National Audit Office

DEPARTMENT FOR INTERNATIONAL DEVELOPMENT

Providing budget support to developing countries

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 6 Session 2007-2008 | 8 February 2008

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DEPARTMENT FOR INTERNATIONAL DEVELOPMENT

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4 February 2008

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Photographs on page 12 (Hospital in India) and page 16 (Ghanaian Parliament) courtesy of DFID

SUMMARY

1 Budget support is the Department for International Development's (DFID's) preferred method of delivering financial aid where country circumstances are suitable. It is aid provided directly to a partner government's central exchequer in support of that government's programmes. It is accompanied by other inputs, in particular support to strengthen government systems and discussion over policies. Budget support is spent using the partner government's financial management systems. It aims to reduce poverty through helping to fund the poverty reduction strategy of the beneficiary country. DFID and many other donors and aid experts consider that budget support can help to strengthen developing country government capacity, increase donor harmonisation, expand service delivery and ultimately assist in poverty reduction. DFID's use of budget support has increased from £268 million to £461 million over the past five years. It now represents nearly twenty per cent of DFID's bilateral expenditure and is likely to increase further in future years provided circumstances in the recipient countries permit.

2 This study examines the aims of budget support, what it is achieving, how DFID manages the risks of using it and how DFID takes individual funding decisions. Our methods included four country case studies and a detailed documentation review for ten countries where DFID provides budget support, as well as literature review, data analysis and surveys. Our methods are at Appendix 1.

Our findings:

On results of budget support (Parts 2 and 3)

3 Budget support has:

- often enabled partner governments to increase expenditure on priority areas;
- resulted in partner governments providing more services, particularly in health and education;
- helped increase the capacity of partner governments to plan and deliver services effectively and to develop better poverty-focused policies;
- helped partner governments to strengthen their financial management systems and encouraged other donors to support such reforms;
- facilitated donor alignment to, and support for, the developing nation's own strategies; and
- reinforced existing economic stability and good economic management.

Developing country officials we spoke to during our country visits expressed a preference for budget support over other forms of aid. They also welcomed DFID's efforts to promote its use with other donors and to support technical and sector working groups.

4 But challenges remain:

- service expansion has often been at the expense of service quality;
- progress in strengthening financial management systems has been slower than expected; and
- DFID and other donors expect budget support to reduce the transaction costs of administering aid, but have found it difficult to quantify these costs.

5 Budget support can also improve domestic accountability by increasing the proportion of development expenditure reflected in government accounts and therefore increasing the potential for scrutiny by domestic stakeholders. In complementary projects to budget support, DFID also assists parliaments, civil society organisations and State Audit Institutions to improve domestic accountability. In many countries, however, these institutions are not yet fully effective.

On monitoring and evaluating budget support (Part 4)

6 Monitoring the impact of aid, and particularly budget support, is challenging given the weaknesses in developing country data and difficulties in attributing changes to a particular type of aid such as budget support. DFID has encouraged joint arrangements between donors to reduce monitoring burdens. But there is still scope to tighten DFID's specification of poverty reduction objectives in some budget support programmes and to improve performance assessment frameworks further. DFID and other donors use data generated by partner government systems to monitor progress. But some gaps in baselines and weaknesses in partner government statistical systems sometimes constrain effective monitoring. DFID provides more support to statistics than other bilateral donors but overall donors have not always done enough to help partner governments strengthen these systems.

On assessing the risks of budget support (Part 5)

7 DFID has done a good job of moving public financial management up the development agenda. It has taken a lead role in developing and using tools to assess the quality of developing country systems and to assess the level of fiduciary risk. But there is scope for DFID to sharpen its estimates of the significance of weaknesses for potential inefficiencies or leakage, and to set out more clearly the extent to which UK and other funds are at risk.

8 DFID requires a shared commitment to three objectives as a basis for providing aid through developing country governments: reducing poverty and achieving the Millennium Development Goals; strengthening financial management and accountability; and respecting human rights and other international obligations. DFID's monitoring of the first two commitments is well established but monitoring of commitment to human rights has been less systematic.

On taking funding decisions (Part 6)

9 DFID analyses country circumstances and systems well when framing its assistance programmes and considers the prospects for budget support widely both internally and with its partners. But it is weaker at documenting evidence of its overall assessment of the risks of budget support against the benefits or comparing the costs and benefits of budget support with other types of aid. DFID's country teams expect to increase budget support in the future and to use it in more countries if circumstances permit. To manage this projected expansion well it will need to link more clearly its assessment of risks and benefits to the design of budget support programmes and the amount committed.

Our conclusions and recommendations

10 As part of a broader move by donors away from traditional project-based aid, DFID has increased its use of general support for the budgets of beneficiary countries, which are then responsible for managing these funds. DFID has been one of the leading bodies promoting budget support and improving best practice in its management. Budget support has allowed developing country governments to increase expenditure in priority sectors, and helped to expand access to essential public services and improve public financial management in partner countries. Evidence on the extent to which budget support has yielded better value for money than other ways of delivering aid, or has had an impact on income poverty, is not conclusive. Nevertheless the evidence to date supports the argument that budget support has some comparative advantages in helping to build capacity in government systems while supporting increased service delivery, and can be an effective component of many assistance programmes. Budget support also carries significant risks that the national administration may not be capable of using the funds efficiently and effectively or funds may be misapplied for political reasons or through corruption – and that aid will consequently not contribute fully to reducing poverty. We set out below recommendations to help DFID improve its appraisal and management of budget support, and to judge better the value for money provided. More detailed recommendations are at Appendix 2.

a **DFID should always set out clearly its precise objectives for budget support programmes, specifying exactly what it expects to achieve and by when.**

b **DFID should build on its current monitoring arrangements to make sure that for each budget support programme it can systematically assess progress against its objectives.** Such monitoring should reflect a balance of process, output and outcome indicators and be coordinated with development partners.

c DFID has done more than most donors to strengthen statistical systems for monitoring progress. But the available information is often still not sufficient for donors to monitor all key aspects of poverty reduction on a timely basis. In countries where it uses budget support, **DFID should identify any key weaknesses in the national monitoring systems and give increased priority to mitigating them, seeking support from other donors in doing so.**

d **DFID should, together with its partners, further strengthen its risk assessments and analysis of developing country government systems.** Specifically, it should make more explicit its judgement of the significance of system weaknesses for potential inefficiencies or leakage of aid in the recipient country. It should use more quantified estimates of these factors where possible. It should use this information to tailor appropriate safeguards to mitigate risks.

e **DFID needs to set up systematic in-country monitoring along the dimensions of human rights in its guidance.** Before using budget support, DFID should establish transparent procedures to respond quickly, firmly and proportionately if concerns arise and make sure contingency plans for other ways of delivering aid cover the most significant risks.

f **DFID should improve its analysis of the prospects for using budget support by:**

- formalising appraisal of options which vary the proportion of budget support in a country programme;
- formalising appraisal of options for using alternative forms of aid; and
- bringing together the risks and benefits of each option to facilitate comparison.[1]

g In support of the above, **DFID needs to rationalise and strengthen the guidance and support available to country teams and keep it up to date.**

1 Figure 26 sets out key considerations for budget support appraisal.

PART ONE

Introduction

1.1 The Department for International Development (DFID) is responsible for leading the UK Government's contribution to reducing international poverty. DFID provides aid in a number of different ways to achieve this aim, such as through funding multilateral agencies, providing partner governments with technical assistance and financial aid, and funding non-governmental organisations. DFID considers that budget support to partner governments is particularly effective in tackling poverty if circumstances are appropriate.

1.2 Budget support is finance provided directly to a partner government's central exchequer in support of that government's programmes. It aims to reduce poverty through helping to fund the poverty reduction strategies of the beneficiary country. It is accompanied by a package of inputs including complementary initiatives to strengthen government systems through technical assistance and policy discussions. When DFID uses budget support, it almost always does so as part of a coordinated group of donors.

1.3 As DFID funding is given directly to partner governments, these funds are spent using the partner government's financial management systems. Donors cannot track their own contributions individually once paid to partner governments and instead monitor the government's overall expenditure and progress against its agreed development strategy. Support can take the form of a contribution to the overall budget (general budget support), in which policy discussion and monitoring focuses on government-wide issues, or can be targeted to a particular sector such as health or education (sector budget support).

DFID's use of budget support

1.4 DFID's use of budget support is part of a broader move by donors away from traditional project-based aid and builds on earlier experience of supporting governments through macroeconomic support and more recently debt relief. Evaluations of project-based aid in the 1980s and 1990s highlighted the high administration costs for partner governments of managing projects outside of government systems, and the challenges for donors in ensuring long-term sustainability of projects when governments have inadequate resources. Tackling these problems led to the development of "programme-based approaches"[2] (including budget support) which emphasise leadership by the developing country government, strengthening developing country institutions, and donor coordination behind a mutually agreed poverty reduction plan.

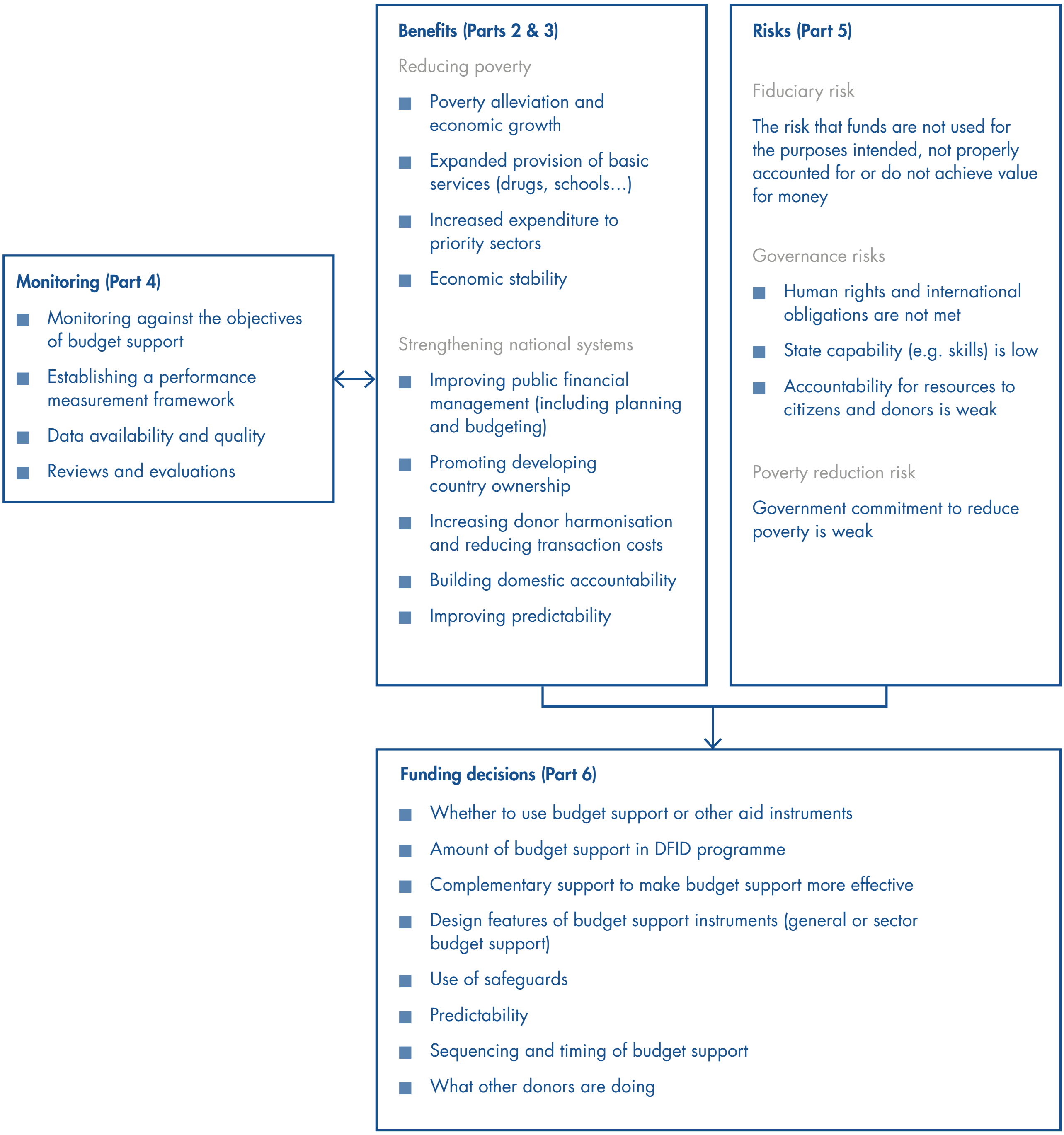
1.5 Budget support evolved following balance of payments support and debt relief. Balance of payments support provided finance to stabilise the economy. But it did not focus on the recipient government's public expenditure, poverty reduction policies or results. In the late 1990s, debt relief focused attention on partner governments' use of their budget and their public finance management systems. Budget support extends this approach by adding a direct emphasis on policies for poverty reduction, improving service delivery and achieving the Millennium Development Goals. Both budget support and debt relief give the developing country government the flexibility to allocate funds between capital and recurrent costs as most needed – for example, costs such as training and salaries of key service providers which had often been underfunded by donors.

2 The Organisation for Economic Co-operation and Development's Development Assistance Committee has defined a Programme Based Approach as: leadership by the host country or organisation; a single, comprehensive programme and budget framework; a formalised process for donor coordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement; and efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation.

1.6 DFID now uses a spectrum of aid types which vary from general budget support, which is fully aligned with government systems, through sector wide approaches and on to stand-alone projects which are less aligned. DFID considers budget support to be more effective and efficient than other ways of delivering aid where the country's policy is focused on reducing poverty, governance is relatively good and improving, and where risks surrounding weak financial management are being mitigated **(Figure 1)**. In these circumstances, budget support is DFID's preferred method of giving bilateral aid. General budget support offers opportunities to:

- engage in wide policy debate and influence expenditure decisions across the whole of the recipient government;

1 Risks and benefits of providing budget support to developing countries



Source: National Audit Office

- have impact on a national scale by using the developing country government's own delivery systems;
- strengthen national systems by delivering resources through them and collecting performance information from them; and
- avoid practices which can undermine the host government's development strategy, such as establishing parallel structures to deliver services or adopting different priorities.

1.7 In 2004, DFID set out a number of short and medium term expected benefits, both for developing countries and for donors **(Figure 2)**. In the light of its experience and the findings of evaluations of budget support, DFID has refined its position on how to manage budget support and what it expects to achieve. A timeline showing the evolution of DFID's use and policy on budget support is at Appendix 3.

1.8 All development assistance carries risks that the aid will not be effective or will not be used for the purposes intended. Monitoring the impact and efficiency of aid is challenging in some of the world's poorest countries which have weak information systems. And it is difficult to attribute reductions in poverty to any aid programme alone. In a fast changing environment there are often concerns about the longer term impact of projects and programmes after they have been completed. Budget support aims to address this by providing longer term support to developing country governments to reduce poverty. In some regards the risks of providing budget support differ from those of project support. Particular challenges are:

- Poverty reduction benefits are dependent on the quality of the developing nation's own Poverty Reduction Strategy Paper or national plan and DFID plays no direct role in delivering results;
- The efficiency and effectiveness of UK funds and their susceptibility to misuse – including corruption[3] – depends on the quality of developing country government systems, where there are often shortages of skilled people and weak capacity;
- Domestic accountability for government public expenditure depends on the quality of institutions such as parliaments, media, civil society and state audit institutions. As these institutions are not yet fully effective in many developing countries, the assurance donors can draw from these remains limited;
- Budget support is particularly vulnerable to a deterioration in political relations. When a country violates fundamental principles such as human rights, donors may find it necessary to suspend or reduce budget support.

The scale of budget support

1.9 DFID started using budget support in countries such as Uganda nearly ten years ago and has significantly increased its use since that time. For 2006-07 DFID estimated that it would provide £550 million to 15 countries through budget support. But in late 2007 DFID reviewed its portfolio and reclassified two programmes in India and one in Rwanda which it judged did not meet its definition of budget support. The reported level of budget support expenditure was therefore lower, at £461 million spent in 13 countries **(Figure 3 overleaf)**. This sum represented 18 percent of DFID bilateral aid. Approximately 75 per cent of the funds went to African countries and 25 per cent to Asian countries. In March 2005, DFID signed the Paris Declaration on Aid Effectiveness which committed DFID and other donors to deliver 66 per cent of their aid through programme-based approaches (including budget support) by 2010. **Figure 4 on page 11** shows that budget support has not displaced other forms of bilateral aid over the last five years, a period of rising aid expenditure.

2 DFID policy statement on expected benefits of budget support

In its policy paper on budget support DFID cites the following expected benefits:

Short-term:

- Increased country ownership and empowerment;
- Improved policy dialogue; and
- Increased donors' harmonisation.

Medium-term:

- Increased predictability of aid;
- Lower transaction costs;
- Improvements in service delivery and development outcomes; and
- Increased democratic accountability.

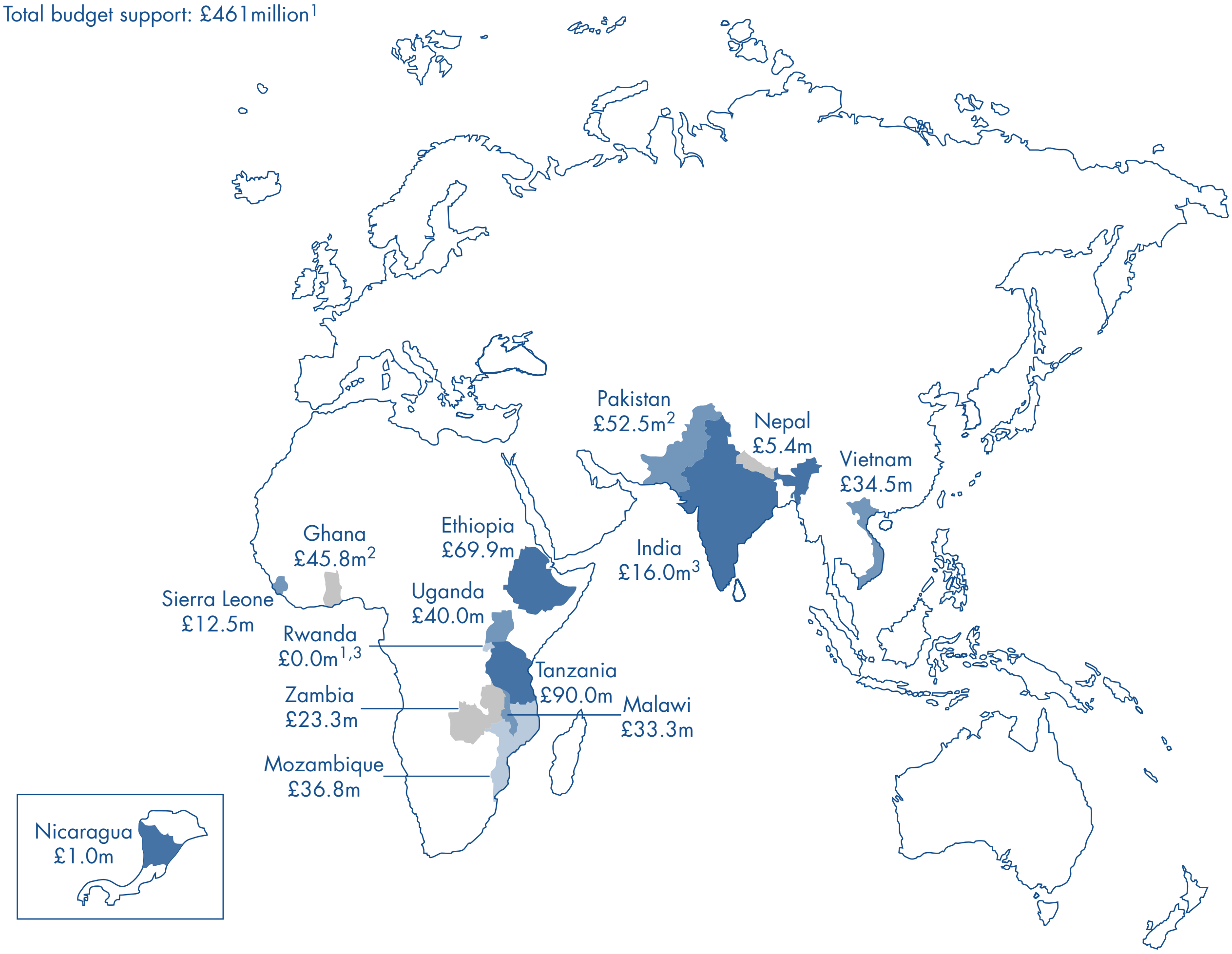
Source: DFID policy paper – Poverty Reduction Budget Support (May 2004)

3 Transparency International defines corruption as the misuse of entrusted power for private gain. This gain may be financial or other gain.

1.10 DFID has been a key player in developing and using budget support, and initiated a recent multi-donor evaluation of budget support. Together with other organisations such as the World Bank and the European Commission, DFID has contributed to developing international good practice. Other donors have also increased the amount of budget support they provide. In total, donors provided over $5 billion of aid through budget support in 2005-06.[4] For recipients, it is a small but growing percentage of all aid, and varies from being negligible in proportion to Gross National Income, to as much as 10 per cent **(Figure 5)**. As a proportion of the government budget it can be significantly more; for example in Rwanda budget support provides 18 per cent of the total budget. The World Bank and the European Commission provide the largest amounts of budget support. DFID is the third largest, providing more than three times that of any other bilateral donor.[5] Donors such as the Netherlands, Sweden and Canada also provide significant proportions of their aid as budget support. Donors providing budget support try to act together in-country. This creates challenges in devising joint monitoring but increases their ability to deliver consistent messages to the country government and to minimise costs.

3 Countries where DFID provided budget support in 2006-07

Total budget support: £461million[1]



Source: DFID Statistics on International Development and management information

NOTES

1 Cambodia did not receive any budget support from DFID in 2006-07 although it will start providing budget support from 2007-08. Rwanda does normally receive general budget support but recorded no expenditure for 2006-07 as the disbursement was brought forward into financial year 2005-06.

2 Errors in DFID published data for Ghana and Pakistan corrected here on DFID advice (now also corrected on DFID website).

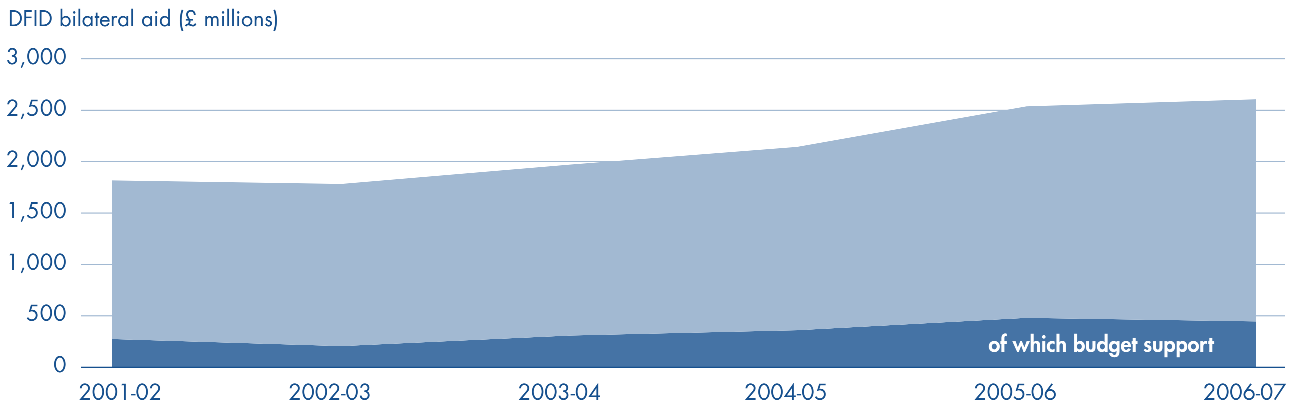
3 In India and Rwanda, expenditure of £50 million and £2.2 million respectively were reclassified during the year as other financial aid.

