



# Guidelines for development contracts

June 2013

## Contents

1.	Introduction .....	3
1.1	The objectives of the guideline .....	3
1.2	Who should use the guidelines, when - and how? .....	4
2.	Budget support – what it is and when to use it? .....	5
2.1	What is general budget support? .....	5
2.2	How is the development contract envisaged to work? .....	6
2.3	Different forms of budget support and budget support-like modalities.....	9
3.	What is the basis for assessing the feasibility of entering into a development contract?... 11	
3.1	Fundamental values of human rights, democracy and rule of law .....	12
3.2	Credible public policies and plans for poverty reduction, good governance and inclusive sustainable development .....	13
3.3	Stable macroeconomic framework .....	14
3.4	Adequate quality and capacity in the public financial management systems and progress on reforms including anti-corruption .....	15
3.5	Transparency and oversight of the budget.....	17
3.6	Risk Management.....	18
4.	Elements to include in the design of the development contract.....	18
4.1	Funding .....	19
4.2	Policy dialogue.....	20
4.3	Performance mechanisms and the use of tranches.....	21
4.4	Monitoring of performance.....	23
4.5	Strengthening key reforms and systems for accountability, transparency and democratic participation .....	24
5.	The preparation, formulation and approval process.....	26
5.1	Preparation stage .....	26
5.2	Formulation process and appraisal.....	27
6.	Implementing a development contract.....	29
6.1	Follow-up on progress and reports .....	29
6.2	Policy dialogue.....	30
6.3	Disbursements.....	32
6.4	Review processes .....	32

# 1. INTRODUCTION

## 1.1 The objectives of the guideline

One of the ambitions in the Strategy for Development Cooperation “The Right to a Better Life” (June 2012) is to make greater use of budget support to enhance ownership and mutual accountability.

The aim of the present guideline is to provide technical guidance for the formulation and implementation of general budget support based on up-to-date lessons on effective budget support, with a focus on budget support as a **package** and where the criteria for support are harmonised with the revised guidelines on budget support from the European Commission (2012). Furthermore, the guideline aims to explain how the Human Rights Based approach and the objectives in the “Right to a Better Life” to fight poverty, promote human rights, build and consolidate democracy and promote sustainable and inclusive economic growth fit with the intentions to strengthen budget support as one of the elements to ensure that Danish development cooperation is effective and focused. “The Right to a Better Life” also emphasises the importance of a critical dialogue concerning both public revenue and expenditure, including domestic mobilisation of tax revenue and the priority given to social sectors.

Key to the approach is the visualization of budget support as a **contract** with the priority country’s government based on shared objectives for poverty reduction, sustainable and inclusive economic development, and the strengthening and consolidation of democracies. The contract involves mutual accountability and a shared commitment to the fundamental values of human rights, democracy and the rule of law. It includes a constructive and critical policy dialogue on public revenue and expenditure, the priorities to social sectors and social progress, and on distribution policy and the respect for basic human rights. The opportunity to encourage citizens to hold their governments accountable for results and public spending through mechanisms for political accountability and civil society engagement is a key part of the approach. The human rights perspective will also be an integral part of the policy dialogue carried out in the context of budget support.

The terminology used has also changed to underline the contract-element. Hence, when providing general budget support it will henceforth be named a ‘Development Contract’. When providing sector budget support, the support will be phrased as a ‘Sector Reform Contract’. And budget support-like modalities to fragile states will be named ‘State Building Contracts’.

The guidelines point to ways whereby the priority in the “Right to a Better Life” to social progress may be promoted through development and sector reform contracts and how the

Human Rights-Based Approach (HRBA) may help reinforce the achievement of these objectives.

Denmark will work for and adopt at realistic perspective on the use of conditions or similarly defined expectations and assumptions about policy reforms a government should implement as basis for the budget support. The consistent conclusion from a number of evaluations on budget support is that development partners (and the budget support) will not be able to shift a government's political or policy priorities in a direction it not already desires from the outset. On the other hand the budget support can successfully strengthen reform processes which the government has already embarked on and favours politically. Denmark should therefore seek to exploit opportunities, and recognize limitations when it comes to assumptions about the commitment to reform.

## **1.2 Who should use the guidelines, when - and how?**

These guidelines on general budget support (henceforth “the guidelines”) are intended for anyone involved in formulating, implementing and in any way assessing and deciding on Danish budget support programmes, including Danida staff at representations, the Ministry of Foreign Affairs, consultants, advisers and others.

The procedures, principles and processes for programme preparation, formulation, and implementation of Danida support are formulated in Danida's Guidelines for Country Programmes (2013) (previously Guidelines for Programme Management). The budget support programmes largely adhere to the same principles and procedures as any other programme. This document aims to describe what applies distinctively in the case of general budget support. The guidelines replace the “Guidelines for the Provision of Budget Support” from October 2009 and should be used in conjunction with the Guidelines for Country Programmes (2013).

In terms of scope, the guidelines do not provide specific and detailed technical guidance on substantive areas, such as public financial management or macro-economic assessments, and neither should the guidelines be regarded as a strategy or policy on Danida's use of the general budget support modality. The intention is to provide general guidance which staff should translate into practice for each case based on the actual context.

It is suggested that users read through the entire guideline at least once and subsequently use the guidelines as a reference tool to consult individual sections on a needs-basis.

### **An overview of the guideline**

What is the aim and scope of the guidelines for development contracts (general budget support)?	Section 1
What is budget support? How may it work? What forms of budget support may be used?	Section 2
What criteria should guide assessments and decisions on development contracts?	Section 3

How should development contracts be designed - what elements to include in the package?	Section 4
What special steps to consider in formulation of development contracts?	Section 5
What elements to consider especially during implementation of development contracts?	Section 6

## 2. BUDGET SUPPORT – WHAT IT IS AND WHEN TO USE IT?

### 2.1 What is general budget support?

OECD/DAC defines general budget support as un-earmarked donor funds being channelled to the partner country's national treasury, and thereafter managed in accordance with the partner's own budgetary procedures. By this definition funds transferred to the national treasury to finance programmes that use different procedures than the partner country's and/or earmarking of the funds for specific purposes are not general budget support.

The objectives for general budget support will always be defined specifically in the national development strategies funded through the national budget. Normally they should relate to poverty reduction and delivery of basic services, social security nets, sustainable and inclusive economic development, and the strengthening and consolidation of democracies.

It is important to emphasize that general budget support consists of more than the funds transferred to the partner country. Danida, and partners like the EU, regard general budget support as a **package** that in addition to the financial transfer also includes elements such as policy dialogue, capacity building in relevant areas such as public financial management, domestic revenue mobilisation, anti-corruption efforts, and the support to parliament, civil society organisations and others. The development contract will encompass these elements in synergy with activities supported in other governance programmes which together form all the elements of the package. Whether all elements will be included in the actual development contract or as part of another programme should depend on the actual situation/context.

And it is in this logic the link between general budget support and a human rights-based approach to development should be seen. The various elements in the package should interact in order to achieve the stated objectives and results.

The development contract (general budget support) is an instrument aimed at providing predictability, enhanced ownership and alignment, better and more sustainable development results to be defined specifically in each case. It is not an end in itself.

## 2.2 How is the development contract envisaged to work?

Provision of effective general budget support through a development contract cannot be expected to be implemented according to a standard formula. As with any modality the design of the programme (the package) is dependent on and should be developed specifically for each case based on the actual challenges and opportunities in each particular country and context. It requires a clear and shared picture among the partners of “how the support is envisaged to work” in attaining the objectives and delivering the defined results - the intervention logic.

