



## **PROGRAMME AND OPERATIONAL GUIDELINES**

# **UNDP ROLE IN A CHANGING AID ENVIRONMENT: DIRECT BUDGET SUPPORT, SWAPS, BASKET FUNDS**

**A UNDP Capacity Development Resource**

**Capacity Development Group  
Bureau for Development Policy  
United Nations Development Programme**

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## Executive Summary

### The Premise:

UNDP's comparative advantage in the changing aid environment, that includes DBS, SWAPs and pooled funds, is to position the organisation around our proven strengths in capacity development, policy advisory services, human development advocacy and support to development programme implementation, founded on evidence based analysis and practice.

### The Current Context:

- OECD DAC estimates that for 2004 DBS will provide up to one-third of total aid flows. Bilateral donor specific estimates seem much lower, with DBS estimated at 5-10 per cent of their ODA contributions. Aggregate published data on DBS is not available.
- The theoretical underpinnings of DBS follow those of PRSs and the H&S agenda.
- Strengths and weaknesses of managing and monitoring DBS, and some assurance of predicatability of DBS flows, are linked most directly to a country's public administration capacities and public finance management policies and practice.
- It remains the case in many countries, that not all ODA and other external flows get recorded on and accounted for in the national budget.

### Early Lessons:

- Budget support can reinforce the centrality of the budget process, and empower MOF. However, it does not address the issue of non recorded external financial flows to a country. Greater attention has to be paid to formalizing external financial flows, and have them recorded and monitored through the national budget.
- DBS has increased government control over aid. It has also provided donors with increased access to and involvement in setting the policy agenda in countries.
- DBS can insert an element of uncertainty into national planning and programming, given possible volatility of DBS flows.
- DBS is expected to reduce transaction costs for both governments and donors.
- There has not been enough analytical and empirical evidence as yet to assess the impact of DBS on development outcomes, or to speak to 'best practice.'

### Three Typologies of Engagement for UNDP:

- Support to CD for national management, monitoring and implementation of DBS.
- Provide targeted support services for an improved management of pooled or basket funds to the government and donors
- Providing funds in specific settings into non-UNDP managed basket funds.

### Priority Action Areas for UNDP Capacity Development Support to DBS/SWAPs:

Ten areas of support have emerged through the ongoing knowledge network and country discussions, across regions, as a *menu* in which UNDP can provide a country specific value-added role in response to government requests in managing a new aid environment.

1. Analysis and policy support for national and local development strategies
2. Mapping of development finance needs and sources of funds
3. Negotiating DBS, SWAPs and pooled funds.
4. Inter ministry coordination mechanisms for policy and budget planning
5. Public Finance Management
6. Public administration reform and decentralization
7. Democratic governance with focus on legislative oversight and anti corruption.
8. National mechanisms for aid management and harmonisation
9. Management support to basket funds (overall fund manager or service provider)
10. National (independent) monitoring and evaluation systems

**UNDP engagement in basket or pooled funds:**

- UNDP would not provide funds directly into Treasury whether for balance of payments support or general budget support.
- UNDP can provide a service function as manager of a basket fund, on request of government. If the basket fund is managed by UNDP, then existing UNDP fund management and cost sharing arrangements apply.
- UNDP could participate in and contribute to a basket fund, managed by a non UNDP entity (be it government or other), through a formal agreement with government as to the programme or sector specificity of results, if such a fund is based on internationally acceptable accounting, monitoring and results management standards. The UNDG Harmonised Cash Transfer Modality could be used as the basis for determining the risk level of transferring monies into the basket. UNDP's specific role and contribution to these activities and results would be detailed in a legally binding project document that should be cleared at the regional bureau level prior to signature. Justification should be provided highlighting the strategic nature of the contribution in supporting UNDP's positioning as a service-oriented organization in subsequent development investments.

**Implications for UNDP Capacities and Organization – What Do We Need To Do?**

- Systematic review and application of diagnostic tools, particularly in areas of MDG needs assessments, capacity assessments, RBM and evaluation.
- Economists and sector specialists in key areas at country level, with CD profiles.
- Assess and deepen CO capacities for fund management, procurement services, and accountability systems. Includes the need to negotiate standard international contract rules and procedures to facilitate use of UNDP fund management services.
- UNDP financial policies and procedures would need to be adjusted to accept financial reports on pooled funds, reporting on an apportioned amount per UNDP inputs.<sup>1</sup>
- Review and update the role of UNDP and the UN RC in support to national aid management functions in the changing aid environment in the follow up to the Paris Declaration.<sup>2</sup>

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<sup>1</sup> The suggested actions in Section 5 contravene financial regulation 1805, which requires separate tracking and reporting on UNDP finances. This would therefore have to be amended.

<sup>2</sup>The UNDG has issued an action plan for follow up actions to the Paris Declaration, including, for example, a requirement that the UN system align with national strategy, reporting and monitoring systems.

## Section 1

### **INTRODUCTION: WHY GUIDELINES, AND WHY NOW?**

A sea-change is taking place in our international development community, reflected in relationships between governments and donor agencies, and in ways that development programmes are funded, implemented and managed. A global consensus<sup>3</sup> has emerged on the imperative of meeting the Millennium Development Goals (MDGs), and the specific, time bound targets associated with each goal. Where countries require external assistance in PRSs, governments and donors are under increasing pressure to find how best to work towards MDG achievement, based on national ownership and empirical evidence.

Following the end of the Cold War, the analysis of ODA and its impact has been based on more objective criteria of aid effectiveness, and new questions have arisen around the complex processes of ODA transfers, as well as the way aid monies are actually spent. Recent widely publicized research<sup>4</sup> has suggested that only about 20 per cent of aid actually gets to the neediest. Furthermore, as much as 40 per cent of ODA may be tied up in 'round tripping'<sup>5</sup> and other practices of procurement.

International attention has also intensified on traditional methods of financing (funding through 'development' rather than 'core' budgets) and implementation (through parallel project units and processes rather than through government ministries or other state institutions). UNDP's extensive work on the 'Programme Approach' in the early 1990s<sup>6</sup>, laid the ground for giving primacy to national policy and programme instruments as the framework and guide for development cooperation. It was also proposed at that time, that development finance should be both more predictable and coordinated in their funding of development programming through such national frameworks. The Learning Network on the Programme Approach (LENPA) was formed to pursue this work under OECD DAC.

Today, there is an increased interest among a group of donors to use one such financing instrument, direct budget support (DBS), that provides development finance directly through national budgets. The OECD DAC estimates (2004) that DBS will provide up to one-third of total aid flows in the immediate future. In some countries in the Africa region, it is already close to 30-40 per cent of total aid flows in 2004.<sup>7</sup> However, little data is published on DBS at this time, and hence an aggregate picture on aid flows through DBS is as yet unavailable. Whether this is to be the instrument of choice to facilitate an increasing disbursement of aid, or one which serves to diversify development financing instruments but to soon plateau, remains to be seen.<sup>8</sup>

The theoretical underpinnings of DBS, which follow those of Poverty Reduction Strategies (PRSs) and the Harmonisation agendas, emphasize government ownership and management of their own development process, and donor alignment behind it for greater aid effectiveness and impact

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<sup>3</sup> A consensus which coalesced over several years, through the 2000 Millennium Summit, the 2002 Monterrey Conference, UN Triennial Comprehensive Policy Reviews in 2001 and 2004, the 2004 Rome Declaration and 2005 Paris Declaration on Aid Effectiveness, and GA RES 56/201, calling for full harmonization by end 2004.

<sup>4</sup> OXFAM International. *Paying the Price. Why Rich Countries must Invest Now in a War on Poverty.* Oxford, England 2005

<sup>5</sup> 'Round tripping is an operation whereby an investor purchases the debt at a discount from a creditor, receives the local currency payout from the debtor government, and instead of investing the money in a local project buys foreign currency and transfers it out of the country, reducing, thus, the debtor country's foreign exchange reserves.' Source: Executive Committee on Economic & Social Affairs. May 20, 1999 <http://www.un.org/esa/coordination/ecesa/eces99-2.htm>

<sup>6</sup> UNDP. *Programme Approach Guidelines.* New York 1990.

<sup>7</sup> Uganda, Tanzania, Zambia, Malawi, Mozambique, Ethiopia, Kenya, South Africa.....

<sup>8</sup> A current diagnostic of development financing trends and instruments is provided by Sagati, Bezanson and Prada, 'The Future of Development Financing: Challenges and Strategic Choices', IDS-SIDA May05.

on poverty reduction. DBS is in its early stages as a development financing mechanism, although some would argue this has been the modality for financial resource transfer by IFIs over time, and its effectiveness not yet well understood<sup>9</sup>. While DBS has been endorsed and increasingly practiced by some donor agencies over the past two years in select countries<sup>10</sup>, the practice still necessitates careful management to allow for accounting back to the donors' own governments and stakeholders/taxpayers<sup>11</sup>, as well as by receiving governments to their citizens.