4 Taken from a survey of 34 countries by the Organisation for Economic Co-operation and Development, Development Assistance Committee in 2006. This survey defined budget support as "resources managed according to the recipient's budgetary procedures and not subject to earmarking".

5 Ibid. See also Strategic Partnership for Africa survey of aid in 2005.

1.11 This Report reviews the results of budget support to date and DFID's assessment of the risks of this form of aid, and explores the way it comes to decisions on the use of budget support in specific country circumstances.

4 Budget support as a proportion of DFID bilateral aid

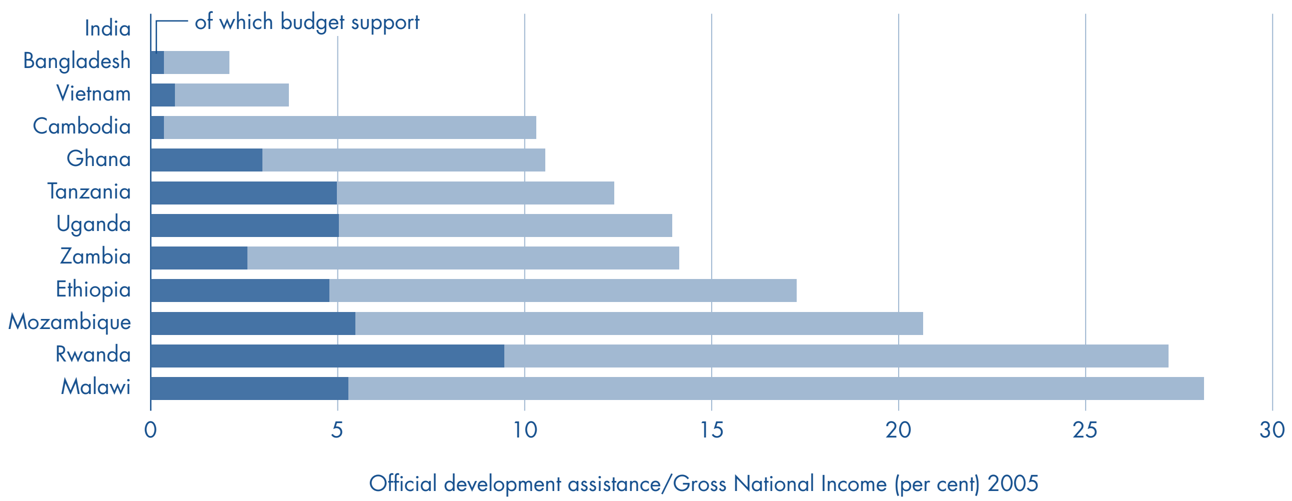


Source: Statistics on International Development (DFID, 2006 and 2007)

NOTE

Expenditure in prior years 2002-03 – 2005-06 has been restated in accordance with DFID's current revised classification of budget support.

5 Total budget support (from all donors) as a proportion of Gross National Income



Source: National Audit Office analysis of Organisation for Economic Co-operation and Development data

NOTE

Official Development Assistance (including budget support) to India was US$1.7 billion in 2005, compared with Gross National Income of US$804 billion, which is rounded to 0 per cent in the above table.

PART TWO

Delivering poverty reduction

2.1 This section examines whether budget support is delivering poverty reduction. We assess the available evidence on the results of budget support to date and review how DFID monitors these results. DFID's ultimate objective when providing aid is poverty reduction. In providing budget support DFID expects this objective will be achieved through a chain of intermediate results. This section looks at the evidence to date on three major areas: how recipient governments spend budget support funds; what service delivery improvements partner governments have achieved with this money; and the impact on income poverty reduction and economic growth. Part 3 sets out the results of budget support against DFID's other aims to create a better environment for poverty reduction, by strengthening national systems.

Increasing partner government expenditure on sectors which target poverty reduction

2.2 Budget support supplements the developing country's national budget with the aim that the recipient government can spend more on poverty reduction. We found that where donors provide budget support then the developing country has normally increased spending on poverty-focused areas such as health and education in absolute terms and often as a share of the budget. For example in Ethiopia spending on poverty-focused sectors doubled in absolute terms between 2004 and 2006 and expenditure increased from 41.9 per cent to 60.9 per cent of the budget over just five years **(Figure 6)**.

2.3 Through its budget support DFID aims to influence the allocation of the whole government budget towards reducing poverty. Our country visits showed a broadly positive picture although there are still year to year fluctuations. In Rwanda, health and education expenditure rose between 2003 and 2007 while defence expenditure declined **(Figure 7)**. Appendix 4 provides more information about our country visits. So far, evaluations of general budget support have found that it was responsible for increased "pro-poor expenditures" in six out of nine countries but found insufficient evidence for this conclusion in the other countries. Four of those six countries had also increased the proportion of pro-poor expenditure.[6] In Ghana and Tanzania budget support allowed the Governments to simultaneously reduce their debts and to raise allocations to poverty-reducing expenditures.[7] Appendix 5 gives more detail for the seven countries assessed in a multi-donor evaluation of budget support (the 'Joint Evaluation').[8]

2.4 It can be difficult to reach clear conclusions on expenditure trends because of classification problems. For example, in Zambia, DFID hired consultants to assess how much of the Government budget was spent in different sectors but the work proved inconclusive. They could not produce budget figures which were comparable from year to year as the Zambian Government was introducing new budget classifications recommended by the International Monetary Fund.

6 The six countries with increasing pro-poor expenditure are: Burkina Faso, Ghana, Mozambique, Tanzania, Uganda and Vietnam. Of these, Burkina Faso, Ghana, Uganda and Vietnam also increased the proportion of pro-poor expenditure. The other countries are: Nicaragua, Malawi and Rwanda. In Nicaragua and Malawi, funds were too recent or irregular to draw conclusions. In Rwanda the systems were not able to identify pro-poor expenditure. In Mozambique, budget support allocations to pro-poor sectors were already high and increasing before budget support existed. Budget support had supported this government prioritisation. And allocations to priority sectors had grown roughly in proportion to the whole State budget. However increasing the overall budget's resources had not changed budget allocations further in favour of pro-poor expenditures. In Tanzania over the seven years from 1999 to 2005 there was a shift in budgetary shares first towards and then away from the priority sectors identified in Tanzania's first Poverty Reduction Strategy, reflecting the evolution of the government's priorities over time.

7 Lawson et al (2007), *Joint Evaluation of Multi-Donor Budget Support to Ghana*.

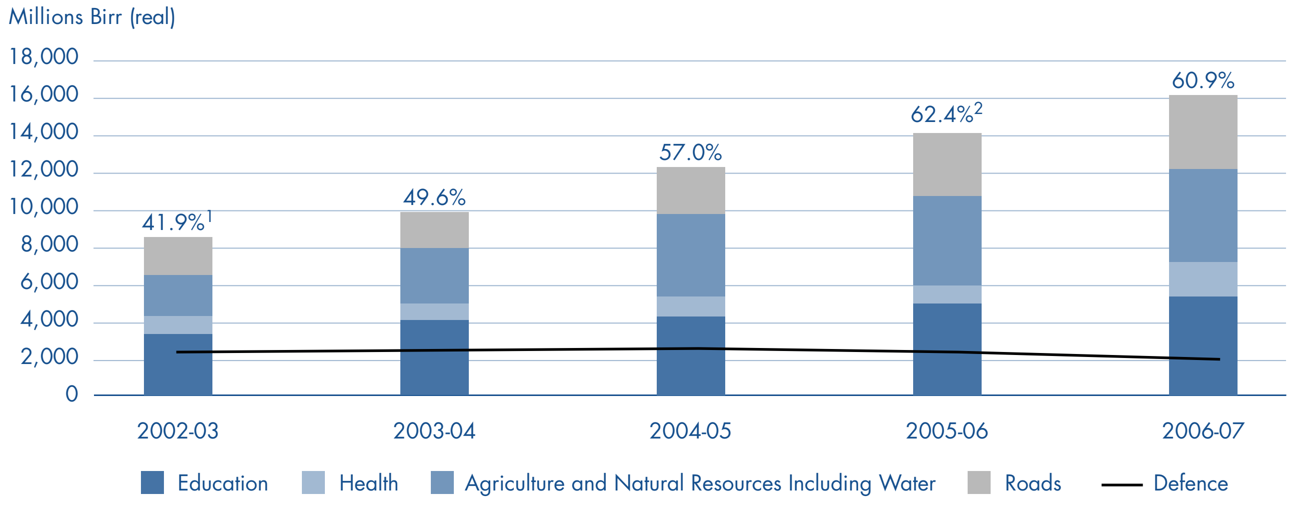
8 *Joint Evaluation of General Budget Support*, Organisation for Economic Co-operation and Development – Development Assistance Committee, 2006.

Expanding the provision of basic services

2.5 Access to basic services is important to individuals' quality of life and to their opportunity to benefit from economic growth. Budget support has been an important factor in increasing the quantity of basic services provided by developing country governments, for instance providing the necessary finance to abolish school fees and to hire and train teachers, increasing access to education. DFID's support to the health sector in West Bengal State in India provided discretionary resources at a time when the State's own budget was heavily constrained and supported the doubling of drug supplies. Evaluations have concluded that budget support increased the quantity of service delivery in seven out of eight countries, usually in basic education or health,[9] although in Ghana, where education services had expanded significantly, health services had not, despite increased funding. DFID country offices using budget support were twice as likely to report improved access to services in the last five years compared to country offices not using budget support.[10] Our country visits showed increases in the number of users of health and education services in all four countries. **Figure 8 overleaf** provides some illustrations.

2.6 As services have expanded to reach more people, maintaining the quality of those services has proved challenging – and expansion in basic services has often been accompanied by a deterioration in quality.[11] For

6 Ethiopia Government spending on poverty targeted sectors 2002-07



Source: DFID Ethiopia calculations, 2007 (conversion into real terms Birr by National Audit Office)

NOTES

1 Poverty targeted expenditure as percentage of total expenditure on top of the bars.

2 2005-06 was an exceptional year, since in the face of resource shortfalls government maintained poverty targeted expenditure at the expense of other sectors, increasing the share in total expenditure even more significantly.

7 Spending trends in Rwanda, 2003-07

	2003	2004	2005	2006	2007
Health and education spending as percentage of total budget	21.0	19.6	23.7	29.1	27.9
Defence spending as percentage of total budget	11.4	8.3	8.5	8.2	8.5
Health and education spending as percentage of gross domestic product	5.8	6.2	7.4	8.7	9.4
Defence spending as percentage of gross domestic product	3.2	2.6	2.7	2.5	2.9

Source: Government of Rwanda official budget documents, 2003-07

9 *Joint Evaluation of General Budget Support* 2006; *Evaluations of budget support in Tanzania (2005) and Ghana (2007)* by the Overseas Development Institute.
10 NAO survey of DFID country offices.
11 *Joint Evaluation of General Budget Support*, Organisation for Economic Co-operation and Development – Development Assistance Committee, 2006, paragraph 5.83.

example, as governments seek to improve enrolment rates, pupil numbers may increase before the government has been able to recruit and train more teachers – as happened in Rwanda **(Figures 9 and 10)**. Even where pupil/teacher ratios – often used as a proxy for educational quality – have been maintained, quality remains a concern. A recent learning assessment in Ethiopia, for example, showed a "very low level of academic achievement", with disparity between regions and no overall progress since a similar assessment some four years previously. Here DFID is contributing £5.25 million from 2005 to 2008 to a programme to improve teacher education and training. DFID also plans to support improvements to the curriculum and to the number of textbooks. Quality issues matter because it is, for example, improved literacy and numeracy – not merely school attendance – that will provide the skilled workforce to promote economic and social development.

2.7 Expanding service delivery poses risks to service quality, whether achieved through budget support or other means. When using budget support, DFID has a wider reach and can provide support to the government to identify and respond to issues around quality. But DFID plays no direct role in delivering services and so cannot directly intervene to balance quality and quantity. There is evidence from Uganda, Rwanda and Mozambique that general budget support has helped developing nations achieve a better balance between capital expenditure and running costs, as budget support is not earmarked to particular types of expenditure. This flexibility can help sustain quality. But at the same time two evaluations have suggested that rapid increases in public expenditure may have weakened incentives to improve efficiency. So monitoring of service quality is an important component in securing effective poverty reduction.

Changes in income poverty levels and economic growth

2.8 Economic growth is the strongest driver for a sustained reduction in income poverty. Budget support has the potential to contribute to economic growth in a number of ways:

- Improved economic management, for example, by maintaining appropriate levels of spending, with the aims of effective exchange rate management and control of inflation;
- Policies to improve the investment climate for private sector development, including an appropriate regulatory and tax system for businesses; and
- Financing spending which boosts future productivity. Such expenditure is potentially very wide-ranging and could include: capital investments in infrastructure; ongoing expenditure to maintain the road network; and even investments to improve the health and skills of the country's workforce.

These benefits are contingent on the way budget support is used and often on additional technical assistance from donors.

8 Examples of improved service delivery: healthcare in Rwanda and education in India

Healthcare in Rwanda

Rwanda has made rapid progress in extending the provision of healthcare to the whole population. Budget support has helped the Government to increase vital 'recurrent' expenditures in health – supporting recruitment, training and salary costs of health workers. The Government also introduced an insurance scheme for poor households to receive medical treatment.

As a result, access to health services has risen rapidly. Utilisation of health services rose from 0.25 outpatient attendance per person per year in 2001 to 0.33 in 2003 and to 0.59 by 2006. Births assisted by trained professionals increased from 30 per cent to 36 per cent of births between 2001 and 2003.

Education in India

DFID has supported education in India for many years, but in 2003 decided to provide nationwide support through sector support to the Government of India (this programme was recently reclassified as other financial aid). The World Bank, European Commission and DFID all contributed to the national universal elementary education scheme called Sarva Shiksha Abhiyan. DFID provided £210 million over three years, together with policy advice. The Government of India's share of financing was significantly more than combined donor inputs and was increasing. The scale of the challenge was enormous. In 2003, an estimated 25 million children aged 4 to 14 were not in school. But the results have been impressive. By 2007, 700,000 new classrooms had been built or were nearing completion; almost 700,000 more teachers had been recruited and the number of children out of school had fallen to less than 10 million.

We visited four primary schools in Madhya Pradesh state, where the Village Education Committees acted to identify local needs. Head teachers and parents said that nearly all of their requests for funds were met and showed us new school buildings and textbooks. Many schools publicly displayed exam results and attendance rates, improving transparency of the use of funds. The programme also targeted attention on girls, and disadvantaged groups, providing 90 per cent of them with free textbooks by July 2006.

Source: Health Joint Sector Review, Rwanda, 2005; National Audit Office country visits to Rwanda and India

9 Primary school enrolment is increasing but pupil/teacher ratios remain high

	2000	2001	2002	2003	2004	2005	2006
Ethiopia							
Net enrolment rate[1] (%)	–	–	52.2	54.0	57.4	68.5	77.5
Number of pupils enrolled at primary grades (millions)	7.4	8.1	8.7	9.5	11.5	12.7	14.0
Pupil-teacher ratio	–	–	63:1	64:1	65:1	66:1	62:1
Rwanda							
Net enrolment rate[1] (%)	72.2	73.3	74.5	91.2	93.0	93.5	95.2
Number of pupils enrolled at primary grades (millions)	1.43	1.48	1.53	1.64	1.75	1.86	2.02
Pupil-teacher ratio	54:1	51:1	69:1	65:1	67:1	69:1	70:1

Source: PricewaterhouseCoopers; Millennium Development Indicators database; Government of Ethiopia Education Statistics Annual Abstract – 2005-06

NOTES

1 Net enrolment rate is defined as the number of children of official primary school age who are enrolled in primary education, as a percentage of the total children of this age.

2 Gaps in the table indicate no data available.

2.9 Budget support is provided to finance countries' own poverty reduction strategies, and many countries, such as Tanzania, Rwanda and Ethiopia, have increased their emphasis on growth. On the impact of budget support on growth, there is evidence that where macroeconomic stability existed beforehand, budget support helped reinforce it. But there are not yet sufficient quantitative data to demonstrate clearly year on year trends in macroeconomic management. So far no simple causality from budget support to economic growth has been established, and there has been very little academic work disaggregating the impact of different types of aid (Appendix 6). The broader literature on the extent to which aid is linked to growth also remains disputed and inconclusive, although DFID considers the weight of evidence demonstrates a positive relationship. Regarding the wider links to poverty reduction, the Joint Evaluation concluded that it was too early to track confidently the impact of budget support on income poverty.

10 The quality of basic education in Rwanda and Ethiopia

Each class in Akanzo primary school (Rwamagana District) in Rwanda has about 65 pupils and each teacher has two classes, one between 8.00am and 12.15, and one between 13.45 and 16.30. In year four, there was only one textbook per class. There are just 14 latrines for 2160 pupils. Taken together, the reduced school hours and poor facilities mean that increases in enrolment are likely to reduce the quality of education in the short term.

In primary schools of Amhara region (Ethiopia), each class has about 60 pupils and teachers have often two classes, one in the morning and one in the afternoon. The number of teachers almost doubled in three years, but only 48 per cent of those teaching children ages 8 to 11 are qualified. There are also severe shortages of textbooks, school furniture and equipment.

Source: National Audit Office country visits to Rwanda and Ethiopia

2.10 Two factors make direct links between budget support, growth and poverty reduction difficult to evidence. First, the services and systems funded through budget support will take some time to improve growth and reduce poverty. And second, there are many competing influences on economic growth, from local economic conditions to external factors like poor rainfall, making it difficult to attribute any growth to the benefits from budget support. But sustainable development depends on growth, so it remains important for DFID to consider both how it can best support growth at country programme level, and more specifically how budget support will contribute to the growth strategy in-country. Enhancing domestic revenue can be vital for self sufficiency of growing economies and important to ensure long term financing of public services. DFID budget support proposals usually contain a good analysis of the economic situation, including domestic revenue levels - and DFID directly supports tax reform in many countries[12] – resulting in improved revenue collection in countries such as Rwanda, Tanzania and Mozambique. But DFID rarely sets out the level and timescale of growth which is needed for countries to achieve greater self-sufficiency or the implications for the level or duration of budget support.

12 DFID has supported 181 tax reform projects since 2001.

PART THREE

Strengthening national systems

3.1 This section examines whether the wider benefits of strengthening countries' own systems that DFID expects from budget support are being achieved. Developing national systems is important to ensuring that a government's plans and policies will be appropriate and effective; that the budget is used to allocate resources appropriately; and that governments are increasingly accountable to their citizens for their expenditure. Budget support aligns donor funds behind a strategy led by the developing country, in accordance with the Paris Declaration of Aid Effectiveness, in which donors committed to use developing country systems "to the maximum extent possible". Increased joint donor working also aims to reduce the high transaction costs to partner governments and donors of managing aid.

Improving public financial management

3.2 Budget support aims to increase partner government capacity through strengthening national systems in key areas of public financial management, including: devising comprehensive medium term spending plans and budgets; setting up robust management information systems to record and control expenditure; safeguarding funds against corruption and wastage and ensuring independent scrutiny of government expenditure through establishing audit institutions. Budget support is not a prerequisite for strengthening these systems: DFID provides a wide range of technical assistance in these areas in countries where it does and does not provide budget support. The advantages of budget support are that it improves recipient government incentives to strengthen public financial management, and helps focus and coordinate donor efforts in this area.

3.3 All countries receiving budget support are addressing weaknesses in their public financial management **(Figure 11)**. DFID often supports these reforms through technical assistance to help countries strengthen their financial management. Our survey of DFID country offices showed that those offices which provide budget support are much more likely to also provide additional funding for reform of public financial management systems, for example through support to the Ministry of Finance or providing accounting or budgeting support to line ministries.

3.4 Our country visits and file review showed that DFID has increased the attention given to financial management reform in developing countries and supported successful reforms in areas such as accounting capacity, planning and procurement. But our review also showed several examples where reforms in this area have been slower or more limited than originally expected **(Figure 12)**.

11 Countries receiving budget support are implementing wide-ranging reforms

Rwanda implemented new Financial Regulations from March 2007. A new Integrated Financial Management system should enable the country to produce annual consolidated accounts for the first time. A training programme for 220 accountants is started in 2006 and is due to be completed in January 2008.

In Zambia, the Government has developed a major Public Expenditure and Financial Accountability reform programme which aims to: reform the country's legal and regulatory frameworks; improve budget preparation and expenditure management (using a new Integrated Financial Management Information System); and enhance spending discipline and reform procurement.

Source: National Audit Office country visits and file review

12 Challenges in strengthening public financial management

In **Ghana** an independent evaluation concluded that:

- The overall scope and number of public financial management reform actions over 2003 to 2006 was exceptional and demonstrated Government commitment to effective systems.
- But implementation of reforms was slow and there were signs that political commitment was fluctuating and incomplete. The authors attributed this to the threat which public financial management reforms represent to powers of patronage.
- Despite the impressive body of reform measures, these have had limited impact to date on the actual performance of the public financial management system. Comparisons of independent assessments in 2006 with earlier ones showed that some serious weaknesses, such as large deviations between budgets and actual expenditures, had persisted.

In **Rwanda**, the Government agreed a programme of public financial management reform in 2003, following two years of preparation. In 2007, a top Rwandan Government official told us that the reforms had only really started in earnest in 2005 and estimated that 60-70 per cent of the reforms were now complete and that the remainder would be complete by 2008. But the slow progress has delayed the introduction of a new central budget management software system, which was expected in January 2005, but was still not in place in 2006. As a consequence, DFID's Fiduciary Risk Assessment in 2006 still reports the same lack of bank reconciliations as previously reported in the Assessment and Action Plans of 2001 and 2004.

Source: Joint Evaluation of Multi-Donor Budget Support to Ghana, Overseas Development Institute, 2007; National Audit Office visit to Rwanda

We analysed assessments in 2001 and 2004 of public expenditure management benchmarks by the World Bank and International Monetary Fund. **Figure 13** shows a mixed picture of progress in reforms, with only two countries showing significant progress. The Joint Evaluation found that general budget support had usually strengthened financial management systems, with a strong or moderate positive effect found in four of the six countries where budget support had been provided for several years and a weak positive effect in the other two. Similar positive findings were shown in evaluations in Ghana and Tanzania.

3.5 It is difficult to obtain evidence of the impact of strengthened systems on the quality of public finance outcomes. Our survey of DFID country offices found that those providing budget support were more likely to perceive improvements in public financial management and good governance than country offices not providing budget support. Budget support has improved the allocation of government budgets towards more poverty-focused areas and towards more efficient allocation of resources between capital and recurrent expenditure, although there remains scope for further progress in many countries. But more broadly based indicators, such as the Worldwide Governance Indicator on 'Government Effectiveness', which includes significant elements of public finance outcomes, have not demonstrably improved between 2000 and 2005, whether or not DFID provided budget support (Appendix 9). One specific impact of improved public financial management would be reduced leakage and corruption. Trends in the Worldwide Governance Indicator on 'Control of

13 Variable progress in public financial management benchmarks 2001-2004

Country	Number of benchmarks not met in 2001 (out of 15)	Number of benchmarks not met in 2003-04 (out of 15[1])	Net change
Ghana	14	8	+6
Tanzania	7	4	+3
Mozambique	12	11	+1
Rwanda	7	7	0
Uganda	6	7	-1
Malawi	8	10	-2

Source: HIPC (Highly Indebted Poor Country) initiative Assessments and Action Plans 2001 and 2004, World Bank and International Monetary Fund

NOTE

1 The 2004 assessment actually used 16 indicators, but for reasons of comparability this figure just presents those benchmarks which were collected on both assessments.

Corruption' between 2000 and 2005 show that among DFID's 25 priority countries, those which received DFID's budget support had on average performed at the same level as those which did not.

Promoting developing country ownership

3.6 Developing governments' ownership of their development policies and plans is important for the sustainability of any benefits from reform and from aid. A government's ownership and autonomy over the development process is not easy to measure but should be reflected in improvements in country systems and policies and ultimately in poverty reduction results. DFID has played an important role in contributing to and strengthening government-led policies. All the developing government representatives we interviewed preferred aid in the form of budget support, and specifically favoured the partnership-based approach, joint commitment to a poverty reduction strategy and increased flexibility of funding. They viewed DFID as one of the leaders within the donor community in making budget support work.

