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THE COMMISSION'S MANAGEMENT OF  
**GENERAL BUDGET SUPPORT** IN ACP,  
LATIN AMERICAN AND ASIAN COUNTRIES



EN





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# THE COMMISSION'S MANAGEMENT OF GENERAL BUDGET SUPPORT IN ACP, LATIN AMERICAN AND ASIAN COUNTRIES

(pursuant to Article 287(4), second subparagraph, TFEU)

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**REPLY OF THE COMMISSION**

# GLOSSARY

**ACP:** African, Caribbean and Pacific states

**CPIA:** Country Policy and Institutional Assessment

**EDF:** European Development Funds

**GBS:** general budget support

**MDG:** millennium development goals

**PEFA:** Public Expenditure and Financial Accountability

**PFM:** public finance management

**SBS:** sector budget support

# EXECUTIVE SUMMARY

## I.

The European Court of Auditors has carried out a performance audit to assess whether the European Commission manages its general budget support (GBS) programmes effectively. GBS has a number of potential advantages over the traditional project approach. It can supply larger volumes of aid in a more predictable manner and since it funds the national development strategy of the partner country the latter tends to have more ownership of this aid instrument. As it is channelled through the national budget, it can encourage the improvement of public finance management (PFM) by the partner country and increase domestic accountability. It is also seen as a way of strengthening policy dialogue and improving the harmonisation and coordination of aid between donors, thereby potentially increasing the efficiency of aid delivery and reducing the costs for the partner country. GBS has been increasingly used by the Commission over the last decade in order to achieve its main development policy objective of reducing poverty.

## II.

GBS programmes typically consist of a support package involving the transfer of funds, capacity-building measures, dialogue with the partner country and the establishment of conditions for disbursement. A number of other donors use GBS and the Commission has to coordinate its programmes closely with theirs.



## EXECUTIVE SUMMARY

### III.

As with other aid modalities, the ultimate impact of GBS on poverty reduction depends on the specific circumstances in each country. It also depends on the effective Commission's management of its GBS programmes. The Court found that, whilst the Commission has made considerable efforts over the last decade to develop its approach to providing aid through GBS, there are still weaknesses in the methodology and management of GBS programmes in ACP, Latin American and Asian countries, which are thus less likely to reach their full potential effectiveness.

### IV.

The Court found that, whilst a positive feature of the Commission's approach is the systematic inclusion of macroeconomic and PFM objectives, the objectives of GBS programmes do not sufficiently take into account the specific circumstances and changing priorities of partner countries, as well as other programmes implemented by the Commission and other donors. Furthermore, although some improvement has been noted in more recent programmes, the objectives of the programmes tend to be formulated in terms which are too general and this hinders the design of the various components of the programmes and makes it more difficult to hold the Commission accountable for their effectiveness.

### V.

The Commission has not yet developed a sound risk management framework to properly assess and reduce the risks of its GBS programmes. This is of particular importance in view of the high levels of fiduciary risk associated with weak PFM systems and significant levels of corruption, and of the development risk arising from weaknesses in the national development strategies of many partner countries.

### VI.

The rationale followed by the Commission to set the amount of funds to be allocated to individual GBS programmes is not clear. It was, however, noted that the Commission has improved the predictability of its disbursements to partner countries which is important for their budgetary management.

### VII.

The capacity-building support provided is useful in strengthening PFM, although it was not based on an appropriate assessment of priority needs. In particular, insufficient attention has been given to the need to strengthen oversight bodies such as supreme audit institutions, parliaments and civil society organisations seeking to monitor government use of budgetary resources. It has also been little used to support other GBS objectives, notably in relation to health and education. The Commission has often not been able to fully implement the capacity-building support within the timeframe of the GBS programmes. However, in 2008 the Commission adopted a strategy that aims to improve the effectiveness of its technical cooperation.

## EXECUTIVE SUMMARY

### VIII.

The performance-based conditions attached by the Commission to disbursement of GBS are generally relevant but are unlikely to achieve their intended incentive effect because of the way they are designed and implemented. It is often difficult to assess whether conditions have been met or not, in particular because of a lack of clarity over what constitutes satisfactory progress, and weaknesses in the statistical systems used for assessing results.

### IX.

Whilst GBS programmes have had a catalytic effect in respect of strengthening dialogue on the national budget and PFM, the Commission does not make full use of the instrument's potential because it has insufficient expertise in the priority areas related to the GBS programmes' objectives and there are weaknesses in its management of the dialogue process.

### X.

The Commission's external reporting on general budget support tends to focus on its potential benefits to improving aid delivery but there is relatively little information on its actual impact on poverty reduction. An evaluation methodology which provides evidence on whether, and in what circumstances, budget support can make an effective contribution to poverty reduction has not yet been established. However, the Commission is leading donor efforts to develop such a methodology.

### XI.

The Commission is aware of the need to improve its management of GBS and at the end of 2009 launched a revision of its internal guidelines to address most of the issues raised by the Court in this report which contains a series of recommendations for the Commission to consider in this context.

# INTRODUCTION

1. Poverty reduction is the overarching goal of EU development cooperation and over the last decade general budget support (GBS) has been increasingly used by the European Commission, as well as by other donors, as a means to try to achieve this objective. It involves the transfer of funds by the Commission to the national treasury of a partner country in order to provide additional budgetary resources to support a national development strategy. The transfer of funds in this way is also intended to contribute to macroeconomic stability which is generally considered fundamental to development and poverty reduction. In addition, the channelling of funds through national financial systems is also intended to lead to improvements in public finance management (PFM) since effective PFM systems also play an important role in poverty reduction efforts.
  
2. The Commission's GBS programmes, and those of other donors, involve not only the transfer of funds but also three other components which provide key inputs to support programme objectives:
  - (a) capacity development measures, mainly through technical assistance, to help countries strengthen their policy-making and management (see paragraph 49);
  - (b) the establishing of conditions for the release of funds which are linked to the programme objectives and agreed between the partner country and the donors. The Commission's approach to using conditions has focused on trying to give countries greater incentives to achieve results by using a so-called 'variable tranche' mechanism to reward performance (see paragraph 58);
  - (c) dialogue with the country on the design, implementation and results of national and sectoral policies including the budget. Increased opportunities for dialogue are often considered to be a particular benefit of budget support (see paragraph 68).

3. General budget support has many similarities with sector budget support which also involves the transfer of funds to the national treasury. However, sector budget support programmes aim to support a sector policy rather than a national strategy. Accordingly, capacity-building, conditions and dialogue all focus on supporting the selected sector.
4. An important feature of GBS is the close cooperation it entails between donors, since they are all supporting the same national strategy and using the same national systems. This means that, when setting the objectives of its GBS programmes and planning the transfer of funds, capacity-building measures, conditions and dialogue arrangements needed to achieve these objectives, the Commission also has to seek to ensure that these inputs are coordinated with the inputs of other donors.
5. Close donor coordination over GBS is also seen as best practice in order to reduce the transaction costs to partner countries of having to deal with numerous donors on a bilateral basis. Nevertheless, while following the principle of donor harmonisation, the Commission continues to have sole responsibility for taking financing decisions and is accountable to the discharge authority for the use of EU funds. Balancing the necessary donor partnership approach and the responsibility and accountability it has for its GBS programmes inevitably represents a difficult challenge for the Commission.

## BUDGET SUPPORT IS THE PREFERRED AID MODALITY OF MANY DONORS

6. The Commission has given GBS to ACP countries since the seventh EDF (1990–95) and to Asian and Latin American countries since 2003. The Cotonou Agreement provides for the possibility of giving GBS to ACP countries<sup>1</sup> and it was also formally included in the new 2006 Development Cooperation Instrument Regulation<sup>2</sup> covering Asia and Latin America. For the management of GBS the Commission uses comprehensive internal guidelines<sup>3</sup> which it first developed in 2002, thoroughly revised in 2007 and then updated in 2009. During this audit the Commission launched another major revision that is scheduled to be completed in 2010. The Commission has also developed a series of training courses for its staff on different aspects of budget support.
7. Budget support, either GBS or sector budget support (SBS), has become the preferred aid modality of many donors, including the Commission, because they consider it the most effective way to deliver aid. In the Paris Declaration, signed in 2005, donors committed themselves to channelling increasing amounts of assistance through country systems. The EU specifically committed itself to achieving this objective by delivering 50 % of its government-to-government assistance through country systems by 2010. In 2008, the Accra Agenda for Action went further than the Paris Declaration by stating that the use of partner country systems — meaning, principally, budget support — should in future be the ‘first option’ for delivering aid and that donors should give clear reasons if they did not use them.
8. The volume of EU budget support has increased accordingly over time. Whereas budget support represented 30 % (GBS: 21 %, SBS: 9 %) of total funding under the ninth EDF (2001–07), it is expected to reach 48 % (GBS: 31 %, SBS: 17 %) of total funding under the 10th EDF (2008–13). For the Asia and Latin America regions, the proportion delivered through budget support increased from 12 % (GBS: 3 %, SBS: 9 %) in the 2003–05 period to 25 % (GBS: 5 %, SBS: 20 %) in the 2006–09 period. GBS has been used in 35 ACP countries and has so far also been given in seven Asian and Latin American countries. **Annexes I and II** present the commitments per country.

<sup>1</sup> Article 61.

<sup>2</sup> Regulation (EC) No 1905/2006 of the European Parliament and of the Council of 18 December 2006 establishing a financing instrument for development cooperation, Article 25(1)(b) (OJ L 378, 27.12.2006, p. 41).

<sup>3</sup> ‘Guidelines on the programming, design and management of general budget support’ which are available on the EuropeAid website ([http://ec.europa.eu/europeaid/what/economic-support/documents/guidelines\\_budget\\_support\\_en.pdf](http://ec.europa.eu/europeaid/what/economic-support/documents/guidelines_budget_support_en.pdf)).

## GBS HAS MANY POTENTIAL BENEFITS COMPARED TO PROVIDING AID THROUGH PROJECTS

9. There are various potential benefits in providing aid through GBS rather than through funding specific projects. It can supply larger volumes of aid in a more predictable manner and since it funds the national development strategies of partner countries the latter tend to have stronger ownership of this aid instrument. As it is channelled through the national budget, it can encourage the improvement of public finance management and planning by the partner country and increase domestic accountability. Furthermore, GBS is seen as a way of strengthening policy dialogue and improving the harmonisation and coordination of aid between donors, thereby potentially increasing the efficiency of aid delivery and reducing the costs for the partner country.
  
10. As with other aid modalities, the ultimate effectiveness of GBS in terms of reducing poverty levels depends on the specific circumstances in each country. The legal framework<sup>4</sup> stipulates that GBS can only be given if there is a sound macroeconomic policy, a well-defined national development policy and sufficiently transparent, reliable and effective PFM. The Commission interprets these conditions in a dynamic manner. In its view, the weaknesses affecting PFM and the national development strategy of the partner country at the time of the financing decision do not preclude the launch of a GBS programme, provided that the will to reform exists and the reforms are relevant and credible. In this way it takes account not only of the initial situation, but also of the direction being taken by the partner country. Other budget support donors follow a similar approach.
  
11. As well as the specific circumstances in each country, a second major factor influencing the impact of GBS programmes is how well the Commission manages these programmes. This report addresses the question: 'Does the Commission manage its GBS programmes effectively?'

<sup>4</sup> Article 61(2) of the Cotonou Agreement and Article 25(1)(b) of the Development Cooperation Instrument Regulation.

# AUDIT SCOPE AND APPROACH

**12.** To answer the question, 'Does the Commission manage its GBS programmes effectively?' the audit focused on four key areas.