***The DBS readiness test:***

The litmus test for a country's preparedness to manage and use DBS in transparent, efficient and results oriented ways often centers around the capacities of national institutions and systems to direct and monitor DBS. Of specific concern are: the lack of internationally recognized norms and standards for accounting and procurement, an inadequate legal framework for contracting and business procedures, insufficient parliamentary oversight on budget allocation and use, and inadequacies in public financial management (PFM)<sup>12</sup>. A capacity development focus to these issues is therefore at the heart of the role that the UN and UNDP can, and must, bring to the table. For instance, while most donors have focused in the past decade on "what" PFM reforms should look like, e.g., enhanced practices and procedures of organizations, only few have already reflected on "how" capacity development in PFM takes place.<sup>13</sup>

According to a number of studies<sup>14</sup>, these shifts in the management environment for ODA have ushered in a new atmosphere of clustering or 'crowding-in'<sup>15</sup> of donors, as well as a marked need for more integrated and endogenous capacity development (CD)<sup>16</sup> at all levels of government (and all other national stakeholders). DBS is premised on an investment in capacity development over time, including in anticipated gains in public finance management, designing and implementing more effective poverty reduction strategies, and the ability to generate, manage and account for both domestic and external resources in effective and transparent ways. For UNDP, the key issue here is to support countries in negotiating, recording, managing and monitoring their ODA funds on the formal national budget, and not have the scatter of a multitude of separate projects and initiatives for which external financing comes in, but which is not recorded on the official budget. This is critical for aid effectiveness. It is then up to the government and donors to agree on which funds best go directly through the national budget, ala budget support, and which take other forms.

It is therefore important to emphasize the complementary roles that international agencies can play in such a DBS environment. The discussion on the value added that each donor brings to the national DBS discussion should therefore not be a polarizing one, but focus on ensuring mutually reinforcing and complementary roles.

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<sup>9</sup> See Hauck et al. EC Budget Support: Thumbs Up or Thumbs Down? ECDPM 2005.

<sup>10</sup> Illustrative examples are Tanzania, Uganda, Ethiopia, Viet Nam, Bangladesh and The Philippines.

<sup>11</sup> 'DFID is accountable to Parliament for how UK taxpayers' funds are used. We have a duty to ensure that development assistance is used to promote poverty elimination. Where aid is provided directly to partner governments through direct budget support, we evaluate the strength of public financial management and accountability and support governments to implement a programme of improvement'. DFID March 2005.

<sup>12</sup> OECD/DAC Good Practice Note on Capacity Development in Public Financial Management. Oct 2004.

<sup>13</sup> Ibid p. 4.

<sup>14</sup> See for example Lopes and Theisoohn 2003, and a recent review (Boesen 2004 p 16) which concludes that 'overall, the CD literature emphasizes the need for donors to use less of a blueprint, and be more process-oriented, less prescriptive and more facilitative.'

<sup>15</sup> This has often been referred to both formally and informally, see UNDP Ghana Note 2004.

<sup>16</sup> UNDP defines Capacity as 'the ability of individuals, organizations and societies to perform functions, solve problems, and set and achieve goals.' Capacity Development is the sustainable creation, utilization and retention of that capacity, to reduce poverty, enhance self-reliance, and improve people's lives.

**Empirical evidence and evaluations of DBS at country level provide some early lessons:**

- a. All forms of budget support reinforce the centrality of the budget process, and tend to empower Ministries of Finance. It also has the potential to strengthen national planning and budgeting systems and bring greater coherence among them. However, in the process, line ministries may be disempowered, and their ability to negotiate directly with donors curtailed.
- b. DBS has increased government control over aid and externally funded activities, but it has also provided donors with increased access to and involvement in setting the policy agenda in countries. Using the PRSP as the frame of reference for DBS has resulted in strengthening the influence & effectiveness of PRSPs<sup>17</sup>.
- c. DBS has facilitated aid coordination as it requires governments to make aid allocation decisions more in congruence with public funds, which under projects would be undertaken directly with contractors and not always even recorded with government.
- d. Budget support can be more unpredictable than other aid instruments, as political or crisis driven factors can lead to donors delaying, canceling or reducing budget support tranches.
- e. There has not been enough analytical and empirical evidence as yet to assess the impact of DBS on development outcomes. Has it resulted in more pro-poor expenditures, and is it a more effective modality for reducing poverty?
- f. DBS is expected to reduce transaction costs. It is expected that such costs will be re-distributed at first (to MOF and to donors) and then fall over time. The practice requires further study to ensure such is the case.
- g. It must be asked if DBS is resulting in the priority development issues being addressed and ODA flowing to countries where demand is greatest, or if donors are increasingly clustering DBS around selective issues and countries, the pressure also to disburse funds more rapidly.

*'The Role of the UN System in a Changing Aid Environment: sector support and sector programmes'*<sup>18</sup> spells out the UNDG position and common understanding on this subject. "UN field-based agencies, funds and programmes recognize and welcome the need for a proactive response to this changing environment." The inter-agency discussions and this paper provide a frame of reference for the UN system's contribution to SWAps. It takes the position that "a SWAp will include activities that are financed from pooled resources, but also some that are not. Of concern in all cases is to increase the degree of alignment of all activities (regardless of how they are financed) within an overall sector strategy and resource plan, with the underlying purpose of improving sector performance." This work takes from this common UNDG understanding and the guiding principles presented therein.

UNDP is well situated to help governments in reforms of their public sectors to accommodate and implement DBS initiatives.<sup>19</sup> *'Particularly in a context where budget support and SWAP mechanisms increasingly dominate donor efforts at reform at country level, the UN's role increasingly must be to support national capacity to lead and manage those instruments. Tomorrow's capacity development programme is yesterday's pre-investment project, with the UN at its heart'*<sup>20</sup>. UNDP can facilitate the CD process for DBS, including SWAps, at country level.<sup>21</sup> It is used to working in the crucial interface between the multinational community and the realities of each country environment. But it needs to remain catalytic rather than intrusive, and this is a complicated stance in view of the 'compacting' that is taking place as donors work to harmonize

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<sup>17</sup> OECD/DAC 2004 p. 4

<sup>18</sup> See UNDG Position Paper 'The Role of the UN System in a Changing Aid Environment: Sector Support and Sector Programmes'. Feb 2005 ([www.undg.org](http://www.undg.org))

<sup>19</sup> See UNDP Human Development Viewpoint 54, 'UNDP Participation in Sector Wide Approaches'. Nov 2004 at [www.capacity.undp.org](http://www.capacity.undp.org)

<sup>20</sup> UNDP Administrator's 1/25/2005 Statement to the Executive Board

<sup>21</sup> See UNDP Human Development Viewpoint on 'SWAps: a Viable Framework for Development Cooperation'. Nov 2004. [www.capacity.undp.org](http://www.capacity.undp.org)

their programme and financing instruments.

In the Tanzania experience, where UNDP has been engaged in the poverty reduction budget support (PRBS) framework, and where the country has undertaken a formal DBS evaluation<sup>22</sup>, UN-system support to the second iteration of the PRSP is focused on how to support the government in its efforts to address critical capacity challenges in managing and monitoring DBS for the PRSP. The question is raised as to whether there is a complementary role for other modalities and partners in this environment, to make use of value-added competencies of all, including how to ensure more effective technical cooperation.

The purpose of these Guidelines is to help UNDP COs work with governments and other national stakeholders in strengthening capacities for the management of development finance and development cooperation. They also offer a response to the role of UNDP in follow up to the Paris Declaration on Aid Effectiveness.<sup>23</sup>

**Three typologies of engagement for UNDP in a DBS environment are identified: (1) support to capacity development for national management and implementation of DBS; (2) managing a DBS basket fund on behalf of government and donors (as fund manager or select service provider); and (3) providing resources into non UNDP managed basket funds.**

The Guidelines are based on experience within and outside UNDP. Three factors have been important in their development. **First**, the process has been participatory, involving network discussions and practitioner groups; **second**, the approach is intended to provide evidence-based guidance to UNDP country staff in their work, and **third**, the Guidelines are web-based, and user input is welcomed so as to keep the Guidelines relevant & 'live'.

It is too early yet to speak of 'best' practice. Furthermore, such may inadvertently imply the 'cookie-cutter' philosophy that these Guidelines seek to avoid. Case studies, however, are available of country experience with at various stages of DBS implementation<sup>24</sup>, some of which are referred here to help the reader review CD priorities and direction.

In Mozambique, where budget support is on the rise, a working paper is available on the long-term implications and challenges of DBS<sup>25</sup>. The degree of donor commitment has varied, but there is agreement that DBS is essential for greater impact of development assistance on democracy and poverty reduction. The downsides of DBS noted are: conditionality limiting full government ownership, centralisation of decision making, and concerns re corruption. Delays in release of funds and in programme implementation have also been experienced due to new procedures and changes within government.

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<sup>22</sup> Overseas Development Institute 2004.

<sup>23</sup> See for example S.A. Oddsden April 20th 2005 memo on PDAE follow up, with questions from the Permanent Mission of Norway to the UN on ownership, harmonization, results and accountability.

<sup>24</sup> Note bilateral examples (e.g. Japan with Vietnam, France with Lebanon, and the UK with Rwanda) in OECD Good Practice Note on Capacity Development in Public Financial Management. 2004.