Aligning and harmonising the delivery of aid

3.7 One way of promoting developing country ownership is to align donor support behind developing nations' own development plans. Alignment is stronger where budget support is provided as, by definition, budget support allows developing country governments to finance their own priority areas and use their own procurement and financial management systems. More than other aid forms, it also aligns aid to country systems to avoid creating parallel financial management systems.

3.8 Further, DFID and other like-minded donors have emphasised the importance of harmonising different donor operations to reduce burdens on partner governments administering many discrete projects with different donor requirements. DFID country teams have taken harmonisation seriously and its decentralised structure allows DFID staff based overseas the flexibility to harmonise with others. We saw good practice examples from the countries we visited where DFID chaired donor groups and worked to agree joint monitoring tools. We reviewed three important indicators of donor harmonisation in 34 developing countries **(Figure 14)**.[13] 15 of the 34 countries surveyed were DFID's focus countries. These countries performed significantly better than the other countries on harmonisation, whether or not DFID provides budget support in country.

3.9 One way DFID contributes to policy development and implementation is through a strong in-country presence, and wide participation in local working groups. Relatively modest expenditure on advice to developing country governments can be an important factor in helping them to consider policy and service delivery options and in promoting better development outcomes. For example, in Uganda DFID worked with the Ministry of Health to review regional disparities in health indicators and to revise the formula used to allocate funds to districts.

14 All foreign aid is better aligned and harmonised in DFID's priority countries

	Countries included in DFID's Public Service Agreement	Other countries with data on harmonisation and alignment
Number in sample	15	19[1]
Harmonising different donor requirements		
Percentage of technical cooperation coordinated with country programmes	46	34
Percentage of donor missions which are coordinated	21	16
Percentage of donor analytical work which is coordinated	45	41

Source: 2006 Survey on monitoring the Paris Declaration, Overview of the Results, Organisation of Economic Cooperation and Development, 2007

NOTE

1 DFID provides only small amount of aid in these countries: in 2005-06 it provided less than £5 million to all but two of the 19 countries listed.

13 In 2006 the Organisation of Economic Development and Co-operation surveyed donors and government officials in 34 developing countries on agreed indicators from the 2005 Paris Declaration on Aid Effectiveness.

3.10 Some DFID country offices have already established 'silent partnerships' to reduce costs for government and donors, whereby they rely on another donor to represent them in a particular group. But our survey showed that DFID staff still participate in 75 per cent of all working groups – and the number of working groups is higher in budget supported countries. DFID is more proactive in engaging in and leading working groups than other donors. This approach means DFID can contribute more to policy discussions but also means that it bears a higher proportion of the administrative costs compared with its share of aid. There may be scope for DFID to reduce its own costs further if it can encourage other donors to take on more responsibility for leading working groups – while maintaining the overall scope and quality of advice.

Reducing transaction costs

3.11 Donor harmonisation should also reduce the transaction costs for partner governments and donors of managing and administering aid. Transaction costs are the costs arising from the preparation, negotiation, implementation, and monitoring of development aid. DFID expected that increasing use of budget support would increase transaction costs in the short-term while new ways of working between developing country governments and donors are established, but that costs would decrease in the medium-term.[14] For example, partner governments would only need to comply with one shared set of monitoring requirements and scarce government capacity would not be wasted negotiating and preparing many separate projects.

3.12 To date, DFID and others have not collected sufficient evidence to show that transaction costs are reducing. Studies have not been successful in assessing the impact of budget support on donors' costs or on those of partner governments. This is partly because DFID and other donors did not define clearly whether they were targeting narrow administration costs or the much broader costs associated with the financial and economic management of uncoordinated aid.[15] Relying on qualitative assessment, the Joint Evaluation concluded that in the short term there were high demands on the scarce time of government staff but asserted that transaction costs were lower during implementation and would decrease in the future. It also concluded that the transaction cost savings are limited by the scale at which other forms of aid continue in parallel and that some of the transactions costs of managing budget support also provided benefits (e.g. learning achieved through sector working groups). DFID country teams we surveyed predicted that more staff were required in the short-term to manage their budget support programmes effectively.

3.13 DFID's administration costs represent just one part of transaction costs. Expressed as a proportion of total country programme expenditure, average administration costs account for just under five per cent, and they are generally lower in countries providing budget support. Budget support is useful in providing economies of scale for donors: once budget support is set up the amount of aid can be increased or decreased at low marginal cost. A World Bank report[16] on its Poverty Reduction Support Credits found that although the set-up costs of these programmes were higher, every dollar spent on preparation translated into US$143 of financial commitments, compared with just US$32 of commitments for other forms of World Bank aid. And **Figure 15 overleaf** shows that DFID budget support administration costs have normally declined as a percentage of country programmes over time, due either to a reduction in absolute administration costs (for just under half of country programmes) or to increasing size of country programmes.

Improving the predictability of DFID aid provided through budget support

3.14 Another expected benefit of budget support was greater predictability of funding for partner governments. Since budget support finances vital expenditures such as wages, predictability is very important. The Joint Evaluation identified predictability of budget support as a problem, but found that donors were improving short term predictability. The predictability of DFID's budget support has fluctuated slightly between years but overall since 2001-02 it has disbursed 96 per cent of its funds according to plan. DFID now aims to disburse funds in the first half of the recipient country's financial year. DFID plans to improve its predictability further by moving towards longer multi-year funding agreements, and linking any performance-based country funding to future (rather than current) payments, which gives partner governments more time to plan.

14 *Poverty Reduction Budget Support*, DFID Policy Paper, 2004.
15 Killick, *Politics, Evidence and the New Aid Agenda* Development Policy Review, 2004, 22 (1).
16 World Bank (2005) *Poverty Reduction Support Credits: A stocktaking*.

15 Trends in administrative costs as a percentage of DFID bilateral programme spending in selected countries providing budget support

	2003-04 (%)	2004-05 (%)	2005-06 (%)	2006-07 (%)
Ethiopia	4.0	4.3	4.4	3.3
Ghana	3.4	3.7	2.2	3.1
India	3.2	2.7	2.2	2.9
Malawi	4.7	5.7	3.6	2.6
Mozambique	6.4	5.1	4.2	4.5
Sierra Leone[1]	3.2	5.6	5.9	5.1
Tanzania	2.7	2.9	1.9	2.2
Uganda	6.8	6.3	6.7	5.3
Zambia	6.9	7.3	5.2	5.9
Average	**4.6**	**4.8**	**4.0**	**3.9**

Source: DFID management information

NOTE

1 Administrative costs in Sierra Leone rose in 2004-05 due to the establishment of a devolved office.

Promoting better domestic accountability

3.15 Strengthening domestic accountability via parliaments, civil society groups and State Audit Institutions is important to ensure that developing country governments are challenged to plan and implement credible poverty reduction strategies and account for their achievements. Budget support can improve domestic accountability by increasing the proportion of development expenditure reflected in government accounts and therefore increasing the potential for scrutiny by domestic stakeholders. A higher proportion of countries where DFID uses budget support receive technical assistance for domestic institutions than in non-budget support countries **(Figure 16)**. Country teams reported that they or other donors often provided assistance to civil society groups prior to starting budget support. But historically DFID had placed less emphasis on domestic accountability to parliaments and State Audit Institutions and so had supported parliaments in just 20 per cent and State Audit Institutions in 13 per cent of such cases. DFID's 2006 White Paper emphasised the need to strengthen domestic accountability in all its programmes.

3.16 Despite their importance, national institutions are often weak. Although accounts are generally independently audited and are increasingly submitted to parliaments on time, follow up is weaker. In our review of Fiduciary Risk Assessments we found that DFID had rated follow up of criticisms and recommendations by auditors as 'C' (the lowest rating) in seven out of nine cases. It also rated eight out of nine cases as 'C' for holding government agencies to account for mismanagement (Appendix 7). In some countries follow up is improving. For example in Ghana DFID support enabled the Parliamentary Public Accounts Committee to broadcast their hearings and so improve transparency and increase media awareness.

3.17 DFID and other donors have recognised an important role for civil society organisations in holding developing country governments to account for implementation of Poverty Reduction Strategies. Overall, DFID expenditure on civil society organisations has been rising although as a percentage of expenditure it has declined slightly from 9.8 per cent to 8.5 per cent between 1997 and 2005. We found examples where DFID is specifically encouraging civil society to engage in debates on the national budget. In India, DFID has argued for the inclusion of civil society groups in dialogue with government on policy and programme implementation, and is supporting the Civil Society Strengthening Programme. And DFID supports the strengthening of civil society organisations to engage with the budget process in Mozambique and Ethiopia.

3.18 There are some examples of improvement: in Zambia we saw a high level of public and press interest in the Public Accounts Committee hearings based on the Auditor General's reports, assisted by the opening of these hearings to the public and press. Civil society organisations there are paying increased attention to budgets and financial data, and are lobbying for improved public financial management. A study of Tanzanian non-governmental organisations concluded that the poverty reduction strategy process had resulted in non-governmental organisations being able to influence the recipient government's policy making in some cases. However, it said it was too early to see how budget support will affect this relationship.[17] Despite these improvements, there remain risks from budget support which DFID needs to manage. A report by UK non-governmental organisations found that DFID had increased support for policy and advocacy work by civil society, but it questioned whether budget support really had increased recipient governments' accountability to their citizens. Instead, it concluded that budget support had predominately increased government accountability to donors. DFID is now drafting new guidance which will highlight the risk that budget support may not improve domestic accountability and suggest other actions that country teams can take to maximise the impact that budget support has on domestic accountability.

16 Technical assistance provided by donors to strengthen domestic accountability

Percentage of countries receiving technical assistance

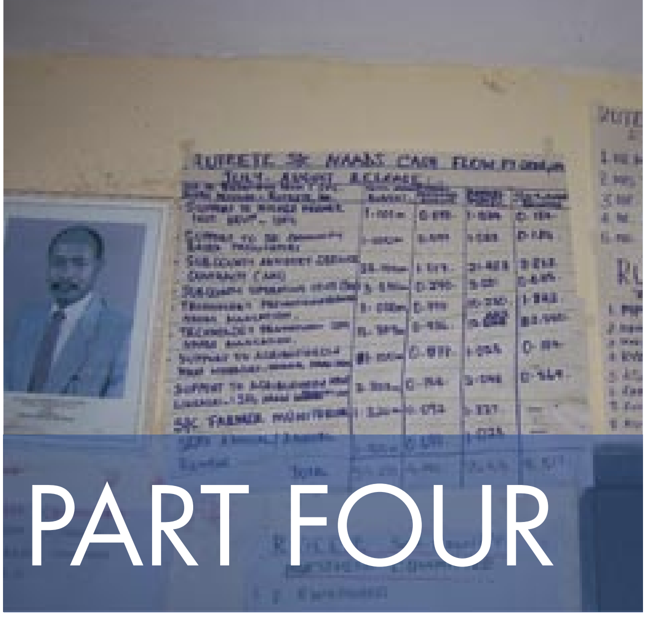
	15 DFID budget support countries	10 DFID non-budget support countries
Civil society	80% (12 countries)	60% (6 countries)
Parliament	67% (10 countries)	40% (4 countries)
State Audit Institution	73% (11 countries)	10% (1 country)

Source: NAO survey of country teams

NOTE

We asked DFID country teams to tell us where they were aware of technical assistance provided by all donors, not only DFID.

17 Research on Poverty Alleviation, 2007 *Tanzanian Non-Governmental Organisations - Their perceptions of their relationships with the Government of Tanzania and donors and their role in poverty reduction and development.*



PART FOUR

Monitoring and evaluating budget support

4.1 This Part considers DFID's processes for monitoring progress towards its objectives for budget support programmes. It shows that DFID has clear processes in place to set programme goals, devise monitoring frameworks and review the results. It also shows that there is scope to sharpen the specification of objectives in some programmes, make sure monitoring frameworks align better to objectives, improve data quality and make better use of programme reviews.

Budget support objectives

4.2 DFID operates a standard process for setting goals, objectives and indicators for all its major projects and programmes – a process which was followed for the budget support programmes we examined. We reviewed the key programme approval documents relating to those programmes in terms of their use as a basis for subsequent monitoring. We found that:

- all programme submissions specified budget support goals and included measurement annexes, although the detail given on objectives and potential indicators varied considerably;
- DFID guidance identifies a range of potential benefits which budget support could deliver. Programme objectives always identified improvements in service delivery and five out of nine included increased democratic accountability. But DFID's expectation that budget support improves the predictability of aid and reduces transaction costs were only included as formal objectives in one out of nine programmes we reviewed, and fewer than half the submission documents recognised these potential benefits in the broader narrative; and
- objectives were sometimes purely qualitative statements, where the degree of improvement sought was not specified, or subject to a timetable.

4.3 The following examples indicate the variety of approaches used to define objectives. The objective for the Vietnam programme was "to support implementation of the reform strategy articulated in the [Vietnamese development strategy] and other key planning documents". DFID's budget support objectives for Mozambique, taken from the Memorandum of Understanding agreed with the Mozambican Government, give more detail, for example: "Providing financing to the public sector for poverty reduction, clearly and transparently linked to performance, in a way which improves aid effectiveness and country ownership of the development process, reduces transaction costs, allows allocative efficiency in public spending, predictability of aid flows, increases the effectiveness of the state and public administration, improves monitoring and evaluation and strengthens domestic accountability". These sorts of objectives can help set the general basis for monitoring, but do not help assess the adequacy of progress. The latter point can in principle be picked up in the way detailed indicators are specified and used – which we review below.

Monitoring frameworks

4.4 Formal performance measurement frameworks, agreed between budget support donors and the partner government, should be designed to reflect the principal objectives of budget support, while protecting developing country governments from the burden imposed by ad hoc donor intervention in any aspect of their programmes. Formal frameworks need to cover intermediate steps on the way to poverty reduction – inputs, processes and government capacity, the volume and quality of outputs – as well as outcomes, given the time lags involved between input and ultimate effects, and infrequent measurement of outcomes. Since frameworks need to reflect the specific objectives of each budget support programme, as well as country circumstances, indicators used will vary across time and between countries.

4.5 DFID usually specifies an initial set of indicators in their programme approval documentation. But that set may be modified by subsequent discussion with its partners. DFID has made efforts to coordinate with other donors and used joint assessment frameworks to monitor progress in all but two of the programmes we reviewed. Joint monitoring minimises the burden on the developing country government in co-ordinating different donor requirements and encourages the developing country government to take the lead. Joint frameworks often reflect a compromise between different partners' priorities. Where DFID has objectives not covered by joint arrangements, they may use other mechanisms to secure appropriate monitoring information. Our analysis of frameworks includes any such supplementary arrangements included in formal monitoring arrangements for budget support, as well as the main monitoring framework.

4.6 Fifteen per cent of indicators do not have specific time-bound targets, and baselines were missing in 22 per cent of relevant cases **(Figure 17)**. These omissions make assessment of progress more difficult, particularly given the often imprecise nature of the objectives to which the indicators relate.

4.7 Sometimes formal monitoring frameworks were not finalised or agreed with partner governments at the start of budget support. In Rwanda DFID has been providing budget support since 2000 but a formal monitoring framework has yet to be agreed with the Government. In the meantime DFID's internal monitoring has largely relied on macroeconomic monitoring by the International Monetary Fund, expenditure data, education sector indicators and, from 2002, the indicators in the Rwandan Government's Poverty Reduction Strategy. In 2006 DFID developed a more focused draft monitoring framework which it has used as an interim tool pending the development of a joint monitoring framework with other donors following a Rwandan Government review of its poverty reduction strategy.

17 Indicators in budget support monitoring frameworks

	Process indicators (priority actions)		Non-process indicators (quantifiable inputs, outputs and results)			
	Number of process indicators	Number with specific, time-bound targets	Number of Non-process indicators	Number with clear baselines	Number with specific, time-bound targets	Annual targets?
General Budget Support Programmes						
Zambia, Performance Assessment Framework 2006-08	9	8	25	23	23	Yes
Tanzania, Performance Assessment Framework 2006	20	10	16	14	14	No
Mozambique, Performance Assessment Framework 2007-09	6	3	35	24	32	Yes
Uganda, Poverty Reduction Support Credit Prior Actions[1]	7	7	5	2	0	Yes
Sierra Leone, 2006 monitoring framework[2]	19	18	6	4	3	Yes
Sector Budget Support Programmes						
Vietnam, Rural Transport 3, results framework 2006	16	16	14	13	14	Some
India, Reproductive Child Health II, 2005-08	9	9	13	9	13	Yes

Source: National Audit Office analysis of Performance Assessment Frameworks

NOTES

1 For the Uganda programme, DFID also uses a set of political governance indicators to inform decisions about the amount of funding dispersed.

2 The 2006 Sierra Leone monitoring framework included the UK and Government of Sierra Leone benchmarks plus the pilot Performance Assessment Framework.

Coverage of objectives

4.8 We found that the indicators in the formal monitoring frameworks were generally well aligned with the objectives and internal DFID measurement annexes which formed the basis for programme approval. There were, however, a number of objectives that did not feature in the formal frameworks. For example:

- in the Mozambique example quoted above, the joint monitoring framework did not contain indicators related to transaction costs or domestic accountability. And at a more detailed level, of nine expected outcomes referenced in project documentation, only six feature in the formal monitoring framework;
- in Sierra Leone, DFID's objective to maintain peace and security is stated in its programme documentation but is not represented in subsequent functioning formal monitoring frameworks; and
- in Tanzania, one of six expected outcomes is not represented in the formal monitoring framework.

Coverage of results

4.9 The frameworks vary in size, with between 41 and 12 indicators each, and also in their focus, with three biased towards results and four towards processes. Striking these balances often reflects the context of the countries concerned: Tanzania has a relatively well-developed public service, and a considerable array of active donors; Sierra Leone has recently emerged from conflict and has weak public management systems. Nonetheless, reviews of performance measurement for strategic partnerships emphasise the need to focus on shared performance goals, with indicators restricted in number to minimise burdens and maximise management freedoms, while maintaining a clear focus on partnership priorities. We found that the sector budget support programmes made these trade-offs most persuasively, generally having more precise objectives, indicators and targets.

4.10 Another issue is the type of result which the formal frameworks cover. There is a chain of results from securing the right distribution of financial inputs, through their use by government to produce physical inputs (such as trained staff, buildings or textbooks) and outputs to customers, to social and economic outcomes. The earlier parts of the chain are often easier to measure, and measured more frequently and immediately than the later parts of the chain. But they are also farthest from the ultimate goals of the programme. So there are trade-offs to be made within the set of results indicators.

4.11 For example, one of Zambia's key development challenges is in the health sector. The table below shows the choices DFID Zambia made over the indicators to include in the formal monitoring framework. Key physical inputs, such as the recruitment and retention of health personnel (responding to a crisis in staffing the health service) were excluded from the framework **(Figure 18)**, along with indicators of health outcomes, because suitable data would not be available to inform the six-monthly reviews envisaged. Instead the outputs are used as proxies for both earlier and later stages in the results chain. Risks presented by the limitations of the proxies to give, for example, good early warning of input quality problems, or of subsequent issues with the quality or relevance of outputs for health outcomes, are managed by reference to other information, including the views of the various stakeholders.

Coverage of public financial management issues

4.12 Strengthened public financial management is an objective of all general budget support programmes, or listed as central to risk management. Formal budget support monitoring frameworks include indicators on public financial management reform. But the extent to which they cover the weakest areas of financial management as captured by DFID's Fiduciary Risk Assessments varies **(Figure 19)**.

18 Monitoring the chain of results – example from the health sector in Zambia

	Financial inputs	Physical inputs	Outputs	Outcomes
Health sector indicators included in the Performance Assessment Framework:	Percentage of Ministry of Health budget transferred to local districts	None	Percentage of institutional deliveries; Percentage of children immunised; utilisation rate of health centres; number of people tested for HIV/AIDS and accessing anti-retro viral drugs.	None

Source: National Audit Office review of Zambia Performance Assessment Framework

Other sources of information

4.13 Of course, the developing country government will have additional performance indicators beyond those in formal budget support monitoring. In the examples above, Zambian health worker statistics and indicators of public financial management reform in many countries are available to donors through general government statistics or as a result of complementary reform projects. And donors will often discuss these and related issues with governments in sector working groups and bring them to general budget support discussions. But these arrangements do not provide the emphasis on aspects of recipient performance that would follow from the inclusion of indicators in the formal framework for accountability to donors for budget support funds.

Data availability and quality

4.14 DFID needs access to a wide range of indicators to reflect the wide potential impacts of budget support, compared to the narrower objectives of discrete projects. But there are challenges to obtaining the data needed to evaluate budget support at all stages, from inputs to service delivery achievements to poverty reduction:

- Difficulties in collecting clear information about partner government budget allocations and execution (see paragraph 2.4 above). Donors are partly to blame here: the Development Assistance Committee found that in 30 out of 34 countries aid dispersed by donors differed from the recipient's budgeted estimates by over 10 per cent[19];
- Service delivery indicators are still missing in key sectors in some countries. For example, of DFID's 25 target countries, the World Development Indicators 2007 show that 15 had incomplete data on primary school enrolment rates 2000-2005;
- There is little data which tackles the quality of service delivery directly. DFID uses indicators such as pupil/teacher ratios as proxies but indicators such as school completion rates and youth literacy rates are needed to measure quality accurately. But literacy rates are typically only surveyed every five years and other data such as exam pass rates or completion rates is often not collated or reported in a useful form; and
- Service delivery information shows what has been achieved, but not whether results were delivered efficiently. None of the Performance Assessment Frameworks we reviewed contained indicators aimed at measurement of efficiency. And the four DFID offices visited did not have routine information on, for example, the unit costs of delivering services – so comparisons between the performance of administrative districts, or between government and private sector or civil society providers, were not possible.

19 Follow-up of fiduciary risks in DFID's monitoring frameworks

	Number of indicators rated C (worst category) in Fiduciary Risk Assessments (out of 15)	Of which explicitly included in formal budget support monitoring framework (Performance Assessment Framework or similar)
Uganda (Poverty Reduction Strategy Credit Five prior actions)	5	4
Zambia (2006-08 Performance Assessment Framework)	7	3
Tanzania (2006 Performance Assessment Framework)	2	0
Sierra Leone (2006 monitoring framework)	4	4
Cambodia (2007 draft benchmarks)	13	7 in action plan, 2 actively monitored (See note)

Source: DFID's Fiduciary Risk Assessments, and Performance Assessment Frameworks or equivalent

NOTE

Cambodia's matrix is an action plan rather than monitoring. Seven 'C' rated indicators were addressed by specific actions although only two of the 'C' rated indicators are monitored in a way comparable with the Fiduciary Risk Assessment.

19 2006 Organisation for Economic Co-operation and Development survey of progress against the Paris Declaration on Aid Effectiveness.

4.15 Many of these gaps result from weaknesses in developing country information systems. Multilateral donors, notably the World Bank and the European Commission, provide significant support for improved government statistics. DFID has also worked to get agreements from multilaterals to support national strategies for the development of statistics. DFID gives direct support to developing statistical capacity in ten of the 15 countries where it uses budget support, for example, by building the capacity of national statistics institutes or by financing international work to collect data on specific areas such as education quality. But only one DFID country office which provides budget support reported more than one per cent of country programme expenditure on directly supporting statistics systems. This was less than for countries not providing budget support, where the DFID country offices in China, Nigeria and Kenya all reported expenditure of 2–3 per cent of their country programme.[20] Despite the relatively small proportion of its support devoted to statistics, DFID still provided more statistics support than all other bilateral donors combined in Sub-Saharan Africa in 2005.[21]

4.16 DFID's work to support its own budget support programmes involves relatively little direct statistics advisory input. Nine statistics advisors serve all of DFID's 60 country offices – although other numerate advisor cadres can help develop monitoring systems. UK-based statistics advisors can also support country offices on international statistical standards and monitoring international progress against Millennium Development Goals. On average, statistical advisor input to a country team amounted to just twenty per cent of a full-time equivalent statistics advisor's time. Most of their time was spent in broader activities geared to improving data quality and statistical systems in the longer term.