EU’s guidelines suggest a framework to guide the determination of the intervention logic for a given country context (summarized in box 2.1). The framework can serve as a starting-point and inspiration for the design of Danish budget support, hence also facilitate harmonization and a shared vision and understanding among partners including the EU. The role of the intervention logic is to inform the design of the elements in the budget support package (see section 4).

### Box 2.1: EU’s intervention logic for budget support – a summary

The framework in EU’s guidelines on budget support states that budget support allows more use of country systems, more discretionary spending and predictability, and reduced transaction costs. These effects may lead to direct outputs in the form of improved macroeconomic management, public service delivery, public financial management, public policy and execution processes, and better links between the government and oversight bodies.

Next in the causality chain, the direct outputs - public policy, institutions, spending and service delivery - will lead beneficiaries and economic actors to respond positively through increased use of public services, more investment and economic production, competitiveness, and public confidence in Government’s performance, specifically on the budget process and service delivery.

Ultimately development impacts will result in the form of sustainable growth and poverty reduction (via reduced income- and non-income poverty, access to social services, empowerment and social inclusion of the poor and marginalized), and in the specific areas defined in the partnership framework, such as democracy, human rights, and the rule of law.

The Danish perspective on budget support uses EU’s intervention logic as the starting-point. But the Danish vision on the budget support instrument puts added emphasis on the **contract** relation and the role of the human rights-based approach as forces of internal change in Denmark’s priority countries. An enhanced focus on the results is also a consequence of this logic. When designing the contract, the sequencing and conditions for the input in the form of financial transactions is often in focus. However, various models for an enhanced focus at the outputs – or the results – are currently developed. Denmark is very interested in gaining experiences with designs that clearly link the input to the output while also considering other factors such as predictability.

As a result, Denmark will stress the role of transparency, accountability, participation and non-discrimination as factors that may provide citizens in the priority countries a better chance to

push for change and improvements “from the inside”, hence reinforce the envisaged development impacts with regard to poverty reduction, sustainable growth, democracy, human rights and the rule of law.

A development contract is a deal in which the recipient country is signing an agreement to deliver on concrete progress and a series of results. We as a development partner on the other hand sign and verify that we will provide the funding, as well as support capacity building, etc.

Denmark also recognizes that budget support is only one of a number of necessary instruments to mobilize as part of a comprehensive and effective support to address poverty reduction, sustainable growth and development, and democracy, human rights and rule of law. Successful support to change processes in these areas require that the budget support package is accompanied by initiatives that directly target the resources, institutions and reforms in the relevant sectors and institutions.

Therefore, a Danish budget support programme should firstly include a package that is based on clear intervention logic for how the development change to achieve the objectives in the particular country will be promoted and supported - via the funds, policy dialogue, performance mechanisms, and capacity development in a partnership with the government and other development partners. Secondly, the package should be reinforced by support to strengthen mechanisms for transparency and accountability (civil society, parliamentary support, monitoring, etc.). In addition the budget support should be supplemented with direct support to key sectors or thematic areas (Human Rights and Democracy, Green Growth, Social Progress and Stability and Protection). The Danish country policy and programme will determine the strategic focus and composition between the different Danish supported programmes in a country.

Section 4 explains in detail how to design the budget support package, while table 2.1 provides examples of how some key Danish priorities may be promoted through budget support in combination with other support interventions.

**Table 2.1. Examples of how the Danish priorities can be promoted via the budget support package (the development contract and elements in complementary programmes e.g. good governance programmes)**

Objectives according to Danish strategy	Poverty reduction and sustainable development	Social progress	Human rights, democracy and rule of law
Focus for policy dialogue:	<ul style="list-style-type: none"> <li>• Equality, equity, allocation, and distribution of expenditure</li> <li>• Pro-poor economic growth policies including sound economic management</li> <li>• Green growth and climate</li> <li>• Employment creation</li> <li>• Domestic revenue mobilisation through i.e. taxes</li> <li>• Private sector</li> </ul>	<ul style="list-style-type: none"> <li>• Social progress, social sector expenditure allocation, service delivery distribution and quality</li> <li>• Social protection</li> <li>• Possibility for establishment of social security nets</li> <li>• Non-discrimination in the availability and access to quality social services</li> </ul>	<ul style="list-style-type: none"> <li>• A minimum respect for human rights,</li> <li>• A free press,</li> <li>• pluralistic democracy</li> <li>• The rule of law, including independence for the judiciary.</li> </ul>
<b>Code words</b> include: transparency, accountability, participation, non-discrimination, equality and inclusion			
Performance mechanisms and monitoring	Promote indicators and targets linked to e.g. public sector reform, pro-poor/green growth initiatives, taxation/tax systems, Public Financial Management and indicators on sound macro economy – growth rates, deficits, inflation, etc.	Promote indicators and targets linked to e.g. education, health, water sector reforms, allocation of expenditures, Human rights principles within the sector etc.	Monitor closely the situation regarding human rights, democracy and rule of law  Focus should be to identify the risk of slippage, policy reversals and deterioration.
Capacity strengthening in systems and processes	Focus on: <ul style="list-style-type: none"> <li>• Poverty analysis, policy analysis, statistics and results monitoring</li> <li>• Public financial management</li> <li>• Budget transparency</li> <li>• Tax systems and revenues and tax management which will include incentives etc. to generate taxes, audit, judiciary, internal audit, etc.</li> <li>• Public sector development and management</li> <li>• Parliamentary controls</li> <li>• Green Growth and the role of the private sector</li> </ul>	Focus on: <ul style="list-style-type: none"> <li>• Statistics and monitoring of social services</li> <li>• Social accountability mechanisms</li> <li>• Reform and development of public sector systems and management of social services incl. decentralization and civil service</li> <li>• Human Rights Training</li> </ul>	Focus on: <ul style="list-style-type: none"> <li>• Audit, judiciary, internal audit, etc.</li> <li>• Parliamentary controls</li> </ul>
Strengthening democratic accountability mechanisms via support to:	<ul style="list-style-type: none"> <li>• Audit, judiciary, internal audit, etc.</li> <li>• Strengthening of parliaments, local councils, etc.</li> <li>• Civil society -advocacy capacity</li> </ul>	<ul style="list-style-type: none"> <li>• Civil society and their capacity to monitor service delivery</li> <li>• Local government training and its accountability functions</li> </ul>	Support to: <ul style="list-style-type: none"> <li>• Civil society</li> <li>• Human rights organisations</li> </ul>

### **2.3 Different forms of budget support and budget support-like modalities**

In addition to general budget support in the form of development contracts, Denmark can also use modalities that have similar features and effects as a development contract but with a focus and approach that is adapted to other types of objectives and contexts. Two of these are introduced below, namely sector reform contracts (sector budget support) and state building contracts to fragile states.

#### ***Sector budget support – sector reform contracts***

Sector budget support is relevant for supporting sector reforms and sector-specific service delivery goals. In its most aligned form, SBS funds are transferred in the same way as general budget support. The difference is that the dialogue between development partners and recipient governments focuses on sector-specific concerns rather than on overall policy and budget priorities (OECD). Furthermore, the priorities, the monitoring framework, and capacity development elements are also narrowed to have a sector-specific focus.