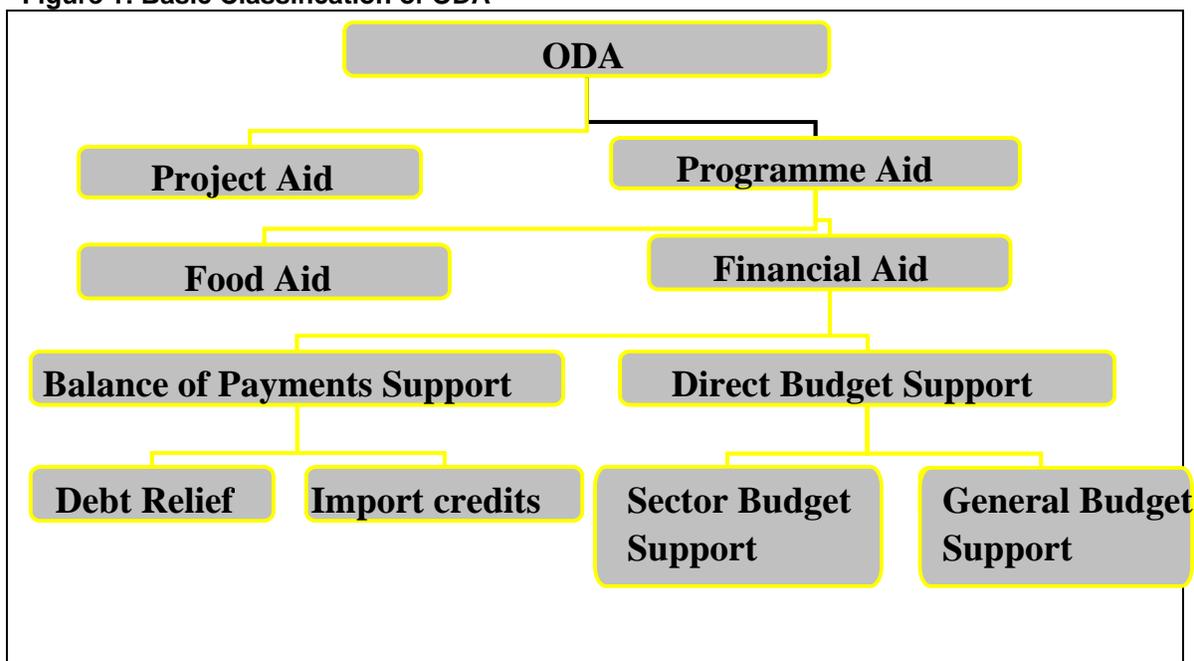
<sup>25</sup> The Working Paper: 'Budget Support: Long Term Implications and Challenges on Development Programmes' is at <http://content.undp.org/go/practices/poverty/docs/Implication of Direct Budget Support>

## Section 2

### DEFINITIONS & GENERAL PRINCIPLES

A UNDP background note<sup>26</sup> reviews recent research and practice, and discusses various definitions and applications of DBS (and related SWApS). For the purpose of these Guidelines, DBS is broadly defined as follows: *joint donor/government mechanisms to permit external resources to be channeled directly through national budgets, using national allocation, procurement and accounting systems, to supplement public expenditure on nationally agreed priorities.*<sup>27</sup>

Figure 1: Basic Classification of ODA



Direct budget support can take different forms, for example General Budget Support (GBS), directed at overall government policy and expenditures, and Sector Budget Support (SBS) for specific sectors. In some cases (e.g. countries engaged in HIPC initiatives or PRSP processes) budgetary expenditures are further earmarked for poverty reduction programs. This method of spending classification can be seen as a component of the broader public expenditure management (PEM) focus by donors encouraging country partners to adopt institutional mechanisms and techniques for strengthening the efficiency and performance of budgetary outlays<sup>28</sup>.

<sup>26</sup> Lawrence J.E.S. Background Note on Preparation of Guidelines on Strengthening Country Capacity for Financing, Implementing, and Managing Development Programs. UNDP. New York. February 2005. <http://www.capacity.undp.org/index.cfm?module=Library&page=Document&DocumentID=5116>

<sup>27</sup> This draws on the OECD definition: a method of financing a partner's budget through a transfer of resources from an external financing agency to the partner government's National Treasury. <http://www.oecd.org/dataoecd/55/0/34065366.pdf>

However, it adds an important second dimension, noted in the World Bank (and other) definitions, in that budget support 'is also linked to sector or national policies rather than specific project activities.' <http://www.eldis.org/healthsystems/aid/>

<sup>28</sup> Surf-Pov Consolidated Reply: Zambia / Examples of Classifications of Poverty Reducing Expenditures in the National Budget. April 5<sup>th</sup>, 2005

Fund management arrangements under DBS could result in a pooled or basket funding arrangement, relating to a specific sector, thematic programme or plan. Basket funds involve a group of donors agreeing to collectively pool their resources under a common fund management arrangement, led by a designated donor or government agency. Such an arrangement often remains outside of Treasury, funding a subset of a sector strategy or national programme.

Four general principles underlie the Guidelines:

*Development effectiveness orientation:* UNDP and government efforts must be focused not only on <sup>29</sup>processes of more effective and transparent ODA management and aid effectiveness alone, but also on sustainability of ultimate beneficial results (better public goods and services) that befits the human development thrust behind the MDGs. CD for strengthened policy and institutional mechanisms to manage ODA works toward this end.

*Explicit recognition of each country's wider action environment or 'big picture':* integration of ODA with, and use of country systems for management, budgeting and reporting takes place within a practical context of macroeconomic policies and performance, and bureaucratic tradition; so countries at different stages of development, or at various levels of structural reform may need different strategies. Effective governance can not simply be "installed" or prescribed by regulation or policy conditionality, but must be nurtured over time through a public sector management culture that is results-oriented, and open to citizens voice in public policy administration.

*Reduction of parallelism;* several decades of ODA transfers using special administrative organization around specific projects (such as separate donor managed project implementation units)<sup>30</sup> have set a precedent for parallel systems, often working against sustainability, and supplementing, rather than augmenting or enhancing government administrative capacity. Upfront attention to national and local level capacities to manage, monitor and account for development resources and results is key to nationally owned and directed harmonization and coordination of development cooperation.

*One size does not fit all:* no one country (or donor) has a 'lock' on how best to accomplish these complex administrative reforms for everyone, so care must be exercised in the application of other country or other sector models. While good practices can and should be shared, in-depth country-specific analysis that is regularly updated and validated is essential in determining local specific DBS effectiveness – what works in one country may not be suitable for its neighbour. These Guidelines, while offering an overall framework, emphasize that the capacity support must be tailored to each situation.

The four guiding principles proposed by OECD are that budget support must: (a) contribute to the strengthening of partner countries' ownership; (b) enhance the performance and accountability of partner countries' PFM systems; (c) seek to minimize transaction costs incurred by participating countries; and (d) be delivered in a way that enhances the predictability of resources and reduces their volatility.

For UNDP, the role in a changing aid environment demands a rigorous and systematic look at what capacity development needs must be addressed in a sequenced and prioritised form. This is further addressed in Sections 3 and 4.

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<sup>29</sup> [OECD/DAC. Paris Declaration of Aid Effectiveness.](#)

<sup>30</sup> UNDP, 'The PIU Dilemma' at [www.undp.org/policy/docs/policynotes/pov-PIU-final4.doc](http://www.undp.org/policy/docs/policynotes/pov-PIU-final4.doc)

### Section 3

#### **PRIORITY ACTION AREAS FOR SUPPORT**

Ten areas of support have emerged through the ongoing knowledge network discussions, across regions, as a menu of areas in which UNDP can provide a value-added role in response to government requests in managing a DBS environment. In each of these areas the following modalities of engagement are envisaged: policy advisory services, facilitation and brokering functions, national capacity development for policy and implementation, direct implementation services, and best practice exchange and analysis. Such would be determined by national considerations, needs and demands.

- 1) **Strategic planning, analytical and policy support to national and sector level strategies:** This includes long term visioning, medium term development planning, sector strategy development and review, development target setting, MDG needs assessment, capacity assessments and monitoring of development results. These are often areas that are preconditions for DBS in support of PRSs and other development needs. Economic governance and policy capacities in managing macroeconomic stability and deficit financing are a part of this work. So are HIV/AIDS and gender equity, energy and environment. The role of providing evidence based policy options in these fields is a value-added role recognized by many governments.

In order to strengthen national ownership of its programmes the UNCT Rwanda, decided to forgo the CCA and derive its UNDAF directly from the PRSP. To ensure that the upcoming PRSP is in line with MDGs and global commitments, the UNCT will assist the Government of Rwanda in conducting an MDG needs assessment in 2005 to evaluate how much public investment/foreign assistance is needed in each sector in order to achieve the MDGs. This (a) implies that sectoral plans will be devised on the basis of actual needs rather than on the basis only of available resources, and (b) calls for a repositioning of the UN system at country level in order to integrate UN system activities to better maximize the technical and logistical sectoral expertise the UN team brings to the country.<sup>31</sup>

UNDP support in the area of MDG assessments and target setting includes helping governments reconcile various regional and international commitments made with their own national priorities and targets (MDGs, PRSPs, EU accession criteria, NEPAD commitments, global environment conventions etc.).

- 2) **Mapping of development finance needs and sources:** This area of work would, based on the above, measure the current and projected costing to meet priority development targets, and analyze the best sources and finance instruments to meet those needs. The sources of development funds would range from development investments, technical assistance, debt instruments, FDI, remittances, international taxes, domestic public and private resources to name a few. A key issue here is to support governments increasingly ensure that all ODA and other resources get officially recorded and accounted for in the national budget. Such work would also include support to national benchmarking of criteria for accessing such funds and managing fiscal space.

In Nigeria, five areas have been identified for UNDP to support national access to DBS: (a) developing tools and mechanisms to enhance capacity at state level to handle DBS and for lagging states to measure up to the national benchmarks for DBS access; (b) mainstreaming

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<sup>31</sup> Aid Coordination Unit, UN RC Office, Kigali, Rwanda (2005). See Rwanda Development Partners Coordination Group Website at [www.developmentpartners.rw](http://www.developmentpartners.rw)

MDG costing into overall DBS exercise; (c) assisting governments in poverty tracking in light of the MDGs—towards which MDG targets are the DBS resources being channeled and what impact?; (d) helping government increase transparency through development of standardized procurement procedures; and (e) support for preparation of manuals, supported by web-based case studies, and guidelines related to the above<sup>32</sup>.