Reviews and evaluations

4.17 DFID requires its country teams to monitor the progress of all its programmes towards their objectives annually and at the end of each programme. We found that most budget support programmes had been reviewed as required, and a number of useful lessons drawn out. But the reviews had not consistently addressed performance as specified at the outset of the programmes. Of six budget support reviews we examined, three assessed progress against only half of the indicators defined in programme approval documents and a further one did not review any of the approved indicators but instead monitored against other criteria. Therefore, in these cases the evidence provided was insufficient to support DFID's scoring. One of the reasons for this situation was that DFID had not fully adapted monitoring arrangements devised for discrete projects to the circumstances of broader, ongoing budget support programmes.

4.18 Evaluating the impact of budget support is also important in ensuring that lessons are learnt for the future. DFID played a leading part in initiating and delivering the Joint Evaluation, which reviewed the effects of budget support in seven countries, and in the multi-donor evaluations of budget support in Ghana and Tanzania. These evaluations have informed DFID central policy and guidance on the design and use of budget support at country level. DFID headquarters also periodically carries out Country Programme Evaluations, looking at entire country programmes. These cover budget support where it is provided, but no scoring system is used.

20 Amounts reported do not include statistics expenditure by the developing country government, which may have been financed in part through budget support, or through programmes where the primary purpose is not statistical strengthening.

21 PARIS 21 Light Reporting Exercise on Statistics.

PART FIVE

Assessing and managing risks

5.1 This section outlines some key risks of providing budget support and the ways in which DFID manages them. In its policy on conditionality in March 2005, DFID set out three major commitments necessary by partner governments if it is to provide them with financial support. These commitments are to:

- strengthening financial management and accountability;
- reducing poverty and achieving the Millennium Development Goals; and
- respecting human rights and other international obligations.

The 2006 White Paper reinforced these three partnership commitments and linked them to the circumstances for providing budget support. Monitoring adherence to the commitments is vital if aid channelled through budget support is to be effective and sustainable. DFID now requires all country teams to make an assessment of the three commitments in their Country Assistance Plans and to monitor them.

Assessing commitment to strengthening financial management and associated fiduciary risks

DFID's use of Fiduciary Risk[22] Assessments

5.2 Channelling funds through developing country systems which are weak poses risks of inefficiency and wastage. In line with NAO recommendations[23], DFID requires country teams to perform Fiduciary Risk Assessments prior to starting budget support programmes and Annual Statements of Progress thereafter. DFID uses this tool to assess and track changes in fiduciary risk.

DFID's Fiduciary Risk Assessments:

- assess countries' public financial management systems against 15 benchmarks, using an "A" (low risk) to "C" (high risk) scale (Appendix 7);
- include an assessment of the trajectory of change;
- cover the key areas which are important for assessing the strength of public financial management, including the national budget, accounting and auditing processes, risk of corruption and whether there is a credible programme of reform; and
- have enabled DFID to focus greater international attention on public financial management, because of its lead role in developing these Assessments.

From 2008 country teams will begin to produce Fiduciary Risk Assessments as part of their Country Assistance Plans.

5.3 Practice in preparing Fiduciary Risk Assessments varies between DFID country offices, for example in which sets of indicators are used, or whether local government systems are assessed. Assessments are not designed to be comparable across countries, because the ratings are not absolute values. Although the quality of assessments has improved over time, and are now usually well-researched, they could be made still more rigorous in three areas:

- **Scoring is not always sufficiently evidenced or does not cover all relevant issues.** DFID's guidance sets generic parameters of what merits an A, B or C rating, but there are no specific guidelines for individual indicators. This makes it difficult to compare levels of risk in different countries or to be confident that ratings are not overly optimistic or pessimistic. Sometimes the criteria set up for the score do not reflect all the important fiduciary issues or risks. **Figure 20 overleaf** highlights an example of this problem;

22 See glossary.
23 NAO paper *Review of Safeguards against the Misappropriation and Diversion of Aid*, February 2003.

20 An example of insufficient evidence to justify scoring in Fiduciary Risk Assessments

DFID rated **Rwanda** "A" for the benchmark "Government accounts are independently audited", although the Rwandan Auditor General was not able to carry out an audit of the State Consolidated Financial Statements (which were not produced) and audited annual accounts of only 81 entities out of about 500. This was largely because the scoring indicator was defined narrowly to look at the auditor's independence so DFID Rwanda did not take into account whether the Auditor General was able to carry out the required work.

Source: DFID Rwanda Fiduciary Risk Assessment

- **Positive trajectories of change are not always supported in analysis.** According to DFID's guidelines, the trajectory of change should indicate expected future progress based on actual evidence of progress achieved to date. But these are two different things. Expected progress should be based on other factors as well as on previous performance. DFID is now working to clarify this position in new guidance; and
- **Risk assessments do not always distinguish between improvements in systems and the assessment of risk to UK funds.** For example in Tanzania, the Fiduciary Risk Assessment reports progress in procurement further to the adoption of a new Procurement Act 2004. But the Act is not yet implemented in practice. For example, while the Act provides for those caught paying bribes to be blacklisted, in practice no such list has yet been created. In 2006, DFID recognised that it lacked concrete evidence of actual change and revised the rating from a B to a C.

5.4 Fiduciary Risk Assessments are carried out by individual country teams which plan to give budget support. Central teams scrutinise the quality and scope of these Assessments and give formal approval, but since these teams have often been involved in advising on the original Assessment, DFID staff reported that this process does not give real arm's-length scrutiny. Country offices must also produce an Annual Statement of Progress to demonstrate that there have been no major changes in risk, although only a sample of these statements are reviewed by headquarters. Of the ten country offices we reviewed we found that three quarters of the expected update assessments were provided annually as required.

5.5 DFID helped develop a joint tool for monitoring public financial management: the Public Expenditure and Financial Accountability framework, which was finalised in 2005. Our survey showed that over 40 per cent of country offices using budget support are now using the framework. The framework contains 28 performance indicators, with criteria for measuring performance on a seven-point scale. It enables partner governments and donors to track progress more systematically over time and may eventually make comparisons between countries possible. Where available, DFID country offices use information from these frameworks to inform their Fiduciary Risk Assessments.

5.6 An 'early experience' report on the Public Expenditure and Financial Accountability framework, in November 2006,[24] concluded that overall this tool was used well and had improved over time. However, it also reported scope for improvement: out of the 18 countries for which reports were reviewed, only 48 per cent of all scores were judged to present adequate evidence and correctly assign a score on that basis. The Mozambique assessment, carried out in 2006, provides an example of good practice. Two key factors here were an assessment showing a "potential score" for two years time; and a summary linking reforms identified with relevant performance indicators. Importantly, these factors allow donors to make an objective assessment in the future of whether public financial management reforms are generating the expected improvements.

Assessing the actual level of risk and its impact on aid

5.7 A summary of DFID's Fiduciary Risk Assessment ratings is included in Appendix 7. Some of DFID's assessments rate fiduciary risk as high (e.g. Cambodia) and some medium (e.g. Ethiopia). Appendix 7 shows that, across countries, risks related to government support for pro-poor strategies and a strong budget process are rated as relatively low (most common score = B). In contrast, DFID assesses risks surrounding procurement processes and corruption to be high (most common score = C).

24 The Report on Early Experience from Application of the Public Expenditure and Financial Accountability Framework covered 19 countries (including nine DFID priority countries).

5.8 But such assessments rarely include quantified estimates of the impact of weak systems in terms of possible wastage of resources through inefficiencies, leakage or corruption. There are a range of sources providing information on risks to value for money, although not all are available in each country. For example, Public Expenditure Tracking Surveys track the flow of resources through the various layers of government to front line services, in order to determine how robust the government systems were, how much of the original resource was shown to reach each level and how long the transfers took. Public Expenditure Reviews typically assess the efficiency and effectiveness of expenditure in a particular sector. DFID often contributes to the design and funding of such surveys and uses them to inform its own analysis. But such surveys and reviews are not always fully used by DFID. Six of eight DFID country offices providing budget support used Public Expenditure Tracking Surveys, and eight of ten used Public Expenditure Reviews as part of their monitoring, in those countries where such reviews were available. **Figure 21** sets out information on the use of Public Expenditure Tracking Surveys in the 10 countries we reviewed.

5.9 Good procurement practice is a vital component of good management as it represents a significant proportion of government expenditure. Use of open competition for award of public contracts is a necessary first step although it is not sufficient in itself. Procurement price indicators are valuable in monitoring prices paid by the public sector over time, in different locations and against prices paid by the private sector. So far, such indicators do not exist in countries where DFID provides budget support, making it harder for DFID to assess fully the efficiency of its expenditure. Similarly, the performance of districts in delivering public services is an important component in securing value for money. In many budget support countries the systems to monitor district performance are still being developed often as part of broader decentralisation reforms. Few other countries have a system like Uganda's for district performance review, although countries such as India and Zambia are starting to develop stronger monitoring of district performance.

21 Public Expenditure Tracking Surveys in selected countries receiving budget support

Country	Total number of completed tracking surveys	Year of most recent survey	Sectors covered	Estimates of potential leakage[1]
Sierra Leone	6	2006	Education, Health	Potential leakage of education materials: 6 per cent
Tanzania	5	2003	Health, Education, Pro–poor expenditure	Potential leakage of education grant: 5 per cent
Uganda	5	2006	Education, Health	Potential leakage: 10 per cent
Vietnam	3	2006	Rural transport and development	Little evidence of substantial leakage
Cambodia	2	2006	Primary education, Health	Potential leakage 7 per cent
Rwanda	2	2004	Education, Health	Education: actual leakage 2 per cent; Potential leakage 8 per cent Health – not estimated
Mozambique	2	2002	Health	Not estimated
Zambia	0	–	(Education and health ongoing 2007)	–
Ethiopia[2]	0	–	–	–
India (DFID priority states)	0	–	Health sector ongoing in 2007	–

Source: PricewaterhouseCoopers survey of Public Expenditure Tracking Surveys

NOTES

1 Potential leakage indicates that funds could not be tracked. This is often due to a lack of reliable record keeping by the recipient. This does not necessarily indicate that funds have been misappropriated.

2 Ethiopia has a federal government structure and is fiscally decentralised so public expenditure tracking surveys would need to follow a revised approach.

5.10 The State Audit Institutions in developing countries can provide another important source of information, as set out in DFID's own guidance on risk assessments. 71 per cent of country offices providing budget support said they used these but DFID could make much more detailed use of this information in making an overall judgements on the level of risks. **Figure 22** shows the high number of qualified audit reports (i.e. reports where the accounts were not true and fair) in a selection of countries. The benchmark in the Fiduciary Risk Assessment requires country teams to report factual information about the audit process and the resulting follow-up but not to use the results of the audit to inform an overall risk assessment. We saw only limited explicit mention of the audit report findings in DFID's risk assessments. Rwanda and the West Bengal sector budget support programme represented good practice, drawing significantly on the results of audit reports, but other countries such as Zambia and Sierra Leone made little mention of weaknesses identified from audit findings. In Zambia, a report called 'Show me the money' by Transparency International summarised the findings of Auditor General reports over the past 20 years, identifying significant sums of money which have not been accounted for, due to a range of reasons including poor recording and tracking of expenditure, wastage or corruption.

5.11 Public perception in the UK is that corruption is also a significant risk in many of the countries where DFID operates but relatively little is known about the actual effect of corruption on the value for money of aid. Unlike many other donors, DFID pays specific attention to corruption in its risk assessment process and all Fiduciary Risk Assessments must include an evaluation of how the risk of corruption impacts on the performance of financial management systems and of the related fiduciary risk. These assessments often describe new anti-corruption legislation or processes but seldom quantify the estimated losses due to corruption. Only two risk assessments contained estimates of levels of corruption in country **(Figure 23)**.

5.12 Corruption is, by its nature, a hidden problem so precise estimates are impossible to make. Where there are many sources of data on finance and activity, it may be possible to model levels of corruption. But in developing countries good data is scarce and it can be difficult to

22 State Audit Institution financial audit results

- In **Tanzania in 2005-06**, out of 70 audited entities, 40 (57 per cent) have an unqualified opinion; 27 (39 per cent) have a qualified opinion; and 3 (4 per cent) have an adverse opinion.
- For 2005, the Auditor General of **Rwanda** could audit only 81 out of over 473 entities (including 17 out of 32 central entities). She provided only 1 unqualified opinion and 2 qualified opinions. The remainder were adverse opinions. There were significant technical problems with accounts due to records being lost during the genocide, but also widespread problems with a lack of basic accounting records and processes. The State consolidated financial statements were not produced so were not audited.
- In the Amhara region of **Ethiopia**, the Regional Auditor General was able to audit only 92 out of 820 entities for 2005-06. He provided 0 clear opinions, 81 qualified, 5 disclaimed, and 6 adverse opinions. Staff at the audit office reported that many of the accounts were qualified due to lack of accounting records.

Source: State Audit Office reports

NOTE

An unqualified opinion generally indicates that the accounts were materially correct. A qualified opinion indicates that the accounts were correct in most respects, with specific significant problems which are listed separately (due to error or lack of data). An adverse opinion indicates that the accounts are materially incorrect, and a disclaimed opinion indicates that it was impossible to audit the account, due to weaknesses in data or other reasons. Definitions may vary slightly between audit offices.

23 Estimates of the impact of corruption from Tanzania and Uganda

- In **Tanzania**, a World Bank report quoted that an estimated 20 per cent of Government expenditure on procurement was lost through corruption. As procurement represents around 70 per cent of total public expenditure, this would translate to a loss of USD 300 million. However, the data used for the estimate were based on a survey of the construction sector in 2001 and so should be treated with caution.
- In **Uganda**, the Auditor General has estimated that about 20 per cent of the value of public procurement is lost through corrupt practices.

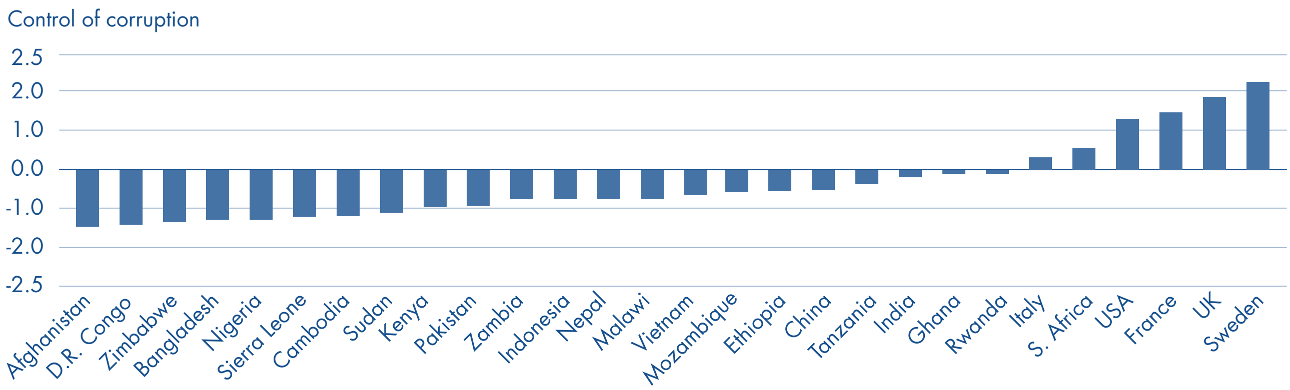
Sources: Public Expenditure and Financial Accountability Review, Tanzania, October 2005. DFID Uganda Fiduciary Risk Assessment, December 2004 distinguish leakage which is due to poor reporting from that due to corruption. Most estimates are consequently based on "perception" surveys. There are several corruption indicators available, comparing corruption levels across many countries. All such indicators have limitations in accuracy and comparability, but they provide the best sort of overview currently available. For example, the Worldwide Governance Indicators series includes a 'control of corruption' indicator **(Figure 24)**, and Transparency International produces a Corruption Perceptions Index. From 2007, it is mandatory for DFID staff to include these sources in their Country Governance Analyses. The new Analyses provide for a fuller analysis of corruption but the available data remain weak. More work is needed to support improvements to the quality of existing corruption survey data and to review fully the implications of survey findings. Such work can be co-ordinated with other development partners.

Mitigating risks and using safeguards

5.13 When providing budget support DFID's policy is to assess whether the beneficiary government has a credible programme of reforms to improve standards of weak or inadequate systems. But such reforms take several years to be designed and then embedded across government. Therefore DFID asks its country offices to consider ways to mitigate any fiduciary risks and to assess whether short-term safeguards are required. These safeguards can either be measures to ensure adequate control over funds prior to expenditure, such as using World Bank procurement procedures, or to gain assurance on their use once money has been spent. Separately from specific safeguards, in all countries DFID tracks the use of funds through its work to monitor budgets and government expenditure and often reviews Auditor-General reports. DFID's new draft guidance on fiduciary risks provides examples of potential safeguards, including independent audit of specific expenditure lines and improved tracking of donor money using dedicated accounts.

5.14 Of nine general budget support programmes we found a mixed picture on the extent to which country teams had secured and used safeguards which give donors rights to verify government accounts and commission audits. DFID often secured the right to independently audit the recipient government's account to which DFID makes the initial transfer of budget support funds, but such an audit gives no information on the use of those funds. In Sierra Leone DFID has secured additional access rights to independently verify the accuracy of government accounts. Additional rights also exist in Rwanda and Zambia but are limited to when State Audit reports are inadequate or late. Separately, in Uganda and Zambia DFID reserves the right to examine expenditure documents and in Ethiopia, donors monitor financial transfers to local government. Where additional rights were secured those rights had not often been exercised in practice. In the four remaining general budget support programmes we reviewed (Cambodia, Mozambique, Vietnam and Tanzania), DFID did not set up any additional rights to inspect the use of budget support funds directly although in Mozambique donors may ask the local Auditor-General to carry out a value for money audit.

24 Estimated corruption levels in various countries, 2006



Source: Worldwide Governance Indicators 2006

NOTE

The scale is from –2.5 to +2.5, with least corrupt countries scoring +2.5. The world average is 0.

Assessing commitment to poverty reduction

5.15 General budget support aims to help developing countries to implement their own poverty reduction strategy. Before providing general budget support, DFID makes sure that such strategies exist and focus on poverty reduction. Analysis of strengths and weaknesses of developing country strategies is normally found in country planning documents and often also in budget support submissions. Our visits to Rwanda and Zambia found that DFID's budget support proposals contained relevant information, for example reviews of government policies and spending trends, but better country data would have made more comprehensive appraisals possible. The quality of a country's economic management is also important as part of its commitment to poverty reduction, in particular, the ability to spend aid and domestic resources whilst controlling debt, inflation and interest rates. We found that DFID's recent budget support proposals assessed the overall economic situation well, often drawing on International Monetary Fund analysis. Proposals varied in the extent to which they explicitly assessed the ability of government institutions to spend large increases in resources effectively. In 2001 and 2002, DFID stopped providing budget support to Kenya and Malawi because of poor economic management, in the latter case, signalled by the International Monetary Fund.

Assessing commitment to respecting human rights

5.16 Some commentators argue that budget support implies political support for a government, and DFID's own guidance recognises that general budget support is vulnerable to a deterioration in political relations. Problems with non-financial aspects of governance, including human rights, have led DFID to suspend elements of budget support in Ethiopia and Uganda **(Figure 25)**. These problems arose in countries previously regarded by donors as model aid recipients – they both had good track records in reducing poverty and improving their public financial management. Until 2007, DFID had no standard approach to assessing these broader governance risks, so DFID country teams devised approaches tailored to country circumstances. For example, DFID Cambodia commissioned a Human Rights Assessment to inform its discussions with Government over the partnership commitment benchmarks.

5.17 DFID is now tightening its approach to assessing human rights. Revised guidance in June 2007 on the preparation of its Country Assistance Plans requires an assessment of human rights, including economic and social rights as well as civil political rights. New Country Governance Analyses adopted by DFID in February 2007 and linked to Country Assistance Plans, are also a positive step, covering political stability, political freedoms and rights, transparency and the media, political participation and access to justice, civil liberties, discrimination and other areas. Unlike assessments of fiduciary risk, no formal rating scales are required, although some key indicators are mandatory. So far, Country Governance Analyses have been carried out in Malawi, Mozambique and Cambodia.

Assessing continued adherence to DFID's partnership commitments

5.18 DFID guidance requires country offices annually to provide updated assessments of adherence to the three partnership commitments to inform decisions to disburse aid. In practice, this issue was covered inconsistently. Most but not all budget support payments require formal submissions prior to payment of each tranche. And of those submissions which were available, most reported that the partnership commitments were still met but did not provide a full assessment in the document. For

25 Changes to DFID budget support on human rights grounds

- In **Ethiopia**, following election-related violence and the detention of opposition supporters, DFID decided to channel its aid through a Protection of Basic Services programme instead of general budget support. DFID's money still goes to the Ethiopian Government's budget, but there are additional safeguards to ensure it increases social expenditure, and it includes specific support to promote improved domestic accountability.
- In **Uganda**, of the £50 million general budget support DFID planned, £20 million was withheld due to a significant overspend on public administration and concerns about the political transition and prospects for a free and fair election. Of this £20 million, £15 million was re-allocated to humanitarian assistance in northern Uganda, provided through the United Nations. Payment of the other £5 million was deferred until after the elections and subsequently released.

Source: DFID

commitment to poverty reduction and public financial reform, DFID normally has clear systems to monitor progress using Performance Assessment Frameworks or Fiduciary Risk Assessments. But monitoring of the commitment to respecting human rights has been less systematic. DFID country teams often rely on Foreign and Commonwealth Office and European Commission sources on human rights violations, but there are no defined systems to secure an appropriate range of information, analyse it and feed it into DFID management of budget support. For example, we heard evidence from Rwandan local civil society representatives of killings of detainees by the police and journalists being beaten. We saw that after discussion with DFID, Foreign and Commonwealth Officials raised these abuses with the Rwandan Government but we did not see evidence that DFID analysed the implications of such abuses for the partnership commitments.

5.19 An important part of managing the risk is to ensure that DFID and partner governments have a common understanding of the partnership commitments. This makes aid as predictable as possible. DFID guidance sets out what would constitute a breach in general terms covering the three partnership commitments:

- a country moves significantly away from agreed poverty reduction objectives or outcomes or the agreed objectives of a particular aid commitment; or
- a country is in significant violation of human rights or other international obligations;
- there is significant breakdown in partner government financial management and accountability, leading to the risk of funds being misused through weak administration or corruption.

But country teams seldom define examples or criteria for the types of circumstances which would constitute a breach of the partnership commitments. Naturally it would not be possible for DFID to define every precise circumstance which it might consider would breach the partnership commitments. But greater clarity on what DFID's expectations are in different country circumstances is important to guide actions when difficult situations arise and to make DFID's expectations clear to partner governments.

5.20 Rwanda provides a good practice example of benchmarks: from 2006 DFID Rwanda started assessing the three partnership commitments on a systematic basis. In addition to the Fiduciary Risk Assessment which provides information on public finance reform, DFID Rwanda uses benchmarks like net primary enrolment or access to safe water to measure commitment on poverty reduction. And it assesses progress in governance, human rights and international obligations through a series of more subjective indicators like the existence of an independent judiciary and effective justice sector or whether civil society is promoting poor people's interests (Appendix 8). Like the Fiduciary Risk Assessments, DFID rates Rwandan compliance with partnership commitments on an A-C scale, along with a trajectory of change. There is still some scope to improve this framework further by formally communicating the dimensions of the framework to the Government of Rwanda to promote a clear shared understanding of how DFID assesses partnership commitments. It could also improve the benchmarks to monitor factors directly within the government's control such as allocation of spending or policy reforms. Other countries such as Cambodia are now agreeing partnership commitment benchmarks.

