Action Fiche/FP.** Beyond this key aspect, the report is, from a practical point of view, an update of the PFM information which has been included in the Action Fiche/FP (and subsequent Financing Agreement). The format to be followed, apart from some details, will be similar to that used for the annex on PFM of the Action Fiche/FP. The report can use many sources of information: for example, a new PEFA PFM-PMF assessment, the annual review of the PFM performance indicators of a variable tranche, results of an audit, or regular policy dialogue on PFM.
  - **Valid for at least six months.** Once the Annual Report on Public Financial Management has been prepared it is considered as valid for at least six months for all disbursements that require satisfactory trends in public financial management (for example, an SPSP using budget support as the financing modality). Should the period of six months be exceeded, then it will not be necessary to produce another report on PFM, however supplementary comments and observations on any pertinent developments since the last Annual Report on PFM will be necessary.
- In the case of pool funds, specific comments on the management and use of the fund are required, including attention to audit requirements.
- In the case of Commission-specific procedures, six monthly reports are required on the execution of contracts and on other specific implementation arrangements.

In general, the monitoring of the SPSP and the sector programme should be undertaken with support from headquarters, in particular with the support of relevant sectoral units, who should in turn liase with economic cooperation units with respect to macroeconomic and public finance questions. Missions from headquarters should be organised where necessary – ideally to co-incide with the half-yearly and/or annual review meetings for the sector programme.

48 *This annual report is the only additional report that Delegations are expected to produce on a systematic basis when budget support is being used.*

A Mid-term review of the SPSP may be carried out by the Delegation, with the support of relevant AIDCO units. As far as possible, this should also co-incide with the Mid-term review (or at least with the annual review) of the overall sector programme. Apart from permitting a stock-taking exercise on the progress of the sector programme, this should also allow for detailed consideration of whether the design of the SPSP remains appropriate to the evolving sector programme. Does the choice of financing modality still seem suitable? Is the scale of the SPSP and its disbursement calendar reasonable in the light of the medium-term financial perspective for the sector? Design changes in the SPSP can be initiated in the light of the results of the mid-term review and the agreements reached with government.

6. The Evaluation Phase

Sector programmes are, by their very nature, carried out along with other donors and under the lead of the government. Consequently, participating actively in joint evaluations of the sector programme is strongly recommended (co-financing or participating in steering committee or panel).

An evaluation specific to the SPSP might be needed depending on context and in any situation where SPSP is not covered by the global evaluation on the sector programme. This exercise should be carried out in consultation with government and other actors. Therefore, it is especially important to adhere to principles of evaluation that are internationally recognised.

Any evaluation should be carried out in line with the requirements applying to Commission spending activities. Evaluations are generally conducted at two points in the life-cycle of any programme:

- mid-term (producing initial results to feed into decisions on the programme's future) is intended to draw lessons from the first years of the programme implementation and to adjust the contents of the ongoing intervention in relation to realities in the field and/or contextual developments. It often includes a report on outputs and an analysis of the first results and impacts achieved. It aims at improving the intervention under way

and

- ex-post (to focus on the actual impact against objectives) is performed right after or a long time after completion of implementation. It is mainly concerned with checking achieved impacts, identifying and judging unexpected impacts and assessing the sustainability of the programme's benefits. It enables to detect the real changes in the field and, if the changes occur soon enough, they can be analysed to estimate those that are attributable to the intervention. Likewise, it helps to transfer acquired experiences to other countries or sectors.

The overall aim of evaluation is to provide an independent and reliable assessment with conclusions and recommendations and lesson learned which should assist policymakers and managers in planning the next stages of the programmes and/or future interventions. Evaluations should also account transparently to stakeholders and the public on the value of past activities funded from Community sources. Evaluations should be relevant, useful, of high quality, and ready on time for the decision-making calendar. In the case of the evaluation of SPSPs, it should also be stressed that evaluations should be of assistance in the future design and management of sector programmes by partner governments.

Evaluations of EC support to sector programmes will centre on the relevance,efficiency, effectiveness and impact (positive and negative, directly or indirectly, intended or unintended long-term effects,)of the programme and the sustainability of the results (probability of continued long-term benefits). Furthermore, in the case of sector programmes, the assessment of coordination between donors, coordination mechanisms and the complementarity and coherence of their approaches is of particular importance.; in addition coherence within the Commission's development programme and with the other Community policies.

The appropriateness of the chosen financing modalities should also be evaluated, taking account of aspects such as leverage, additionality and value for money.

The evaluations shall take account of programme preparation and implementation, including relevant data produced by monitoring, reviews, audits and controls, while focusing on the impact of the programmes. The evaluations will check that the results are in line with the objectives laid down in the financing agreements and other strategic documents.

Guidelines for general use, which have been developed by the evaluation unit, are available on its website: http://ec.europa.eu/europeaid/evaluation/intro_pages/methods.htm. These are based on OECD/DAC evaluation principles, as used by all the major international donors. The Evaluation Unit recognises the need, so far not comprehensively addressed by international aid agencies, to develop more specific evaluation tools and methods for dealing with sector programmes. It has launched an exercise which is intended to produce a set of concrete guidelines, manuals and training modules to deal with the specific challenges arising in evaluating budgetary aid and support to sector programmes.