DBS may not always be the best modality for all situations, and UNDP must remain impartial in its advice to governments, even under strong donor pressures to align and harmonise, on helping to truly assess what aid modality best fits the context and need.

**Negotiating DBS**, which is often attached to various types and levels of conditionality that have to be met over given periods of time, rests often with the Ministry of Finance. However, if such is driven by sector needs and programmes, line ministries also play a lead role. Providing capacity development and analytical support to national negotiating teams, so that all policy and programme options under discussion are fully articulated and assessed from the receiving country's perspective is a key area of demand. Also, facilitating the state-non state stakeholder dialogue around ODA and DBS, at both central and sub national levels.

In Ethiopia, where approx 50 per cent of all ODA is DBS (2004), these negotiations were centered around the SDPRP<sup>33</sup>, which was endorsed by government and donors as the overarching strategic development framework. The SDPRP is built around a flexible reform package and prioritizes capacity constraints which must be addressed. Its policy matrix is the point of departure for performance assessment and its annual progress report functions as the common reporting instrument for all.

Memorandums of Understanding (MOUs) can articulate a clear strategy for a mix of modalities, to capture DBS and off-budget capacity development work that must go hand-in-hand. MOU experiences can be found from Tanzania, Ghana, Malawi, Rwanda and Uganda.<sup>34</sup> Negotiating earmarked funds for capacity development within a DBS package or as a linked technical cooperation package that works with it, is essential at this early stage.<sup>35</sup>

The Partnership Framework MOU in Tanzania governs the provisions of general budget support to the Government of Tanzania, and all PRSB/PRSC donors subscribe to it. The MOU aims to minimize transaction costs, harmonize performance benchmarks and dialogues between parties; link funding commitments by donors to achievement of set targets; and increase the predictability of donor flows. A joint process of appraisal, review and dialogue with the authorities is conducted on PRBS-related matters. The review of progress against the Performance Assessment Framework (PAF) is structured around working groups to achieve burden sharing among donors. Additional operational information is also provided from the phasing of a health sector SWAp program in Uganda which gives empirical guidance on steps, and timelines toward reaching an MOU<sup>36</sup>.

- 3) **Inter-ministry coordination mechanisms for policy and budget planning:** DBS often supports cross sectoral work such as HIV/AIDS<sup>37</sup>, poverty reduction, decentralisation and gender equality. These require national coordination mechanisms that are often in embryo stages and require support. It also highlights another area of support which is to support integrated planning and budgeting, which are often separately managed processes within

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<sup>32</sup> Ram Shankar. 3/14/2005 Communications with Surf/Pov: discussion on DBS.

<sup>33</sup> Sustainable Development and Poverty Reduction Programme adopted in 2001 as the common platform for accelerating growth and fighting poverty in Ethiopia.

<sup>34</sup> See SURF/Pov Consolidated Reply 2/4/2005. Cape Verde. Comparative Experiences: Aid as Budgetary Support.

<sup>35</sup> The DFID-UNDP Strategic Partnership Initiative in Viet Nam, 2004-2005, is a good example of such a mix of modalities, where DFID is a leading DBS donor to Viet Nam.

<sup>36</sup> See Annex 1 of Hutton G. Case study of a 'successful' sector-wide approach: the Uganda health sector SWAp. Swiss Tropical Institute. April 2004. <http://www.sti.ch/pdfs/swap351.pdf>

<sup>37</sup> See, for example, UNDP's capacity development in HIV/AIDS response in Botswana, Malawi, and the Gambia.

national government architecture. Support to MOF in their inter-ministerial coordination functions can also be useful.

This implies that programme measures must be considered strategically and that programme design accounts for what impacts (a) horizontally or cross-ministry, (i.e. if MoF is the lead or principally engaged agency, ensure impacts on other ministries are not ignored); (b) vertically, at all levels of government (national to provincial/local, with emphasis on municipal government in large urban centres); and (c) externally, in relation to private sector and other civil society counterparts.

Support to government and parliaments, to enable all development resources flowing into the country to be mapped and detailed on the budget, even if implementation may be varied and not all programmes would go through the budget mechanism as budget support, is an area of increasing need and demand. This would also enhance planning and monitoring capacities of both the government and legislative branches at national and local level, including improved information sharing on the budget, with the public.

- 4) **Public Finance Management:** A crowded field in most countries, this is a comprehensive area of support covering budget allocation, monitoring and tracking of funds, accounting systems and financial reporting. UNDP can bring evidence-based global policy experience in economic and financial management, for government consideration, as well as in the practice of decentralized PFM. OECD Practice Notes provide principles and 'good practice' information on how budget support can be delivered so as to enhance the capacity of national PFM systems<sup>38</sup>. The fundamental goals of a PFM system are identified as: aggregate fiscal discipline; a strategic allocation of funds; value for money (meeting donor and national accountability standards); and probity in the use of public monies<sup>39</sup>.

*National audit requirements* that comply with international standards is a key area of support, through support to the supreme audit institutions, ensuring independence of the audit functions, technical support on data and reporting systems, and training of national audit personnel. Modern audit is moving towards 'value for money' audits, and is a key area of capacity support requested. Support to reach internationally accepted accounting and procurement standards, and the work done here by the Public Expenditure & Financial Accountability Secretariat (PEFA)<sup>40</sup>, is notable.

- 5) **Public Administration Reform (PAR)**<sup>41</sup>: public sector change management processes range from overhauling institutional structures and roles, to personnel management, introducing results based management, leadership development, one-stop shops, business and procurement services and other service delivery upgrades, establishing stakeholder engagement and feedback forum etc.

In **Nepal**, a dedicated government institution is suggested with full accountability for the sustained CD of public administration, to be done on-site rather than through sporadic training away from the government institutional environment. Current weak data management capacity in government departments is also highlighted as an inhibitor to transparency and accurate monitoring of development financing and results. In **Papua New Guinea**, CD is prioritized for the national and provincial health offices. TA covered management and accounting systems, defining health worker job descriptions and performance evaluation criteria, implementing a national health monitoring system, and to improve the budgeting

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<sup>38</sup> See OECD Good Practice Note on Capacity Development in Public Financial Management 2004.

<sup>39</sup> OECD/DAC A Public Financial Management Prospective. Draft 20 October 2004  
<http://www.oecd.org/dataoecd/55/0/34065366.pdf>

<sup>40</sup> [www.pefa.org](http://www.pefa.org)

<sup>41</sup> DBS is becoming increasingly contingent on adequate reforms in public sector management. See Oxford Analytica. May 2005.

process, expenditure monitoring, cost containment and user fee system<sup>42</sup>.

Inherent in support to PAR initiatives is the concept of *incentives*. A culture of professionalism, merit based promotions and adequate compensation can contribute to a positive pattern of incentives.

The Tanzania evaluation documented little change in underlying incentives facing spending agencies<sup>43</sup>. In addition, donor efforts at improvements, such as making salary enhancements more transparent as incentives, may end up slowing, or even substituting for civil service reform.<sup>44</sup> The solution is continuing rationalization of government appointments, compensation, and promotion schemes across the board, with clear donor exit strategies for provision of salary supplements. Models can be found in frameworks such as Tanzania's Selective Accelerated Salary Enhancement program aimed at teacher retention in the education sector<sup>45</sup>, or the SUNAT scheme in Peru, which introduced professional competition into the Tax Administration, and which resulted in greatly improved compensatory incentives for proficiency and professionalism.<sup>46</sup>

- 6) **Local Development and Decentralisation:** Decentralisation strategy that responds to absorptive capacity constraints and opens up the flow of funds to sub national levels is an area of increasing need. The measure of transparency and accountability in fiscal decentralisation and funds management at sub-national levels is often a prerequisite for access to funds. Support to local development funds is an effective mechanism in this regard, for both local investment and capacity development, and could act as a local level SWAp.

To support local development and the decentralization policy, UNCDF and UNDP are piloting the use of local level direct budget support through funds transferred to Local Development Funds (LDFs) in a number of countries. In Senegal, for example, this work is being carried out on the basis of a programme signed with the Government of Senegal, where UNDP/UNCDF open a special account with the Central Bank of West African States (BCEAO). The heads of rural community organisations make public tender offers for the use of funds and selection is made on the basis of their community priorities. The rural communities are responsible for the implementation of these local funds. The national treasury makes the actual disbursement on the basis of the contracts signed by the Presidents of these Rural Community Organisations. UNDP/UNCDF simultaneously also provides technical support to these organizations to enhance their capacities in the management, budgeting and implementation of these investment funds and programmes. In order to improve tracking of bank transfers and oversight on the use of the allocated resources, the LDF accounts were opened community scrutiny and are also subject to annual audits. This effort has improved the sustainability and predictability of public financing into rural communities to address local development priorities, and has also allowing them to increase their capacities in these areas.

- 7) **Support to Programme Implementation:** Assistance to governments in implementation service capacities, at both central and sub national levels is a key area for UNDP support. This is critical for the scaling up of development finance and its utilisation for MDG-based results. Both state and non-state entities can be supported through a package of services offering capacity development and direct service support, to overcome delivery obstacles in

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<sup>42</sup> Izard and Dugue 2003

<sup>43</sup> Overseas Development Institute and Daima Associates. Joint Evaluation of General Budget Support. Tanzania 1995-2004. Final Report. November 2004. p. 94

<sup>44</sup> Edgren 2002.