5.21 All country teams include arrangements for resolving disputes with recipient governments in their Memorandum of Understanding. But these arrangements are often very high level. For example, in Mozambique arrangements were simply to "engage in increasingly higher level dialogue in order to reach an agreed and amicable solution". DFID has made a conscious decision not to specify more detailed arrangements but this may leave it less able to respond quickly and firmly to circumstances as they arise.

5.22 DFID guidance does not require country teams to put in place contingency plans for alternative ways to deliver aid so none of the 13 budget support programmes reviewed had such plans. Programme documents identified risks but they did not develop the implications for budget support under different scenarios. In Ethiopia, following political violence after elections, DFID judged that partnership commitments had not been met.
In this case DFID, along with other donors, withdrew from general budget support and instead funded a form of sector budget support which provided additional assurance that budget support was reaching the poor. This was a political signal and DFID continued to channel funds through the federal government to local level so that local governments could continue financing the same broad range of services for poor people. In contrast, in Uganda, DFID moved a proportion of its resources out of the Government sector but continued with some unrestricted budget support. DFID designed each of these different responses as events unfolded. Balancing sanctions for poor performing governments with the needs of the poor is not easy, but contingency plans may assist country teams to respond in a timely way.

PART SIX

Taking funding decisions

6.1 This section examines how DFID assesses the overall balance of risks and benefits of budget support and tailors the design and management of its programmes according to country circumstances. It also reviews the implications of the projected increase in the amount of budget support DFID may provide in the future. Our review of proposals showed that analysis of risks and benefits could be more rigorous, and options for using it made more explicit. The factors which could lead to the formulation of options are shown in **Figure 26** and are discussed throughout this section.

DFID's initial decision to use budget support

6.2 We reviewed DFID project documentation for 10 countries using budget support. The submissions to Ministers were usually strong in outlining a rationale for budget support, providing analysis of the country context including evidence of commitment to poverty reduction and discussing coordination with other donors. DFID requires country teams to make an explicit assessment that "potential development benefits justify the fiduciary risks"[25] of using budget support but only two of the appraisal documents we reviewed explicitly pulled together analysis of risks and benefits to evidence this assessment. In these circumstances we found it difficult to see how the risks had been factored in to an assessment of potential benefits to form an overall assessment. DFID recognises that assessments of benefits can be improved and is now developing further guidance, building on the findings of evaluations to date.

6.3 Budget support proposal documents did not generally identify options against which the proposed programme could be compared. In some cases proposals were for continuing budget support against the background of supportive evaluation findings. In these and other cases, while the prospects for budget support and design options were subject to widespread discussion within DFID and with development partners, there was no stage at which different options were formally defined and analysed. Such options could include considering other types of 'programme-based' aid or variant designs of budget support.

6.4 Options could also include varying the proportion of the country programme delivered using budget support compared with other types of aid. Budget support proposals we reviewed were not always explicit about how they related to other complementary aid, such as to improve capacity and strengthen government financial management and accountability systems. Some programme documentation considered the appropriate quantity of budget support relative to a country programme overall but treatment of such options varied. DFID country programmes recognise that a mix of aid instruments is necessary to achieve their objectives and always use a mix of aid types. DFID policy is not prescriptive on the mix of instruments: it expects country offices to consider the most appropriate mix of aid instruments in country assistance planning given their objectives and the focus of other donors. Research to date on the most cost-effective mix of budget support and other aid types is limited – partly due to difficulties in distinguishing the effects of different types of aid.

25 *Poverty Reduction Budget Support*, DFID policy paper, 2004.

26 Design options for budget support

Decisions on budget support and design options	**Examples of relevant questions to address in proposal**
Whether to use budget support or other aid instruments	Is the partner government committed to poverty reduction, upholding human rights and strengthening public financial management and accountability? What benefits are expected to be achieved through the budget support programme? How do these differ from expected benefits that could be achieved through another aid delivery mechanism? What risks will the budget support programme will be exposed to? What risks may alternative delivery mechanisms be exposed to and how will risks impact on expected benefits? What will this decision signal to others about DFID's partnership with government?
Amount and share of budget support in DFID programme	What are the objectives of DFID's development programme and what mix of aid instruments is required to deliver them? How much budget support is required to deliver the intended benefits and what other programmes are required to maximise the impact of budget support? (see complementary support, below). How is the overall risk of DFID's aid portfolio influenced by the amount and share of budget support? What is the opportunity cost of reducing funding to other programmes? How are other donors providing assistance? How much budget support do they provide?
Complementary support to make budget support more effective	To maximise impact of budget support funds, what is appropriate spending on: ■ support to government financial management systems and policies? ■ support to enhance transparency and accountability mechanisms? ■ support for collecting the statistics needed to monitor budget support? ■ support to sectors, for example to tackle quality in service delivery? What types of complementary support are others providing?
Design features of budget support (general budget support or sector budget support, including whether funds can be freely allocated by the recipient government or are 'earmarked' for use in a particular area)	What is the priority and where is DFID's added value likely to be highest: improving core government systems (planning, budgeting, financial management) or sector level issues? Is it important to DFID to prioritise dialogue in a particular sector or on cross-cutting issues? What balance does DFID want to strike between influencing the ministry of finance or a particular sector ministry? Will more discretionary resources increase the effectiveness of the national budget process? Will earmarking reduce the fiduciary risk to UK funds? If so, how? Will donor earmarking actually affect the final budget allocation?
Use of safeguards (e.g. increased monitoring requirements or external audit as used by DFID Cambodia and DFID Ethiopia)	What are the different options for safeguards? How much would these safeguards effectively reduce fiduciary risks compared with the cost of implementing them, including the impact on national public financial management systems?

26 Design options for budget support *continued*

Decisions on budget support and design options	Examples of relevant questions to address in proposal
Encouraging good performance and responding to changes in circumstances (use of performance-related funding and predictability)	To what extent do expected benefits depend on predictable aid flows? How will partnership commitments be assessed and breaches dealt with? How many years in advance can DFID provide a commitment, (subject to conditions being maintained)? How will decisions be taken to commit future aid and to disburse this year's commitment? What is the appropriate balance between using funding flexibly to encourage good performance and ensuring that sufficient funding is delivered in a predictable way? What incentives does DFID want to create for government, and how is performance-related funding likely to contribute to these? What proportion should be performance-linked? What are the criteria and process for assessing payments against this? What time-lags should apply to performance payments?
Sequencing and timing of budget support	For individual countries, at what point in the country's development is it appropriate to: ■ start using some budget support? ■ increase the amount of aid given as budget support? ■ provide a large amount or share of aid as budget support? ■ start decreasing the proportion of budget support? What is the acceptable level of risk at each point in time?

Source: National Audit Office

Programme design and funding levels

6.5 It is important that budget support is tailored to specific country circumstances to maximise its effectiveness. Variations can include the type of budget support, the amount, the monitoring procedures, whether payments are contingent on good performance, safeguards used and complementary capacity building support. The submission documents we reviewed put a strong case for the overall benefits of using budget support but less analysis of exactly how it should be provided, for example, DFID did not explain the rationale for the proportion of aid which was performance linked.

6.6 Budget support often contributes to a range of objectives. But assessments of the amount and type of budget support required in individual cases will depend on precisely what DFID is trying to achieve. So imprecise objectives are a problem for the amount of funding and design of the programme. For example, the amount of budget support required to have an impact on partner government expenditure patterns might be quite different from the amount required to strengthen government financial management systems or to increase the number of clinics, schools or rural roads. DFID is improving the quality of its guidance to country teams on setting specific objectives and relating them to programme design options. A recent example of good practice is DFID Cambodia, which plans to target initially just three main impacts from its budget support programme and has tailored it to achieve these objectives **(Figure 27)**.

27 A tightly focused budget support proposal in Cambodia

DFID Cambodia has designed a general budget support programme which has more tightly specified objectives than existing budget support programmes. It will initially target just three main impacts: reforms in public financial management, land management and private sector development. With fiduciary risk rated as high, DFID will also provide only a small proportion of aid as budget support. This is also consistent with DFID's policy-related objectives – for example, expansion of service delivery might require a larger volume of aid.

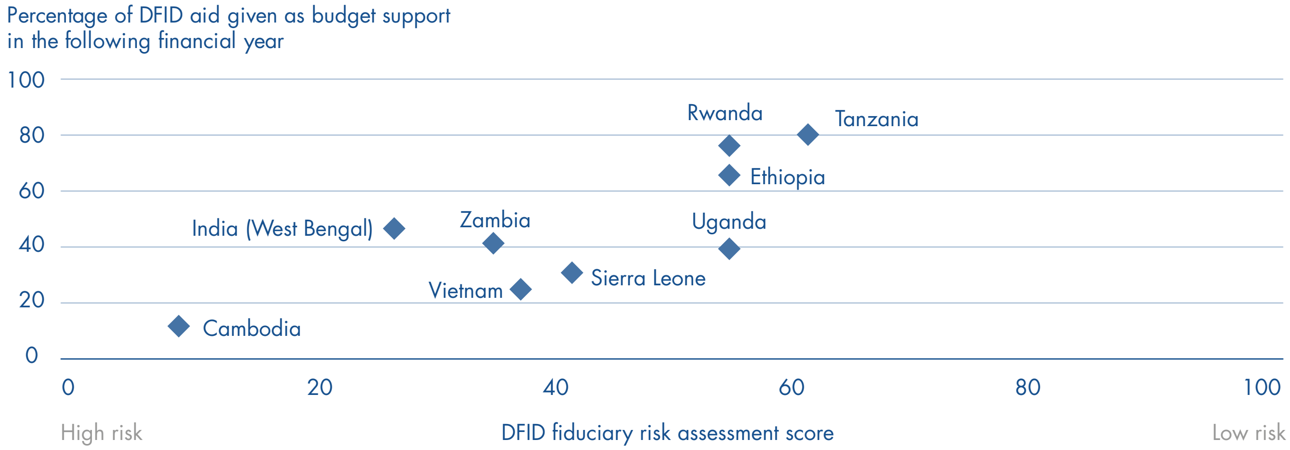
Source: DFID budget support submission for Cambodia

6.7 DFID's budget support proposals did not normally contain explanations of how the funding design would maximise all the potential benefits. For example, more than one DFID country team told us that a benefit of budget support can be to support and influence the development of a partner government's policies. But we saw little analysis of what level of funding might achieve this in a particular country, or how the DFID country team could maximise this influence through monitoring and discussion.

6.8 Documents for sector budget support programmes usually contained more explicit analysis about the rationale for targeting budget support to achieve sector-level benefits. For example, DFID Vietnam viewed it as a way of targeting benefits on priority groups. DFID Rwanda expected education sector budget support would help coax other donors to join budget support thereby improving the overall quality of aid. In some cases sector budget support is used as a response to political concerns or to mitigate risks because DFID guidance states that sector budget support is less 'vulnerable to risk', specifically political concerns. For example, DFID moved from general to sector budget support in Ethiopia in response to political concerns while trying to maintain service delivery. However, a move to sector support does not in itself provide the additional assurance or decrease vulnerability to political governance risks. Given the recent rapid rise in sector budget support it is particularly important that DFID gives full consideration to real differences in risk and benefits between the two types of budget support.

6.9 DFID does not define a maximum level of risk it is prepared to tolerate, nor does it set particular levels of risk at which different amounts of budget support would be appropriate. Instead, it takes an overall view on the likely benefits that can be achieved, given the risks that exist. We looked at the relationship between level of funding and risk factors, bearing in mind that the scale of potential benefits would also influence funding and so the relationship would not necessarily be linear. Programme documentation explicitly detailed how risks affected the amount or share of budget support provided only for Uganda, Mozambique and Cambodia (for example, see Figure 27). In practice, DFID tends to give a higher proportion of its aid as budget support where it has rated fiduciary risks as lower **(Figure 28)**.

28 Comparing DFID's risk assessments and the percentage of its country programmes given as budget support



Source: DFID Fiduciary Risk Assessments; Statistics on International Development 2007

NOTES

1 We converted each of the 15 benchmarks in DFID's most recent Fiduciary Risk Assessments to a numeric equivalent where 0 = 'C' rated (high risk); 1 = 'B' rated (medium risk); 2 = 'A' rated (low risk). Maximum possible score = 30. These scores were then expressed as a percentage of 30.

2 Data for Cambodia relates to the proposed budget support in 2007-08, not yet approved. Data for Rwanda shows DFID aid in 2005-06 since the timing of the 2006-07 payment was brought forward into 2005-06.

6.10 We found that DFID had not generally provided budget support to countries which were perceived to be least adept at controlling corruption, such as Nigeria and Democratic Republic of Congo **(Figure 29)**. But where DFID does provide budget support, its share of the country programme is not closely associated with the quality of controls but reflects DFID's assessment of risks and benefits. We looked at the level of budget support funding against the extent of a developing government's commitment to DFID partnership commitments, using three indicators as the best available proxies for that commitment (Appendix 9).[26] We found no obvious pattern. For example, Sierra Leone received 35 per cent of DFID aid as general budget support from 2001 to 2005, whereas Kenya received none – although the latter scored better on all the criteria we examined and the direction of change was the same. DFID considers that the amount of budget support provided reflects its overall assessments of benefits and risks in a particular country. For example, it stated that it provided budget support in Sierra Leone despite high risks because it considered the potential benefits of supporting a state emerging from conflict to also be high. DFID does not routinely analyse the nature of its budget support decisions across its country portfolio or the factors which influence its budget support decisions in practice.

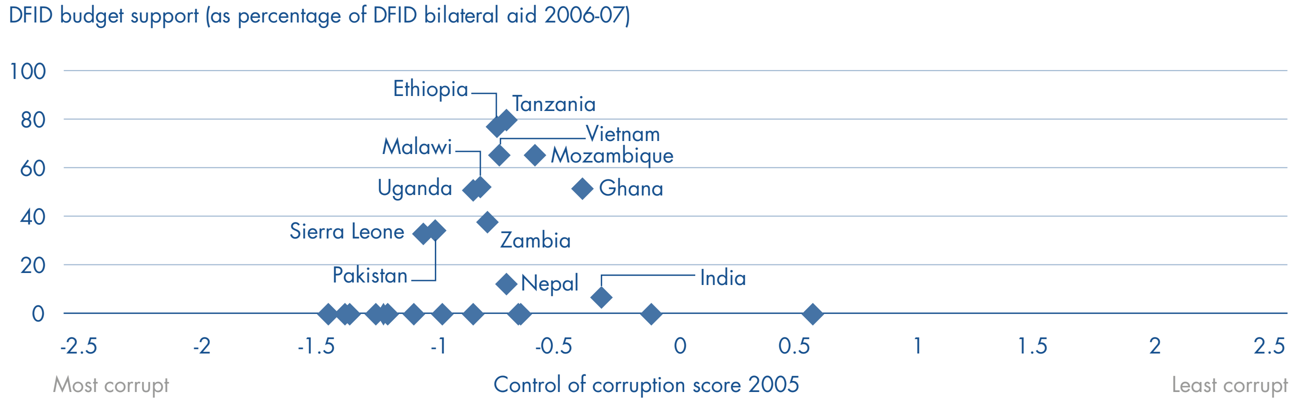
6.11 DFID varies its management of budget support expenditure by choosing how many years ahead to make funding commitments and whether to reward countries for good performance with extra resources. DFID must strike a balance between developing countries' needs to plan their future expenditures; the desirability of performance incentives; and the need to respond flexibly to changes in circumstances. These include changes in DFID's own budget or expenditure priorities. In general, DFID makes longer term aid commitments where it judges the partnership with a country is strong and stable. For example in Tanzania DFID commits a large proportion of its budget support for three years in advance, but in Malawi, DFID sets out risk-related reasons for maintaining a one year rather than multi-year commitment.

6.12 DFID's use of performance-related aid and its need for administrative flexibility mean that the amount of budget support fully committed (core funding) varies by country programme **(Figure 30)**. Where DFID decides to link budget support funding to performance it is increasingly using past performance to alter future aid commitments, rather than current year aid disbursements, allowing partner governments to plan with more certainty. But the picture is mixed: in Sierra Leone and India these variations are in-year whereas for the other countries performance affects future years' funding. Central DFID policy on the appropriate size of a performance tranche is not prescriptive, indicating that the design should depend on the strength of partnership with the recipient government.

6.13 Considerations about performance based tranches form part of the design process of a budget support programme. This has led to different approaches by different country teams. In India, DFID budget support to the health sector in West Bengal is dependent on satisfactory progress against its performance framework, with around half of the funds being linked to performance. In contrast DFID Mozambique's indicative tranche was set at just two per cent of its £41 million in 2007-08, rising to ten per cent of a £49 million budget support programme by 2010-2011. The country team stated that this arrangement gave them "more flexibility to deal with uncertainty" in future years and a "balance between predictability and flexibility…[in] this still-risky environment". In addition DFID does not always have an objective or transparent way of assessing how much of a performance tranche it should disburse, which may undermine both performance incentives and the transparency of decision making. In West Bengal, DFID's funding was contingent on performance against a set of benchmarks with the State Government, but it did not agree with the State how these benchmarks would link to funding levels.

26 DFID does not believe that the proxies used are adequate to support the analysis but acknowledges no better proxies are available.

29 Comparing corruption indicators to the proportion of bilateral aid given as budget support

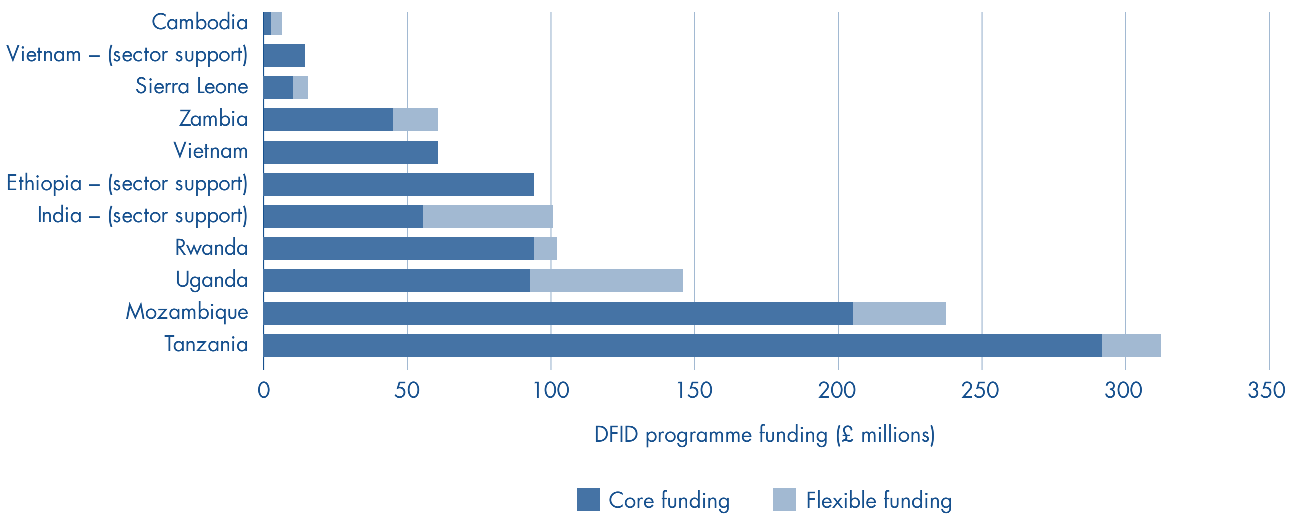


Source: World Governance Indicator on control of corruption and DFID management information

NOTE

Countries with 0 per cent budget support (from left to right) are: Afghanistan, Democratic Republic of Congo, Sudan, Zimbabwe, Bangladesh, Nigeria, Cambodia, Kenya, Indonesia, China, Rwanda, South Africa and Lesotho. Rwanda normally receives general budget support from DFID, but the 2006-07 payment was brought forward into 2005-06.

30 Country teams vary in their plans to use core and flexible funding



Source: National Audit Office review of programme documentation

NOTE

Estimates used for Cambodia as budget support not yet provided.

Guidance on budget support

6.14 DFID guidance on budget support has been developing over time as DFID learns from its experiences. There are now over ten separate policy and guidance documents covering various aspects of budget support, most rated highly by country teams for content, and used to varying degrees.[27] But DFID's tendency to issue new policy and guidance rather than update existing documents has led to some inconsistencies and confusion. Although DFID is generally strong on setting out its position, country teams and other stakeholders identified some areas where guidance could be further improved:

- assessing risks and benefits – including political and reputational risks;
- addressing governance weaknesses. For instance, it is not clear how foreseeable risks in areas such as human rights should be mitigated;
- how to monitor and evaluate budget support; and
- defining budget support. DFID guidance documents[28] show that aid is defined as budget support when UK funds are merged with partner government funds and when government systems are used to allocate, spend and account for the money. But there are some complexities of definition, particularly on programmes where safeguards are used, such as where funding is provided on a reimbursement basis. There are examples where programmes have been inconsistently classified **(Figure 31)**.

6.15 DFID is currently revising its approach to strengthen specific aspects of its guidance, such as the forthcoming guidance on how to assess expected benefits of budget support. It has also updated its 2004 budget support policy paper to reflect the White Paper and evaluations of budget support.

Implications of projected future increases in budget support

6.16 The country teams we surveyed expected that the share of budget support will rise in countries where it is currently used. Country teams also projected they will start using it in more countries, including Kenya, Nigeria and the Democratic Republic of Congo **(Figure 32)**, assuming that the partnership commitments are met as circumstances change over time. With the overall increase in the UK aid budget, this means that the volume of budget support is likely to increase.

6.17 DFID's corporate strategy has helped to promote this projected increase in budget support. For example, Africa Division has had an ambitious target to increase budget support, as circumstances allowed, to 61 per cent of its country programme expenditure in 2007-08 from 35 per cent in 2005-06. Although DFID's budget has been increasing rapidly and is set to double over the next five years, it will not receive a corresponding increase in staffing. This means that budget support has been an attractive option for spending its increasing budget – once budget support arrangements have been established in a country DFID incurs little administrative cost from subsequently increasing the volume of aid provided. And fewer large payments are cheaper to administer than a larger number of payments for small projects.

6.18 DFID's 2006 White Paper states that budget support may be used in countries where "governance is not so good… the commitment to reduce poverty is weaker or where the risk of corruption is greater", provided there are restrictions on how budget support is used. The White Paper gives high level examples, for example, that DFID might "channel funds through ring-fenced accounts". But DFID has not yet produced detailed guidance to staff on how to use these restrictions or safeguards in practice to mitigate risks, or how to consider them in the appraisal process for budget support.

6.19 The projected increase in the volume of budget support, and DFID's increasing use of ten year partnership arrangements with partner governments create new opportunities and pose new risks. Any DFID increases in budget support, and any success in securing increased donor participation in budget support, could make developing nation budgets more heavily dependent on donor support – particularly for recurrent expenditure such as salaries. At the same time, support may be extended to countries originally regarded as higher risk. Experience with Uganda and Ethiopia shows that over time, even countries with clear commitment to poverty reduction at one point may subsequently breach one of DFID's partnership commitments. In these circumstances, paying more attention to risks at design and monitoring stages, and having contingency plans should problems arise, is important.

27 Appendix 3 lists the major policy and guidance milestones.
28 DFID's *Blue Book* (containing mandatory procedures) and the 2006 *Guidance on Aid Instruments*.

31 Inconsistent classification of budget support programmes

Comparing Afghanistan and India

Afghanistan

- DFID provides funding to the central Treasury Account in Afghanistan, through the World Bank-managed Afghan Reconstruction Trust Fund.
- DFID has stated this is not budget support because it pays out for eligible expenditures submitted to the Trust Fund for reimbursement and because the Trust Fund is managed and audited by an independent monitoring agent. As a result, DFID did not carry out a Fiduciary Risk Assessment for this aid.
- An independent evaluation of the Trust Fund described 85 per cent of the funds (those used to fund recurrent costs) as "de-facto budget support"[1].

India

- DFID India provides support on a reimbursement basis in education and health which DFID classified as budget support in its 2007 Departmental Report. But since the NAO audited DFID India's budget support programmes as part of this study, DFID has reviewed what constitutes budget support and decided two of the programmes were misclassified. A health programme is still classified as budget support but another health programme and an education programme have been recategorised as non-budget support financial aid.