- (a) Does the Commission appropriately select and formulate the objectives and expected results of its GBS programmes?
- (b) Does the Commission appropriately manage the main risks to the effectiveness of GBS programmes?
- (c) Does the Commission design and implement its GBS programmes effectively?
- (d) Does the Commission report in a clear, exhaustive and accurate manner on whether GBS is meeting its objectives?

<sup>5</sup> Public Expenditure and Financial Accountability.

**13.** The audit focused on the Commission's management of GBS programmes in ACP, Latin American and Asian countries. Given their particularities, countries in a fragile situation were excluded from the scope of this audit. The audit covered the ninth and 10th EDFs, which means commitments made from 2001 onwards, and all GBS programmes under the general budget, the first of which was committed in 2003. The Commission's assessments of countries' eligibility for GBS are addressed by the Court's financial audits, the findings of which are presented in the Court's annual reports. This report refers to these findings where relevant. The audit did not aim to make an assessment of the advantages and disadvantages of GBS compared to other aid modalities.

**14.** The audit involved an analytical review of all GBS programmes funded in these regions over the 2001 to 2009 period to assess the Commission's approach to managing GBS. It included visits to four countries: Benin, Laos, Paraguay and Uganda. During those visits, the Court's auditors interviewed Commission staff, representatives of national authorities and other donors. In addition, GBS programmes in Nicaragua and Vietnam were covered through a documentary review and questionnaires sent to the Commission Delegations in the two countries. The audit also involved meetings with the PEFA<sup>5</sup> secretariat, the World Bank and the International Monetary Fund and a mission to the United Kingdom to visit the Department for International Development, the National Audit Office and a consultancy company. The audit was carried out between May 2009 and May 2010.

# OBSERVATIONS

## THE COMMISSION INSUFFICIENTLY TAILORS THE OBJECTIVES OF ITS GBS PROGRAMMES TO THE SPECIFIC CIRCUMSTANCES OF EACH COUNTRY

- 15.** The overall objective of GBS programmes is to support the implementation of a country's national development strategy<sup>6</sup>. The Commission seeks to align the specific objectives of its programmes with these strategies.
- 16.** This section addresses the question of whether the Commission adequately selects and formulates the objectives and expected results of its GBS programmes. The Court examined whether programme objectives are precise and tailored to country circumstances. Furthermore, the Court examined whether the objectives include strengthening PFM in partner countries and whether programmes clearly set out how budget support will contribute to achieving the expected results.

## THE OBJECTIVES OF GBS PROGRAMMES TEND TO BE SIMILAR FOR ALL PARTNER COUNTRIES DESPITE THEIR DIFFERENT SITUATIONS

- 17.** For the most part the objectives of GBS programmes are very similar across the different countries where the Commission uses this aid modality. In particular in ACP countries, in the great majority of cases over the last 10 years, each GBS programme has had objectives relating to four areas: macroeconomic stability, PFM, health and education<sup>7</sup>. This 'one size fits all' approach does not sufficiently take into account each country's specific and changing priorities or the other programmes funded by the Commission and other donors in the country.

<sup>6</sup> Frequently such national development strategies have been presented in the form of 'poverty reduction strategy papers' although in recent years this designation has been used less often.

<sup>7</sup> According to the Commission's internal guidelines, 'where support is being given to poverty reduction strategy papers, it is normal to focus on the social sectors of education and health as being key elements in reducing income and non-income poverty'.



**18.** The systematic inclusion of overall economic governance objectives relating to macroeconomic stability and PFM reform is a positive feature of the Commission's GBS programmes. Both are essential to achieving the GBS programmes' overarching objective of contributing to poverty reduction. However, the PFM objectives selected are often not tailored to address the PFM reform priorities of individual partner countries. Thus, for example, in Laos, PFM objectives do not address the important areas of internal control and corruption and in Vietnam PFM issues have not been prioritised. In Paraguay and Nicaragua, although PFM diagnostics identified significant weaknesses, the GBS programmes do not formulate specific programme objectives relating to PFM.

**19.** As regards the other objectives of GBS programmes, the Commission's approach does not adequately reflect the fact that the national development strategies of some countries have moved in recent years to growth-targeted approaches in order to achieve the overarching objective of poverty reduction. This change is not reflected in the objectives of the new GBS programmes to support such national strategies. An example is Uganda's new 'national development plan' which was being prepared at the time of the Court's audit. It placed much more emphasis on infrastructure and private sector development than previous national development strategies which had taken the form of 'poverty eradication action plans'<sup>8</sup>. Although the Commission's internal guidelines recognise that growth is a necessary condition for poverty reduction, they do not address the new importance attached to it by partner countries and how the Commission should deal with it when selecting programme objectives and related conditions.

<sup>8</sup> Uganda's first poverty eradication action plan was established in 1997. It served as a model for the subsequent 'poverty reduction strategy papers' which the World Bank encouraged other developing countries to draw up.

**20.** The Commission's programming procedures provide for each country's overall aid allocation to be largely channelled into no more than two priority or 'focal' sectors and, if the country is eligible for it, GBS. The Commission's relatively standardised approach to setting GBS programme objectives does not take into account the focal sectors selected. In some countries this has also led the Commission to having both GBS programmes with health and education objectives and also health and/or education as sectors with funding channelled through SBS. In such cases the value added of the GBS programme having education and health objectives is unclear. The Court identified such cases in the current programmes of four ACP countries<sup>9</sup>. This was less of a problem in Asia and Latin America, mainly because GBS programmes in these countries tend to be less standardised and have more focused objectives. GBS programmes in Asian countries, for example, are structured around World Bank poverty reduction support credits, which place particular emphasis on growth as a key element in reducing poverty, rather than on social sectors.

**21.** The Commission's use of standardised objectives for its GBS programmes means that it is difficult to adjust the programmes to coordinate them with other donors' objectives for their GBS programmes. Moreover, the 2007 EU Code of Conduct on Complementarity and Division of Labour in Development Policy requires the Commission and Member States to aim at focusing their active involvement in a partner country on a maximum of three sectors<sup>10</sup>. This raises the question of the extent to which GBS programmes should have sectoral objectives since this requires the participation of the Commission in these sectors in addition to the two focal sectors.

<sup>9</sup> Dominican Republic, Mozambique, Tanzania and Zambia.

<sup>10</sup> Guiding Principle No 1 of EU Code of Conduct.

## THE OBJECTIVES OF GBS PROGRAMMES ARE OFTEN DEFINED IN TERMS WHICH ARE TOO GENERAL

- 22.** The objectives of GBS programmes are formulated in most cases in rather general terms and do not set out clearly what the programmes are expected to achieve and by when (see **Box 1**). This is detrimental to the design of the various components of GBS programmes, namely the transfer of funds, capacity development, conditions and dialogue (see paragraphs 1 and 2). Moreover, it does not allow an objective assessment of whether objectives have been achieved, making it more difficult to hold the Commission accountable for the effectiveness of its GBS programmes.

### BOX 1

## SELECTING AND FORMULATING OBJECTIVES

### Good Commission practice: Laos

The Commission's GBS programmes in Laos<sup>11</sup> are integrated<sup>12</sup> in the World Bank's budget support policy matrices which provide clear, detailed information on priority actions to be completed within the timeframe of the programme. For instance, the objective to introduce key PFM reforms is broken down into three detailed objectives relating to the budgetary process, the transparency of intergovernmental fiscal transfers and the financial audit function. For each of these detailed objectives, the policy matrices define which actions the government has to take during each year of the programmes' implementation. The clear link with performance indicators allows objective monitoring of the achievement of the objectives of the programme.

### Weak Commission practice: Nicaragua

The financing agreement for the Commission's GBS programme in Nicaragua<sup>13</sup> focuses on rural areas but does not define general and specific objectives and expected results. It refers to the overall objectives of the national development plan, but does not set out what the Commission expects the GBS to achieve. Furthermore, the expected contribution to PFM is unclear. Although the financing agreement describes PFM weaknesses and the main measures taken by the government to improve the PFM system, PFM improvement is not an explicit objective of the programme.

<sup>11</sup> A first programme with a single fixed tranche of 3,2 million euro was committed in 2007 and a second four-year programme for 13,0 million euro in 2008.

<sup>12</sup> On the one hand, the Commission has an input when poverty reduction support operations are set up and, on the other hand, the Commission draws from the poverty reduction support operations when setting objectives and defining conditions for its GBS programmes.

<sup>13</sup> The GBS programme was committed in December 2004 and provides for an amount of 68 million euro to be disbursed over the period from 2006 to 2009.

- 23.** Some progress was made in the financing agreements under the 10th EDF in improving the formulation of objectives by clearly distinguishing general and specific objectives in the structure of the document. By revising its internal guidance on budget support (see paragraph 6), the Commission intends to introduce further improvements by requiring its staff to:
- (a) specify in the financing documents the steps needed to implement PFM reforms and national development strategies or sector policies;
  - (b) establish medium-term objectives for the programme.

**THE COMMISSION DOES NOT APPROPRIATELY  
MANAGE THE MAIN RISKS TO EFFECTIVE GBS**

- 24.** All development cooperation involves taking risks which may have an impact on the effectiveness of the aid. GBS involves risks that are different from those arising from the traditional project approach to development cooperation. The main risks to the effectiveness of GBS are fiduciary risk and development risk: fiduciary risk can be defined as the risk that government funding is not used for the intended purpose of poverty reduction; development risk can be defined as the risk that the national policies and strategies supported by GBS are inadequate.
- 25.** This section addresses the question of whether the Commission appropriately manages the main risks affecting the effectiveness of GBS. The Court examined how the Commission assessed fiduciary and development risks and what steps it took to manage those risks through relevant capacity development, conditions, dialogue and measures for monitoring and reducing risk.

## THE RISK MANAGEMENT FRAMEWORK IS NOT WELL DEVELOPED

- 26.** The eligibility conditions for budget support are designed to ensure that GBS is only provided in countries which have the necessary framework for GBS to be effective: a sound macro-economic policy, a well-defined national development policy and a sufficiently transparent, reliable and effective PFM system (see paragraph 10). Since the Commission uses a dynamic interpretation of the eligibility conditions, the existence of significant weaknesses in PFM or development strategies at the time of the financing decision does not preclude the launch of a GBS programme, provided that the partner country is committed to reform and its progress in implementing reforms is deemed to be relevant and credible. Implementing reforms is a lengthy process. Whilst the dynamic approach means that the Commission, together with other donors, is investing in the future, it needs to assess and reduce the risks that result from systems that do not immediately provide sufficient guarantees in terms of transparency, efficiency and effectiveness<sup>14</sup>.
- 27.** For ACP countries<sup>15</sup>, the Commission's assessment of risk has focused on the risk of countries not continuing to meet eligibility conditions throughout the entire implementation period of the GBS programmes. This assessment was based on the country's previous track record with GBS and its future prospects for meeting the eligibility criteria. The conclusions of the assessment were an important factor in deciding whether or not to provide budget support in those countries (see paragraph 45). Although this risk assessment is useful, it is not sufficient as it does not cover the potential impact of fiduciary risk and development risk on the effectiveness of GBS.

<sup>14</sup> The Court's Special Report No 2/2005 concerning EDF budget aid to ACP countries: the Commission's management of the public finance reform aspect, paragraph 13.

<sup>15</sup> The assessment was carried out in the context of the programming of the 10th EDF. Such an assessment was not carried out for non-ACP countries.

- 28.** The Commission's internal guidelines do not provide for the assessment of fiduciary and development risks. The main types of risks are not identified and there is no guidance on how to assess the significance, probability and potential impact of risks. Furthermore, it is not clear how risk-mitigating measures such as capacity-building support, dialogue, conditions and shorter-term measures are to be designed for the different types and levels of risk and how these measures should be coordinated with other donors.