<sup>45</sup> See Tanzania Development Partners Group. Payments by Development Partners to Government Officials. <http://www.tzdac.or.tz/Allowances/allowances.html>

<sup>46</sup> OECD Good Practice Note on Capacity Development in Public Financial Management. 2004 p. 14

the short and long run. This includes support to operational areas of procurement standards, fund management and contracts administration.

Such an Offer of Service, as conducted in Sierra Leone<sup>47</sup>, Sudan and Angola, would include on-time capacity development in each of these areas, such as on-the-job skills training, exchange of experiences with other countries, and operational knowledge transfer on project management, monitoring systems and procurement procedures. Exit strategies for support to such implementation services must be agreed upon on the outset by both the government and donors.

Strengthening national procurement capacities is an integral part of this function. This includes reviewing supply chain management constraints and facilitating the opening up of supply bottlenecks. Ongoing work in the Latin America and Africa regions (ARMADA initiative) attest to UNDP's valued role in assessing and strengthening national procurement services, legislation and oversight systems, while providing direct procurement services where such still remains under required standards.<sup>48</sup>

**The management of 'pooled' or basket funds** is offered as part of this package of service support, when and where requested by government. UNDP provides fund and programme management services through instruments such Offer of Service Agreements, or as CD Facilities. This is particularly so in situations of crisis, post conflict and economic transition situations.

A UNDP **Viet Nam** Discussion Note on the programme-based approach and budget support in Viet Nam<sup>49</sup> sets out lessons learned from Viet Nam's experiences: 'The conditions for budget support are seldom in place from the very start. In this situation, UNDP could promote its new pool-funding mechanisms, such as the PAR Support Facility (PSF) and Legal Strategy Development Facility (LSDF), as viable transitional solutions that allow donors and the Government to seize opportunities for change and capacity development as they arise.

Donors established a basket fund for supporting Harmonization and Alignment in **Rwanda**, managed by the Aid Coordination Unit (ACU, UN RC office) and administered by UNDP. The ACU's tasks are to: support the Government in leading the H&A process under a clear framework; promote alignment of external aid to the PRSP; build the Government's capacity for effective aid management and to improve coordination of donors' interventions at country level.<sup>50</sup>

A variant of such basket funds are the Capacity Development Facilities (CDFs). These facilities consist of multi donor pooled funds under a common programme umbrella, provide support to civil service training and salary supplements, direct policy and management support, transitional staffing, procurement services, legal system reforms, and information and monitoring systems for public administration.

In the **ECIS region**, CDFs are used to strengthen national capacity for managing development in several countries<sup>51</sup>, enhancing aid coordination, and improving resource

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<sup>47</sup> Refer *Support Services for Improved Efficiency of Project Implementation in Sierra Leone*, UNDP 2005.

<sup>48</sup> A current UNDP initiative, with IAPSO as implementing partner, is analyzing the value added roles and practice on procurement capacity development across region. 'Procurement Capacity for Development', BDP/UNDP. March 2005

<sup>49</sup> UNDP Vietnam. The programme-based approach and budget support in Viet Nam. June 2004.

[http://content.undp.org/go/practices/governance/docs/download/Viet+Nam+DBS+note.doc?d\\_id=182937&g11n.enc=ISO-8859-1](http://content.undp.org/go/practices/governance/docs/download/Viet+Nam+DBS+note.doc?d_id=182937&g11n.enc=ISO-8859-1)

<sup>50</sup> Aid Coordination Unit, UN RCO, Rwanda.

<sup>51</sup> Serbia, Montenegro, Kosovo and Georgia. Macedonia and Albania are contemplating similar initiatives aiming at

utilization within the context of political and economic transition. CDFs have facilitated donor harmonization and built a common government-donor platform for resource mobilization and utilization. While lessons are still being learned, it is clear that a) the design and priorities differ greatly by location, and b) a necessary factor is a binding agreement between government and donors on an exit strategy for donor funded salary supplements and capacity substitution through external advisors and management support.<sup>52</sup>

- 8) **Democratic Governance:** UNDP's role as an impartial partner in engaging on issues of key governance reform and deepening democracy remains an area of highest priority. Support provided to human rights institutions, rule of law and anti corruption mechanisms, judiciary and legislative bodies, office of the ombudsman, capacity strengthening of the electoral and political party systems, and to local governance remain high on the agenda in a DBS environment. This work focuses on domestic and international accountability, of a government to its people, and of a country to its international obligations. The related activities could be supported on and off budget.

DBS is a relatively new funding modality. Governments should ensure public *access to information* on the development priorities it is intended for, and encourage greater input and feedback from all stakeholders. This requires easy to access and updated information systems and support to forum for civic participation in public debate.

Part of a DBS strategy must be a public information campaign especially at local levels<sup>53</sup>. Much will depend however on strategic partnering between government and donors in carrying out such campaigns, such as those underway in Bangladesh around key MDG based sector-wide programmes.

- 9) **Aid Management through national mechanisms:** Coordination and harmonization around priority setting, monitoring of inputs and project progress, and reporting on funds and results albeit on the rise remain donor driven in many situations. Nationally led, inclusive mechanisms that guide these processes require facilitation and support. Although it is said that DBS reduces reporting requirements, individual donors often require separate reports and audits national systems have to cope with such.

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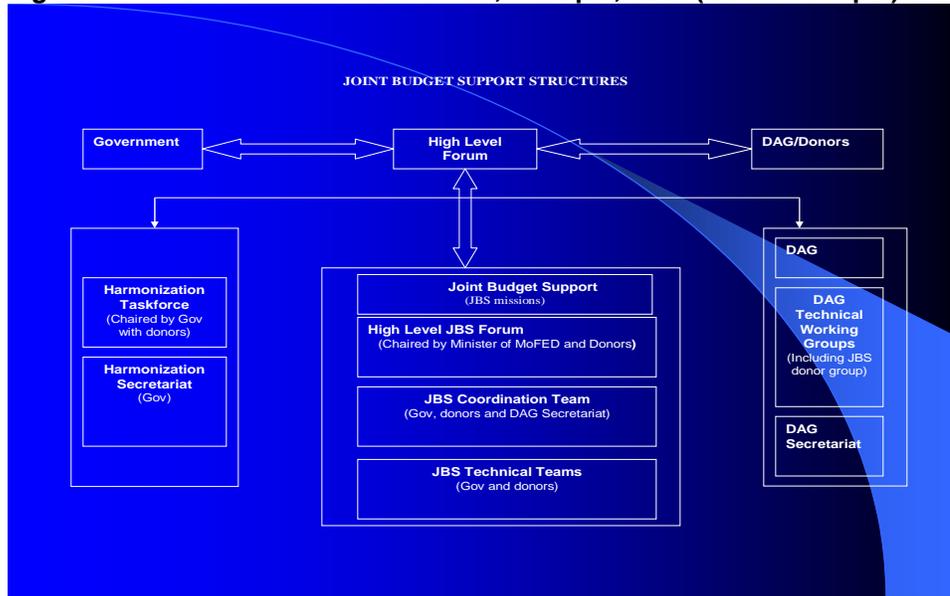
building national capacities for managing development and strengthening aid coordination and utilization of resources.

<sup>52</sup> See Gercheva D. and Theisohn T. (Capacity Development Fund/Facility – Topical Workspace Introductory Note) which outlines guiding principles in the areas of long term vs short term goals, governance, ownership, and requisite quality control.

[http://content.undp.org/go/practices/poverty/docs/download/Capacity+Development+Fund-brief+note.doc?d\\_id=189247&g11n.enc=ISO-8859-1](http://content.undp.org/go/practices/poverty/docs/download/Capacity+Development+Fund-brief+note.doc?d_id=189247&g11n.enc=ISO-8859-1)

<sup>53</sup> See Bolivian example in United Nations Development Program. Final Report. UNDP's 1<sup>st</sup> Global Sub Practice Meeting 14-15 December 2002 on Decentralisation, Local Governance and Urban Development. Marrakech, Morocco. January 2003.

**Figure 2: Aid Coordination Mechanism, Ethiopia, 2005 (UNDP Ethiopia)**



- 10) **National Monitoring and Evaluation Systems:** This involves technical support to M&E systems for measuring and reporting on development results, as well as support to independent monitoring and oversight bodies that track and oversee the use of DBS funds for the given development ends. Donor driven monitoring mechanisms cannot and should not replace state-citizen accountability mechanisms in this regard. UNDP supports strengthening media groups and civil society organisations to contribute more actively to ‘social watch’ roles and MDG oversight. The need to track actual impact of DBS on poverty reduction and other development ends is an area that requires empirical study and exchange of knowledge, methodology and practice between countries. Independent state-civil society-donor mechanisms for joint monitoring and oversight of the use of DBS, and of public finance more generally, have been initiated, or are under consideration in some countries. This is a key area for UNDP engagement.

In Tanzania, an independent monitoring group (IMG) of government, NGO and donors, holds all partners to account, recommending regular improvements based on impartial and transparent assessments. The group’s findings are widely accepted, and provide a sound guide for the implementation of essential capacity development principles<sup>54</sup>. Another example is the Programme Aid Partners Performance Assessment (PAPPA) mechanism in Mozambique.<sup>55</sup>

There is current work ongoing on evaluation of overall DBS implementation, and several relevant frameworks available<sup>56</sup>. Furthermore, monitoring and evaluating capacity-strengthening initiatives in a DBS environment can also be focused on a specific sub-area of concern, such as procurement<sup>57</sup>.