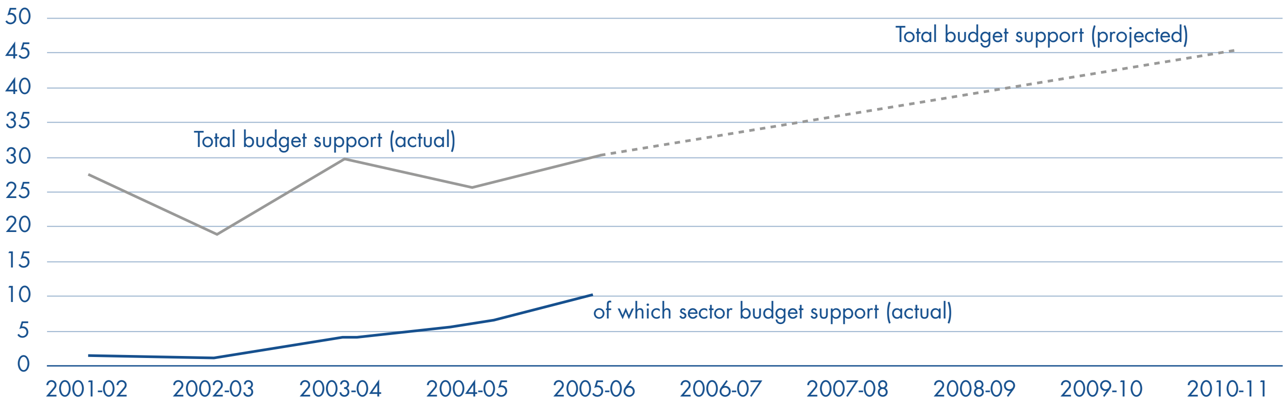
Source: National Audit Office review of DFID documents and discussions with DFID staff

NOTE

1 Assessment, Afghan Reconstruction Trust Fund, Scanteam, 2005.

32 Country teams' expectations of the share of aid delivered through budget support in 25 countries

Budget support as a percentage of DFID country aid



Source: National Audit Office survey to 25 DFID country offices

NOTE

Projections were made by the 25 DFID country offices in DFID's Public Service Agreement prior to DFID's reclassification of expenditure. Currently 75 per cent of DFID bilateral aid is spent in these countries.

APPENDIX ONE

Study methodology

Review and analysis of literature and other documents

We reviewed a range of sources:

- We reviewed reports published by the Department, other donors and multilaterals on their use of budget support. The most important and comprehensive of these was the Joint Evaluation of General Budget Support, published in May 2006 by the Development Assistance Committee of the Organisation for Economic Co-operation and Development. Other bodies such as the World Bank and the European Court of Auditors have also published reports on budget support.
- We also reviewed internal Departmental documents such as policy and strategy documents, country plans, evaluations, working papers and internal reviews.
- At operational level we also mapped DFID processes for assessing prospects for budget support and managing its programmes. We assessed the quality of DFID's internal guidance and systems regarding budget support implementation.

This analysis established:

- findings to date on the results of budget support;
- the coherence of the Department's policy and strategy documents on budget support;
- the strengths and weaknesses of DFID's current arrangements for providing budget support.

We also commissioned PricewaterhouseCoopers to produce five related outputs as follows:

- A research paper on the available evidence on the efficiency of programme-based approaches (this includes budget support);
- A review of Public Expenditure Tracking Surveys and similar studies carried out in developing countries. The review summarised the results reported by each study and assessed how robust the method was in each case;
- A comparison of five key bilateral and four key multilateral donors' approaches to providing budget support, including strategy, conditions attached, design and assessment processes and monitoring arrangements. Information was gathered via desk review and follow-up telephone interview;
- Presentation of basic statistics regarding total budget support expenditure by recipient country and by donor; and
- Collection of relevant input data for our four case study countries (Ethiopia, India, Rwanda and Zambia), together with all available output and outcome data in health and education.

This analysis established:

- what research has found to-date on the efficiency of budget support and other programme-based aid;
- the number of Public Expenditure Tracking reviews and their results;
- how DFID's approach to budget support compares with that of other donors;
- the increasing importance of budget support as a way of delivering aid;
- the extent of regional variations in both inputs and outputs within the case study countries; and
- identification of interesting locations for field visits.

Analysis of inputs, outputs and wider country performance data by country

We analysed basic information for 25 countries and more detailed information for the four case study countries:

- For the 25 countries included in DFID's Public Service Agreement target, we collected all available information on DFID's aid programme over the last five years, including programme size and the type and amount of budget support. PricewaterhouseCoopers collected similar information for all major bilateral and multilateral donors (see above). We compared the budget support inputs to trend data on country performance over this period, including basic economic and social indicators, such as growth rates and assessments of financial management capacity. This highlighted interesting results but was not sufficient to establish causal links.

This analysis established:

- the limited information currently available comparing trends in country performance and use of budget support;
- the factors influencing DFID's decisions regarding the amount and type of budget support provided; and
- the lack of output data in some key areas to assess progress.

Analysis of inputs, outputs and wider country performance data by country *continued*

- We also carried out a regression analysis for the same countries to identify if there are any significant factors which affect the type or amount of budget support provided. Factors tested included the country history and circumstance and assessment of fiduciary risk.
- For the four countries we visited, we collected more detailed data on progress on service delivery outputs. Where possible we mapped this to budget allocations.

Survey to DFID country teams

We carried out a census of all 25 country teams included in DFID's Public Service Agreement target, whether or not they provided budget support. We received a response from every country team. We tailored the questionnaire depending on whether country teams provided budget support. We asked questions on the design of country programmes (including expenditure plans), the partner government's commitment to reform and poverty reduction, assessment and monitoring arrangements, technical assistance, perceptions of progress made to-date, the adequacy of central guidance, and staff skills.

Collectively the countries who completed this questionnaire represent 99.7 per cent of DFID's budget support expenditure and 71 per cent of all DFID bilateral aid (2005-06 data).

Full results are at www.nao.org.uk.

This analysis established:

- the strengths and weaknesses of DFID's central guidance;
- how country teams adopt varied approaches to budget support;
- the major sources of analysis used by country teams to monitor their budget support programmes;
- how DFID uses technical assistance as a complementary input;
- perceptions of the progress made in-country; and
- a better understanding of the staff time and skills engaged in budget support.

File review for ten country teams using budget support and four not using budget support

For the ten countries providing budget support, (Cambodia, Ethiopia, India, Mozambique, Rwanda, Sierra Leone, Tanzania, Uganda, Vietnam and Zambia) we reviewed the content of the key appraisal, risk assessment and review documents relating to the budget support programmes. We paid particular attention to governance issues and monitoring of results.

The four countries we reviewed not using budget support were: Democratic Republic of Congo, Indonesia, Kenya and Nigeria.

For all fourteen countries we reviewed country planning documents to establish the rationale for the country programme.

This analysis established:

- the key factors behind the decisions over whether or not to provide budget support;
- the strengths and weaknesses of DFID's appraisal documents;
- key risk areas covered by DFID's fiduciary risk assessments;
- the wide variation in monitoring arrangements and performance assessment frameworks; and
- good practice examples of appraisal decisions and monitoring arrangements.

Fieldwork visits to four countries

We visited Ethiopia, India, Rwanda and Zambia to obtain evidence of the Department's activity in-country. Our case study countries all had significant bilateral country programmes, with a significant amount and percentage being provided through budget support. The total amount of budget support provided in 2006-07 in these four countries was nearly £180 million, some 30 per cent of all DFID budget support. We picked countries which represented a range of country circumstances. Ethiopia is a particularly important example as budget support was redirected to local governments there in 2005 following deterioration of the political situation. In each country we held discussions with the Department's in-country staff and with their partners including other donors, partner government officials and civil society groups. In addition we carried out file reviews of documentation in country.

During each visit we spent several days outside of the capital cities visiting schools and hospitals across different regions of the country. We used these visits to gain first hand experience of the effect of budget support on service delivery in key sectors, and the impact on the poor. We interviewed local government officials, health workers and teachers as well as local populations to assess progress on the ground and remaining constraints and issues.

This analysis established:

- the views of key stakeholders in-country regarding their experience of the Department's activities;
- a greater understanding of what is being achieved at school and hospital level;
- the perspective of the Department's in-country staff on the Department's central guidance and its relationships with development partners; and
- the major constraints to development.

Interviews

We carried out over 25 interviews in the United Kingdom. Within the Department we interviewed a range of policy staff, advisers, evaluation and statistics teams, and internal audit. We conducted a large number of interviews during each country visit.

We also contacted key academics and international non-governmental organisations at global and country levels to gain their perspectives on DFID's strengths and weaknesses and on our emerging findings.

This analysis established:

- the views and concerns of the Department's own staff;
- the perceptions of key stakeholders of the Department's activities; and
- the experience of partner organisations where they have undertaken joint working with the Department.

Survey of and consultations with Non-Governmental Organisations

We conducted a survey of key non-governmental partners, coordinated through the UK Aid Network. We received nine detailed written responses. We asked for respondents' perceptions of whether budget support is effective in reducing poverty and reaching the poorest, the relative risks of budget support compared with project aid and the strengths and weaknesses of DFID's approach.

We followed this up with a round table discussion with seven key bodies including ActionAid, CAFOD, Oxfam, Save the Children and CARE international. We used the discussion to explore further the views expressed by individual bodies and to discuss the NAO's emerging findings.

This analysis established:

- the views and concerns of the non-governmental organisation community regarding budget support in principle and in practice; and
- validation that our emerging findings covered key areas of concern and were balanced and fair.

Expert panel

We set up a panel to provide expert advice on our emerging findings and draft report. The panel provided a wide range of expertise in budget support and comprised:

Jean-Louis Lacube – Head of Unit, "Macroeconomic support", EuropeAid

Andrew Lawson – Research Fellow, Overseas Development Institute

Stephen Lister – Principal Consultant, Mokoro

Luc Moens, Director, PricewaterhouseCoopers, UK

William Morrison and Peter Young – Directors, Adam Smith International

This analysis established:

- validation that our emerging findings covered key areas of concern and were balanced and fair; and
- that our study had used and reflected available literature and research on the effectiveness of budget support.

APPENDIX TWO

Detailed recommendations

This table sets out detailed actions under each of the recommendations in the executive summary.

Recommendation		Detailed actions	Outcomes
Monitoring to maximise expected benefits			
A DFID should always set out clearly its precise objectives, specifying exactly **what** it expects to achieve and by **when**.	i	DFID country teams, supported by headquarters, should always set out clearly the precise objective(s) of providing general budget support on a country by country basis. These will be tailored according to country circumstances but should address relevant benefits of budget support, such as more predictable aid, identified in DFID guidance.	A more systematic approach to budget support, setting out clearer expectations for what progress should be achieved.
	ii	Objectives need to be sufficiently precise and time-bound to facilitate monitoring and assessment of funding.	
	iii	DFID should set out how a budget support programme will contribute to growth, and so lead to sustainability of public services.	
B DFID should build on its current monitoring arrangements to make sure that for each budget support programme it can systematically assess progress against its objectives. Such monitoring should reflect a balance of process, output and outcome indicators and be coordinated with development partners.	i	Formal performance monitoring frameworks should cover all of DFID's stated objectives of providing budget support as well any key risks to the programme.	Clearer targeting of the country-specific goals of budget support, and better monitoring of efficiency enabling donors to provide stronger evidence that budget support is effective.
	ii	DFID should agree with the recipient nation clear and specific indicators (and if using targets, time-bound) covering inputs, outputs and outcomes linked to its objectives, with baselines to allow DFID to assess progress. These should be agreed at the outset of budget support programmes.	
	iii	DFID should secure sufficient analysis of partner government budget allocations, expenditure, and service delivery – for example by district or population groups – to ensure that budget support funds are used to reduce poverty appropriately.	
	iv	At corporate level DFID should work with other donors to improve the time series data available in key areas such as financial inputs, quality of public financial management and predictability of aid.	
	v	DFID should consider whether it can reduce its administrative costs through encouraging other donors to lead working groups.	

Recommendation	Detailed actions	Outcomes
Monitoring to maximise expected benefits *continued*		
C DFID has done more than most donors to strengthen statistical systems for monitoring progress. But the available information is often not sufficient for donors to monitor all key aspects of poverty reduction on a timely basis. In countries where it uses budget support, DFID should identify any key weaknesses in the national monitoring systems and give increased priority to mitigating them, seeking support from other donors in doing so.	i Prior to starting budget support DFID should assess developing country monitoring systems to establish what evidence they provide, and what more is needed to give donors adequate assurance on partner government performance. DFID should use this information to set out a monitoring framework before budget support funding is given, and to develop a plan to secure the needed strengthening of developing country monitoring systems. ii DFID should ensure that statistics support is sufficient to establish adequate monitoring systems as part of the budget support "package". This assistance can be provided by DFID or through other donors. DFID should ensure that it can effectively track expenditure trends, service delivery and quality as well as social outcomes.	Quicker progress towards monitoring systems that provide all partners with a fuller view of progress, facilitating better programme management and accountability.
Assessing and managing risks		
D DFID should, together with its partners, strengthen its risk assessments and analysis of developing country government systems. It should make more explicit its judgement of the significance of system weaknesses for potential inefficiencies and wastage of aid in the recipient country. It should use more quantified estimates of these factors where possible. It should use this information to tailor appropriate safeguards to mitigate risks.	i DFID should make better use of in-country information collected from domestic stakeholders – Parliaments, Audit Offices and civil society organisations – providing support to these institutions where necessary – to help it to monitor the efficiency and effectiveness of public expenditure. It should continue to assess the role of domestic institutions in holding their government to account and ensure that budget support does not undermine their role. ii Before providing budget support DFID and its partners should assess the available information on issues such as efficiency of expenditure and leakage, and seek agreement from partner governments about how to monitor these factors. Tools may include: ■ Public Expenditure Tracking Surveys and expenditure reviews; ■ State Audit Institutions' findings; ■ Budget execution reports to assess local level capacity; and ■ Price and performance comparisons in areas such as procurement and service delivery. iii DFID should explicitly discuss in its appraisal documentation the significance of system weaknesses and associated risks for the potential impact on UK public funds. Such analysis should be supported by estimates of leakage or other quantitative data where possible to obtain. iv DFID should use a better range of safeguards against fiduciary risk in different country circumstances and disseminate examples of existing good practice. v DFID should link the system weaknesses identified through its risk assessments more closely with its monitoring of progress. Where significant weaknesses are identified DFID should explicitly monitor progress against these factors using formal monitoring frameworks.	More informed risk management and better safeguards to mitigate risks to UK funds.

Recommendation	Detailed actions	Outcomes
Assessing and managing risks *continued*		
E DFID needs to set up systematic in-country monitoring to measure achievements along the dimensions of human rights in its guidance. Before using budget support, DFID must establish transparent procedures to respond quickly, firmly and proportionately if concerns arise and make sure that contingency plans cover the most significant risks.	i DFID should adopt clear indicators on the partnership commitment to human rights, discuss these with partner governments, and assess commitment on these issues at least annually. Where possible, indicators should include identifying the types of circumstances which would jeopardise the provision of budget support. ii DFID should work closely with the Foreign and Commonwealth Office and others to develop a more systematic approach to collecting evidence and analysing it to inform DFID judgements on the commitments. Such an approach should specify respective roles and responsibilities. iii Prior to providing budget support, DFID country teams should draw up credible programme-wide contingency plans which cover the most significant risks.	Greater transparency about donor assessment of partnership commitments, leading to improved predictability of aid.
Taking funding decisions		
F DFID should improve its analysis of the prospects for using budget support by: ■ Formalising appraisal of options which vary the proportion of budget support in a country programme; ■ Formalising appraisal of options for using alternative forms of aid; and ■ Bringing together the risks and benefits of each option to facilitate comparison.	i When formulating a Country Assistance Programme, when the prospects for assistance through government systems will normally be considered, country teams should be asked to establish and appraise a limited number of credible options for support. ii When proposing a specific budget support programme DFID should be more systematic in appraising options for different designs of budget support programmes – for example, considering the proportion of aid to be provided as budget support and whether performance-related funding is appropriate. iii Country teams should also be challenged by the centre to document evidence supporting an overall assessment of whether the potential development benefits outweigh the risks. iv At corporate level, DFID should work with other donors to fill in gaps in the evidence on benefits and risks of budget support compared with other types of aid, and on the impact of country circumstances on the effectiveness of budget support. v DFID should review its overall portfolio of budget support commitments to analyse the factors which have in practice most influenced budget support decisions, and to assess consistency in the decisions made at country level. vi DFID should identify the basis for calculating disbursement of any element of budget support that is performance-based, and communicate this to partner governments to promote predictable aid and help them plan their budgets. Many of the above analyses are summarised in Figure 26.	Better assessment of balance between risk and benefits, and more assurance that DFID is using the most appropriate form of aid, leading over time to more cost-effective programmes.
G In support of the above, DFID needs to rationalise and strengthen the guidance and support available to country teams and keep it up to date.	i DFID needs to rationalise its guidance on budget support in fewer authoritative pieces of guidance. It could also support this through setting up a one-stop advice line for budget support. In particular, DFID should improve the profile of its guidance on the choice and mix of aid instruments. ii DFID should refine further its current review arrangements for discrete projects to reflect the circumstances of broader ongoing programmes so that such reviews are of maximum value to DFID.	Improved understanding by country teams of the factors influencing the design of budget support programmes, leading to better decisions.

APPENDIX THREE

Key developments in the provision of budget support

This table shows the key dates and milestones in DFID's provision of budget support.

Year	International and External Milestones	DFID Policy, Guidance and Reporting Milestones	Country level Milestones
1998			Uganda: 3 year budget support programme approved by DFID.
1999	Poverty Reduction Strategy Process launched.		
2000		December: HMG White Paper on International Development refers to support for poverty reduction strategies, including through direct budgetary support (paragraph 315).	
2001			October: Tanzania budget support programme and Performance Assessment Framework agreed.
2002		March: DFID paper on *Managing Fiduciary Risk when providing Direct Budget Support* – set out broad guidance on potential benefits and risks associated with budget support.	
2003	Rome Declaration on Harmonization. March: Planning started for multi-donor *Joint Evaluation of General Budget Support*, chaired by DFID. NAO report *A Review of Safeguards Against the Misappropriation and Diversion of Aid.*		
2004	January: Report of Strategic Partnership with Africa first annual Budget Support Survey (DFID-funded). January – October: World Bank issues Operational Policies and Good Practice Notes for Development Policy Lending.	June: DFID Policy Paper *Poverty Reduction Budget Support.* May: DFID Central Support and Scrutiny process introduced, requiring Fiduciary Risk Assessments. September: DFID How to Note on *Managing Fiduciary Risk when providing Poverty Reduction Budget Support* – provided guidance on assessing fiduciary risk against 15 performance benchmarks. October: DFID *Statistics in International Development 2004* contained new tables showing budget support for the first time.	Mozambique: agreement on Performance Assessment Framework for budget support donors. Uganda: DFID's first rolling multi-year budget support programme approved.

Year	International and External Milestones	DFID Policy, Guidance and Reporting Milestones	Country level Milestones
2005	March: Paris Declaration on Aid Effectiveness, including donor commitment to use country systems to the maximum extent possible. March: Development Assistance Committee publish guidelines on budget support *(Harmonising Donor Practices for Effective Aid Delivery: Budget Support, Sector Wide Approaches and Capacity Building in Public Financial Management*). June: Public Expenditure Financial Accountability (PEFA) assessments launched. October: Strategic Partnership with Africa Sector Budget Support Workshop (DFID Co-Chaired).	March: DFID Policy Paper *Partnerships for poverty reduction: rethinking conditionality.* June: DFID additional guidance on Fiduciary Risk Assessments – clarified when FRAs were needed and introduced the concept of Annual Statements of Progress to support annual DFID budget support submissions. June: DFID additional guidance on managing the risk of corruption. July: internal DFID approval of the new PEFA assessments, encouraging Country Offices to use this information as an input to Fiduciary Risk Assessments where available.	Mozambique: first independent Performance Assessment review of Programme Aid Partners: *Perfect Partners?* Tanzania Multi-donor Evaluation Report of General Budget Support.
2006	May: Joint Evaluation of General Budget Support published (see Appendix 5). July: World Bank Development Policy Lending Retrospective.	January: *Implementing DFID's conditionality policy* draft DFID How To Note. July: HMG White Paper on International Development refers to use of budget support, linked to good governance. June: DFID *Guidance on Aid Instruments.* May: DFID Departmental Report 2006 – provided detail on predictability of budget support for first time.	Ethiopia DFID Protection of Basic Services grant approved. Tanzania Performance Assessment Framework revised in line with recommendations of Multi-Donor evaluation.
2007		July: Budget support policy review to Development Committee.	Ghana Multi-Donor Evaluation of General Budget Support.

Source: DFID

APPENDIX FOUR

Results from four case study countries

In 2007 the NAO visited Ethiopia, India, Rwanda and Zambia as part of this study. DFID has provided significant amounts of budget support in each of these countries, in a broad range of circumstances. **Figure 33** shows the significance of budget support to these countries' budgets. It also highlights the significant proportion of budget support provided by DFID.

Ethiopia

Ethiopia is the second most populous country in Africa, with 75 million people – increasing 2 million per year – living on an area about five times as big as the UK. It contains one of the largest concentrations of poor people and ranks 170 out of 177 countries in the United Nations Human Development report. Each year between 6 and 13 million people are at risk of starvation. There is a border dispute with Eritrea.

Eighty five per cent of the population is rural. The main activity is agriculture, but productivity is low and it suffers from land degradation and division. The country is landlocked and scarcity of roads translates into high transport costs. After four years of ten per cent growth, there are signs of overheating with macroeconomic concerns since inflation exceeds 18 per cent and reserves represent only two months of imports.

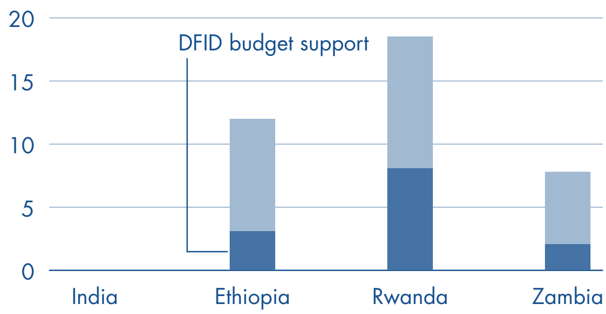
The Government of Ethiopia implemented a Sustainable Development and Poverty Reduction Programme followed by a Plan for Accelerated and Sustained Development to End Poverty 2005-06 – 2009-10. The Government is committed to reduce poverty and Ethiopia is spending nearly 20 per cent of Gross National Product on pro-poor expenditure. This effort was supported by DFID and other donors through Poverty Reduction Budget Support.

The Government of Ethiopia is also committed to strengthen its public financial management systems and launched a number of reforms supported by a large five year multi-donors' Public Sector Capacity Building Programme 2005-2009.

Poverty in Ethiopia affects most of the population, all Human Development Indicators are poor and it will probably miss all Millennium Development Goals. Progress was recorded in poverty expenditure, as well as intermediary results such as number of schools and teachers, school enrolment rates, number of health posts and health workers, immunisation coverage, and access to safe drinking water **(Figure 34)**.

33 All budget support as a share of developing country government budgets in case study countries, 2006-07

Budget support as a percentage of total government budget



Source: National Audit Office analysis of national authorities and DFID data

NOTE

Budget support is 0 per cent of the Indian national budget when rounded; data are from 2006-07.

DFID faced a difficult dilemma further to human rights abuses which occurred after the May 2005 elections. Together with other donors including the World Bank and the European Commission, DFID suspended general budget support. But it wanted to secure basic services to the population. Due to the decentralised structure of this federal country and to its size, it considered that they could only reach the poor by working through government. Thus, it put in place a new Protection of Basic Services programme, in which DFID committed about £94 million from March 2006 to June 2007. Donor money still goes to Government's budget, but the new programme includes specific support to domestic accountability as well as additional safeguards to ensure it increases social expenditure.