In practice, however, sector budget support comes in a variety of forms with varying levels of earmarking and traceability, and varying degrees of alignment with national budget planning, execution and reporting procedures. There is a continuum where some sector budget support cases are very close to general budget support while others are closer to basket arrangements. When supporting social safety schemes or social safety net programmes, the specific design of the support will decide which modality it can be classified as.

As a rule the Danish decision to enter into a sector reform contract (sector budget support), and the exact choice of its form, should be determined based on assessments of the relevance and feasibility of sector budget support in the concerned sector and context. There is therefore no standard or specific model to follow. Danida's Technical note on Programme Support Preparation<sup>1</sup> (currently pending a minor update) provides guidance on the principles and assessments to make when deciding whether sector budget support is the appropriate modality to use in a particular context.

In situations where a sector reform contract is relevant, the principle should be to aim for maximum alignment in terms of earmarking and traceability based on the possibilities in the context. Denmark should normally choose to join an existing support mechanism and hence maximise coordination and harmonization with other development partners to the extent possible. This enables Danish use of sector reform contracts to be harmonized with EU and other development partners engaged in sector budget support.

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<sup>1</sup> See [http://um.dk/da/~media/UM/Danish-site/Documents/Danida/Resultater/Risikohaandt/TECHNICAL\\_NOTE\\_Final50.ashx](http://um.dk/da/~media/UM/Danish-site/Documents/Danida/Resultater/Risikohaandt/TECHNICAL_NOTE_Final50.ashx)

## *State Building Contracts to fragile states*

Financial support to state budgets to countries affected by conflict and fragility may be deemed relevant if found that it will contribute to stabilization and to restore core state functions and basic level of service delivery in areas such as education, health, water and sanitation etc. This could for example be financial support to enable payment of salaries to education or health workers, police, or other critical areas to ensure the provision of basic public services and people's safety. EU has introduced a model based on time limited "state building contracts" for this purpose.

In order to meet this objective, funds may be earmarked to specific budget items that match the public functions Denmark and other development partners wish to promote. Due to the often precarious situation in these countries, an agreed level of earmarking and traceability of funds is therefore accepted normal feature.

The funding modality should be designed in a way which ensures ownership, alignment, and harmonization as far as feasible in view of specific opportunities and challenges for fiduciary control. The modalities should as far as feasible be designed in a manner intended to achieve the same aid effectiveness results as in development contracts and sector reform contracts.

Decisions regarding the design of the funding modality will be taken on a case by case basis depending on the specific context and the fiduciary assessment. There is no single model for the design of the funding mechanism.

In addition to the specification of the funding mechanism, the other elements in the budget support package should also be decided, including documentation expressing the government priorities, dialogue, a monitoring framework, and capacity development. The horizon for budget-related support to countries affected by conflict and fragility (including the elements in the package) will typically be shorter (e.g. 1-3 years) than for development contracts and sector reform contracts.

The strategy and design of "direct budget-like" support to countries affected by conflict and fragility need to include milestones and processes for a possible exit or transition to a development or sector reform contract where possible.

Danish support to the state budget (central or local government) in fragile situations should be used as an instrument alongside other support instruments and based on relevant policies and strategies. Further development of the modalities and forms of budget support will also come out of Denmark's active engagement in the International Dialogue on Peacebuilding and Statebuilding Goals under the New Deal which re-defines the international engagement in countries affected by conflict and fragility.

The New Deal and the International Dialogue is rooted in the need to ensure strong ownership and leadership from the side of the countries affected by conflict and fragility. It includes support to conduct thorough and consultative fragility assessments to be used as the basis for ‘one vision – one plan’ and the development of compacts as the basis for international support.

The work on the New Deal implies the promotion of change in behaviour of international partners building on transparency, risk sharing, use and strengthening of country systems, strengthening capacities and timely and predictable aid (TRUST). The fragility assessments and the compacts will constitute the foundation for budget support or on budget support. Further guidance can be found in the Technical Guidance Note for Danish Assistance to Countries Affected by Conflict and Fragility (still in draft form).

### **3. WHAT IS THE BASIS FOR ASSESSING THE FEASIBILITY OF ENTERING INTO A DEVELOPMENT CONTRACT?**

The feasibility of providing general budget support in the form of a development contract should be assessed based on five sets of criteria, namely:

- Fundamental values of human rights, democracy and the rule of law;
- Credible public policies and plans for poverty reduction, good governance and inclusive sustainable development;
- A stable macroeconomic framework;
- Adequate quality and capacity in public financial management, including anti-corruption activities;
- Transparency and oversight of the budget.

The assessment should lead to a conclusion of whether the criteria are met to an acceptable degree for enabling a development contract.

Denmark is ultimately responsible for the conclusion of whether the criteria are assessed satisfactory for the provision of Danish budget support. This underscores the need to draw on several sources for the assessment of the five sets of criteria.

The decision to enter into a development contract and the assessment of the feasibility varies from one country to another. Consequently, poor performance on one or more of the criteria does not in itself disqualify a country from receiving budget support and the focus should be on trends. The decision is contingent on a comprehensive assessment of all the criteria together and is ultimately also political. The assessment should also take into account whether there has been a demonstrated willingness to reform and change. It should highlight which areas of the criteria that should be raised in the political and budget support dialogue in the short- and medium term. Any political risks to be considered for the “risk management framework” for

the country should be stated as well as ways of handling or mitigating the risks should they materialise.

### **3.1 Fundamental values of human rights, democracy and rule of law**

Denmark shares the general EU commitment and adherence to the fundamental values of human rights, democracy and the rule of law as essential elements of all the EU's partnerships and cooperation agreements with developing countries. Furthermore, Denmark has committed itself to apply a human-rights based approach in its development cooperation<sup>2</sup>. Consequently, entering into development contracts is only relevant where there is trust and confidence that state budget funds will be spent pursuant to these fundamental values shared with the priority country, and for the respect of which priority countries commit to move forward.

The issues to assess and subsequently monitor during implementation include the level of good governance, encompassing a minimum respect for human rights, a free press, pluralistic democracy and rule of law, including independence for the judiciary. During implementation the focus should be to identify the risk of slippage, policy reversals and deterioration.

#### **Box. 3.1 Human rights, democracy and rule of law: Elements to assess**

- The degree to which free and credible multi-party elections are held, or – where this is not the case to any degree – the extent of broad public legitimacy of the government, and citizen participation in political decision-making.
- The degree of respect for basic human rights as defined in UN conventions. Relevant criteria are the extent to which the country has ratified UN conventions, as well as, *inter alia*, the independence and efficacy of the judiciary system, the tolerance of independent media and of opposition groups, absence of torture and arbitrary detentions, and extent of gender equality.
- The government's willingness to improve regional security, peace and reconciliation, where this is relevant.
- Extent of operationalization of human rights principles in delivery of social services.
- Corruption can be included in so far as there may be fundamental breaches in the rule of law, but concerns related to public financial management and fiduciary implications will be dealt with under the PFM-criteria.

Human rights, democracy and the rule of law are highly interlinked issues. A good starting point in the assessment of basic human rights could be to consult the recent Universal Periodic Review (UPR) and also draw on international human rights organisations' report (Human Rights Watch, Amnesty International). The EU human rights country strategies should also inform the assessment. It will be highly relevant to draw on domestically and regionally-based governance assessments such as the African Peer Review Mechanism to assess democratic development, human rights and the rule of law. Also reports from UN special procedures, World Bank indicators, election mission reports etc. could be used. For further guidance on

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<sup>2</sup> "A human rights based approach to Denmark's development Cooperation" – Guidance and Inspiration for Policy dialogue and programming, 2013

sources please refer to the ‘strategic priorities for democratisation and human rights for the benefit of the people’ (2009)<sup>3</sup>.