### **RISKS ARE HIGH IN MOST COUNTRIES BENEFITING FROM GBS BUT ARE NOT ADEQUATELY ADDRESSED BY THE COMMISSION**

#### **FIDUCIARY RISK**

- 29.** GBS is mostly provided in countries with weak PFM systems. This is demonstrated by the annual Country Policy and Institutional Assessment (CPIA) published by the World Bank where the indicator for the quality of budgetary and financial management is relatively low for the majority of countries benefiting from GBS<sup>16</sup>. Weak PFM systems can lead to waste of funds and inefficiency which reduce the effectiveness of GBS programmes in achieving their poverty reduction objectives.
- 30.** Another consequence of weak PFM systems is increased corruption. The CPIA also includes an indicator concerning transparency, accountability, and corruption in the public sector whose score is similarly low for most countries benefiting from GBS<sup>17</sup>. Further indications of the often high level of corruption can be derived from the Corruption Perception Index published by Transparency International. Among the 27 ACP countries that are not in a fragile situation<sup>18</sup> and for which GBS has been planned in the country strategy papers for the 10th EDF, 12 of them<sup>19</sup>, on the basis of the 2009 Corruption Perception Index, are classified as having 'rampant corruption'<sup>20</sup>. Among the six Latin American and Asian countries with GBS programmes, five of them<sup>21</sup> have the same classification.

<sup>16</sup> The CPIA assesses how conducive the country's policy and institutional framework is to fostering poverty reduction, sustainable growth, and the effective use of development assistance. The World Bank uses the CPIA ratings in its aid allocation process. The CPIA consists of 16 indicators that are rated on a scale of one (low) to six (high). For the ACP, Asian and Latin American countries benefiting from GBS, the scoring in 2008 for Indicator 13, 'Quality of budgetary and financial management' averages 3,4, ranging from 2,0 to 4,0.

<sup>17</sup> For the ACP, Asian and Latin American countries benefiting from GBS the scoring in 2008 for Indicator 16, 'Transparency, accountability and corruption in the public sector' averages 3,0, ranging from 2,0 to 4,5.

<sup>18</sup> These countries were not included in the scope of the audit (see paragraph 13).

<sup>19</sup> Benin, Ethiopia, Gambia, Guyana, Kenya, Mali, Mauritania, Mozambique, Niger, Tanzania, Togo and Uganda.

<sup>20</sup> Corruption Perception Index of less than three. The index ranges from zero (high risk) to ten (low risk).

<sup>21</sup> Cambodia, Laos, Nicaragua, Paraguay and Vietnam.

**31.** The Court found that relevant information on PFM systems and the reform programmes to improve them is available to the Commission for its decision-making and monitoring purposes. The Public Expenditure and Financial Accountability (PEFA) are a particularly useful source of information on PFM systems. These are based on a common methodology drawn up in 2005 through joint donor efforts, including significant inputs from the Commission. The PEFA assessments have been carried out for many countries<sup>22</sup> and report on the state of a country's PFM system according to 28 indicators. The assessments have in many countries stimulated PFM dialogue and the drawing up of PFM reform action plans and support programmes. The results of the assessments also provide a good basis for measuring improvement over time. They are complemented in this respect by annual PFM reports prepared by Delegations that generally provide a good overview of the PFM situation and recent developments.

**32.** Nevertheless, the Commission does not assess and conclude on fiduciary risk. This is partly because, unlike some Member States such as France<sup>23</sup> and the United Kingdom<sup>24</sup> and other organisations<sup>25</sup>, it has no methodology for doing this. Furthermore it has insufficient information on how well PFM systems are actually working in practice. The PEFA assessments are not intended to be a fiduciary risk assessment tool because they do not contain a sufficiently in-depth assessment of the extent to which controls and procedures are complied with and the estimated impact of corruption. Such information should normally be found in the annual reports of the supreme audit institutions and other oversight bodies. However, in Uganda, where the supreme audit institution issues an annual audit report reasonably on time, the Commission Delegation had not made sufficient use of it for identifying fiduciary problems. In most countries supreme audit institutions issue their reports with significant delays or, in the case of Laos, they are not even made public.

<sup>22</sup> PEFA assessments have been carried out for all of the 28 ACP countries for which GBS commitments were made under the 10th EDF as at 31 December 2009. For nine of these countries more than one PEFA assessment had been carried out, which in principle should enable the measurement of progress over time. Some of these follow-up assessments, however, aim to create a more reliable baseline than the first assessment and thus do not enable the tracking of performance changes from the previous assessment. For Asian and Latin American countries, PEFA assessments were made in four out of the six countries in which GBS has been provided so far by the Commission.

<sup>23</sup> 'Doctrines en matière de risque fiduciaire dans les états étrangers', France Coopération, April 2008.

<sup>24</sup> 'Managing fiduciary risk in DFID bilateral aid programmes', DFID, January 2008.

<sup>25</sup> This lack of methodology contrasted with, for instance, the approach followed by the Asian Development Bank for its sectoral budget support interventions in Laos. The ADB had developed a matrix setting out each significant risk, how it would be addressed and over what time period.

- 33.** In addition, for most countries examined, the lack of transparency in the presentation of national and subnational budgets also makes it difficult for the Commission to analyse how budgetary resources are being used. Diagnostic studies such as public expenditure tracking surveys<sup>26</sup> and public expenditure reviews<sup>27</sup> can help compensate for a lack of information by identifying major inefficiencies and leakages, so that donors and beneficiary governments can prioritise their efforts on first addressing these problems. The Commission has made relatively little use of such tools.
- 34.** The Commission applies a number of methods in its GBS programmes to contribute to reducing fiduciary risk, in particular the PFM eligibility criterion, which requires satisfactory progress in PFM reform, and other PFM conditions attached to disbursements. Commission support for PFM reform programmes through capacity-building and dialogue is also used to reduce risk. However, the lack of a thorough and explicit fiduciary risk assessment makes it harder to draw up a risk reduction plan which clearly sets out the risks and defines what measures are needed to reduce them and over what time period. Moreover, Commission risk reduction measures mostly focus on improvements which will only have an impact over the medium to long term. Little use has been made of shorter-term measures agreed with partner governments to address high-risk areas through, for example, assisting supreme audit institutions to carry out more prompt and higher quality audits or supporting countries in the application of standard international procurement procedures (see **Box 2**).
- 35.** While the Commission did include such measures for reducing risk in the design of its GBS programmes under the ninth EDF in Uganda and Benin, such as the use of private audit firms to assist supreme audit institutions in carrying out audits and the carrying out of public expenditure tracking surveys and public expenditure reviews, they were not accompanied by a clear and agreed plan of implementation that sets out how and by when these measures would address specific risks. In fact, most of the planned measures were ultimately not implemented. The GBS programmes under the 10th EDF for these countries and the GBS programmes of the Asian and Latin American countries examined do not provide for shorter-term measures.

<sup>26</sup> The public expenditure tracking survey is a method used to study the flow of public funds and other resources, through the various levels of government and administrative hierarchy. It is most relevant where public accounting systems function poorly or provide unreliable information.

<sup>27</sup> Public expenditure reviews analyse the allocation and management of public expenditure. They may cover all government expenditure or focus on a few priority sectors (e.g. health, education, agriculture, water, roads). They can be used to inform strategic planning and budget preparation and to identify ways in which to improve the efficiency and effectiveness of resource allocations. Increasingly, they also review expenditure management systems and institutions.



## REDUCING FIDUCIARY RISK

### Good Commission practice: Ethiopia

The Protection of Basic Services Program II<sup>28</sup> was designed to support the budgets of regional level and lower tiers of government which were responsible for basic services such as education, health and water. The programme contains strengthened reporting and accountability measures to enable verification that the services were reaching the intended beneficiaries. These measures include more regular and timely reporting on regional and local spending for basic services. Furthermore, the flow of government funds was to be tracked to the final service delivery point, for instance, through public service delivery surveys. The reporting and accountability measures also included an *ex-post* review of procurement, measures to improve disclosure of public budget information at regional, subregional and service delivery point, and the continuous audit of local government expenditure by the Auditor General combined with the necessary capacity-building support for the Auditor General's staff.

### Weak Commission practice: Paraguay

The preparatory documents for the approval of the Commission's GBS programme do not refer to fiduciary risk, although the overall conclusion of the Country Financial Accountability Assessment of August 2004 was that the financial management risk is high and that, to reduce risk to an acceptable level, reforms were needed in the areas of internal control, external audit and the control of decentralised entities. Furthermore, the preparatory documents do not describe the main risks relating to inefficiencies and wastage of the national budget and do not address the issue of corruption in spite of the extent of this problem<sup>29</sup>. Despite the high level of fiduciary risk, the preparatory documents do not demonstrate how the main weaknesses are to be tackled and no shorter-term measures were implemented.

<sup>28</sup> This programme is not formally labelled a GBS programme. Nevertheless its basic objectives and purpose, the large-scale transfer of funds with the objective of poverty reduction and through national systems using a multi-sector approach, are typical of GBS programmes.

<sup>29</sup> Transparency International reports poor performance in terms of corruption perception and the situation is deteriorating. Its Corruption Perception Index has listed Paraguay as one of the most corrupt countries in Latin America. The relative position improved between 2004 (140th) and 2006 (111th) but later deteriorated again: 138th place in 2007 and 2008 and 154th place in 2009. This perception is confirmed by an evaluation of corruption by the United States Agency for International Development (USAID) in June 2008 as well as by various interlocutors during the Court's audit mission to Paraguay.

- 36.** The Commission has paid relatively little attention to the risk of corruption in its GBS programmes in terms of objectives, capacity-building support and monitoring and generally makes little reference to it in its programme appraisal documentation. One reason for this is that the Commission tends to treat it as a wider governance issue which has led to it not being sufficiently addressed in the context of PFM reform efforts. However, in 2008 the Commission considerably increased its efforts to tackle corruption in Uganda in conjunction with other donors and the European Anti-Fraud Office.

<sup>30</sup> Results-based national development strategies: Assessment and challenges ahead, The World Bank, December 2007. The review used three criteria for its assessment: a unified strategic framework, prioritisation within that framework and a strategic link to the budget.

#### DEVELOPMENT RISK

- 37.** In addition to PFM systems that work, countries also need to have well-defined national development strategies, integrated with the national budgetary framework and sectoral policies, for GBS to be effective. A structured assessment of the strategy should therefore be a significant part of the Commission's work of drawing up GBS programmes. The Court found that national development strategies are generally described in Commission programming, identification and formulation documents but are not critically appraised and the Commission does not draw an explicit conclusion on the relevance and credibility of the strategy.
- 38.** National development strategies are generally still weak, which is likely to mean that development risk is relatively high. Thus a 2007 World Bank review concluded that only eight of the 62 developing countries (13 %) examined had a 'largely developed' strategy<sup>30</sup> although it considered that all countries were making progress towards this. In particular the review found that:
- (a) in most countries, strategies were still only weakly linked to the budget;
  - (b) many of the countries were still pursuing multiple medium-term strategies, which may involve a significant duplication of effort and jeopardise progress on the other components of the development strategy;
  - (c) many countries have identified goals and priorities matching their specific needs but need to provide better clarification of how to achieve these goals.

- 39.** The Commission holds considerable information on development risks. However, these are not clearly set out in the identification and formulation documents of the GBS programmes. In Paraguay for instance, risks include insufficient planning of the financial and human resources needed to implement the national development strategy, inappropriate institutional arrangements which have led to weak and inefficient policies, lack of transparency in the design and implementation of policies and programmes and inappropriate targeting of expenditure. Where the Commission did identify risks, as for instance in Uganda and Vietnam, it did not make an explicit judgement on the level of development risk and did not systematically identify measures for reducing it.

**THE COMMISSION'S DESIGN AND IMPLEMENTATION OF THE DIFFERENT COMPONENTS OF ITS GBS PROGRAMMES DO NOT ENSURE THAT THEIR POTENTIAL IMPACT IS OPTIMISED**

- 40.** This section addresses the question of whether the Commission's design and implementation of the different components of GBS were effective, i.e. transfer of funds, capacity-building support, conditions and dialogue.