India

Relative to other countries where DFID operates, central government systems and the Government's leadership of the development process is extremely strong in India. In 2003 the Government of India requested that smaller donors no longer work directly with them, because it considered that the cost of managing a relationship with them outweighed their financial assistance. With donor resources only a tiny fraction of the Government's total resources, DFID does not provide general budget support in India, but contributes directly to large health and education programmes run by central government as well as providing budget support to the health sector in West Bengal State. In late 2007, DFID reviewed its portfolio and judged that the two central government education and health programmes did not meet its definition of budget support.

34 Performance in Ethiopia against selected result indicators

Indicators	Baseline 2004-05	Target 2005-06	Actual 2005-06	Target 2006-07
Net enrolment rate (%)				
■ Grades 1–4 girls	65	68	**71**	72
■ Grades 1–4 boys	70	73	**75**	77
■ Grades 5–8 girls	29	35	**34**	41
■ Grades 5–8 boys	38	44	**41**	50
Average pupil/teacher ratio				
■ Grades 1–4	71	69	**64.5**	65
■ Grades 5–8	55	55	**57.9**	52
Percentage of rural population with access to potable water within 1.5 km	35%	44%	**41%**	53%
Under-5 mortality rate (out of 1,000 live birth)	140	127	**123**[1]	115
Proportion of children vaccinated against				
■ DPT3 + HepB3 + Hib3	70%	74%	**76%**	77%
■ Measles	61%	65%	**66%**	68%
Contraceptive prevalence rate	25%	32%	**36%**	37%
Number of insecticide treated nets distributed (cumulative, in million)	3	10	**11.5**	18
Sub-national governments' expenditures on basic services (in million Birr)	4,364	5,372	**5,689**	6,474

Source: Protection of Basic Services Joint Review report, May 2007

NOTE

1 This value is estimated. Next observation is due in 2010.

With 370 million of India's 1.1 billion people living in poverty, DFID considers its presence as essential to meeting the Millennium Development Goals worldwide. India is DFID's largest country programme but unlike the other countries we visited, India is on track to become a middle-income country by 2011. This means that although DFID currently considers it a priority to provide a large amount of finance to India now, it will scale back its support to the Government in the medium-term.

DFID has provided £210 million over four years to the government's flagship universal elementary education programme. This was in the context of many years of DFID project support to education, which progressively became more harmonised with the Government of India's own systems. As an incentive, donor funds were linked to the Government of India's own contribution, but Government expenditures exceeded the development partners' expectations dramatically and the programme is reporting improvements in service delivery **(Figure 35)**.

DFID also recently committed £245 million over four years towards the Government of India's Reproductive and Child Health Programme. DFID delayed its support while the World Bank carried out an investigation into procurement irregularities under an earlier scheme. As a result, donors have provided special assistance to strengthen procurement systems and DFID's budget support is now underway.

Both of these central programmes operate on a reimbursement basis, and development partners do not reimburse any expenditure which is poorly accounted for or ineligible under these programmes. This is normal procedure for the Government of India.

DFID India has selected four priority States, and provides sector budget support to one of these, West Bengal. India's spending on health is low by international standards, at less than 1 per cent of Gross Domestic Product. 70 per cent of health expenditure is at the State level and West Bengal was no exception, with very low levels of health spending. DFID used this as an argument to provide earmarked budget support.

We found that DFID India was well respected by the Government, and often perceived as able to smooth over differences of opinion with other donors. But the country office's approach to assessing fiduciary risk had been less rigorous than demanded by DFID guidance, since it relied heavily on the World Bank where they were sharing joint funding. This has cut costs and improved harmonisation but reliance on the World Bank in assessing public financial management was a cause of strain – DFID did not always have access to the World Bank's assessments at times when government systems were called into question. DFID India will now strengthen its financial management control by applying full risk assessment procedures for all new programmes providing financing through government systems.

Rwanda

DFID first provided budget support in Rwanda in 2000, in the context of its recovery from the deeply damaging effects of the genocide in 1994. In 2006, DFID's £31 million of general budget support (two thirds of its country programme expenditure) was the largest amount provided by any donor, making up 43 per cent of all Rwanda's budget support. Rwanda is highly aid dependent, and DFID's budget support

35 Education in India: programme monitoring and results have been generally impressive

Target	2003 baseline	Progress at March 2005	Progress at July 2006
Increase school enrolment age 6–14	160 million enrolled	187 million enrolled	187 million enrolled (same data)
Reduce out of school children age 4–14 to 9 million	25 million	13.5million	9.6 million
Increase share of girls in primary school to 47 per cent	44 per cent	45 per cent	46 per cent
Increase share of scheduled caste in primary school	19 per cent	21 per cent	21 per cent
Increase share of scheduled tribe in primary school	10.3 per cent	10.3 per cent	11 per cent
Improve transition rate from primary to upper primary	75 per cent (2002) subsequently revised to 74 per cent (2003-04)	No reliable data	78 per cent
Test scores in language and maths measured and show improvement in repeated measures	Various baseline assessments	No reliable data (in progress)	Data pending

Source: Sarva Shiksha Abhiyan: Development Objectives: Status (as at July 2006) on Results Framework that year contributed 13 per cent of the Government's non-investment expenditures. Recently, DFID has started providing a small amount of additional funding (initially classified as budget support but later reclassified as other financial aid) earmarked for the education sector, designed to harmonise scattered donor projects in the sector. Budget support donors, including DFID, the World Bank and European Commission have also provided support to strengthen weak government systems, but major weaknesses such as a lack of qualified accountants are only now beginning to be remedied.

Rwanda experienced rapid economic growth and poverty reduction in the years following 1994. Poverty has continued to reduce, although at a slower rate, with 57 per cent of the population living in poverty in 2005, down from 60 per cent in 2000. During this period the economy grew by one third, but there is evidence of rising inequality. Our field visits and meetings with Government, donor and civil society officials showed that access to basic services had improved, with government expenditure on health and education rising steadily from 21 per cent of the budget in 2003 to 28 per cent in 2006 (Figure 7 in main text).

Both Government and donors recognise that progress in 'productive' sectors, such as agriculture and infrastructure has been slow, and they are receiving increased attention through the government's new Economic Development and Poverty Reduction Strategy.

Rwanda's Government is acknowledged to provide strong leadership and an ambitious vision for development; but there have been criticisms of political openness and commitments to human rights, by organisations such as Christian Aid and Human Rights Watch. In 2005, several donors, including DFID, delayed or suspended budget support payments in response to a possible border conflict with Democratic Republic of Congo. To date, DFID has not had comprehensive monitoring mechanisms to monitor governance and other conditions important for budget support, but is now planning a joint Country Governance Analysis with other donors as well as a Performance Assessment Framework for its budget support.

Zambia

Around 68 per cent of the population lives in poverty, but Zambia's democratically elected government has shown commitment to combating corruption, strengthening budgeting and increasing service delivery for the poor. In many ways, Zambia represents the type of poor-but-reforming country where DFID always intended budget support to be actively used.

Earlier assessments had shown that it was too risky in Zambia to provide budget support, but by 2005, the government had made a number of financial management improvements, had begun to implement its Poverty Reduction Strategy and Zambia had completed the criteria for debt relief under the Highly Indebted Poor Countries initiative. DFID made its first budget support payments in 2005, when multilateral donors including the World Bank and European Commission were already using budget support. DFID also contributed £15 million over five years to a joint-donor programme to strengthen public financial management. Other donors have closely linked the volume of their budget support to country performance, suggesting a more risk-averse approach, but with the downside of less predictable aid.

From 2007 DFID Zambia plans to channel around 60 per cent of its annual £40 million programme through general budget support. The government's budget shows large planned increases in health and education expenditure, although the defence budget is also set to rise **(Figure 36)**. Past spending trends could not be established even though DFID commissioned consultancy work – the Government's previous budget classification structure proved too complicated. Overall, Zambia seems to be committed to poverty reduction, and has abolished tuition fees in primary education as well as user fees in rural health centres (DFID financed the latter on an exceptional 'earmarked' basis). The main risks to providing budget support centre on the slower than expected progress in reforming weak public financial management systems.

Unusually, DFID has switched its direct support from the health sector to provide this aid through the central budget support mechanisms. Although there were teething problems for the Government in the transition process, DFID remains a lead donor in health despite providing no direct support to the sector.

36 Government of Zambia planned budget allocations (as a percentage of total government budget)

	2006[1] (%)	2007[2] (%)	2008[2] (%)	2009[2] (%)
Health	10.7	12.7	13.1	13.3
Education	16.2	16.9	17.4	17.7
Defence	6.4	7.2	7.9	8.3

Sources: 1. Actual allocation, 2006 budget. 2. Government of Zambia 2007-09 Medium Term Expenditure Framework projections.

APPENDIX FIVE

Summary of findings from Joint Evaluation of General Budget Support

The results of the Joint Evaluation of General Budget Support were released in May 2006. This evaluation was led by DFID on behalf of 24 donors and seven partner governments. It assessed general budget support from all donors in seven partner countries from 1994-2004 – a total of US$ 4 billion (approximately £2.2 billion). The evaluation was carried out independently by a team of consultants and academic experts.

The evaluation asked to what extent and in what contexts budget support is a relevant, efficient and effective means of delivering sustainable poverty reduction and growth. Seven country level evaluations were conducted in Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam.

The table below summarises the ratings which the evaluation consultants gave to the seven countries for the effect of budget support in various areas. We have organised the different assessment areas under the main potential benefits of budget support which we assessed. These ratings do not summarise the full findings of the evaluation. All the country reports and the synthesis report which brings together findings, conclusions and recommendations are available at www.oecd.org/dataoecd/25/43/37426676.pdf.

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam
Poverty reduction							
Improving expenditure							
Budget support has generally supported increases in priority expenditures, however the definition of what this means is often broad and superficial. Improvements in the poverty analysis of public expenditures are required everywhere.							
Budget support has increased the scope of partner government discretion, leading to improved budget allocation and greater operational efficiency.							
■ Influence on expenditure allocation (on the levels and shares of pro-poor expenditures)	●	●	●	●	●	●	●
■ Efficiency of expenditure	●	●	●	●	●	●	●

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam
Poverty reduction *continued*							
Policy content and processes							
This is one of the most challenging areas for budget support – its influence is intimately connected with the poverty reduction strategy. Most of the study countries have far to go in strengthening the systemic links between public expenditure and policies. The effects identified are definite, but modest. Budget support does not transform underlying political realities.							
■ Influence on policy content, in which policies address major market failures, the regulatory environment and the appropriate balance between public and private sectors	●	●	●	●	●	●	●
■ Extent to which PGBS has helped to establish/ maintain a comprehensive coherent and effective pro-poor reform process, owned by the government	●	●	●	●	●	●	●
Delivering services							
The most obvious effects of budget support on service delivery have been through increased expenditure and expanded basic services (especially in education and health). This responded to strong demand for such services. The expansion of basic services has often been accompanied by a deterioration in quality.							
■ Basic services for the poor	●	nf	●	nf	●	●	●
■ The extent to which PGBS has contributed to pro-poor public service delivery	●	●	●	na	●	●	●
Poverty reduction and economic growth							
Study teams could not confidently track distinct budget support effects to the poverty impact level in most countries. They cautioned against attempts to seek a mechanical relationship between budget support and poverty outcomes, especially in view of the likely lead times for budget support and the potential for exogenous factors to swamp the predicted effects of budget support.							
■ Contribution to fiscal discipline and macroeconomic stability	na	●	●	●	●	na	na
■ Income poverty	●	nf	●	nf	●	●	●

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam

Strengthening national systems

Public financial management and other systems

Budget support has improved the comprehensiveness and transparency of partner government public financial management. By bringing funds on-budget it can strengthen the budget process significantly.

Budget support has helped to focus the attention of donors on the public financial management capacity. But there is scope for more donor coordination to support capacity building strategies.

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam
Supporting capacity development in PFM							
Developing the sustainable capacity of service delivery institutions				na			

Improving domestic accountability

There is limited evidence of significant changes in relationships between service delivery institutions and beneficiaries, but budget support dialogue has increasingly brought issues of quality, equity and responsiveness into focus

Donors need to be careful that their accountability demands do not overshadow those of domestic institutions. Individual country reports repeatedly identified domestic accountability as a weaker area.

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam
Empowerment of poor people because of improvements in the accountability of government …		nf		nf			
The extent to which PGBS has contributed towards service delivery institutions becoming more responsive to beneficiaries		nf		nf			
Improved accountability of public expenditures							

Delivering better aid

Aid harmonisation

In all the study countries, budget support contributed to greater policy alignment of aid. However, what this actually means depends strongly on the quality and ownership of the government strategies that international partners align with.

Alignment with government budget cycles is generally improving, but developing country leadership in aid coordination is rather limited.

Donor harmonisation has improved – although there is still significant scope for further harmonisation.

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam
Alignment with government systems (government planning and budget cycles)							
Alignment with government systems (increasingly relying on government cash management)							
Harmonisation among donors and modalities (extent to which PGBS has contributed to improving overall coordination and complementarities of IPs' programmes)							

	Burkina Faso	Malawi	Mozambique	Nicaragua	Rwanda	Uganda	Vietnam
Delivering better aid *continued*							
Transaction costs							
The high-level negotiation and monitoring costs of budget support are often perceived as onerous. Even where budget support is well established, the up-front transaction costs are not perceived to have fallen as much as some had expected, but partner governments' transaction costs at implementation stage have been significantly reduced, by virtue of being able to follow standard government procedures.							
■ Transaction costs of the budget process and utilising aid	Moderate	Weak	Moderate	Weak	Moderate	Moderate	Moderate
Predictability							
Short term predictability of budget support has been a frequent problem, but mitigating measures are having an effect. There has been less progress in ensuring the medium term predictability of budget support.							
■ Contribution to overall predictability of aid flows and public expenditures	Moderate	Perverse	Moderate	Perverse	Moderate	Weak	Moderate

Key

Strong	Budget support has made a definite and very significant difference to the general situation; it is not necessarily the only factor which has made such a difference, but it is an important one
Moderate	Budget support has made a definite and moderately significant difference to the general situation; but it may be a subsidiary factor, or one amongst a considerable number of significant factors
Weak	Budget support has made only a small difference to the general situation
Null	Budget support is assessed to have made no difference, or only a negligible difference to the general situation
Perverse	Budget support has worsened the general situation
nf [not found]	No clear evidence either way of an effect due to budget support
na	The implied question is Not Applicable in this case

The seven countries assessed

Burkino Faso received general budget support from donors (although not DFID), from 2001. This evolved from earlier structural adjustment programmes of the World Bank and in the context of greater harmonization and alignment of donor projects and programmes. The evaluation found that budget support, along with funds freed up by debt relief, resulted in significantly increased resources to the social sectors. A weaker aspect was the contribution of budget support to sector policies and institutional reform.

Malawi's first effort at budget support in 2000 got off to a false start, with budget support suspended in 2002 because of poor economic management by the Government of Malawi, with major expenditure over-runs. Budget support was never established in a way which enabled the evaluation to track the hypothesised positive effects. Economic management problems persisted both before, during and after budget support was suspended and the evaluation suggested that donors did not adequately assess the necessary political governance. Budget support was restarted in 2004, following a change of government and signs of improved governance and economic management.

Mozambique received budget support from 2000 and has remained highly aid dependent since the civil war which ended in 1992. From 2000 to 2004, the share of budget support rose from 3 per cent to 19 per cent of official development assistance, although the evaluation found that it had not replaced other forms of aid. In response to a banking crisis in 2001 and associated violations of human rights, in 2002 some donors temporarily withheld disbursement. This led the government to request transparent criteria for disbursement, and to the eventual design of the Performance Assessment Framework as a shared instrument to assess government performance. The evaluation found that budget support had strengthened planning and budgeting, supported donor harmonisation and increased the proportion of public expenditure through the growing state budget. On the other hand, the evaluation described improvements to service delivery, responsiveness and access as 'positive, but generally slight and uncertain' and domestic accountability did not improve.

In **Nicaragua**, significant budget support funds have only recently begun to flow, making it too soon to assess progress in many areas. But the context for budget support is difficult, with institutional and political fragmentation of the Nicaraguan government and weak government policies and systems which budget support is meant to align with and support. Budget support evolved from an earlier debt relief programme and its effects are often indistinguishable from this. Most noticeably, budget support has boosted donor harmonisation. The evaluation concluded budget support was very ambitious, given the country's deep political divisions, but that it could reduce some of the key inefficiencies of aid provided in the past.

DFID was the first donor to provide budget support to **Rwanda**, in 2000, in the context of its rebuilding from the genocide of 1994 and development of its first Poverty Reduction Strategy, which was finalised in 2002. This emphasised the role of budget support in rebuilding government systems institutions and processes and its importance in reducing the transaction costs to Rwanda of managing aid. The World Bank, European Commission and Sweden also provided budget support, but other donors felt that the political and governance situation prevented them from joining. The evaluation found that budget support was successful in channelling large flows of resources to the national budget to support reconstruction and development and build government systems. Progress in strengthening public financial management systems has been continuous, but the results are harder to measure and take longer to materialise.

Budget support in **Uganda** began in 1998, alongside debt relief funding, and initially targeted at financing Uganda's Poverty Action Fund. This was the first country where DFID provided budget support. Budget support was effective expanding basic services to the poor through decentralised bodies. There were positive effects on the harmonisation of aid. The systems for linking policies and budgets that the Ministry of Finance had developed prior to budget support were a big advantage in ensuring it was used effectively, but the scale of budget support flows was also important in giving the government budgeting system a decisive influence.

In **Vietnam**, donors provided budget support from 2001. This followed Vietnam's development of its interim Poverty Reduction Strategy and approval of International Monetary Fund lending. There were moderately strong links to pro-poor service delivery and private sector regulatory policies which led to a more conducive growth-enhancing environment. Budget support was likely to have had some impact on poverty, although there was not sufficient evidence to demonstrate this with any certainty. Budget support flows were more predictable than previous forms of aid and there was some evidence of lower transaction costs for government. One of the weak areas was donor attention to the technical assistance and capacity building needed to underpin policy implementation.

APPENDIX SIX

Comparing budget support and economic growth

The expected impact of budget support on growth

Budget support can be expected to have an impact on economic growth through several channels:

- unlike most aid, because of its focus on government systems, **improved macroeconomic management** is an expected outcome of budget support (for example, improved discipline over spending, control of inflation, appropriate private sector policies);
- like debt relief, budget support increases the financial resources available to governments: this may have the effect of **reducing the need for governments to borrow from the private sector or to impose heavy taxes on economic activity. It also has the potential to improve the balance – and therefore efficiency – of expenditure** between capital and running costs;
- like other aid, budget support can be used **to make investments which aim to boost future growth**. Budget support's effectiveness as an investment will depend in part on recipient governments' strategies for spending it: poverty reduction strategies have traditionally focused on the social sectors, but in recent years have had an increased focus on economic growth;
- like other aid, budget support is also an external financial flow. This may (i) **stimulate demand in the economy** and (ii) **increase the value of the exchange rate**, potentially requiring countries to change their exchange rate management.

While there are individual cases where budget support has almost certainly made a significant contribution to the economy, there is not yet systematic evidence to suggest that this is generally the case or that budget support is any better than other aid in this respect. DFID, other donors and academics have not made any assessment of budget support's contribution to economic growth, except insofar as the Joint Evaluation assessed its contribution to macroeconomic stability (see below).

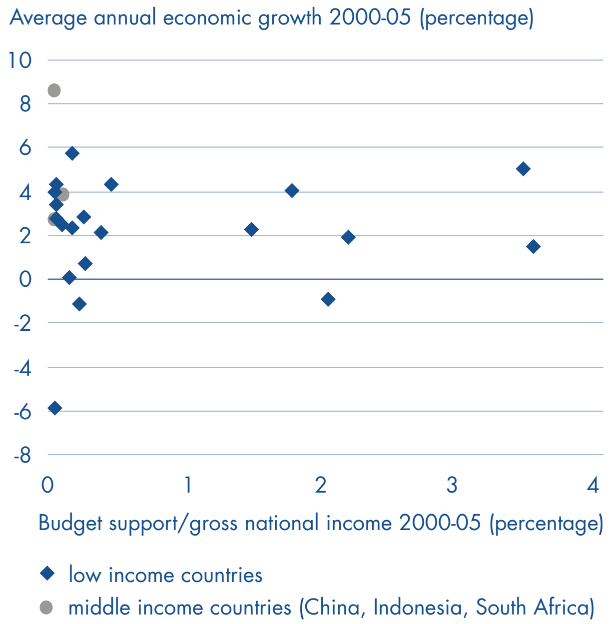
NAO analysis

We looked at countries' growth rates compared with the share of budget support they received. For countries covered by DFID's Public Service Agreement targets, we collected data on Official Development Assistance, Gross National Income and the amount of Programme Aid received, from 2000 to 2005. We used Programme Aid as the best available proxy for the total level of budget support that countries received. The results are shown in **Figure 37 overleaf**.

Given that all donors, including DFID, are selective to some extent in giving budget support to what they consider as 'better performing countries' it is perhaps surprising there is not a stronger relationship. This lack of relationship holds true when middle income countries (often strong economic performers, but not normally considered for budget support) are excluded.

But there are many influences on economic growth, of which foreign aid is only one; and budget support is not usually a large proportion of all foreign aid. Both local factors such as droughts, and international factors such as oil price shocks may have much larger effects on economic growth. There may also be long time lags from aid being given for it to have an impact.

37 There is no simple correlation between a larger proportion of budget support and higher economic growth



Source: International Monetary Fund World Economic Outlook, 2006 and OECD.stat website (used by National Audit Office to estimate the share of budget support in gross national income)

NOTE

Budget support is defined as 'programme aid'. Data includes programme aid by all donors although precise definitions may vary. We averaged data over five years to produce a best estimate of the share of budget support in gross national income. No data available for Afghanistan and Sierra Leone (no data on growth rates).

The Joint Evaluation of General Budget Support

The Joint Evaluation found that in five of the seven study countries (Burkina Faso, Mozambique, Rwanda, Uganda and Vietnam), macroeconomic stability had been established prior to, and independently of, budget support. In these countries, overall, budget support subsequently reinforced this stability by making it easier for the authorities to keep within their domestic expenditure limits. However, short-term unpredictability of budget support undermined this effect at times, with Mozambique and Rwanda being forced to resort to expensive short term domestic borrowing. In Rwanda, this contributed to a near doubling in domestic interest payments between 2001 and 2004. In Malawi, expenditure discipline was never established prior to or during budget support and the suspension of budget support exacerbated this situation.

The Joint Evaluation also concluded that there were no negative effects on government efforts to collect revenues or the environment for private sector investment.

But the Joint Evaluation did not directly evaluate the impact of budget support on economic growth, leaving this to the wider literature on aid and growth. It was unable to track distinct effects on poverty reduction, because of difficulties in data, time-scale and methodology – factors which are also problematic in demonstrating an impact on economic growth.

Academic research on aid and growth

Overall aid, including budget support, should support economic growth if it is to be sustainable. The wider literature on aid and growth is also important. Because budget support provides governments with financial support like debt relief, any literature showing a relationship between debt relief and growth would be important. But there is relatively little literature on whether debt relief has boosted economic growth in the particular case of low-income countries. Economic theory predicts that heavy debt burdens stifle economic growth. Clements, Bhattacharya and Nguyen[29] tested the hypothesis that a large stock of debt or high debt service obligations dampened economic growth. They found evidence that debt service obligations had a direct impact on levels of public investment and that where the face value of all outstanding debt exceeded 50 per cent of gross domestic product, economic growth was slower. Thus in low-income countries with high outstanding amounts of debt or debt service, budget support may also help boost economic growth. Of the countries where DFID gives budget support, Ethiopia, Malawi and Pakistan all had debt-to-gross domestic product ratios of greater than 50 per cent in 2006.