### **3.2 Credible public policies and plans for poverty reduction, good governance and inclusive sustainable development**

Development contracts should only be established with priority countries with a national development strategy on poverty reduction of acceptable quality. Furthermore, adequate public sector implementation capacity is essential and a commitment and political commitment to the reform agenda as well as a trustful and progressing partnership between the development partners and the government.

The main issues that should be assessed under this criterion are the following:

- Solid (relevant and credible) poverty reduction strategy and political commitment to implement it.
- Commitment and efforts to address weaknesses in the public sector systems to implement poverty reduction policies.
- Positive experiences with development co-operation generally and budget support specifically, as well as on-going documentation of concrete development results (track record).
- Mutual observance of agreed obligations.
- A high level of consensus among budget support development partners regarding approach (incl. rules for transfer and monitoring) and conditions for general budget support.

#### **Box 3.2.: Public policy and development partnership: relevant elements to consider**

##### *Solid poverty reduction strategy*

- The inclusiveness of the process by which the national development strategy and related policies are developed and agreed (participation of the legislature, civil society, private sector).
- The quality of the national development strategy as a planning document, including the feasibility and consistency of the priorities, objectives, expected outputs, and the resource envelope available.
- The willingness to implement the strategy by allocating resources in the budget, i.e. the degree to which the strategy’s priorities are reflected in the annual budgets, actual expenditures and MTEF/MTEFs.

##### *Commitment and effort to address weaknesses in the public sector systems*

- The country’s commitment and capacity to implement the national development strategy.
- Quality of monitoring and evaluation of progress and results of the implementation of the national development strategy.

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<sup>3</sup> Click [here](#) to go to the strategy

- Implementation of key strategic reforms to improve public sector efficiency and effectiveness for poverty reduction, incl. management and effectiveness of the public sector, civil service reform, pay reform, and decentralisation, privatisation, or other relevant in the context.
- Implementation of sector strategies relevant to the programme for poverty reduction

*Positive experiences with development cooperation, including budget support*

- The partnership process linked to the implementation and monitoring of the national development strategy, the dialogue between the parties on its implementation.
- The track record between the government and development partners on the budget support including the ability to jointly address challenges and move forward constructively.
- Trends and developments in the group of budget-support development partners regarding their commitment and capability to find shared solutions to problems, agree on common approaches and a joint PAF, and the commitment to budget support based on a common approach.

The assessment relating to the national development strategy may be largely based on recent reports regarding the successful implementation of the strategy e.g. annual progress reports, IMF/World Bank joint staff advisory notes, etc. For the assessment of government's commitment and will to implement the reform agenda, elements of political analysis are needed. Often these are elaborated and presented in special studies by consultants or think tanks locally on behalf of development partners and are shared among relevant stakeholders. Inspiration can sometimes be found from Freedom House, Index of Economic Freedom or similar sources. More information on political stakeholder analysis can be found on [www.UM.DK](http://www.UM.DK)<sup>4</sup>.

### 3.3 Stable macroeconomic framework

One of the criteria for Danish budget support is a stable macroeconomic and fiscal framework to provide for the best potential for economic growth and development, and for a sustainable public sector. The term "macroeconomic stability" implies an economy where the vulnerability towards external shocks is minimized and hereby protecting the national economy against currency and interest fluctuations in the global markets and providing better conditions for private sector growth (see Box 3.3). A stable macroeconomic framework and fiscal sustainability is the foundation for poverty reduction by creating conditions for inclusive and sustainable growth and ultimately for the human rights objective.

**Box 3.3.: Macroeconomic Stability is measured along five variables**

- **Low and stable inflation** indicates healthy demand in the marketplace;
- **Low long-term interest rates** reflect stable future inflation expectations;
- **Low national debt relative to GDP** indicates that the government has sufficient funds (tax revenue) to address domestic needs.
- **Low deficits** prevent growth in the national debt.

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<http://amg.um.dk/en/~media/amg/Documents/Technical%20Guidelines/Capacity%20Development/ApplyingPoliticalStakeholderAnalysis2011.jpg>

- **Currency stability** allows importers and exporters to develop long-term growth strategies and it reduces investors' needs to manage exchange-rate risk.

The following issues regarding the macro-economic situation and public sector should be assessed as a minimum:

- Macroeconomic stability, including developments, prospects and policies on inflation, interest rates, balance of payments, the exchange rate, etc.
- The main components and drivers of growth including their sustainability and their linkages across the sectors of the economy, vulnerability to external factors and international developments, growth trends and prospects.
- Domestic revenue-raising in terms of the level of tax collection including from royalties and licence/concession fees on natural resources exploitation etc.: trends, prospects and policies, reforms and strengthening of systems regarding its volume and structure.
- Fiscal analysis with regard to developments, prospects and policies regarding the weight of the public sector in the economy, budgetary balance and its economic impact, domestic debt, the structure of the budget, budgetary performance, significance of aid for the budget.

Assessing the stability of the macroeconomic framework and the sustainability of the fiscal policies will often rely on available documentation and analysis provided by the IMF. Often the World Bank CPIA will contain useful information as well as any recently conducted Public Expenditure Tracking Surveys (PETS) or similar.

### **3.4 Adequate quality and capacity in the public financial management systems and progress on reforms including anti-corruption**

Evaluations have singled out public financial management (PFM) as an area where budget support has had positive impacts. The public financial management system should be assessed to confirm that it meets certain basic standards and to identify the improvements that are or will need to be undertaken before or during the budget support period.

The assessment should comprise the following issues:

- the entire budget process from planning, budgeting, budget implementation, reporting, and auditing, as well as from the legal and institutional frameworks and their operationalisation in organisational designs, procedures and rules down to the practical implementation, including the level of capacity and compliance with the formal framework.

- Anti-corruption policy framework with implementation of prevention and control measures and follow-up with a view to improving the country's standing in the international corruption league table

The Public Financial Management Performance Measurement Framework, PEFA, is a central tool when assessing the PFM system. It identifies key strengths and weaknesses in PFM systems, allowing governments to develop reform plans as well as providing a platform for reform dialogue between development partners and governments. This will develop a common understanding and help build a partnership between the government and international partners. Denmark recommends that a PEFA Framework is used as a starting point in assessing the basic elements of a PFM system.

**Box 3.4: The six critical dimensions of PFM systems covered by PEFA assessments**

- The credibility of the budget
- Comprehensiveness and transparency
- Policy-based budgeting
- Predictability and control in budget execution
- Accounting, recording and reporting
- External scrutiny and audit

A PEFA will normally be available for countries where Denmark considers budget support, although it may not be recent. If a PEFA process has yet to be established, the representations should explore the scope for initiating one with the government and other development partners.

The PEFA should not be used as a scientifically objective and comprehensive tool. Procurement is an important part of any PFM system needing more thorough and direct assessment than provided by the PEFA (contains only one indicator for procurement). Therefore the area of procurement systems will need additional assessment to ensure this eligibility criteria is fully addressed.