**THE RATIONALE FOR THE ALLOCATIONS TO INDIVIDUAL GBS PROGRAMMES IS NOT CLEAR BUT THE DISBURSEMENT OF FUNDING IS INCREASINGLY PREDICTABLE FOR THE PARTNER COUNTRIES**

- 41.** The Court examined whether the Commission appraised the amounts of individual GBS programmes according to the objectives of the programmes and the countries' specific circumstances. Furthermore, it examined whether the Commission disburses GBS on a predictable basis and in alignment with country budgetary systems.

**THERE IS NO FRAMEWORK FOR ASSESSING THE APPROPRIATE AMOUNTS FOR GBS PROGRAMMES**

- 42.** The country strategy papers and the various documents used for deciding on GBS programmes examined by the Court lack clear explanations on how the amount of GBS allocated had been decided. In most cases, a reference is only made to the overall objective of increasing the Commission's use of budget support (see paragraph 7).
  
- 43.** Imprecise objectives (see paragraph 22) are a problem for assessing the amount to be allocated to individual GBS programmes. For example, the amount required to have an impact on partner country budgetary expenditure patterns or to finance the budget deficit may be quite different from the amount required to strengthen PFM systems.
  
- 44.** The Commission does not carry out a structured assessment to weigh the expected benefits and risks. Its internal guidelines stipulate that first the financial envelope for GBS must be established and then the expected benefits and risks arising from this allocation are to be assessed. A more logical approach would be to first assess the expected benefits and risks of a GBS programme and then determine the financial allocation on the basis of this assessment within the limits of the overall country allocations.

45. As regards risks, the Commission takes account of the risk of non-utilisation of GBS due to non-respect of the eligibility criteria (see paragraph 27). For the 10th EDF, generally the lower this risk was assessed to be for a given country, the more GBS it was likely to receive and the higher the percentage of its national indicative programme allocated to GBS (see the **Table**). However, the Commission does not consider fiduciary and development risks (see paragraphs 32 and 37) when deciding on the amount of funding.

TABLE

### LINK BETWEEN GBS ALLOCATIONS AND THE COMMISSION'S ASSESSMENT OF RISK OF NON-UTILISATION OF GBS DUE TO THE NON-RESPECT OF THE ELIGIBILITY CRITERIA

		LOW RISK	MEDIUM RISK	HIGH RISK
Number of ACP countries with budget support programmes planned in their national indicative programme for the 10th EDF		20	14	8
Number of ACP countries with no budget support programmes planned in their national indicative programme for the 10th EDF <sup>1</sup>		0	8	18
Budget support as a percentage of the national indicative programme for the 10th EDF	Average	73,0 %	63,2 %	35,0 %
	Lowest	48,1 %	39,6 %	19,9 %
	Highest	89,4 %	95,3 %	84,7 %

<sup>1</sup> No risk assessment was made for nine ACP countries because they are relatively small or do not benefit from the EDFs.

**THE COMMISSION DISBURSES GBS ON A PREDICTABLE BASIS AND IN ALIGNMENT WITH COUNTRY SYSTEMS**

- 46.** By definition, a central part of budget support is the transfer of funds by the Commission to support the national budget of the beneficiary country. In recent years, best practice in the provision of budget support has emphasised the importance to partner countries of the predictability of the flows of budget support allocated by donors. This allows partner countries to know sufficiently in advance the amount and timing of disbursements.
- 47.** The predictability of the Commission's disbursement of GBS is generally good. In most countries, the disbursement is scheduled to take place in the year after the performance assessment which allows the partner country to include the GBS as planned revenue in its budget. In most cases where payments have been made late, it was because of delays on the part of beneficiary countries in the submission of disbursement requests and did not result in significant negative impacts.
- 48.** In particular, the Commission has taken significant steps to improve predictability through the introduction of the MDG contracts<sup>31</sup>. These programmes commit funds for a six-year period instead of the typical three years and, if eligibility conditions continue to be met, allow the disbursement of at least 70 % of the total commitment independent of performance. MDG contracts are only granted to countries that have a successful track record in implementing budget support, show a commitment to monitoring and achieving the MDGs, and have active donor coordination mechanisms to support performance review and dialogue.

<sup>31</sup> The name intends to highlight the contractual nature of the long-term financial commitments and its focus on MDG-related results, notably in health and education.

**CAPACITY-BUILDING SUPPORT HAS MADE USEFUL CONTRIBUTIONS BUT WAS OFTEN NOT BASED ON AN APPROPRIATE ASSESSMENT OF PRIORITY NEEDS**

- 49.** Capacity-building support is one of the key components of GBS programmes and is either included directly in the GBS programme or through an accompanying specific capacity-building support programme to contribute to GBS programme objectives. Typically about 5 % of overall GBS programme funding is set aside for capacity-building.
- 50.** This section addresses the question of whether capacity-building support provided within the context of GBS programmes effectively contributes to meeting the programmes' objectives. The Court examined whether capacity-building support is relevant, sufficient and clearly defined in view of the programme objectives and the interventions made by other donors. Furthermore, it examined whether capacity-building support has been implemented appropriately.

**CAPACITY-BUILDING SUPPORT MAY NOT BE SUFFICIENT AND MAY NOT BE THE MOST RELEVANT**

- 51.** Despite the importance of capacity-building support, the Commission has no criteria or guidelines to assess the capacity-building support required to address the partner country's priority needs. The assessments of capacity-building needs are not comprehensive and do not systematically take into account support provided by other donors when the Commission decides on the capacity-building allocations under GBS programmes<sup>32</sup>.
- 52.** Improving PFM is an important objective of all the Commission's GBS programmes (see paragraph 18) and capacity-building can play an important role in reducing risk. The Commission's capacity-building support therefore mainly focuses on PFM. However, there is no clear link between the needs for improving PFM in a particular country and the amounts provided for capacity-building support. It is therefore not clear that the share of GBS programme funding allocated to capacity-building, usually in the order of 5 %, is sufficient to have a significant impact.

<sup>32</sup> See also paragraphs 10 and 11 of the Court's Special Report No 6/2007 on the effectiveness of technical assistance in the context of capacity development.

- 53.** Only a limited part of the capacity-building for PFM has been used for strengthening oversight bodies such as supreme audit institutions, parliaments and civil society organisations seeking to monitor government use of budgetary resources<sup>33</sup>. Support for capacity-building in areas other than PFM, on which GBS programme objectives are also focused, notably health and education, has been very relevant but in general marginal.
- 54.** In some cases, capacity-building support was used to finance assistance for the management of GBS programmes. As a result, these funds did not directly contribute to the creation of sustainable capacity in the partner country. In Nicaragua, technical assistance mostly focused on the production of reports, monitoring of conditions, preparing disbursement requests and the review of the government's plans. Similarly, in Benin, more than a third of the funds available for capacity-building support under the ninth EDF were devoted to the assessment of indicators, the preparation of joint annual reviews, the formulation of the GBS programme under the 10th EDF and the design of capacity-building support for PFM and statistics.
- 55.** In July 2008, the Commission adopted a strategy<sup>34</sup> that aimed to improve the effectiveness of its assistance for capacity development by requiring it to support country-led programmes, be based on partner demand and be focused on sustainable results. Improvements were observed in the design of the capacity-building support under programmes launched after the adoption of the strategy. The capacity-building support provided under the 10th EDF in Benin and Uganda is delivered through multi-donor trust funds and is, compared to the ninth EDF, more relevant to the priority needs, better planned and better coordinated with other donors. It remains unclear, however, how the amounts for support through such mechanisms were established.

<sup>33</sup> Special Report No 2/2005 concerning EDF budget aid to ACP countries: the Commission's management of the public finance reform aspect (paragraphs 56 to 62). The Court recommended that relations with parliaments and supreme audit institutions should be strengthened.

<sup>34</sup> A backbone strategy — reforming technical cooperation and project implementation units for external aid provided by the European Commission.



**THE SUPPORT PROVIDED MADE USEFUL CONTRIBUTIONS TO CAPACITY-BUILDING BUT A SIGNIFICANT PART OF THE FUNDS AVAILABLE HAS NOT BEEN COMMITTED**

- 56.** Capacity-building support has made useful contributions, especially when support was provided in response to a clear demand from the partner country. In the area of PFM, support is mostly related to government PFM reforms in fields such as the budgetary process, internal control, procurement and the quality of statistical information. In those cases where capacity-building support focused on other sectors, it covered areas such as the formulation of national and sector strategies, the development of sector management information systems, monitoring and evaluation (see **Box 3**).

**BOX 3**

**CAPACITY-BUILDING SUPPORT**

**Good Commission practice: Laos**

The Commission has devoted a significant share (approximately 20 %) of its GBS-related funding to capacity-building which reflects the capacity constraints of the government. The programme focuses on PFM weaknesses but also seeks to build capacity in the provision of social services which is relevant to the Commission's objective of improving performance in the health and education sectors. The technical assistance objectives include facilitating sector dialogue between ministries and development partners and helping the government to achieve the performance indicator targets linked to the variable tranches of the GBS programme. Thus synergies were created between different components of GBS, namely capacity-building support on the one hand and dialogue and conditions on the other hand.

**Weak Commission practice: Benin**

The capacity-building support to be provided in the framework of the ninth EDF GBS programme represents approximately 2 % of the programme financing and is not clearly defined in terms of needs, objectives, priorities and planning. There is no documented view on what improvement could and should be made within the period of the programme and how capacity-building support will contribute to this. There is no needs assessment and no justification of why certain areas have been selected to be supported and why some, such as anti-corruption measures and administrative reform, have not, even though they were identified by the poverty reduction strategy as relevant to contributing to good PFM. There is also a separate specific programme to support the reform of public management by objectives. This programme addresses relevant weaknesses but the articulation with the GBS programme is unclear. The results of the support provided have been variable, as some of the support provided did not lead to an actual improvement of systems.

- 57.** For most GBS programmes, funds allocated to capacity-building support have in the end been only partially committed, thus reducing the effectiveness of this component of GBS programmes. In fact, on average, only approximately 60 % of capacity-building allocations are committed before the closure of the programmes. This is in part because the programme implementation period is often too short to design and fully implement their capacity-building component. This problem has been exacerbated by difficulties in first defining needs and then delays in the implementation of the capacity-building activities. Thus the Court found significant delays in the launching of the capacity-building actions in four of the six countries. However, such implementation difficulties are not specific to the capacity-building support provided by GBS programmes<sup>35</sup>.

<sup>35</sup> See the Court's Special Report No 6/2007 on the effectiveness of technical assistance in the context of capacity development.

<sup>36</sup> Fixed tranches sometimes also have one or two additional conditions attached to them normally requiring the government to carry out specific actions.

#### **THE CONDITIONS ATTACHED TO DISBURSEMENT ARE PERFORMANCE ORIENTED BUT IN PRACTICE ARE NOT WORKING AS INTENDED**

- 58.** Conditions attached to the disbursement of GBS comprise general conditions relating to eligibility for budget support which have to be met before the payment of any fixed or variable tranche, and specific conditions mainly linked to the variable tranche mechanism connected to the achievement of performance indicator targets<sup>36</sup>. The variable tranche mechanism is a particular feature of the Commission's budget support programmes and reflects the growing emphasis in development cooperation on managing for results. As an incentive, the amount disbursed from the variable tranches depend on the extent to which targets for selected performance indicators have been reached.
- 59.** The Court examined whether conditions attached to the disbursement of GBS programmes are relevant in relation to their objectives, provide an incentive to the government to achieve the objectives and allow the objective assessment of progress achieved.