There is a wide econometrics literature which uses statistical methods to explore the relationship between aid and growth. But there is no clear consensus on the relationship between aid and growth. Many studies find a positive relationship between aid and economic growth, but many others find no relationship or even a negative relationship. Doucouliagos and Paldam[30] carried out 'meta analysis' of 97 individual studies, comparing the results of their 1025 statistical models. They found no general relationship between aid and growth. Specifically, their analysis shows that direct effects of aid on growth, as well as indirect effects (through increased savings and investments) are small and statistically insignificant.

29 Clements, Bhattacharya and Nguyen (2003) *External Debt, Public Investment and Growth in Low-Income Countries*, IMF Working Paper.
30 Doucouliagos and Paldam (2005 a, b, c), University of Aarhus, Denmark.

Roodman's[31] review of the literature argues that aid effectiveness studies generate wildly different results and are so far inconclusive as a body of literature. Against this, can be cited reviews, such as McGillivray[32] which also summarises literature, arguing that since 1997 the majority of the aid effectiveness literature has found a positive relationship between aid and growth.

One problem is that very little of this literature differentiates between different types of aid. It is possible that different types or combinations of aid may have different effects. One paper by Cordella and Dell'Ariccia[33] looks at differences between budget support and project aid across several countries, arguing that budget support is more effective in boosting growth where there is a 'good policy environment'. This considered project aid and budget support given between 1974 and 1993, but budget support is provided very differently now, with much more emphasis on a joint approach between donor and recipient and on building developing country systems. Promising approaches have been developed by Mavrotas[34] and Clemens et al[35], which disaggregate the effects of different types and combinations of aid on economic variables. Both studies are interesting but limited in their implications for DFID's use of budget support. Mavrotas' approach assumes that results are likely to be country specific and in each case examines several years of data in just one country. Because of this the results cannot be generalised, and the analysis would need to be repeated in each country. Clemens et al find that 'short term' aid, which includes investments in agriculture and infrastructure and all programme aid, has an impact on economic growth. But 'short term' aid does not include spending in areas such as health and education, although in reality, these are often priority areas for much recent budget support.

31 Roodman, *Macro Aid Effectiveness Research: A Guide for the Perplexed*, Centre for Global Development (2007).
32 McGillivray *Is Aid Effective?* draft WIDER conference paper (2004).
33 Cordella and Dell'Ariccia *Budget Support versus Project Aid*, IMF working paper (2003).
34 Mavrotas (2003).
35 Clemens, Radelet and Bhavani *Counting chickens when they hatch: the short term effect of aid on growth* (2004).

APPENDIX SEVEN

DFID's Fiduciary Risk Assessment scores

The table below sets out DFID's fiduciary risk assessment scores where completed in a standard format for the ten countries we reviewed. A is the lowest risk and C is the highest. The arrows indicate a positive or negative trajectory of change.

DFID's recommended Good Practice Principles (GPP) & Benchmarks	Cambodia	Ethiopia	India	Rwanda	Sierra Leone	Tanzania	Uganda	Vietnam	Zambia
Date of DFID's assessment report	2006	2005	2004	2006	2005	2005	2004	2005	2004
GPP 1 – A clear set of rules governs the budget process									
1 A budget law specifying fiscal management responsibilities is in operation	C↑	A↔	none	A↑	B↑	A↑	A↑	A↔	C↔
2 Accounting policies and account code classifications are published and applied	C↑	A↑	B↔	A↑	B↑	A↑	A↑	B↑	B↑
GPP 2 – The budget is comprehensive									
3. All general government activities are included in the budget	C↑	B↔	A↔	C↑	A↔	B↑	A↑	B↔	B↔
4 Extra budgetary expenditure is not material	C↑	A↑	A↔	C↑	B↑	A↑	B↔	B↑	B↑
GPP 3 – The budget supports pro-poor strategies									
5 Budget allocations are broadly consistent with any medium term expenditure plans for the sector or for the overall budget	B↑	B↑	C↑	B↑	B↑	A↑	A↑	none	C↑
GPP 4 – The budget is a reliable guide to actual expenditure									
6 Budget outturn shows a high level of consistency with the budget	C↑	B↔	C↔	A↑	B↔	B↔	A↑	A↑	C↑
GPP 5 – Expenditure within the year is controlled									
7 In-year reporting of actual expenditure	C↑	C↑	C↔	C↑	B↔	B+↑	C↑	B↑	B↑
8 Systems operating to control virement, commitments and arrears	C↑	A↔	C↔	B↑	B↑	B+↑	B↑	B↔	B↑
GPP 6 – Government carries out procurement in line with principles of value for money and transparency									
9 Appropriate use of competitive tendering rules and decision making is recorded and auditable	C↑	B↑	C↑	C↑	C↔	B↑	C↑	C↑	C↔
10 Effective action taken to identify and eliminate corruption	C↑	B↑	C↔	B↑	C↔	B↑	C↔	B↑	C↔

DFID's recommended Good Practice Principles (GPP) & Benchmarks	Cambodia	Ethiopia	India	Rwanda	Sierra Leone	Tanzania	Uganda	Vietnam	Zambia
GPP 7 – Reporting of expenditure is timely and accurate									
11 Reconciliation of fiscal and bank records is carried out on a routine basis	C↔	B↔	C↑	C↑	B↔	A↔	B↑	B↑	A↑
12. Audited annual accounts are submitted to parliament within the statutory period	B↑	C↔	C↔	B↑	B↔	B↑	A↑	B↑	A↔
GPP 8 – There is effective independent scrutiny of government expenditure									
13 Government accounts are independently audited	C↑	B↔	A↔	A↑	B↑	B+↔	B↑	C↑	B↑
14 Government agencies are held to account for mismanagement	C↔	C↓	C↔	A↑	C↔	C↔	C↔	C↑	C↑
15 Criticisms and recommendations made by the auditors are followed up	C↔	B↔	C↔	A↑	C↔	C+↔	C↔	C↑	C↑
Country offices overall assessment (High/Medium/Low) of:									
Fiduciary risk	High	Medium	None	Medium	High	Medium	Medium	Medium	High
Risk of corruption	High	Low	None	Low	High	Medium	High	Medium	High

Source: DFID Fiduciary Risk Assessments

APPENDIX EIGHT

DFID's assessment framework for Rwanda

DFID-Rwanda's framework for assessing Rwanda's performance includes three matrices. One for assessing fiduciary risks, which corresponds to DFID's standard matrix (see Appendix 6); one for assessing poverty reduction; and one for assessing governance, human rights and international obligations. The latter two are displayed below.

PERFORMANCE MATRIX

Poverty reduction

Performance Area	Benchmark for Assessment
Agricultural transformation and rural development Reduce heavy dependence on rain fed agriculture	1 Reduced variability in food production 2 Increase in value of Agricultural Exports 3 Completion and Implementation of Agriculture Strategic Plan
Health Maintain and improve the health status of the population	4 Improved access to healthcare
HIV/AIDS Implement plan to reduce HIV/AIDS incidence	5 Falling new infections and overall incidence
Education Basic education for all	6 Increased net primary enrolment 7 Gender equity in primary enrolment 8 Increased Primary completion rates
Water and Sanitation Improve the living condition of the population through the optimal use of water resources and access to sanitation services for all	9 Integrated and sustainable management of water resources 10 Increase access to safe water and sanitation services
Economic Infrastructure Improve access to transport, energy and Information Technology to improve livelihoods	11 Improved primary and feeder roads 12 Energy production meets demand 13 Rates of Information Technology usage increase
Commercial Sector Development Improved performance of the sector through capacity development, privatisation and fiancé sector reform	14 Export volume growth of key commodities at 6 per cent per annum

PERFORMANCE MATRIX *continued*

Poverty reduction *continued*

Performance Area/Principles	Benchmark for Assessment
Social Protection Development and maintain good social risk management	15 Development of strategic and operational plans to take this forward
Gender To promote gender equality for equitable and sustainable development	16 Gender issues are systematically integrated in all policies and sectoral programs of Government 17 To promote a legal framework guaranteeing gender equality and equity

Governance, Human Rights and International Obligations

Political Governance and Democracy	1 Legal framework, structures and systems for effective democratic governance are in place and operational. 2 Adequate political space exists for competition of ideas and power (civil and political rights).
Decentralisation	3 Institutional framework, structures and systems for effective local governments in place and operational. 4 Local governments have adequate resources and capacities.
Unity and Reconciliation	5 Appropriate systems and actions are leading to increasing unity and reconciliation.
Capacity Building and Human Resources Development	6 Clarity of roles, relationships and ways of working in government organisations reflected in appropriate laws, Human Resources policies, structures and systems. 7 Effective government capacity to deliver Poverty Reduction Strategy and other key objectives.
Justice and Human Rights	8 Independent judiciary and effective justice sector providing access to all. 9 Appropriate environment to ensure economic, social and cultural rights.
Civil Society and Voice	10 Civil society is effectively promoting poor people's interests (representation, service delivery and watchdog roles). 11 Media is independent and capable of effectively examining and reporting on government policies and actions.
Regional Peace and Stability	12 Complying with relevant international obligations and participating in regional initiatives 13 Support for conflict prevention in other parts of Africa
Other International Obligations	14 Participation in regional trade, development and governance institutions

Source: DFID-Rwanda

APPENDIX NINE

Comparison of DFID's budget support decisions by country

We investigated to what extent DFID's use of general budget support has matched countries' performance against DFID's three partnership criteria for channelling aid through foreign governments. Namely, commitments by these governments to:

- poverty reduction;
- human rights and international obligations; and
- public financial management and accountability.

We compared the proportion of DFID country programmes given as budget support between 2001 and 2005 with indicators reflecting countries' performance in these areas, as well as administrative factors which may also affect DFID's decisions. Wherever possible, data is shown as five year averages, which minimises year-to-year fluctuations and measurement errors. **Figure 38 on page 68** shows the results.

Choice of indicators

We used three indicators which, taken together, approximate a country's adherence to DFID's partnership commitments. For ease of reference, we re-scaled each indicator from 0 to 10, where 0 represents the lowest score possible (worst) and 10 represents the highest score possible (best).

Choice of countries

We looked at low-income countries from the 25 countries in DFID's Public Service Agreement targets. We excluded middle income countries since DFID does not give budget support to countries where the state should have sufficient financial resources.[36] We also excluded India, since the Government of India does not allow general budget support. Around half the countries in the table received some DFID general budget support between 2001-02 and 2005-06. In Vietnam and Zambia, DFID started using general budget support during the period – to this extent the average percentage of aid given as general budget support is below its current level in these countries. In Pakistan, DFID stopped providing general budget support during the period and switched to sector budget support. Most other countries saw broadly similar shares of DFID budget support throughout the period.

DFID's decisions

There is no obvious pattern between the three indicators and DFID's share of budget support. Decisions on budget support have clearly reflected specific local or other factors in addition to judgements on suitability for partnership. Examples which illustrate the strength of those other influences include:

- Sierra Leone scores worse on all three criteria than many of the other countries but received an average of 35 per cent of DFID's funds as general budget support. Unlike other countries receiving budget support, Sierra Leone's 'Government Effectiveness' deteriorated over the period. In contrast, Kenya received no general budget support at all over the period but scored better on all three criteria. Other components of the Worldwide Governance Indicators suggest Kenya scores similarly on corruption and better on 'Voice and Accountability' than Sierra Leone.
- Rwanda received the highest share of general budget support (on average 71 per cent) despite Ghana, Tanzania and Uganda scoring better on each of the three indicators. In particular, Ghana out performed all other countries in our sample over the period, but received less general budget support than four of them, averaging just 42 per cent of DFID aid over the period.
- Vietnam received an average of 25 per cent general budget support (and this masks higher figures towards the end of the period). It scores well on pro-poor policies and government effectiveness. But its scores on indicators of political rights and civil liberties are extremely low.

36 Lesotho is included, although it reached Middle Income Country status by the end of this period.

Indicator	Description	Link to Partnership Commitments
Social inclusion and equity score (from World Bank Resource Allocation Index 2005)	This is a subcomponent taken from the World Bank's Resource Allocation Index[1] for low-income countries in 2005. This rates countries on: ■ Gender equality; ■ Equity of public resource use; ■ Building Human Resources; ■ Social protection and labour; and ■ Policies and institutions for environmental sustainability. Data for earlier years does not exist, but the 2005 score is likely to be a fair approximation to policies for social inclusion in recent years. We found no other indicators available to estimate commitment to poverty reduction.	Commitment to Poverty Reduction Commitment to Human Rights (social rights)
Freedom House index of civil liberties and political rights	Freedom House[2] rates civil liberties and political freedom across different countries, based on a range of sources. Ratings assess an individual's ability to: ■ Participate freely in the political process; ■ Vote freely in legitimate elections; ■ Have representatives that are accountable to them; ■ Exercise freedoms of expression and belief; ■ Be able to freely assemble and associate; ■ Have access to an established and equitable system of rule of law; ■ Have social and economic freedoms, including equal access to economic opportunities and the right to hold private property. Data was available for all years from 2001-2005. The scores correlate well with the independently compiled Worldwide Governance Indicator on 'Voice and Accountability', suggesting that they are reliable and that they capture elements of a government's accountability to its people.	Commitment to Human Rights (which covers a wide variety of rights, including civil, economic, social, cultural and political). Commitment to Public Financial Management and Accountability (insofar as the index reflects democratic accountability).
'Government Effectiveness' (from Worldwide Governance Indicator)	The World Bank's Worldwide Governance Indicator[3] on 'Government Effectiveness', measures the quality of public services, the quality of the civil service, and the quality of policy formulation and implementation. This captures 'public financial management' in its broadest sense. We have also included the trajectory of change over the period. Although based on perceptions, this indicator correlates strongly with other measures of public financial management, including those from the World Bank's Resource Allocation Index for low-income countries and the Worldwide Governance Indicator on control of corruption. This suggests that it is reliable. Data was available for 2000, and 2002-2005. This makes it preferable to the Resource Allocation Index, which only has data for 2005.	Commitment to Public Financial Management and Accountability

NOTES

1 http://go.worldbank.org/S2THWI1X60.

2 www.freedomhouse.org.

3 Kaufmann, Daniel, Kraay, Aart and Mastruzzi, Massimo, *Governance Matters VI: Governance Indicators for 1996-2006* (July 2007). World Bank Policy Research Working Paper No. 4280 Available at SSRN: http://ssrn.com/abstract=999979.

38 Share of general budget support compared with criteria for budget support

Country	Average percentage of DFID aid given as general budget support (2001-02 – 2005-06)	DFID's required Partnership Commitments[1]: Freedom House (political rights & civil liberties) average score 2001-05	Government effectiveness: Average score (2000-05)	Government effectiveness: Change over period[2]	Social inclusion and equity score (2005)
Rwanda	71	2.0	3.2	⇔	6.5
Tanzania	64	5.7	4.3	⇔	7.0
Mozambique	48	5.8	4.3	⇔	5.8
Uganda	47	3.7	4.1	⇔	7.3
Ghana	42	8.2	4.7	⇔	6.8
Sierra Leone	35	5.3	2.2	⇔	4.8
Pakistan	30	2.5	3.9	⇔	5.3
Vietnam	25	1.0	4.2	⇔	7.0
Malawi	22	5.3	3.6	↓	6.3
Ethiopia	17 (34[3])	3.3	3.3	⇔	6.5
Zambia	15	4.8	3.3	⇔	6.0
Afghanistan	0 (35[4])	1.8	2.1	↑	Not rated
Bangladesh	0	5.2	3.6	↓	6.5
Cambodia	0	2.5	3.4	⇔	5.3
Congo, Dem. Rep.	0	1.7	1.7	⇔	4.8
Kenya	0	5.5	3.6	⇔	5.3
Lesotho	0	7.0	4.5	⇔	5.8
Nepal	0	4.2	3.7	↓	5.5
Nigeria	0	4.7	3.1	⇔	5.3
Sudan	0	0.0	2.6	⇔	3.3
Zimbabwe	0	1.3	2.7	↓	2.5

Sources: Statistics on International Development (DFID, 2006); Worldwide Governance Indicators 2006; World Bank Resource Allocation Index 2005; Freedom House; World Development Indicators 2007; Organisation for Economic Co-operation and Development.

NOTES

1 Original indices: Freedom House (1 to 7 scale for each of Political Rights and Civil Liberties, weighted 50 per cent each); Government effectiveness (–2.5 to +2.5); Social inclusion and equity (1 to 5).

2 A positive or negative change is recorded where scores changed by twice the standard error or more.

3 Ethiopia 34 per cent figure includes Protection of Basic Services (defined by DFID as sector budget support, but can be spent in several sectors).

4 Afghanistan 35 per cent figure represents the Afghan Reconstruction Trust Fund, at one stage described as budget support by DFID: http://www.dfid.gov.uk/mdg/aid-effectiveness/prbs.asp.

5 Official Development Assistance as a proportion of Gross National Income.

Other relevant factors		
GNI per capita (2001-05) $	Average Aid Dependency (ODA/GNI[5] 2001-05)	Average size DFID Bilateral Programme (2001-02 – 2005-06) £ millions
216	23	40.3
304	14	89.9
246	30	43.8
246	15	62.3
340	12	69.0
196	36	32.8
556	2	55.3
494	4	31.1
150	26	54.8
130	18	48.3
372	16	38.3
162	32	76.4
414	2	87.8
348	11	9.4
100	37	24.7
450	5	38.7
682	6	3.3
238	7	30.2
402	2	41.1
462	4	50.1
608	4	27.8

GLOSSARY

Alignment	Alignment is the extent to which donors base their overall support on partner countries' national development strategies, institutions and procedures.
Bilateral aid	Bilateral aid is provided to developing countries on a country to country basis.
Budget support	Budget support is a form of financial aid in which funds are provided directly to a partner government's central exchequer to support that government's programmes. In budget support: a Funds are provided in support of a government programme that focuses on growth and poverty reduction, and transforming developing country institutions. b The funds are provided to a partner government to spend using its own financial management and accountability systems. Budget support can be in the form of general budget support (not directed at particular sectors) or sector budget support.
Civil society organisations	All civic organisations, associations and networks, which occupy the 'social space' between the family and the state who come together to advocate their common interests through collective action. It includes volunteer and charity groups, faith-based groups, workers' clubs and trade unions, non-profit think-tanks and 'issue-based' activist groups.
Conditionality	When donors require developing country partners to do something in order to receive aid. If the condition is not fulfilled it will often lead to aid being interrupted or suspended. The UK policy on conditionality is that aid is based on three shared commitments with partner governments: poverty reduction and meeting the Millennium Development Goals; respecting human rights and other international obligations; and strengthening financial management and accountability and reducing the risk of funds being misused thorough weak administration or corruption.
Country Assistance Plans	DFID has produced or is producing Country Assistance Plans for all countries where it provides development assistance programmes of more than £20 million. These papers, produced in consultation with partner governments, business, civil society and others within the country concerned and within the UK, set out how DFID aims to contribute to achieving the international development targets in the country in question. Country Assistance Plans are normally intended to cover a three to four year period.

Country-led approaches	Where donors allow partner countries to take the lead in the design and delivery of development and provide support to partner countries (see ownership and alignment).
Debt relief	Debt relief may take the form of cancellation, rescheduling, refinancing or re-organisation. Interest and principal foregone from debt cancellation forms part of DFID programme expenditure whilst other debt relief is funded from other official sources.
Development Assistance Committee	The Development Assistance Committee of the Organisation for Economic Co-operation and Development is a forum for consultation among 22 donor countries and the European Commission on how to increase the level and effectiveness of aid flows to all aid recipient countries. The member countries are Australia, Austria, Belgium, Canada, Denmark, European Commission, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the UK and the United States.
European Community	The 27 member states and the common institutions, notably the European Commission, cooperating on a range of economic and other issues.
European Development Fund	The European Development Fund is the main route through which funds committed under the European Commission's Cotonou Convention for development activities are channelled.
Fiduciary risk	Fiduciary risk is the risk that funds: (a) are not used for the intended purpose; (b) are not properly accounted for; and (c) do not achieve value for money.
Financial aid	Financial aid in the wider sense is defined as a grant or loan of money which is the subject of a formal agreement with the recipient government or institution. In practice it is all bilateral aid except technical cooperation and administrative costs.
Fragile states	Those states where the government cannot or will not deliver core functions to the majority of its people, including the poor.
General budget support	See budget support.
Gross domestic product	The total value of goods and services produced within a country.

Gross national income	Previously known as gross national product, gross national income (GNI) comprises the total value of goods and services produced within a country (i.e. its gross domestic product), together with its income received from other countries (notably interest and dividends), less similar payments made to other countries.
Gross national product	Gross national product comprises the total value of goods and services produced within a country (i.e. its gross domestic product), together with income received from other countries (notably interest and dividends), less similar payments made to other countries.
Harmonisation	Where donors coordinate their aid and use common procedures to ensure they are not duplicating work or placing unnecessary demands on their developing country partners.
International Development Association	Part of the World Bank Group that makes loans to countries at concessional rates (i.e. below market rates) of interest.
Millennium Development Goals	A set of eight international development goals for 2015, adopted by the international community in the UN Millennium Declaration in September 2000.
Multilateral aid	Aid channelled through international bodies for use in or on behalf of aid recipient countries.
Non-governmental organisations	Private non-profit making bodies, which are active in development work. To qualify for official support, UK non-governmental organisations must be registered charities.
Organisation for Economic Cooperation and Development (OECD)	A group of major industrial countries promoting growth and high employment among its members, fostering international trade and contributing to global economic development.
Ownership	Partner countries exercise effective leadership over their development policies and strategies and coordinate development actions.
Paris Declaration	The Paris Declaration is an international agreement in which over one hundred countries and organisations committed to continue to increase efforts in harmonisation and alignment of aid with a set of monitorable actions and indicators.
Poverty Reduction Strategy Papers	These are prepared by partner governments, often in collaboration with development partners. They describe the country's macroeconomic, structural and social policies and programmes to promote growth and reduce poverty. These are required before budget support is given.
Programme aid	Programme aid is financial assistance specifically to fund (i) a range of general imports, or (ii) an integrated programme of support for a particular sector, or (iii) discrete elements of a recipient's budgetary expenditure. In most cases, support is provided as part of a World Bank/International Monetary Fund co-ordinated structural adjustment programme.

Programme-based approaches	Programme-based approaches are funds provided to a sector to deliver a single programme, led by the partner country, with a single budget and a formal process for donor coordination, and that make efforts to increase the use of developing partner countries' systems.
Public financial management	A public financial management system has three key objectives: ■ to maintain fiscal discipline (securing stewardship) – keeping spending within limits created by the ability to raise revenue and keeping debt within levels that are not prohibitively expensive to service; ■ to promote strategic priorities (enabling transformation) – allocating and spending resources in those areas that make the greatest contribution to the government's objectives; and ■ to deliver value for money (supporting performance) – efficient and effective use of resources in the implementation of strategic priorities.
Public Service Agreement	A set of measurable targets for DFID's work, as required by the White Paper Public Services for the Future: Modernisation, Reform, Accountability.
Sector	One of the areas of recipient countries' economic or social structures that aid is intended to support. DFID categorises its aid into eight broad sectors: Economic, Education, Health, Governance, Social, Rural Livelihoods, Environment and Humanitarian Assistance.
Sector budget support	See budget support.
Sector wide approaches	A sector wide approach is a process that entails all significant donor funding for a sector supporting a single, comprehensive sector policy and expenditure programme, consistent with a sound macro-economic framework, under government leadership. Donor support for a sector wide approach can take any form – project aid, technical assistance or budgetary support – although there should be a commitment to progressive reliance on government procedures to disburse and account for all funds as these procedures are strengthened.
Technical cooperation/ technical assistance	Technical cooperation is the provision of advice and/or skills, in the form of specialist personnel, training and scholarship, grants for research and associated costs.
World Bank	This term is commonly used to refer to the International Bank for Reconstruction and Development and the International Development Association. Three other agencies are also part of the World Bank, the International Finance Corporation, the Multilateral Investment Guarantee Agency and the International Centre for Settlement of Investment Disputes.

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