It is also important to consult documentation and insights directly from major partners in public financial management (including IMF, World Bank, EU, DFID, and other available public finance studies should naturally be consulted (PERs (Public Expenditure Reviews), PETS (Public expenditure tracking surveys), CPAR (Country Procurement Assessment Review), value-for-money studies, etc.). For further guidance on the assessment of PFM systems please refer to Danida's Technical note on Programme Support Preparation<sup>5</sup> (currently pending a minor update).

<sup>5</sup> See [http://um.dk/da/~media/UM/Danish-site/Documents/Danida/Resultater/Risikohaandt/TECHNICAL\\_NOTE\\_Final50.ashx](http://um.dk/da/~media/UM/Danish-site/Documents/Danida/Resultater/Risikohaandt/TECHNICAL_NOTE_Final50.ashx)

It is not a requirement for budget support that a country's public financial management system performs to international standards, and there is not a set minimum rating for budget support. A few partner countries have public financial management systems that meet international standards, and several have progressed considerably especially in the area of public financial management. An important part of the assessment is to confirm the commitment and effort to reform and strengthen systems and to verify that the development continues in the right direction.

### **3.5 Transparency and oversight of the budget**

A budget is a government's plan for the use of public resources to meet the objectives in the poverty reduction strategy and ultimately to meet the needs of the population. Budget transparency means that government discloses all relevant fiscal information on revenues and spending in a timely and systematic manner to allow for domestic accountability and public participation in governance processes.

The lack of information or a non-transparent budget doesn't allow for analysis of government's use of public funds nor can its implementation be effectively monitored. Consequently, the lack of transparency and democratic control of budget processes potentially leaves space for corruptive behaviour. Budget transparency is thus a criterion to assess when deciding on future Danish budget support.

More and better budgetary information will make it easier for national control bodies, like the parliament, auditors, local authorities, civil society organizations, and media to scrutinize the budget and hold decision makers accountable for collecting and using public funds effectively and efficiently and to call for policies that improve service delivery.

Effective oversight and scrutiny of the budget also requires that the national legislative and oversight bodies and internal control bodies have the capacity to undertake their functions of scrutiny and oversight. Therefore the capacity in these institutions should be assessed and it has to be considered how weaknesses are addressed e.g. through supplementary capacity development support interventions (see section 4).

The main issues to assess include:

- The eligibility criterion on transparency and oversight of the budget focusses on the timely availability of comprehensive and sound budget information ;
- The government has published either the Executives' proposal or the enacted budget within the previous or current budget cycle ;
- Satisfactory progress with regard to the public availability of accessible, timely, comprehensive, and sound budget information.

In recent years there has been a civil society movement to improve transparency in budget processes. The Open Budget Initiative (Initiative) - a global research and advocacy program – is an example of recent initiative to publicly inform about assessments of budget information for many countries worldwide. A number of developing countries have also enacted legislations to enhance public access to budget information. These government efforts have been aided by a number of international transparency standards developed to provide benchmarks for government performance. The International Monetary Fund’s (IMF) Code of Good Practices on Fiscal Transparency, provides a set of guidelines to establish a sound and viable transparency framework for fiscal policy. The IMF also publishes country reports on fiscal transparency, the “Report on the Observance of Standards and Codes” (ROSC) that measures a country’s performance against the IMF Code. The OECD’s “Best Practice on Budget Transparency” also sets standards for government performance.

Any form of budget support should always start with the assessment of the five criteria at country level. If the decision is to provide support in the form of a sector reform contract, criterion 2 and criterion 4 should be assessed at sector level. For further guidance on providing sector reform contract please refer to the Technical note on programme support preparation.

### **3.6 Risk Management**

Following directly and as part of the assessment of the five sets of criteria, a risk assessment outlining the risk scenario and possible ways of mitigating the identified risks should be conducted. This will accompany the overall assessment of the five sets of criteria to reach a conclusion regarding the feasibility of a development contract. The guidelines for risk management (at AMG.um.dk) will provide the overall guidance for risk management throughout Denmark’s development cooperation. Furthermore, the Technical Note (Section II.3) may serve as inspiration.

## **4. ELEMENTS TO INCLUDE IN THE DESIGN OF THE DEVELOPMENT CONTRACT**

The elements that should be included and detailed in the budget support package in order to exploit the contract-effects include:

- The funds and criteria for disbursement;
- Policy dialogue on critical development issues;
- Performance mechanisms;
- Monitoring of performance.

Furthermore, and to complete the package, support to capacity building and strengthening of systems in key areas for instance identified in the risk assessment can be considered as corresponding elements of the package. These activities can both be financed as part of the development contract or through the complementary programmes in the country to enhance the elements in the package and create synergies with existing programmes.

The design of the budget support package should reflect the Danish country policy and programme, the role of the development contract in relation to other support areas and the interlinkage and possibilities for synergy. Typically there will be a very close correlation with the programme for good governance. They should be mutually supportive in achieving the objectives and results agreed with the government, and they should reflect the strategic approach that has been defined for the specific Danish budget support programme as an element in the overall country programme support.

The level of detail in the description of the budget support design should be carefully balanced. There should be enough detail to clearly show the focus, coherence, and main content at the formulation and approval stage, but the description should allow for a certain level of flexibility for the Representation to manage the support strategically and address challenges and exploit opportunities during implementation. The success depends on the implementation process and thus the ability to react to emerging opportunities.

The sections below highlight the main principles that should guide the design of each of the elements in the package.

Pointers on the implementation are summarized in section 6.

#### **4.1 Funding**

The Danish country programme will always be the starting-point for the decision regarding the level of funding. The decision should be taken based on the objectives, needs, possibilities and risk assessments in each case.

The following elements defined by the EU should be considered when deciding the funding levels:

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

- Result orientation in the partner country's development strategy including a monitoring system.
- Each factor may be judged as high, medium or low, allowing an overall but not too mechanistic assessment of the elements.

## 4.2 Policy dialogue

Budget support is the only form of support fully under the democratic control of parliament. Furthermore, budget support programmes should not be seen separately, but in conjunction with other efforts within the country programme. Accordingly, the policy dialogue as an element of the budget support package should include issues of human rights, anti-corruption, transparency and accountability in relation to e.g. financial management, etc. The respect for basic human rights will be an integral part of the policy dialogue carried out in the context of budget support.

Budget support thus provides opportunities for policy dialogue with the priority country on a wide range of relevant cross-government policies and reforms for poverty reduction: Government expenditure allocation; resource mobilisation/tax, the efficiency and effectiveness of core government systems and implications for service delivery levels. The policy dialogue should to the extent possible be focussed on promoting particular reform areas that in each context are assessed to be most critical for achievement of the specific objectives of the budget support regarding poverty reduction.

At the same time based on the lesson that the budget support dialogue is sometimes overloaded with issues resulting in large and unwieldy performance assessment frameworks (PAFs), Denmark should encourage a focussed dialogue on a confined and manageable set of issues. These should be selected to reflect the jointly agreed issues of most central importance for achieving the specific development goals of the budget support in the context.

Denmark should normally select a few (1-3) policy areas which we will take special responsibility for promoting and attending to in the dialogue. The issues should be selected from the processes and goals defined in the joint PAF, which Denmark has participated in defining. Often the Danish area(s) of responsibility will be based on division of labour between development partners, which may be more or less formalized. In accordance with “the Right to a Better Life”, table 2.2. suggests a framework for deciding on the issues which Denmark may want to focus on within the joint frameworks. The opportunity to draw on Danish knowledge and presence in other sectors or thematic areas should also be considered in the choice of Danish focus areas (e.g. social sectors, public financial management, governance, climate, green growth, or other).