**CONDITIONS ARE GENERALLY RELEVANT BUT ARE UNLIKELY TO ACHIEVE THEIR INCENTIVE EFFECT**

- 60.** The general conditions attached to the payment of any fixed or variable tranche are relevant since they are aligned with the country's objectives of maintaining macroeconomic stability and making progress in relation to sound PFM and poverty reduction. In some cases there is scope for improvement in the identification of priority PFM measures to be implemented<sup>37</sup>. The specific conditions attached to the variable tranches of GBS programmes are also generally relevant as they are aligned with the national development priorities of the partner country (see **Box 4**). The Commission is increasingly taking over performance indicators from the country's national development strategy. In some programmes, the Commission used indicators focused on poorer regions in the partner countries or which were broken down by gender in order to increase their relevance to poverty reduction priorities.
- 61.** The Court found that the incentive effect of the variable tranche mechanism was likely to be less than intended. It was often difficult to set appropriate targets for the performance indicators. Targets that are insufficiently challenging or targets that are overly ambitious can reduce the incentive effect. Moreover, reliable statistical data to establish clear baselines and to provide information on past trends are often not available (see paragraph 67).
- 62.** Furthermore, the Commission's documentation did not demonstrate that there had been sufficient analysis during the target-setting process of what reforms and additional budgetary resources would be necessary and feasible in order to achieve the targets. Since proposals for targets increasingly come from the country itself, the Commission has to hold in-depth dialogue with the national authorities to ensure that targets are not set deliberately low or unrealistically high. However, there is insufficient expertise for this in many Commission Delegations (see paragraph 74). In addition, occasionally targets were not set until well into the year for which performance was being measured.

<sup>37</sup> See paragraph 46 of the Court's Annual Report on the activities funded by the seventh, eighth, ninth and 10th European Development Funds (EDFs) for the financial year 2008.

## SELECTION OF CONDITIONS

### Good Commission practice: Nicaragua

The GBS programme in Nicaragua focuses on rural areas and selected social indicators, private sector indicators and PFM indicators. The three social indicators of the programme are relevant to the objectives of the poverty reduction strategy papers since they address some of the causes of poverty identified in this national strategy. The four private sector indicators of the programme relate to the issue of land tenancy and productive capacity and this is consistent with the priority given by the poverty reduction strategy papers to investments in rural areas and the need to enhance the link between production, competitiveness and land development in order to reduce poverty. One of the two PFM indicators is relevant to the recommendations of the PFM action plan. Furthermore, the Commission's selection of indicators has taken account of the complementarities with two SBS programmes.

### Weak Commission practice: Benin

The relevance of the performance indicators is affected by a number of weaknesses.

- All targets for 2005 relating to the education sector were achieved, providing the impression of a good performance by the sector but the joint annual review<sup>38</sup> for that year concluded that the implementation of reforms in this sector was unsatisfactory.
- Two of the four indicators that relate to the health sector measure the frequency of visits to health centres. However, a government priority was preventive action against malaria, which is likely to have an adverse effect on the indicators. As a result, the Commission had to exclude these indicators from the calculation of the variable tranche amount for the year 2006.
- The PFM indicators do not address the main needs of the PFM reform process. According to the conclusions of the joint annual reviews as well as of the PEFA assessment, improvements were most needed in the areas of external control, financial accountability and tax collection. This was also the view of the Commission's internal quality review for the formulation of the GBS programme under the 10th EDF. However, this programme does not contain a condition concerning the fiscal collection rate and includes only one condition on external control for the variable tranche of 2009 which was not kept for the rest of the programme.

<sup>38</sup> This is a yearly review of the performance of the government by cooperation donors and the government of the partner country.

- 63.** In Uganda half of the GBS targets relating to the health sector were set either below or much above the baseline without explanation. In Laos and Paraguay a number of the targets set were not very challenging, sometimes simply being set at the same level as the baseline. In Nicaragua the government acknowledged that for many targets there was no adequate accompanying budget.
- 64.** A further factor influencing the incentive effect of the variable tranche is the proportion of the GBS programme allocated to it. The Commission has no criteria for deciding on the allocation of funds between fixed and variable tranches, which leads to significant differences between regions and countries in the proportions allocated<sup>39</sup>. Indeed the mix of fixed and variable tranches can also vary significantly between two consecutive programmes in the same country and without a clear explanation being given for this change. The Commission considers that the proportion of GBS allocated to the variable tranche should be higher in countries where it has more concerns about their commitment to poverty reduction and reforms. However, this approach is not referred to in the Commission's internal guidelines or individual programme documents. Furthermore, in a significant number of the GBS programmes, particularly in Asian and Latin American countries, variable tranches are not used.
- 65.** Some financing agreements also contain provisions to the effect that, when variable tranche performance indicators are not achieved, the Commission may pay out undisbursed funds at the end of the programme if new conditions are met. Such a possibility was provided for under GBS programmes in Benin, Nicaragua and Paraguay. In other cases undisbursed funds were reallocated to other Commission programmes or projects in the country.

<sup>39</sup> Variable tranche allocations range between 10 % and 91 % of the total amounts of GBS programmes in ACP countries and between 23 % and 54 % for programmes in Asian and Latin American countries.

**IT IS OFTEN DIFFICULT TO ASSESS WHETHER CONDITIONS  
HAVE BEEN MET OR NOT**

- 66.** The general conditions for GBS disbursements are often vaguely defined, being based on 'satisfactory' performance by partner governments in implementing national development strategies, PFM reform and macroeconomic management. No specific milestones or outputs are established to serve as criteria for what constitutes 'satisfactory'. As observed by the Court's annual reports on the activities funded by the seventh, eighth, ninth and 10th EDFs<sup>40</sup>, the Commission often concludes that progress on the reform of PFM has been 'satisfactory' while having only limited evidence to support this position. This approach tends to reflect the Commission's concern to ensure the continuity of its programmes, although it should be acknowledged that the Commission has improved its analysis in this area since the start of the 10th EDF.
- 67.** Unreliable data can make it difficult to assess whether conditions based on performance indicator targets have been achieved or not. The World Bank's 2007 review of 'Results-based national development strategies' highlighted weak statistical systems as a major challenge faced by nearly all the 62 countries it examined. The problem is aggravated by the fact that the Commission sets its variable tranche performance indicator targets on an annual basis although year-on-year progress in some areas can only realistically be expected in terms of small percentage increases. Such small increases are difficult to measure reliably.

<sup>40</sup> See paragraphs 19 and 46 of the Court's Annual Report on the activities funded by the seventh, eighth, ninth and 10th European Development Funds (EDFs) for the financial year 2008 and paragraph 34 of the Court's Annual Report on the activities funded by the eighth, ninth and 10th European Development Funds (EDFs) for the financial year 2009.

## DIALOGUE WITH PARTNER COUNTRIES IS NOT USED TO ITS FULL POTENTIAL

- 68.** One of the main benefits of budget support is the increased opportunities it can give donors for dialogue with governments on national policies. Dialogue can also play a very important role in helping to achieve the objectives of GBS programmes, since it allows the Commission to discuss with governments the definition and implementation of the key policy objectives supported by the programmes. Dialogue is also intended to be a key part of the Commission's results-oriented approach to budget support since the Commission uses it in conjunction with the conditions and targets set to review the government's performance. Dialogue typically takes place both at the policy level and at the technical level and is carried out jointly with other donors.
- 69.** The Court examined whether the Commission manages its dialogue with the partner country in a manner that contributes to meeting the expected results of GBS programmes. For this purpose, it examined whether the objectives and modalities of dialogue were clearly defined and appropriate, whether the Commission actively participated in the dialogue at an appropriate level and in accordance with the modalities laid down and whether the Commission's contribution to dialogue has adequately addressed key aspects of poverty reduction and PFM.

### THERE IS NO APPROPRIATE FRAMEWORK TO ENSURE EFFECTIVE DIALOGUE

- 70.** In most countries where GBS is provided, joint donor agreements have been established between donors and with partner countries to lay down common principles and procedures for conducting dialogue and the Commission actively supports and participates in such arrangements. Nevertheless the Commission has not yet developed the detailed guidance necessary to help ensure that within such frameworks its staff make full use of opportunities for dialogue.

- 71.** The Commission's internal guidelines provide little information on what the objectives and content of dialogue should be or on how to undertake and document dialogue at the various stages of the programme cycle. They do, however, require 'an appropriate dialogue strategy' to be put in place when weaknesses affecting key aspects of the GBS programme are identified. In practice, such strategies have not been drawn up despite the useful role they could play in all GBS programmes in helping to systematically improve effective dialogue by fixing clear objectives and modalities and defining the necessary staff resources needed to conduct the dialogue.
  
- 72.** The extent to which GBS programmes have established a sound basis for dialogue has varied. In Laos and Vietnam the objectives and modalities of dialogue were clearly laid out in the annual cycle of the World Bank-led poverty reduction strategy programmes to which the Commission GBS programmes contributed, with the dialogue focusing on reforms to be introduced by the national governments. In contrast there was little detailed information in Uganda and Paraguay on what the specific aims of the Commission's dialogue would be during the course of the programme and in Paraguay the modalities to be applied to pursue them were also less clear. In Benin, significant progress was made in this respect in the 10th EDF compared to the ninth EDF.



**THE COMMISSION'S INVOLVEMENT IN DIALOGUE VARIES BUT IS OFTEN LIMITED**

- 73.** GBS programmes have been particularly important in enabling the Commission to conduct a dialogue on the national budget and PFM and the Commission's contribution to GBS dialogue is generally more developed in this area. The results of PEFA assessments (see paragraph 31) have often played a catalytic role in strengthening PFM dialogue. In the other areas on which GBS programme objectives are typically focused, the Commission's dialogue is in many cases limited to issues relating to assessing compliance with the variable tranche and fixed tranche conditions of the programme rather than addressing overall government performance in the areas concerned. As a result, the Commission often does not play the role in dialogue that could be expected, given its significant financial contributions (see **Box 5**).

**BOX 5**

**DIALOGUE**

**Good Commission practice: Vietnam**

In Vietnam, the Commission provides GBS within the framework of the World Bank poverty reduction support credits, which is the GBS mechanism used by all donors in Vietnam. It is a clear framework for dialogue between the donor community, led by the World Bank and the government. It involves an annual cycle whereby all co-financers jointly define, monitor, and evaluate conditions with the government. For its dialogue, the Commission targets a limited number of areas which reflects its efforts to respect the EU Code of Conduct on Division of Labour in Development Policy.

**Weak Commission practice: Paraguay**

The objective of the GBS programme in Paraguay is to support the implementation of the Social Protection Network which is a significant element in the social protection axis of the national poverty reduction strategy. Following the major political change after the elections, dialogue took place in a particular political context. There is no structured framework in place for dialogue with donor coordination mechanisms such as working groups or joint annual reviews to discuss in detail the implementation of the national poverty reduction strategy. The Commission has concentrated its dialogue on the government's compliance with the indicators used for the variable tranches. As a result, it paid little attention to the overall implementation of the Social Protection Network and did not seize the opportunity for a wider debate on the quality of social services. In fact, the Commission's limited monitoring of the implementation of the Social Protection Network and the PFM action plan places limits on the possible extent of the dialogue. This means that inadequate performance is not detected early enough to allow a timely response through dialogue. When indicators were not achieved or when they were met with a much larger margin than would normally be expected, the Commission did not seek explanations from the government, nor did it question the reliability of the statistics.

**74.** A key factor affecting the quality of dialogue is the capacity of the Commission staff involved. An important reason for the Commission not having made full use of the opportunities for dialogue provided by GBS has been insufficient expertise in many Commission Delegations in the priority areas covered by the GBS programme objectives. In its 2007 Annual Report on the EDFs (paragraph 33), the Court indicated that **'the increase of budget support ... creates the need for specific skills and knowledge, and the Court notes that EuropeAid's Internal Audit Capability (IAC) has recommended that a human resources policy is developed to incorporate objectives on numbers, skills and knowledge of budget support staff'**.