The use of the Performance Assessment Framework (PAF) in **Mozambique** and **Tanzania** is informative. The PAF is a joint review tool for government and donors jointly engaged in

<sup>54</sup> Refer <http://www.tzdac.or.tz/IMG/IMG-main.html>

<sup>55</sup> The baseline assessment can be accessed at [http://www.sarpn.org.za/documents/d0000955/P1069-Baseline\\_survey\\_PAP\\_04.pdf](http://www.sarpn.org.za/documents/d0000955/P1069-Baseline_survey_PAP_04.pdf)

<sup>56</sup> For example Lawson and Booth 2004; Overseas Development Institute 2004;

<sup>57</sup> See OECD/DAC Volume 3. 2005 at <http://www.oecd.org/dataoecd/12/14/34336126.pdf>

DBS, and is used to monitor ongoing reform and poverty reduction processes. In Mozambique, an indicator matrix has been introduced, on MDGs and related underlying conditions, such as legal reforms, macro-economic and financial policies and good governance, including addressing corruption<sup>58</sup>.

Several diagnostic tools exist to assess capacity of public financial management systems. UNDP is required to assess the capacities of implementing partners, which includes their financial management and monitoring capacities.<sup>59</sup> Similarly, the UN system in defining the UNDAF and its related cash transfer modality (CTM) is expected to carry out (or utilise existing assessments where possible) a macro and institution level assessment of same.<sup>60</sup>

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<sup>58</sup> L. Dacosta in UNDP Mozambique communication to Surf/Pov discussion.

<sup>59</sup> UNDP Programme Guide, 2005. 'Key Considerations for selecting Implementing Partners'.

<sup>60</sup> A joint WB, IMF and PEFA working group is developing a common framework for monitoring financial performance. See revised Consultative Draft, October 21, 2004 at <http://www.pefa.org/Documents.htm>

## Section 4

### A CAPACITY DIAGNOSTIC FRAMEWORK FOR SUPPORT TO SWAPS/DBS

**Figure 3: Key Factors in Capacity Development for DBS**

FACTORS	INDIVIDUAL	ORGANIZATIONAL	CONTEXTUAL
<b>Challenge Factors</b>	Low motivation/morale	Weak technical and management capacities	Donor conditionalities
	Inadequate skills	Task overload	Aid fatigue
	Perceived threats of reform	Parallel staffing, budgeting, and accounting systems	Inconsistency/fragmentation of programme interventions
	Rent-seeking	Weak supervision	Systemic corruption
	Bureaucratic attitudes	Migration of skilled staff	Lack of strong inter-ministerial coordination
	Expatriate skills domination	Incentive distortions	Constantly changing leadership
	Alternative occupational opportunities	Inefficient service delivery mechanisms	Limited public access to information and debate
	Insecurity/perceived threats	Flight of capital/human resources	Unstable political situation
<b>Facilitating Factors</b>	Professional ethics and expectations	Culture of accountability and oversight	High level political commitments
	Relevant education and skills training	National (e.g. civil society) pressure	Appropriate policy, legal and regulatory infrastructure
	Monetary and non monetary incentives	Output orientation	Donor harmonisation on development results
	Availability of local expertise in required management and technical competencies	Merit based performance measurement and reward systems	Transparent accountability mechanisms
	Active participation in national policy dialogue/debates	Vibrant network of impartial media	Inclusion of marginalised groups, especially women

DBS works on the understanding of reforms to both government and donor behaviour. Its effectiveness and eventual success is based on a mutual understanding of these core changes and harnessing and sustaining the capacities to undertake them over time.

In strengthening national engagement on DBS, key principles of CD as advocated by UNDP must be ensured:

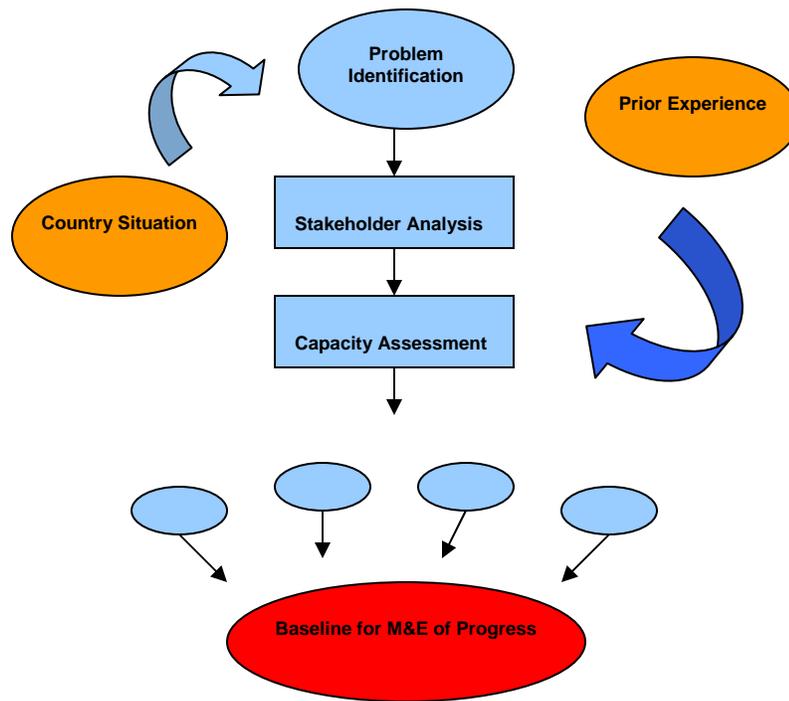
- It must seek to build on existing capacities - there are always considerable strengths present in terms of human resourcefulness in all organizations, often these can be uncovered and given new life by enlightened management and improved incentives.
- It must identify priorities and new policy for untied and well targeted technical cooperation (TC). A diversification of TC delivery modalities, including working directly with sub national bodies and through public-private partnerships.
- It must ensure both government and non government stakeholder engagement and ownership. CD processes must not be, or even perceived to be, externally driven, and be embedded in national process and systems.
- It must be linked to linkages with other ongoing CD efforts for economic and governance reforms underway.

The pace of DBS or SWAp initiation must be linked to an achievable pace of a poverty reduction

strategy, economic reform or governance/decentralisation reform program<sup>61</sup>. Thus it is important not to be over-optimistic in mapping DBS capacity needs at any one given point of time, but set up an evolving and regular system of assessing capacity requirements to manage DBS.

There are many tools to assess the readiness of a country to negotiate, accept and implement DBS for national development, including the strength of public financial management systems in programme countries<sup>62</sup>. Some of these relate to generic capacity development tools and measures. In defining and detailing UNDP's support to the above areas, essential elements of a CD programme design for DBS are as follows (Figure 4).

**Figure 4: Diagnostic Framework for DBS Capacity Building**



<sup>61</sup> Izard and Dugue 2003 p 52

<sup>62</sup> OECD Good Practice Note on the Provision of Budget Support 2004. p. 6

- a) **Problem identification – What is the national commitment to MDG based development results, and DBS to support it?** Programme support and capacity development for DBS does not take place in a vacuum. It is a political issue as well as a developmental one<sup>63</sup>, and therefore, for it to be effective it has to be nurtured by a national political commitment to change and to the agreed development results. This includes a broad willingness among donors and country governments alike to taking on, in sustainable ways, the challenges and responsibilities of direct budget support. This implies both an adequacy and a predictability of the level of DBS resources over an agreed period of time, contexted by issues of fiscal space and fiscal management, the dynamics of government-donor relations, the balance of power among ministries and inter sector coordination mechanisms, and the voice of civil society institutions.

Such key factors in the national context for change (the 'big picture') must be discerned and interpreted accurately in view of special economic, socio political and cultural circumstances of each situation, and addressed in the programme of support and CD efforts accordingly. These 'big picture' factors which will challenge and those likely to facilitate DBS capacity development programs, are exemplary of existing conditions that must be taken into consideration. Such factors should be important determinants in the selection and design of any programme support. Stakeholder networks and in-country contacts, as well as systemic and organisational capacity assessments<sup>64</sup>, and MDG needs assessments will help provide the necessary information. This includes ascertaining, through surveys, the public trust in how well public resources are allocated, spent and accounted for. In this context, country gender assessments and gender budget audits of national and local budgets are important tools in determining fair and equitable budget allocation and expenditures for facilitating results oriented development (Kenya and Senegal).

- b) **The national institutional framework – who ultimately calls the shots on DBS and who implements?** The clear identification of responsibilities and coordination between Treasury, Ministry of Planning and Budget Department in the Ministry of Finance, and the role of the Budget Committee in Parliament and so on. It is also necessary to have clarity in roles such as which departments administer what aspects of public administration reform; where does fiscal decentralisation policy get defined and implemented; what is the budget calendar and the role of parliament in budget allocation decisions. The need for CD to ensure a more 'joined-up' government becomes essential, with shared responsibility among government agencies for delivering on the DBS performance measures. This implies a link up of the budget with the PRS and with results based management in public service. A capacity diagnostic would therefore look both within and across such public institutions, and the rules that govern their interactions. Once such is known and detailed, specific institutional capacity development arrangements can be put in place to support their roles and coordination mechanisms.