The policy dialogue should cover both process (formal and informal meetings, consultations, and processes) and content/substance such as e.g. sector policy and performance indicators. It may address not just the policy elements of the budget support operation, but also the wider context if important for achievement of the objectives.

The policy dialogue should also be seen as a key element in the risk management (mitigation) of the budget support. Risks rated in the risk assessments as likely or possible and with major impact may be addressed as core issues in the dialogue during implementation of the programme.

Finally - and not least - budget support provides an opportunity for policy dialogue with the government on the priorities of the country's public resources and the development of strategies, policies, etc. Denmark will advocate the rights based approach - for example, inclusion and non-discrimination in policy development, hold the government accountable for its obligations to provide basic services (including through priority to the social sectors in the national budget).

### **4.3 Performance mechanisms and the use of tranches**

Denmark strongly supports the principle of predictability in budget support payment. We believe that a higher priority should be given to predictability in countries that are more aid dependant. At the same time an enhanced political focus on the achievement of results makes the linking of results to payments an integral part of the development contract holding governments accountable and linking disbursements to realistic plans and achievement of results. It is thus important to have a functioning and reliable system for monitoring progress in place against which the performance can be assessed

The conditionalities are usually defined in the Performance Assessment Frameworks (PAFs) as performance indicators with associated targets and deadlines. The performance indicators signal the issues which are perceived to be of special importance to the partners in view of the objectives of the programme. They define where the government is expected to concentrate attention and implementation efforts and where to focus the monitoring and policy dialogue.

The performance mechanism consists of payment tranches linked to the achievement of results or processes reflected by indicators and targets in the PAFs. The mechanism should reinforce rather than be a constraint on development efforts and at the same time strengthen the government's incentives to move forward on critical reforms.

Experience has shown that in practice a multitude of approaches are used by various GBS development partners with a mix of different tranches and payment-mechanism. Denmark wishes to harmonise to the extent possible, and consequently designing the "Danish" support in a manner that reflects the mechanisms and features used locally is encouraged.

The payment tranches are normally designed based on the following principles:

- Fixed tranches linked to the overall development in the five sets of criteria (often called the underlying principles) for the provision of budget support, the development in the macroeconomic situation (often assessed by IMF) or progress in the implementation of the poverty reduction strategy.
- The variable tranche is normally linked to progress on indicators for specific policy areas of strategic importance for the objectives of the budget support on poverty reduction.
- The size and phasing of the variable tranche should be set with a view to ensuring adequate incentives to reform, payment linked to results *and* to avoid excessive unpredictability in the disbursements. Harmonization of the variable tranche with other development partners should be prioritized.
- The indicators for the variable tranche should be selected from the performance assessment framework in agreement with the national authorities and in coordination with the other development partners.
- Ensure that assessments and decisions regarding disbursements take place in a timely manner to support the budget execution for the fiscal year into which the funds are disbursed (predictability).
- Funds that have not been disbursed due to less than full achievement of performance targets should as a general rule be returned to the Danish authorities. An exception to the rule could be to provide a smaller amount of funds to a local civil society organisation to support activities that address the issues behind the lack of performance. Hence, the funds should strictly be disbursed to non-government institutions. The proposal should be sent to the Undersecretary for development for approval.

A general experience is that budget support development partners may use different tranche structures (fixed/variable), and that development partners may not be harmonized in the indicators and targets linked to the payments.

It is often debated if larger variable tranches have a stronger incentive effect or whether recipient countries are sensitive to the signalling effect of any reduction in payments due to lack of performance in certain areas. Denmark aims at linking payment closer to results and is interested in gaining experience with the various forms of results-based financing.

The Danish approach to design of the performance mechanism and choice of indicators, targets, and triggers should always be to seek harmonisation with other likeminded

development partners including the EU. At the same time it is important to strike a balance between creating incentives and to maintain a large level of predictability in payments.

#### **4.4 Monitoring of performance**

The frameworks for the joint monitoring of performance by the government and development partners should be the primary basis for measuring and having dialogue on progress with regard to the budget support. It should be used as a forward-looking tool to identify policy slippages and to reach a common understanding on measures for meeting policy objectives, or refine objectives and targets if necessary.

In practice the performance frameworks vary a great deal between the partner countries in size, organisation and in the level of indicators at strategic or detailed input or activity level. Often the frameworks are recognized by the partners as being too large and complex with indicators focused too much on detailed activities and processes rather than strategic results and reforms. The transaction costs involved for both government and development partners in compiling and conducting the dialogue based on the overly complex monitoring frameworks are recognized as being a significant challenge.

Denmark should actively support efforts that reduce the transaction costs linked to the performance frameworks. Denmark should follow a harmonized approach in the promotion of particular indicators to include in the frameworks, especially with likeminded development partners, and be proactive in reducing the size and complexity of the frameworks as well as ensuring that they focus on strategic issues rather than detailed activities.

In practice the frameworks tend to be organized in a way that mixes indicators linked to the basic criteria for providing budget support (e.g. macro-economic stability, human rights, democracy, rule of law, public financial management, anti-corruption, etc.) with indicators linked to any context-specific strategic policy areas for achieving the specific objectives of the budget support linked to poverty reduction (e.g. equitable service delivery, agricultural productivity, or other).

In some countries joint efforts have been initiated to separate these two sets of indicators, which can help focus the dialogue and reduce the transaction costs. It may also create a more clearly demarcated and shared set of indicators for linking the fixed and variable tranches.

#### **4.5 Strengthening key reforms and systems for accountability, transparency and democratic participation**

The budget support package should include direct support to strengthening of the specific reform processes and capacity development needs assessed to be key for achievement of the budget support objectives in the actual context.

In particular, strategic support to strengthen selected elements in the mechanisms for promoting accountability, transparency and democratic participation, should be used to reinforce the effects and sustainability of the policy dialogue and performance mechanisms of the budget support. The interventions should be selected to unblock specific capacity constraints on the government side - and strengthen the effects that transparency, accountability and participation in the budget process and execution may have on stimulating a government to move forward on reforms.

The focus of the capacity development and support to reforms should be determined primarily by considering the needs and possibilities in the context *and* the ability of Denmark to add value to the area. With this point of departure the following focus areas should be considered:

- Capacity for policy analysis, national monitoring and statistics systems to strengthen government's capacity to formulate and follow up on effective strategies to address poverty reduction and respect for human rights;
- Measurement, publicising and follow-up on results to enable transparency, accountability and learning based on results;
- Public financial management, tax reforms, including the level of tax collection as well as capacity in tax administration to strengthen accountability and transparency and sustainability of the reforms;
- Supreme audit institutions, judiciary bodies, internal audit and control institutions for transparency and accountability;
- Public sector reforms and public administration to strengthen the systems and processes centrally and locally to deliver services effectively, efficiently and meet basic quality standards;
- Strengthening of the role of parliaments to exercise their political control over government's budget execution;
- Strengthening of social accountability mechanisms for enabling citizens to hold government accountable for the public budget at local and central government level.

A Danish country programme normally includes targeted support to selected institutions and actors in the area of good governance, human rights, democracy and rule of law (e.g. through a designated programme support). This reflects the Danish perspective on the intervention logic for budget support (see section 2.2) where budget support is one of several instruments to

support improvements in human rights, rule of law and democracy in a priority country. The instrument needs to be supplemented by direct and comprehensive support to the concerned sectors and institutions in the field of human rights, democracy, and rule of law in order for the overall support to be fully effective.