**75.** While the Commission has generally made PFM dialogue a priority, it has been difficult to recruit PFM specialists because of the relatively limited expertise available in this area. The Commission has made efforts to overcome this problem by developing several PFM-related training courses. A lower priority tended to be given to ensuring there was adequate staffing to contribute to health and education sector dialogue despite the Commission systematically including objectives for these two areas in its GBS programmes<sup>41</sup>. Thus the Delegation in Benin did have PFM specialists but had no staff specialised in health and education which meant it did not attend the health and education working groups<sup>42</sup> and can only to a limited extent participate in the joint annual reviews<sup>43</sup>.

**76.** The letters sent by the Commission to governments to inform them what amount from the variable tranches is to be disbursed are used as part of the dialogue. The Commission includes in these letters relevant messages on issues of concern regarding the continued eligibility of the GBS programme, the implementation of the GBS programme and the performance of the government in the areas focused upon by the GBS programme. In some countries, however, this opportunity was not used at all (e.g. Paraguay) or only partially (e.g. Benin).

<sup>41</sup> See the Court's Special Report No 10/2008 on EC development assistance to health services in sub-Saharan Africa, paragraphs 18 and 41.

<sup>42</sup> Working groups monitor performance within sectors and consist of donors and representatives of the national authorities.

<sup>43</sup> Joint annual reviews are yearly reviews of the performance of the government by cooperation donors and the government of the partner country.

- 77.** Despite the importance of dialogue, the Commission's internal reporting on dialogue undertaken specifically in the context of its GBS programmes is limited<sup>44</sup>. The Commission's internal management reporting from Delegations to EuropeAid's headquarters is mainly limited to general comments on the state of political dialogue concerning the overall cooperation programme. This lack of information and the absence of clear objectives for the Commission's dialogue on GBS (see paragraph 71), makes it difficult for the Commission to assess and demonstrate the extent to which dialogue has effectively contributed to GBS programme objectives.

### **THE COMMISSION'S REPORTING TO EXTERNAL STAKEHOLDERS TENDS TO FOCUS ON THE POTENTIAL BENEFITS OF GBS RATHER THAN ON RESULTS**

- 78.** The main Commission documents for reporting on its external cooperation, including GBS, are its annual reports on the 'European Community's development and external assistance policies and their implementation'<sup>45</sup>. In 2008, the Commission also published two documents dedicated to the subject of budget support, one entitled 'Budget support — A question of mutual trust' and the second 'Budget support — The effective way to finance development?'. In addition, it produces information notes for the EDF and development cooperation instrument management committees composed of Member State representatives<sup>46</sup>.
- 79.** The Court examined the Commission's reporting on its GBS programmes to assess whether it reported in a clear, exhaustive and accurate way on them, in particular in relation to their effectiveness, potential benefits and risks, and implementation challenges. The Court focused on the Commission's annual reports over the period 2001–09.

<sup>44</sup> Except for the requirement for payment files to report on important deteriorations in the dialogue with the national authorities, the Commission's internal guidelines do not provide for any specific reporting on the GBS-related dialogue undertaken.

<sup>45</sup> Hereafter simply referred to as 'annual reports'.

<sup>46</sup> In addition, the Commission is associated with other reports, which, however, are not produced under its sole responsibility and do not necessarily reflect its views. The Court considered that it was not appropriate to include them in its examination. Examples of such reports are the joint annual reports it produces with each of the ACP partner countries as well as reports of evaluations of the European Commission's cooperation with specific partner countries.

## EXTERNAL REPORTING FOCUSES ON THE POTENTIAL BENEFITS OF GBS

- 80.** The annual reports regularly contain information describing the Commission's procedures for managing budget support and new developments in the design of the instrument. They also provide details of the funding committed under budget support. In addition, they give considerable coverage to the potential benefits of budget support.
- 81.** The Commission has regularly used the annual reports to explain the potential benefits of budget support such as alignment of assistance with national policies and systems, stronger ownership, improved opportunities for dialogue, better donor harmonisation, greater aid predictability and lower transaction costs. However, the reports tend not to emphasise the fact that the benefits described are only potential. In reality, many of them can at most be only partially realised because the necessary conditions in the beneficiary country are not yet fully in place, in particular due to continued weaknesses in national development plans and public finance management systems (see paragraphs 26, 29 and 38). Similarly the Commission itself often does not have the capacity to fully take advantage of the potential benefits, notably where its Delegations do not have sufficient expertise to make full use of the improved opportunities for dialogue which budget support offers (see paragraph 74).
- 82.** Following the 2005 Paris Declaration on Aid Effectiveness, the Commission's annual reports have emphasised budget support's role in increasing 'aid effectiveness'<sup>47</sup>. However, the reports do not make a clear distinction between the 'aid effectiveness' targeted by the Paris Declaration — by which is meant improving delivery of aid by following the core principles of the Paris Declaration — and 'aid effectiveness' in terms of the ultimate impact of the assistance on reducing poverty. Using budget support as a means to adhere more closely to the principles of the Paris Declaration is no guarantee that the aid has been effective in contributing to improving the lives of poor people.

<sup>47</sup> The Paris Declaration identifies actions to reform the ways aid is delivered and managed with the ultimate objective of increasing the impact of aid. It lays down five core principles which it considers should be followed in the management of aid if its impact is to be increased: ownership, alignment, harmonisation, managing for results, and mutual accountability.

- 83.** In view of the potential role that budget support could play in delivering aid in line with the principles of the Paris Declaration, the European Union committed itself to a target of channelling 50 % of its government-to-government assistance through country systems (see paragraph 7). Moreover, the percentage of aid channelled through budget support is used as a results indicator in the EuropeAid annual work programmes. On this basis, an important feature of the annual reports' coverage of budget support is to highlight progress towards this quantitative target, although an increase in the use of budget support does not necessarily mean an increase in its effectiveness in terms of poverty reduction.

**EXTERNAL REPORTING GIVES LITTLE INFORMATION ON RISKS, IMPLEMENTATION CHALLENGES AND ACTUAL EFFECTIVENESS**

- 84.** The annual reports' coverage of the actual results of budget support is considerably less than their commentary on its potential benefits and increased usage. The lack of information in the annual reports on the results of budget support contrasts with the information on other forms of aid which the Commission obtains from the 'Results-oriented monitoring system' it has developed to carry out annual assessments of projects. The Commission has no other internal reporting procedures for systematically assessing the poverty reduction results of its GBS programmes which could then be used for external reporting purposes. There is no equivalent to the Delegation annual PFM reports (see paragraph 31) for reporting on progress in achieving objectives related to poverty reduction. The six-monthly external assistance management reports (EAMR) produced by Delegations for EuropeAid focus on implementation status rather than results.

- 85.** The most substantial feedback related to the results of GBS was given in the 2007 annual report. This provided an overview of the findings of the 2006 joint evaluation of GBS, which was the first major evaluation of GBS carried out. However, while setting out the evaluation's assessment that GBS had had a positive effect on policy and PFM processes, the annual report also noted that '**most of the effects of GBS inputs so far have been on access to services, rather than income poverty and empowerment of the poor**'. In its 2009 annual report, the Commission recognised the limitations of this evaluation which '**fell short of evaluating results**'.
- 86.** It is of concern that there is no established evaluation methodology resulting in a body of evaluation work which provides evidence on whether, and in what circumstances, budget support can make an effective contribution to poverty reduction. The difficulties encountered by the 2006 evaluation were partly linked to the fundamental challenge in evaluating the effectiveness of budget support, which is how to attribute improvements in development outcomes specifically to budget support. This is because donor budget support is merged with national budgets, and therefore cannot be separately identified, and because improved outcomes may be due to external factors as well as the government programmes to which budget support contributes.
- 87.** Since the 2006 joint evaluation, the Commission has been at the forefront of donor efforts within the framework of the Development Assistance Committee of the Organisation for Economic Cooperation and Development Evaluation Network to develop an improved evaluation methodology which is intended to better address the question of the impact of budget support. At the end of 2009 three pilot evaluations were launched at country level of which two were being led by the Commission.

88. An important intermediate objective of GBS, on which it would also be useful to obtain information, is to contribute to improving public finance management in partner countries. Ensuring that PFM systems effectively transfer budgetary resources for pro-poor expenditure is an essential part of achieving overall poverty reduction objectives. However, although the Commission has developed a system of annual internal reporting by Delegations on PFM issues, these reports do not assess the achievement of the PFM objectives of GBS programmes. This means that there is again little information available for external reporting on the achievement of GBS PFM objectives, which explains why there is also limited coverage of this issue in the annual reports.
89. A central risk with budget support, particularly in a context of weak public finance management and often significant levels of corruption, is that the budget of the recipient country will not be used for the intended purpose of poverty reduction. However, the annual reports tend to give little attention to this issue. Indeed the foreword to the 2009 annual report stated in reference to the largest beneficiaries of budget support that they had '[demonstrated the reliability of their public finances](#)'. The annual reports again focus more on the potential benefits of budget support for developing PFM systems than on the risk that weak PFM systems will lead to budget support not achieving its poverty reduction-related objectives.
90. In addressing PFM issues in the context of budget support, the Commission's annual report has made frequent reference to the development of the PEFA framework as a diagnostic tool for PFM. As already noted (see paragraph 31), PEFA indeed plays a useful role in highlighting areas where countries need to improve PFM, and measuring those improvements over time. However, a more balanced presentation of PEFA's role would also recognise its limitations and that it is not in itself a risk assessment tool.

- 91.** The Commission's annual reports have also not addressed the key challenges it faces in its management of GBS, which are raised in this Court's report such as the disadvantages as well as the advantages of the Commission's results-based conditions, the capacity of its staff to make full use of the opportunities offered by GBS for dialogue, and the relevance and effectiveness of technical cooperation linked to GBS programmes.
- 92.** The European Parliament in its discharge report on the EDF for the financial year 2007 stressed the need for Commission reporting on budget support to be based on 'analytical and evaluative and not only descriptive information'<sup>48</sup>. More generally it called for the Commission to base its approach on 'reality and conclusive evidence' rather than 'rhetoric'<sup>49</sup>. In its follow-up report the Commission undertook to provide more in-depth coverage of budget support issues in future annual reports.

<sup>48</sup> European Parliament Report on discharge in respect of the implementation of the budget of the seventh, eighth and ninth European Development Funds for the financial year 2007, Committee on Budgetary Control, Rapporteur: Boguslaw Liberadzki, A6-0159/2009, paragraph 42.

<sup>49</sup> Ibid., paragraph 50.



# CONCLUSIONS AND RECOMMENDATIONS

## OVERALL CONCLUSIONS

- 93.** Providing aid through GBS has various potential benefits in terms of aid delivery. As with other aid modalities, the ultimate impact of GBS on poverty reduction depends, however, on the specific circumstances in each country. It also depends on effective Commission management of its GBS programmes. The Court found that, whilst the Commission has made considerable efforts over the last decade to develop its approach to providing aid through GBS, there are still weaknesses in the methodology and the management of GBS programmes in ACP, Latin American and Asian countries, which are thus less likely to reach their full potential effectiveness.
- 94.** It must be acknowledged that the Commission's GBS programmes are designed and implemented in coordination with other donors and that many deficiencies found by the Court are not specific to the Commission. Other supreme audit institutions, such as the UK National Audit Office<sup>50</sup> and the Swedish National Audit Office<sup>51</sup>, have made similar observations concerning the management of GBS by their donor agencies. However, the Commission has sole responsibility for taking financing decisions and is accountable to the discharge authority for the management of its GBS programmes.
- 95.** The Commission is aware of the need to improve its management of GBS and launched, at the end of 2009, a revision of its internal guidelines which aims to address most of the issues raised by the Court. A key aspect that is not currently being addressed is the need for the Commission to improve its reporting to external stakeholders. Whilst it is encouraging that the Commission has embarked on this revision process, whether it is ultimately effective will depend on results. It remains a challenge for the Commission to draw up appropriate guidelines and have them applied effectively and consistently by all Commission staff. It will require a strong commitment at all levels, a clear timetable, further efforts to train the staff concerned, strengthened support to Delegations and thorough monitoring of compliance with the revised guidelines.