*Institutional twinning* can be an effective method of supporting CD for DBS. Government ministries along with donors, can jointly orchestrate mutually recognized and beneficial bilateral arrangements, such as the twinning of the Japanese and Vietnamese Ministries of Finance<sup>65</sup>. Furthermore, inter-ministerial networking has proved effective, for example between Ministries of Finance and Ministries of Education, as in Vietnam<sup>66</sup>, where analysis of the existing cost structure of the sector and of interactions between existing policies and demographic trends (and their HRD implications) are yielding results, and hold promise for similar linkages in other sectors. However, as with other modalities, the empirical evidence of

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<sup>63</sup> Boesen 2004 p 6.

<sup>64</sup> Refer UNDP Practice Note on Capacity Assessments, which provides a review of methodologies & tools.

<sup>65</sup> OECD Good Practice Note on Capacity Development in Public Financial Management. 2004 p. 6

<sup>66</sup> OECD/DAC Working Party on Aid Effectiveness and Donor Practices. Good Practice Note on Providing Support to Sector Programmes. Draft. 15 October 2004. p. 12.

current practices in this area should be closely reviewed and situations where such has led to long term dependence on external institutions should be avoided.

- c) **Policy reference – What policies must be in place for DBS to work in the given environment?** This requires checking legislation, policy statements and ministerial papers, major government documents and consultant reports that bear directly on DBS, including those related to fiscal decentralisation, accountability and tax policy.
- d) **Stakeholder analysis – Who are the core stakeholders involved?** This involves extracting the immediate stakeholder requirements for DBS capacity development at management and technical levels. Feedback from key decision-makers, press commentaries, building informal networks, and determining core political and civil society support for specific DBS initiatives are also critical actions for its success. This also requires adopting an inclusive approach for ensuring participation of the marginalised and disadvantaged groups especially women and ethnic minorities. Capacity development responses that also have to do with building trust, dialogue channels, independent monitoring etc as part of ensuring stakeholder engagement and capacities to address the grievances of non state actors in this context become critical.
- e) **Identification of training needs** - Capacity development efforts for DBS are increasingly being re-oriented towards mainstream activities of government<sup>67</sup>. This calls for broader attention to public policy and public expenditure issues rather than more routine project management and administration, with corresponding implications for enhanced policy-analytic skills in addition to the more traditional qualifications normally required of line government employees. There has traditionally been a shortage of staff skills in government for effective, accountable and timely public resources and ODA management. This is part cause of the PIU syndrome around development programming<sup>68</sup>. This shortage is often most marked in certain specialized areas crucial to reform, and to more sophisticated public sector management<sup>69</sup>. Addressing these human resource constraints through appropriate training and learning initiatives are critical for effective DBS management.

Targeting training on a specific outcome can not only maximize resource efficiency, but also facilitate immediate short term results. The focus should be on in-country training or with regional centers of excellence wherever possible. In some cases (e.g. NGOs and SMEs) especially in the less industrialized countries, training in basic budgeting, accounting, management and reporting can have lasting effects<sup>70</sup>.

Not being able to execute the public payroll in Sierra Leone, represented a substantial risk that government saw had to be addressed as an immediate priority. As a result, this provided a rationale for capacity development elements that supported effective payroll management, including strengthening the internal audit of payroll<sup>71</sup>.

Training for local CSOs in participative awareness of government practice and 'watch dogging' is also productive in addressing corruption, and many such initiatives have been underway recently<sup>72</sup>. In-country institutional partnering agreements can link local with national, and address scaling up capacities in effective ways.

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<sup>67</sup> Lawson and Booth 2004.

<sup>68</sup> UNDP. The PIU Dilemma. 2003.

<sup>69</sup> World Bank. Reforming Public Institutions and Strengthening Governance. Washington DC. November 2000.

<sup>70</sup> See World Bank LICUS Report 2002

<sup>71</sup> OECD Good Practice Note on Capacity Development in Public Financial Management. 2004 p. 10

<sup>72</sup> See for example the Technical Assistance Module. Citizen Participation to Strengthen Transparency in Latin America and the Caribbean. USAID. Washington D.C. 2004

Interactions between the national Institute of Finance in Lebanon (which provides assistance to the institutions of financial management and the Lebanese Ministry of Finance. The Institute provides training aimed at more professional work practices, developing a new generation of skilled staff<sup>73</sup>.

- f) **Interest groups, networks and information channels** - national ownership is essential for DBS initiatives to be effective and sustainable. Thus identifying specific commitments and potential shortcomings/liabilities of the leadership engaged at national and sub national levels should happen before a DBS programme/fund is designed. Determining the roles and interests of each stakeholder group; identifying outreach and open consultation channels that can be maintained across time, and developing networks with key stakeholders for ongoing input into the related CD initiatives are essential to this. These networks can provide for continuous assessment of CD needs to reflect local priorities and capacities for meeting DBS requirements.

Related to the above, is the need for a national information strategy to take the DBS strategy to the public. Building interest in line ministries is an important component, and has been a factor in success in some cases<sup>74</sup>.

In Guatemala, for example, initiation and adequate documentation of a Financial Management Information System (FMIS) helped generate crucial support within line ministries to see the changes implemented. In Benin, support from key line ministries was vital to acceptance of DBS. The unique characteristics of this approach to disseminating information for the purpose of nurturing in-country support included explicit outreach efforts collectively by donors and government agencies towards middle and lower-level technical staff as well as key policymakers. In Bangladesh, for example, where bilateral donors (e.g. DFID) have worked for some time on capacity development in MoF, there were deliberate public relations efforts to create a “bottom- up” interest in PFM reforms. Success stories were publicised, and broad and participatory dialogue and ‘teaming’ around new ideas for PFM improvement encouraged.

- g) **Defining Monitoring and Evaluation tools** - At municipal and local district levels, participatory evaluation methods have been used to develop various measures of capacity to deliver services, such as report cards, citizen charters, and transparency commissions, and other forms of legally designated local government or “community” institutions<sup>75</sup>. UNDP can support national capacity to assess progress and monitor the results and impact of development finance, including DBS, through sectoral, thematic or sub-regional programmes. This would require building capacities to formulate gender and location sensitive targets and indicators, compile related base line data and statistics<sup>76</sup>, produce periodic surveys, assessments and impact evaluations, and put in place monitoring mechanisms and institutions for this purpose.<sup>77</sup> An example of these kinds of capacities exists in EU member countries, where the impact of social inclusion policies and measures are monitored using a comprehensive set of social indicators, and peer reviews involving authorities, civil society organisations and social partners.

<sup>73</sup> OECD Good Practice Note on Capacity Development in Public Financial Management. 2004 p. 8

<sup>74</sup> OECD Good Practice Note on Capacity Development in Public Financial Management. 2004 p. 9

<sup>75</sup> See Surf/Pov Consolidated Reply. Mozambique/ Comparative Experiences/ Participatory Monitoring & Evaluation Mechanisms for Accountability at District Level. March 30, 2005.

<sup>76</sup> See for example 2005 PRN discussions on UNDP Intranet on developing country capacity for improving aspects of statistical systems (Turkmenistan, Jordan, Thailand, Zimbabwe).

Tanzania DBS evaluation focus: Has technical assistance and capacity building been re-oriented towards key policy and public expenditure issues?<sup>78</sup> The inquiry extended to both government agencies (e.g. MoF) and NGOs, and examined capacity for strategic planning, budgeting, budget execution, and accounting at national to local (including municipal) levels . Methodologically, the ODI framework for such an evaluation is a useful tool, providing broad guidance, with adaptation for local context needed.

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<sup>78</sup> Lawson and Booth 2004 p. 55

## Section 5

### **UNDP ENGAGEMENT ON POOLED OR BASKET FUNDS**

Direct Budget Support, including the pooling of funds to support sector or programme approaches, has become a preferred method of development assistance by some donors and for some governments. The comparative advantage of doing so is primarily for those donors providing large amounts of financial assistance to a country. UNDP is not a funding organisation, and this is not its value added role. UNDP would therefore not provide its funds into the general budget. The comparative advantage for UNDP is to support national and local capacities (detailed in Part3) for country's to negotiate, manage and utilize DBS in ways that best support the human development agenda and achieve the MDGs.

UNDP also provides a value-added role in given countries, as a development service provider, to support the Government in the management and monitoring of pooled or basket funds, when called on to do so. This would often be done as an interim measure, while strengthening the capacities of national and local institutions to take on such functions, including in areas of international procurement.

However, there may be contexts in which UNDP is requested by government to contribute to a pooled or basket of fund which is managed by a non UNDP entity, be it government, a sub contracted company or other donor. If it is decided with government that UNDP should indeed contribute its monies to such a pooled fund (hereafter referred to as a "basket fund"<sup>79</sup>), the following corporate standards would apply:

- **UNDP would not provide funds directly into Treasury whether for balance of payments support or general budget support.**
- **UNDP can engage in a service provider function as manager of a basket fund, on request of government. If the basket fund is managed by UNDP, then existing UNDP fund management and cost sharing arrangements apply.**
- **UNDP could participate in and contribute to a basket fund, managed by a non UNDP entity (be it government or other), through a formal agreement with government as to the programme or sector specificity of results, and based on internationally acceptable accounting, monitoring and results management standards. The Harmonised Cash Transfer Modality would be used as the basis for determining the risk level of transferring monies into the basket<sup>80</sup>. UNDP's specific role and contribution to these activities and results would be detailed in a jointly signed and legally binding project document.**

UNDP will collaborate with other donors in the preparation and implementation of DBS programmes. It will, in doing so, have to assess the design, monitoring and reporting arrangements to ensure suitability for UNDP's own participation. These preliminary considerations should be well documented.