A Danish country programme may also in parallel to the budget support package include specific support to strengthening of accountability and participation in the budget process by civil society. The support may be targeted and selective, or it may be comprehensive, depending on the needs and possibilities in the context. The scope and relevance of support to think tank-type civil society organizations as well as grass-root civil society organisations should be considered. The choice of supporting either one or both types of civil society organizations in combination should take into account how each may add value from their vantage point to awareness creation (e.g. on human rights), monitoring, and advocacy through analytical input and monitoring of service delivery at the front-line level in communities.

The basis for deciding how to organize the elements in the budget support package in relation to the support outside of the package will be the Danish country programme (see box 5.4.)

**Box 4.1: Organizing supplementary interventions in a budget support programme or separate programme - examples**

Danish support to public financial management through a joint-mechanism which addresses the same reform issues, and requires the same discussions and technical competences, as the budget support may be organized most effectively under a budget support programme. Similarly, support to strengthening of tax systems, statistics, policy analysis, etc. through capacity development efforts may also be placed more effectively in a budget support programme.

Support to strengthening the role of parliaments, anti-corruption or the role and capacity of civil society could well be covered by a Danish budget support programme, but only if the components are few and simple. More comprehensive and complex support to these areas may be organized more effectively in a Danish supported good governance, human rights and democracy programme.

Support to the process of elaborating a legal framework for promotion of green growth in private sector production could be supported in the context of a budget support programme. It could be designed to promote synergy in providing for better conditions in the implementation private sector activities in another programme.

The focus of the capacity development interventions should be selected based on the strategic objective of the budget support operation on risk management as well as a capacity needs assessments. It should fit the context and build on existing capacity and be based on a clearly expressed demand from the partner and specified results and expected outcomes. They should be provided through harmonized and aligned approaches. It may include direct capacity

development support as well as support to processes and outputs that contribute to move reforms forward.<sup>6</sup>

## **5. THE PREPARATION, FORMULATION AND APPROVAL PROCESS**

The preparation process for a development contract, sector reform contract or state building contract is the same as for any intervention (or programme) as defined in the Guidelines for Country Programmes (2013). With the point of departure in these guidelines, the following pointers are relevant to consider when preparing, formulating and approving a budget support intervention in particular.

### **5.1 Preparation stage**

To identify the possibility of carry out a joint assessment of the criteria and identify possibilities for joint formulation of a development contract is an important part of the preparation stage. Apart from this, the preparation stage contains:

- Undertaking an assessment of the five sets of criteria outlined in section 3. See relevant annex in Guidelines for Country Programmes (2013). The evidence for the assessments should include assessments by the EU, other DPs, and any relevant additional sources including think-tanks, NGOs, etc.
- Identifying as part of the assessment process any information needs and gaps to be addressed during the formulation phase by additional studies/assessments. Include these in the process action plan (PAP). Consider in particular the need for capacity needs assessments.
- Assessing the risks to determine whether these are likely to be outweighed by the mitigating measures and expected benefits during the identification, formulation and implementation phases.
- Preparing the conclusion regarding the justification and feasibility of budget support based on the assessment of five sets of criteria. Establish based on the assessment the category in table 3.1., where the country should most accurately be placed. The conclusion should take into consideration the risks and expected results, including

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<sup>6</sup> Danida's note "Addressing Capacity Development in Danish Development Cooperation" (Danida, 2011) advises on the guiding principles and operational steps to follow when preparing and designing capacity development support.

effects from the elements in the budget support package and mitigation measures. The conclusion should include a clear argumentation.

- Preparing a *preliminary design of the budget support intervention* based on the elements in the budget support package, and related principles outlined in section 5. The process to design a development contract, sector reform contract or state building contract should follow the normal consultative and analytical procedures in accordance with the Guidelines for Country Programmes (2013).
- Presenting the conclusions and summary of the assessments of the five sets of criteria in the *Concept Note* as well as the preliminary proposed design and other required sections and elements. Presentation to the programme committee.

## 5.2 Formulation process and appraisal

During the preparation phase, the assessment of the five sets of criteria might have indicated areas needing additional studies or analysis. These should be carried out in time for the results to be ready for the appraisal of the intervention. The studies might result in a need to identify and formulate support to strengthening of key reforms and systems for accountability, transparency and democratic participation through capacity development or other elements in the budget support package. As mentioned above, the design of the support to capacity development should be based on a capacity assessment of the organisation(s) concerned.

Referring to the Guidelines for Country Programmes (2013), another important element of the formulation and appraisal phase is the formulation of safeguards related to the risks identified and assessed during the preparation phase. The Technical Note on Programme Support Preparation (Section II.5) suggests a way to present these.

The documents to make up the underlying programme documentation will vary from case to case but relevant documents include the national development policy supported, summary of key selected analysis, a Memorandum of Understanding (MoU) or similar, and the Performance Assessment Framework.

### **Box 5.1. Important elements in a programme support document as input to an outline of intervention documentation:**

- Experience of previous budget support or similar programmes.
- Results hierarchy and expected impact.
- Assessment of the poverty reduction strategy and/or national development policies and implementation.
- Assessment of the macroeconomic and fiscal framework.

- Assessment of governance.
- Assessment of the public financial management system, budget process and reforms.
- Analysis of risks and presentation of risk management.
- Management of the budget support.

*Appraisal (TAS):*

Conducting the appraisal in accordance with the Guidelines for Country Programmes (2013) and would be part of the appraisal of the country programme. An appraisal of the budget support interventions should put particular emphasis on: The assessment of context issues, especially the five sets of criteria; the relevance and coherence of the “package”; risks assessment; the justification and rationale of the support in view of the expected risks and results. The budget support mechanism and donor-government partnership should also be emphasised in the appraisal.

The Representation assumes the full responsibility for follow-up to the appraisal report in order to ensure that all recommendations from the appraisal are incorporated in the final version. If an appraisal recommendation is not followed, the Representation must specify the reasons in the table summarizing the recommendations. A summary of appraisal recommendations and the Representation’s comments is forwarded by the Representation to the Under-Secretary for Global Development and Cooperation and TAS at least five weeks prior to the country programme being submitted to KVA for the Grant Committee.

*Finalizing relevant agreements (The Representation):*

The government agreement for a development contract will usually be part of the country programme. It will usually reflect the joint agreements based on the common mechanisms described in Joint Financing Arrangements (JFAs). The agreements - i.e. the MoU or similar - relating to such common mechanism will be a key part of the Government Agreement.

**Box 5.2.: The three typical parts in a government agreement for general budget support:**

- A bilateral agreement between Denmark and the priority country – either as part of the agreement for the whole country programme (or an element hereof) or as a separate agreement.
- A Memorandum of Understanding (annexed to the agreement) – often the Joint-Financing [Arrangement/Agreement] - describing the joint budget support mechanism with details on funding arrangements, disbursement, reporting, monitoring, etc.
- A common Performance Assessment Framework (PAF), which is a matrix of performance indicators with associated targets, deadlines, etc. for monitoring and review. The PAF embodies the conditionality related to the budget support operation, and is typically annexed to the MoU/JFA, although the indicators and targets included in the PAF are usually updated annually.