<sup>50</sup> Department for International Development — Providing budget support to developing countries, Report by the Comptroller and Auditor General, 8 February 2008.

<sup>51</sup> Aid through budget support — The Government's and Sida's handling of a key type of development aid.

## SPECIFIC CONCLUSIONS AND RECOMMENDATIONS

96. Whilst a positive feature is the systematic inclusion of macro-economic and PFM objectives and some improvement has been noted in more recent programmes concerning the definition of objectives, objectives are insufficiently tailored to the specific circumstances of the country and often not precise. In addition, the objectives do not take into account the staff resources available to Delegations.

### RECOMMENDATION 1 SELECTION AND FORMULATION OF OBJECTIVES AND EXPECTED RESULTS OF GBS PROGRAMMES

The Commission should tailor the objectives of its budget support programme to the specific circumstances of the partner country. In doing so, the Commission should:

- (a) ensure complementarity between GBS and other Commission support programmes in the country;
- (b) more focus on specific areas within the overall national priorities where the Commission can have the most value added;
- (c) set out objectives that are sufficiently precise, measurable and time-bound to allow monitoring of progress and the assessment of achievements;
- (d) clearly spell out the logic of intervention by making explicit the link between the objectives and the design of the various components of the GBS programme.

97. The Commission's dynamic interpretation of eligibility conditions involves high risks that funding is not used efficiently and effectively by the partner countries. However, the Commission's risk management framework for its GBS programmes is not well developed and risks are not managed in an appropriate manner.

**RECOMMENDATION 2**  
**MANAGEMENT OF THE MAIN RISKS TO THE**  
**EFFECTIVENESS OF GBS PROGRAMMES**

The Commission should strengthen its risk management to give EU funds better protection against leakage, waste and inefficiency. In doing so, the Commission should:

- (a) perform a structured and explicit assessment of fiduciary and development risks at the outset of the GBS programmes and update it regularly during programme implementation;
- (b) as a basis for fiduciary risk assessment:
  - o make better use of information already available, notably PEFA and CPIA assessments, information on budget implementation, reports by supreme audit institutions and parliaments, and information from civil society organisations;
  - o make greater use of other tools such as public expenditure tracking surveys, public expenditure reviews and reports on corruption;
- (c) as a basis for development risk assessment, perform a thorough assessment of the relevance and credibility of the national development strategy including its credibility in respect of its links with the budget and main sector policies;
- (d) build into the conditions, dialogue and capacity-building support an appropriate range of precise measures to monitor and reduce the main risks identified within a specific timeframe, including shorter-term measures where PFM systems are particularly weak.

- 98.** The design and implementation of the four components of GBS programmes, i.e. funding, capacity-building support, conditions and dialogue, do not ensure that their potential impact is optimised.
- (a) Disbursements are made in a predictable manner and in alignment with the countries' budgetary systems, but the rationale followed to determine the amounts to be committed to individual GBS programmes is not clear.
  - (b) Capacity-building support is useful in strengthening PFM but is often not based on an appropriate assessment of priority needs and is only partially delivered because of delays in implementation. However, in 2008 the Commission adopted a strategy that aimed to improve the effectiveness of its capacity-building support.
  - (c) The Commission's approach to performance-based conditions for disbursing GBS reflects the growing emphasis in development cooperation on managing for results. However, the incentive effect is unlikely to be achieved because of serious shortcomings in the incentive mechanisms, particularly in relation to variable tranches, and the difficulties in assessing whether conditions have been met or not.
  - (d) Dialogue is rightfully considered by the Commission to be a key component of its GBS programmes but is not used to its full potential. GBS programmes have had a catalytic effect with regard to strengthening dialogue on the national budget and PFM, but the absence of a dialogue strategy for each programme and insufficient expertise in Delegations are key limiting factors with regard to greater and more effective involvement in dialogue.

### RECOMMENDATION 3 FINANCIAL RESOURCES

The Commission should determine the amounts to be allocated to individual GBS programmes in a better supported and more transparent manner. The Commission should:

- (a) make a structured assessment weighing up risks and benefits;
- (b) be able to demonstrate that the amount of funds allocated to the GBS programme is appropriate in view of the objectives and the framework for dealing with risks and benefits.

### RECOMMENDATION 4 CAPACITY-BUILDING SUPPORT

In accordance with its recent new strategy for technical cooperation, the Commission should focus its capacity-building support on priority needs. In doing so, the Commission should:

- (a) carry out, with the partner country and in coordination with other donors, an assessment of its priority capacity-building needs;
- (b) focus on the areas where its support can provide most value added;
- (c) give sufficient attention to the needs for support to accountability and anti-corruption mechanisms of the partner country, as well as to areas other than PFM.

#### RECOMMENDATION 5 CONDITIONS

The Commission should strengthen its management of performance-related conditions. In doing so, the Commission should:

- (a) make a formalised appraisal of the appropriate proportion of fixed and variable tranches in view of the country's specific circumstances as well as the objectives and design of the GBS programme;
- (b) as regards general eligibility conditions, set out in each financing agreement a clear assessment framework that defines the conditions, timetable, source of evidence, as well as criteria against which satisfactory progress has to be assessed;
- (c) as regards specific conditions for the disbursement of variable tranches:
  - o set out clear indicators, targets, calculation methods and verification sources;
  - o set out challenging but realistic targets using baselines, past trends and adequate assessment of the expected impacts of the actions and budgets planned to achieve these targets;
- (d) support disbursement decisions with a more structured and formalised demonstration of satisfactory progress during the period concerned by clearly setting the criteria against which progress was to be assessed, the progress made and the reasons why progress may not have been according to plan.

**RECOMMENDATION 6  
DIALOGUE**

The Commission should strengthen its approach to dialogue. In doing so, the Commission should:

- (a) define for each GBS programme a dialogue strategy that sets out the objectives, content and modalities of the Commission's involvement in dialogue;
- (b) ensure that the necessary expertise is available to allow the Delegation to be effectively involved in the dialogue for the priority areas on which the GBS programme objectives focus;
- (c) report to external stakeholders on the dialogue undertaken and its achievements.

- 99.** The Commission's reporting to external stakeholders tends to focus on the potential benefits of GBS rather than on the implementation and achievements of its programmes. One reason for this is that the Commission has not set up internal reporting procedures for systematically assessing progress against all the stated objectives of its GBS programmes which could then be used as a source of information for reporting to external stakeholders. Furthermore, in the absence of a suitable evaluation methodology, the Commission, like other donors, cannot yet demonstrate the effectiveness of GBS programmes.

**RECOMMENDATION 7  
REPORTING ON WHETHER GBS IS MEETING  
ITS OBJECTIVES**

The Commission should improve its reporting on the effectiveness of its GBS programmes. In doing so, the Commission should:

- (a) systematically monitor progress against all stated intermediate and ultimate objectives of the GBS programme and develop the internal reporting system accordingly;
- (b) pursue its efforts, together with its partners, to develop a suitable and generally accepted evaluation methodology that allows the impact of GBS programmes to be assessed;
- (c) clearly distinguish in its reporting to external stakeholders between 'aid effectiveness' in terms of the delivery processes of aid and 'aid effectiveness' in terms of the ultimate impact of the assistance in improving PFM systems and reducing poverty;
- (d) provide to external stakeholders a complete, clear and accurate picture of its GBS programmes, notably in respect of the risks involved, including corruption, progress made in the implementation of the programmes and the achievement of objectives.

This Report was adopted by Chamber III, headed by Mr Jan KINŠT, Member of the Court of Auditors, in Luxembourg at its meeting of 16 November 2010.

*For the Court of Auditors*



Vítor Manuel da SILVA CALDEIRA  
*President*



## BUDGET SUPPORT COMMITMENTS AND PROGRAMMING IN ACP COUNTRIES UNTIL 31.12.2009

Code	Country	9th EDF commitments		10th EDF programming		10th EDF commitments	
		GBS	SBS	GBS	SBS	GBS	SBS
BB	Barbados		10 500 000		8 300 000		
BF	Burkina Faso	197 000 000	2 000 000	320 000 000	75 000 000	325 620 000	50 000 000
BI	Burundi	84 120 000		90 000 000		68 700 000	
BJ	Benin	92 580 000	97 000 000	100 000 000	75 600 000	76 900 000	25 000 000
BS	Bahamas			4 200 000			
BW	Botswana		51 416 000		62 000 000		60 000 000
BZ	Belize				10 000 000		
CD	Congo (RDC)	106 000 000				22 620 000	
CF	Central African Republic	18 530 000		34 000 000		29 210 000	
CG	Congo (Brazzaville)	30 450 000					
CV	Cape Verde	21 225 000		33 000 000		16 300 000	11 500 000
DM	Dominica		10 780 000	4 600 000			
DO	Dominican Republic	38 000 000	48 200 000	91 300 000	53 700 000		
ET	Ethiopia	58 273 703	162 464 024	195 000 000	200 000 000		200 000 000
FK	Falkland Islands		4 547 116				
GA	Gabon				10 000 000		
GD	Grenada		10 000 000		5 000 000	5 290 000	
GH	Ghana	111 000 000	5 000 000	175 000 000	83 000 000	216 020 000	8 000 000
GM	Gambia			22 000 000			
GW	Guinea-Bissau	18 100 000		32 000 000		32 950 000	
GY	Guyana	41 196 379		30 200 000	14 800 000		
HT	Haiti	36 200 000		48 000 000	10 000 000	64 580 000	
JM	Jamaica	32 550 000	12 250 000	60 500 000	33 000 000	41 900 000	33 000 000
KE	Kenya	125 000 000		126 800 000	66 400 000		
KM	Comoros		16 465 000			7 270 000	
LC	Saint Lucia				6 900 000		
LR	Liberia	3 500 000		20 200 000		27 000 000	
LS	Lesotho			53 800 000		26 000 000	

## ANNEX I

Code	Country	9th EDF commitments		10th EDF programming		10th EDF commitments	
		GBS	SBS	GBS	SBS	GBS	SBS
MG	Madagascar	129 500 000		170 000 000	160 000 000	90 000 000	
ML	Mali	156 530 000	87 000 000	150 000 000	106 500 000	155 700 000	
MR	Mauritania			38 000 000	29 000 000		
MS	Montserrat		17 200 000				
MU	Mauritius	28 552 531	44 357 000	43 500 000		44 990 000	16 600 000
MW	Malawi	85 500 000		175 000 000	60 000 000	123 890 000	
MZ	Mozambique	149 922 000	92 700 000	311 000 000	181 200 000	315 110 000	30 000 000
NA	Namibia		85 000 000		60 200 000		
NC	New Caledonia		21 500 000				
NE	Niger	181 000 000		150 000 000	135 000 000	93 000 000	15 000 000
PM	Saint Pierre and Miquelon		12 810 000				
RW	Rwanda	101 764 000		175 000 000	35 000 000	184 440 000	78 800 000
SC	Seychelles			7 500 000		15 500 000	
SH	Saint Helena		15 590 000				
SL	Sierra Leone	62 000 000		90 000 000	10 000 000	64 820 000	
SN	Senegal	53 000 000		133 000 000	25 000 000	75 000 000	
ST	São Tomé and Príncipe				13 300 000		
TC	Turks and Caicos Islands	14 635 000					
TD	Chad	23 800 000					
TG	Togo	5 000 000		32 000 000		32 500 000	
TT	Trinidad and Tobago		27 300 000		24 300 000		
TZ	Tanzania	201 000 000	43 500 000	305 000 000	139 000 000	314 840 000	70 000 000
UG	Uganda	92 000 000	17 500 000	175 000 000	55 000 000	175 000 000	
VC	Saint Vincent and the Grenadines				6 200 000		
VU	Vanuatu	4 750 000		8 600 000			
WS	Samoa				25 500 000		15 300 000
ZM	Zambia	179 000 000	93 000 000	232 000 000	136 000 000	255 000 000	35 000 000
<b>TOTAL</b>		<b>2 481 678 612</b>	<b>988 079 139</b>	<b>3 636 200 000</b>	<b>1 914 900 000</b>	<b>2 900 150 000</b>	<b>648 200 000</b>