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<sup>79</sup> A DBS basket fund is defined as one where multiple stakeholders (donors, with or without government) pool funds towards a common end, against agreed progress and results targets. These funds are managed by government, a donor or an agreed third party. If managed by a donor or third party, on behalf of government, the DBS Agreement would specify the amount and periodicity of the release of tranches of resources, into the government account.

<sup>80</sup> [http://www.undg.org/documents/Framework for Cash Transfers to Implementing Partners](http://www.undg.org/documents/Framework%20for%20Cash%20Transfers%20to%20Implementing%20Partners)

UNDP's contribution to a basket fund implies that UNDP cannot distinguish the use of its specific funds for specific purposes, but that UNDP's funds are mixed with those of other donors to support outputs and results specified in the DBS agreement. The policy and programmatic framework for such could be in the form of a Poverty Reduction Strategy, Sector policy/programme or other thematically or geographically defined national plan of action. The UNDP Country Office should therefore first decide, together with government, if funding the 'basket' is strategically and programmatically desirable, both as a UNDP value added role, and if it brings additionality to the development process.

Based on the above, if it is decided that UNDP funds are not best directed into a basket fund, but instead to support the design and implementation of DBS initiatives and the capacities to manage them through separate programmes, then country level negotiations would determine if UNDP can still be a signatory to an MOU, with an exception written in as a non fund provider, or remain as a non signatory with observer status in the DBS partnership group.

**Conditions to be satisfied for UNDP to contribute to non UNDP managed basket funds<sup>81</sup> in the pilot phase**

1. A clear articulation of UNDP's specific roles and responsibilities must be spelt out in the standard DBS Agreement/MOU, with value added clearly defined, including: (a) policy and coordination support to governments undertaking the SWAp/basket; (b) role in programme design and oversight, and (c) access to technical cooperation to support the needs assessments and capacity development measures required to best design, monitor and account for the basket fund as needed.
2. UNDP would be specified as a full member of the governing structure for the basket fund initiative.
3. A clear risk analysis must be conducted, together with government and other donors. A joint report on this is acceptable. For example, the World Bank Country Financial Accountability (CFAA), DFID's Assessment of Fiduciary Risk, PERs as used. The guidance on "macro" assessment in the Harmonized Approach to Cash Transfers provides specific instructions on how such an analysis could be conducted.<sup>82</sup> However, there is no automatic link between decisions by other donors and UNDP's decision to participate or disburse, based on such common reports.
4. The support to capacity development activities should focus on establishing full implementation arrangements within national structures and procedures. While short-term measures may require use of interim measures such as a PIU or Capacity Development Fund, there must be a concrete exit strategy agreed to for such, and a detailed plan to allow for full government implementation within the medium term as part of the DBS/SWAp Agreement.
5. Regardless of whether the initial pooling of funds is within the government's own structure or government or donor managed PIU, the current financial, administrative and management capacity must be assessed and specific capacity development measures, with concrete timelines and assignment of responsibility of who will carry out those measures must be defined. For more detailed guidance, refer to the "micro" assessment in the Harmonized Approach to Cash Transfers.

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<sup>82</sup> *ibid.*

6. A clear definition of roles and accountabilities of the government and donors to the basket fund must be present, including joint monitoring functions, in the governance structure of the DBS initiative. This would be based on a national financial and programme tracking system with measurable indicators of the outputs of the pool/basket, as well as agreement on the development results. An Annual Programme Review (APR) or Performance Assessment Framework (PAF), used with PRSs, could be used for this purpose. A periodic evaluation of the basket fund would be included.
7. The common programme reporting on use of the basket fund would satisfy UNDP reporting requirements. UNDP would not require any additional results reports other than that provided by the government to all involved donors. In the case of UNDP contributing non-core funds to a basket fund, prior agreement to such a reporting arrangement must be included in the UNDP cost-sharing agreement with that donor.
8. National financial reporting of the use of the basket fund would need to provide an apportionment of the resources spent, detailing the pro rata expenditure to be attributed to the UNDP contribution. While UNDP would not be able to identify what its specific contribution was spent for, it can be satisfied that its contribution was spent for the purposes intended.
9. The agreement covering the “basket” must indicate the treatment of unused funds.
10. Based on the above, a national audit statement, or audit arrangements, as agreed and specified in the DBS Agreement/MOU, would be accepted by UNDP.

**UNDP Operational Procedures for provision of funding to non-UNDP managed basket funds in the pilot phase:**

When the above conditions are satisfied, the following procedures would apply:

- 1) UNDP would attach the DBS/SWAp Agreement detailing the basket funding arrangement to a project document<sup>83</sup>. The purpose of the project document is to release the UNDP funds for the given purposes, into the national account. Both UNDP and Government’s signature would be required on the standard DBS Agreement and the related Project Document (government signs latter as Implementing Partner).
- 2) If the DBS funding to be provided by UNDP is from non-core sources, then this would be detailed in the resource agreement (whether cost-sharing agreement, MOU, etc.) with the donor concerned, including reference to the reporting arrangements under the DBS/SWAp Agreement.
- 3) Any exceptions to the standard DBS Agreement/MOU should be reviewed by the Office of Legal and Procurement Support (OLPS).
- 4) If the basket is managed by government or an external agent, the provision of DBS would require formal approval, delegated by the Office of the Associate Administrator to the appropriate management unit (i.e. Regional Bureaus, UNCDF HQ and so on) during this pilot period. The DBS Agreement, with UNDP project document and other relevant attachments would be forwarded to OSG for review and onward to the Associate Administrator for signature.

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<sup>83</sup> This would be in the standard format or in the format of an annual work plan (AWP) for countries using the harmonized operational modalities.

- 5) The entire amount provided would be recorded as an advance in Atlas, charging account 16005 or the respective account in Atlas as appropriate for other partners (such as 16065 for UNCDF).
- 6) The amount would be expensed upon receipt of the certified government financial report showing the use of the funds and apportioning the funds to the various donors to the DBS pooled fund.

## Section 6

### **IMPLICATIONS FOR UNDP CAPACITY AND INTERNAL ORGANISATION**

While the focus of these Guidelines is the role of UNDP in supporting governments and other stakeholders strengthen their capacities to manage DBS, there obviously are implications for UNDP's own policies and practice. In response to changing times in the ODA environment, and the differing requirements of governments, UNDP staff skills and competencies, tools and operational procedures are evolving to meet challenges presented as countries move to improve their governance and PFM systems. Some of these areas are identified below:

- A systematic review and application of diagnostic tools is underway, particularly in areas of MDG needs assessments, capacity assessments<sup>84</sup>, results based management and programme evaluation.
- National and international economists and sector specialists in priority DBS areas of UNDP involvement, *with specific profiles in capacity development skills and experience*, are becoming a priority in staff re-profiling and recruitment exercises.
- A re-orientation of technical/policy advisory and programme staff job descriptions is underway, to move away from traditional project monitoring and reporting functions to increased time spent on facilitating policy dialogue, support to national aid coordination and harmonisation and providing support and coaching in such areas as a result of a growing DBS environment.<sup>85</sup>
- UNDP Country Offices are adapting also to the need for external communication and skills in facilitating policy dialogue and networking. COs must be ready to communicate their DBS support strategies and programs to a wider audience in government and civil society, taking advantage of various information channels as appropriate. For example, UNDP Mozambique has formulated a UN Communication Strategy and recruit a UN Information Officer for this purpose.
- A clear articulation of UNDP support to implementation services, particularly in direct management and procurement services through the Country Office, must be backed by appropriate accountability measures, time bound exit strategies and avoidance of conflict of interest concerns. This includes the need for an urgent review and negotiation of standard international contract rules and procedures that can be used to facilitate provision of UNDP implementation support services to governments, when required. Semi-independent Business Service Centres or procurement units have been established or under consideration in a number of COs, open to servicing government agencies, the UN system and other development partners as well.
- Internal financial policies and procedures would need to be adjusted to allow for acceptance of financial reports on pooled funds, reporting on an apportioned amount as per UNDP inputs.<sup>86</sup>
- A review of existing core and non core funding arrangements, would need to be carried out in light of the above, and discussed and updated with individual donors to ensure DBS provisions are in agreement with their own requirements of UNDP for financial and results reporting.
- A review of existing Standard Basic Agreements would have to be carried out in DBS countries to ensure agreements are in place to appropriately cover the new areas of engagement between UNDP and the government concerned.
- Arrangements to support new national aid management functions, as a follow up to the Paris

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<sup>84</sup> Refer Capacity Assessment Practice Note, Oct 2005

<sup>85</sup> See UNDP Cape Verde's experience with building Aid Coordination Unit, its TOR and human resources qualifications for the respective staff in this unit - 2/4/05 Consolidated Reply by Haley Horan in Surf/Poverty archives.

<sup>86</sup> The suggested actions in Section 5 contravene financial regulation 1805, which requires separate tracking and reporting on UNDP finances. This would therefore have to be amended.

Declaration must be prioritised.<sup>87</sup> The RC role in bringing the UN country team into these arrangements, bringing together UN sector teams and articulating their role in various aid management mechanisms and modalities, using the capacity of UNDP, should also be reviewed and articulated.

- The information available thus far has been provided through network discussions and sharing of experience at regional and national workshops. For a more thorough mapping and review of UNDP's existing and planned levels of involvement, a region-by-region review on how many UNDP country offices are directly engaged in CD for DBS and managing basket funds should be conducted in the near future.

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<sup>87</sup> The UNDG has issued an action plan for follow up actions to the Paris Declaration, including, for example, a requirement that the UN system align as one with national strategy, reporting and monitoring tools and systems.

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