## 6. IMPLEMENTING A DEVELOPMENT CONTRACT

During the implementation of general budget support a substantial amount of the work takes place in the donor-government coordination frameworks and workgroups for budget support within which donors are assigned specific roles. Denmark will to the extent possible assume roles which correspond to the particular fields of expertise available at the representation or that provide possible areas of synergy with other parts of the country programme.

The main elements in the implementation of a Danish budget support package are:

- Participation in the on-going dialogue and follow-up on the progress and reform processes, through formal and informal processes;
- Follow up and administration of progress reports
- Follow-up and engagement in the Danish supported capacity development support efforts;
- On-going monitoring and assessments of development in the situation regarding the five sets of budget support criteria
- Performance assessments and disbursements of funds via the fixed and variable tranches
- On-going risk reporting and risk management

The following comments on some of these elements:

### 6.1 Follow-up on progress and reports

#### *Progress reports*

The MoU or Government Agreement should specify reporting requirements which include some or all of the following relevant documentation:

- Annual progress reports on the implementation of the poverty reduction strategy, including macroeconomic performance and data on outputs, outcomes and impact from the poverty/sector monitoring system
- Annual reports on implementation of specific measures and achievement of specific targets as agreed in the Performance Assessment Framework.
- Annual State Budgets and updated Medium Term Expenditure/Fiscal Frameworks.
- Any diagnostic reports, assessments or reviews agreed as part of the monitoring system. This could include, for instance, PEFA assessments, Public Expenditure Reviews, Public Expenditure Tracking Studies, or reports from anti-corruption bodies.
- Any other reports, as agreed, on the implementation of the national development strategy.

#### *Financial reports*

The MoU/JFA and/or the Government Agreement should specify the financial documentation required by development partners. Core financial reporting includes:

- Regular reporting on in-year execution of the State Budget (typically quarterly).
- Annual State Accounts for the previous financial year as presented to the national legislature. This is the mechanism of accountability for budget support. This annual statement should include a specification on the revenue side of the accounts of the budget support received from individual development partners.
- Account statements on the flow of budget support into the central treasury account, including confirmation of receipt of budget support in foreign currency by the central bank, as well as proof of exchange and the corresponding amount in local currency that has been credited to the treasury account.
- A letter of confirmation of budget support received after each disbursement by Denmark, specifying the amount received in foreign and local currency.

### *Audit reports*

The JFA and Government Agreement should specify the documentation required by development partners in terms of audit reports. Core audit reports are:

- The annual report on the audited state accounts from the National Audit Office (NAO) as presented to the legislature. (Regarding the timeliness of these reports, Denmark accepts the legal requirements of each partner country. However, if the NAO does not abide by these, this constitutes a risk, and mitigation measures should be put in place, e.g. by focusing on it in the dialogue, supporting the NAO, etc.).
- The legislature's formal comments on the annual audit report.
- Annual audit report verifying the flow of funds from the foreign exchange account to the central treasury account (often relevant to ensure that budget support funds are made available for public expenditure, rather than accumulated as reserves).
- Regular performance or value-for-money audits of samples of activities relevant to poverty reduction. (The purpose of such audits of selected flows is to add value to audits carried out by the NAO, which are often only financial audits. Such performance audits should be carried out at least once during a three-year period. They will usually be agreed upon at the annual review.)

## **6.2 Policy dialogue**

The policy dialogue is at the centre of the follow-up on development contracts and part of the budget support package. The formal structure and process defined for the policy dialogue in a country will normally determine the main opportunities for the development partner group (and Denmark) to raise and promote particular policy or reform issues with the government.

Specifically:

- The process is typically structured in annual reviews and regular sessions throughout the year - the intervals vary between countries anywhere from monthly to quarterly and semi-annually. It is typically structured according to different levels (technical, head of development cooperation, and head of mission).

- Formally the policy dialogue will focus on the issues defined in the performance assessment frameworks and the reports provided by the government in accordance with the MoU/JFA or similar agreement. The annual updating of the performance assessment framework and review is an important part of the policy dialogue.
- Denmark aims to address the issue of domestic revenue mobilisation and equal distribution and sustainable economic growth

The experience from budget support interventions with Danish participation is that the mechanisms for the policy and political dialogue tend to be clearly defined, but they vary in their structure and content between countries. Within countries the design of the mechanisms evolve over time, especially regarding how issues are processed and move up from the technical to policy and political levels as well as between sector and cross-sectoral groups. Much of the debate can be occupied by discussions on the structure of the mechanisms itself, including on the division of labour between sector and general budget support working groups; heads of cooperation/heads of mission-levels; and definition of structures for the political dialogue on any particularly critical topics.

Denmark is committed to the agenda of aid effectiveness and will participate in coordination, where at all possible dialogue through the forums established for that purpose and promote “lead donor approach” arrangements where development partners divide the work related to the dialogue between them in order to minimize transaction costs for government as well as development partners. Danida should avoid too frequent and detailed discussions that blur the division of roles between government and development partners and raise the transaction costs.

Since mutual trust is important for an effective budget support dialogue, the Danish Representations should work actively to sustain and develop this trust by keeping close relations with other development partners and relevant levels and sectors in government.

There will normally be occasions at technical level for joint work-processes between government counterparts and representatives of the donor group (e.g. around the development of particular programme interventions, monitoring, system development, sub-strategies or action plans, or other). When driven by the government counterpart, such collaboration can be highly valuable, both in terms of its direct results and to strengthen the mutual trust that will facilitate the policy dialogue at higher levels between government and development partners.

Denmark should exploit collaboration at the technical level as an opportunity to add value. At the same time since normally such involvement can be demanding in terms of resources, Danish Representation should carefully consider its capacity and resources to participate.

### **6.3 Disbursements**

The government agreement should clearly indicate the schedule of planned disbursements including specifying the sums of disbursement and the triggers required for disbursement of these planned amounts. In many cases the triggers will be determined in a rolling assessment, decided upon in a joint forum. The aim should be to ensure maximum predictability for the government by the Representation making the disbursements according to the agreed timetable, provided that agreed requirements and performance criteria have been met. Good practices regarding the timing and spacing of disbursements and use of triggers for disbursement should be observed.

In practice the tranches and payments of Danish budget support programmes are often adapted to joint-mechanisms in the specific country due to Denmark's adherence to the principle of harmonization.

There are "huge differences" in the number of indicators in the PAFs of the different countries, including on the balance between macro-economic and social indicators. Anti-corruption and PFM issues appear to dominate the triggers in the variable tranche, but mostly of a process indicators (input) type.

### **6.4 Review processes**

The annual reviews are held by the partner government together with the budget support development partner group. The Danish approach to participation in the annual reviews of budget support follows the general procedures for reviews described in the Guidelines for Country Programmes (2013), although the issues listed in the guidelines for programme management will need to be adapted to the budget support context.

The annual cycle for the budget support is normally organised to match the annual budget process and the reviews linked to the national development strategy (poverty reduction strategy, or similar). Denmark should always work for reviews to be timed as appropriately as possible for the national budget process, thus enabling the development partners' commitments for the following year to be integrated properly into the government's budget preparation process.

The experience in some cases has been that considerable time is spent on the discussion of technical aspects of indicators and targets or process issues. Since this may take time away from dialogue on more strategic policy issues, Danida should promote that discussions focus mainly on higher-level strategic issues and indicators.

In cases where a Danish development contract, sector reform contract or state building contract includes other components than budget support in a narrow sense (such as institutional support, public financial management, public sector development, social

accountability, etc.), the review cycle and partner group can differ from that of the budget support.

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