## BUDGET SUPPORT COMMITMENTS IN ASIAN AND LATIN AMERICAN COUNTRIES UNTIL 31.12.2009

Code	Country	GBS	SBS	TOTAL
BD	Bangladesh	0	105 000 000	105 000 000
BO	Bolivia	0	96 500 000	96 500 000
EC	Ecuador	0	54 600 000	54 600 000
GT	Guatemala	0	33 800 000	33 800 000
HN	Honduras	60 500 000	34 000 000	94 500 000
ID	Indonesia	0	145 000 000	145 000 000
IN	India	0	340 000 000	340 000 000
KG	Kyrgyzstan	0	65 000 000	65 000 000
KH	Cambodia	23 100 000	30 000 000	53 100 000
LA	Laos	16 200 000	0	16 200 000
NI	Nicaragua	75 500 000	92 900 000	168 400 000
NP	Nepal	0	38 000 000	38 000 000
PE	Peru	0	60 800 000	60 800 000
PH	Philippines	0	59 000 000	59 000 000
PK	Pakistan	0	109 000 000	109 000 000
PY	Paraguay	24 000 000	54 000 000	78 000 000
SV	El Salvador	37 000 000	37 100 000	74 100 000
TJ	Tajikistan	0	43 000 000	43 000 000
UY	Uruguay	0	8 000 000	8 000 000
VN	Vietnam	102 000 000	16 000 000	118 000 000
	<b>TOTAL</b>	<b>338 300 000</b>	<b>1 421 700 000</b>	<b>1 760 000 000</b>

# REPLY OF THE COMMISSION

## EXECUTIVE SUMMARY

### I.

The Commission welcomes the Court's performance audit on budget support as a useful input into the further refinement of its approach to providing aid through this instrument. The European Consensus on Development Policy (adopted by the European Parliament, the Council, the Member States and the Commission in 2005) established budget support as the European Union's preferred aid modality. This policy was adopted following substantial experience in implementing budget support programmes highlighting the potential benefits of budget support in contributing to national policies for poverty reduction and economic reform. The prospect of increasing the relative share of aid provided through budget support is an answer to the limitations met by the project modality in supporting the structural reforms. As the Court rightly notes, by working through national systems, budget support tends to strengthen ownership, support the role of national institutions, foster domestic accountability and facilitate the achievement of development objectives.

The Commission's GBS programmes exist in their current form since the 2000 communication 'Community support for economic reform programmes and structural adjustment: review and prospects' (COM(2000) 58). The Commission intends to update its budget support policy in 2011 following a public consultation based on a Green Paper that aims to collect views and evidence that could contribute to improving its approach in the future and its current work with Member States towards a more coordinated approach to EU budget support.

### III.

The Commission takes care to ensure that it follows OECD Good Practice Guidance on Budget Support in order to maximise the potential benefits of budget support. This entails joint monitoring arrangements, harmonised reporting, the streamlining of disbursement conditions and the alignment of disbursements and reviews to fit in with national budgetary timetables. The principles underlying this approach are firmly enshrined in the Paris and Accra Declarations on Aid Effectiveness to which the Commission fully subscribes. A key issue in this respect is the importance of delivering budget support in a timely and predictable manner so that countries can readily plan the scaling-up of poverty-focused public expenditure programmes.

The Commission is continually striving to improve the effectiveness of design and management of its general budget support programmes. Particular emphasis has been placed on the need to demonstrate and monitor eligibility for budget support through a focus on macroeconomic policies, improving public financial management and credible poverty reduction strategies. Following the Court's observations in its annual reports, the Commission has recently deepened its assessments of eligibility through a more structured and formalised process.

## REPLY OF THE COMMISSION

### IV.

The general and specific objectives of the Commission's GBS programmes derive directly from the objectives of the national development and poverty reduction strategies which they are designed to support. In countries where social sectors were a significant component of the poverty reduction strategies, this has been reflected in GBS programmes. The Commission's intention is to set out a more precise intervention logic for GBS programmes which will provide a clearer articulation between general and specific objectives and will ensure a more precise definition of specific objectives.

### V.

The Commission is strengthening its risk management framework in particular in the context of its revision of the budget support guidelines. The Commission already employs a number of important risk mitigation measures in the design and implementation of its budget support programmes. Where the Commission notes that progress is insufficient, disbursements are withheld until credible reassurances or measures have been established.

### VI.

The GBS envelope is established primarily by the assessment of the expected benefits and adapted in the light of the assessment of risk. The Commission is reviewing the criteria that inform decisions on amounts programmed for budget support through the consultation based on the Green Paper with a view to introducing a more structured approach.

### VII.

The Commission aims to provide capacity-building support to accompany budget support programmes with a view to ensuring relevance and effectiveness. A number of important successes have been noted in key policy areas related to supporting domestic accountability, poverty monitoring systems and public financial management. Closer attention to design and an understanding of the institutional setting is essential to achieving sustainable and consistent results in delivering technical cooperation. For this reason, the Commission has recently established its Backbone Strategy on Technical Cooperation which is increasingly applied and sets out a framework for assessment and identification of the needs. In addition, capacity-building support including to supreme audit institutions and parliaments or in poverty monitoring is frequently provided through separate but complementary programmes.

### VIII.

The Commission has introduced result-based conditions in budget support and has integrated important lessons learned over the years. This approach has been crucial in ensuring a stronger focus on outcomes in GBS performance monitoring in countries and has often been accompanied by support to strengthen weaknesses in statistical systems. It is currently reviewing its experience, including the extent to which countries find result-based conditions an effective incentive to perform better, through the consultation Green Paper on the future of EU budget support. In this context the Green Paper aims to establish how conditions can best contribute to policy dialogue and promote and capture progress in partner countries' development results.

## REPLY OF THE COMMISSION

### IX.

Policy dialogue is central to any general budget support programme. This is typically based on a multi-donor framework in which the Commission is actively engaged. A more strategic approach to the management and documentation of policy dialogue, along with continued attention to training, will further enhance the effectiveness of dialogue. In the context of both the Green Paper and in ongoing discussions with EU Member States, the Commission is in the process of reflecting on how to optimise the potential impact of policy dialogue in the context of general budget support programmes.

### X.

The Commission publishes a wide range of reporting covering budget support issues such as the annual report on external assistance, country fiches on budget support sent to Member States and the European Parliament, country evaluations and, in ACP countries, the joint annual reports on the implementation of the CSP.

The Commission is not alone in facing the important challenge of reporting comprehensively on the impact of general budget support. Nevertheless the strong demand from external stakeholders for such reporting is recognised. The Commission takes these challenges seriously and is working to develop more informative reporting on the results of its GBS programmes.

The Commission has taken the leadership in developing an evaluation methodology with the OECD/DAC which clearly sets out the main channels through which budget support contributes to poverty reduction.

It is expected that as evaluations progress they will increasingly feed into the Commission's annual reports on the management of external assistance. In the meantime, the Commission has already taken steps to bolster the coverage of budget support in its 2010 Annual Report and through additional country information on budget support provided to Member States and the European Parliament. The Commission is ready to further develop its reporting on budget support in the light of feedback from stakeholders.

### XI.

The Commission appreciates the Court's recommendations in the context of GBS programmes, both from recent annual reports and this special report, and will use them as an input to refine and deepen the scope of its methodological guidelines for general budget support.

# REPLY OF THE COMMISSION

## INTRODUCTION

**6.**

Structural adjustment support was provided in different ways under previous EDFs. The current Commission GBS is based on the communication 'Community support for economic reform programmes and structural adjustment: review and prospects' (COM(2000) 58 of 4.2.2000) and subsequent guidelines.

**8.**

The European consensus enshrined the objective to increase the use of budget support, where circumstances permit, as a means to strengthen ownership, to support partners' national accountability and procedures, to finance national poverty reduction strategies (including operating costs of health and education budgets) and to promote sound and transparent management of public finances.

**9.**

General budget support encourages the identification of the policy and institutional constraints to the effective delivery of the partner governments' functions. It also aims at contributing to the progressive removal of these constraints and focuses on overall country outcomes, rather than on specific and limited outputs.

## OBSERVATIONS

**17.**

The general and specific objectives of the Commission's GBS programmes are derived directly from the objectives of the national development strategies which they are designed to support. Where these are poverty reduction strategies that give prominence to the social sectors, these have been reflected in GBS programmes.

The Commission's intention is to better tailor objectives to the particular circumstances of the country.

**18.**

The Commission is encouraged by the Court's recognition that the systematic inclusion of macroeconomic and PFM objectives is a positive feature. GBS programme objectives should be derived from national priorities. This is the case in Laos where internal audit was not government PFM top priority and the focus is on other critical areas of PFM reform where the Commission and other donors are providing support. As regards Nicaragua, the GBS financing agreement describes PFM weaknesses and the main corrective measures taken by the government. Progress on PFM reform specific objectives defined by the government and GBS donors in the framework of a joint financing agreement (JFA) for the provision of general budget support was monitored through a performance assessment framework (PAF). The conditions set in the financing agreement for the release of the GBS programme tranches explicitly refer to both the JFA and the PAF.

## REPLY OF THE COMMISSION

As regards Paraguay, the disbursement conditions also include a large number of PFM-related criteria. The Commission, however, agrees that PFM objectives, which can be related to disbursement conditions and indicators, can be more specific and is addressing this in the revision of its guidelines.

### 19.

The Commission is aware of the stronger focus on growth and infrastructure issues in most recent national development strategies compared to the ones of the last decade. In this context, sustainable growth is indicated as a key global objective in the intervention logic in the Commission's GBS guidelines and is also explicitly emphasised in a number of more recent GBS programmes. Even where growth-related issues have not been explicitly identified as specific objectives in GBS programmes, they are typically addressed in the context of the overall assessment of the national strategy which is made at the time of formulation and before each disbursement through an assessment of progress against PAF indicators. In the case of Uganda, therefore, while growth-related issues have not been explicitly identified as a specific objective of the programme, these are nevertheless captured in the PAF and assessed by the Commission before each disbursement. The revision to the intervention logic in the GBS guidelines will seek to clarify the definition of specific objectives. It is anticipated that this will be informed by the recently established budget support evaluation methodology.

### 20.

General budget support (GBS) by definition does not aim to support a specific sector, but rather aims at providing additional discretionary resources to support macroeconomic stability, public financial management and to enhance the prospects of delivering its public expenditure programmes across the full range of its development policies. In a limited number of cases (Tanzania and Dominican Republic under the ninth EDF and Zambia and Dominican Republic under the 10th EDF) the specification of the poverty reduction GBS objectives includes one social sector that is also a focal sector. While it has been the Commission's approach to emphasise social sectors in the definition of the objectives in the design of its GBS programmes, implementation has nevertheless taken full account of progress across the entire range of poverty indicators in the country's performance assessment framework.

### 21.

The Commission considers that its coordination with other GBS providers in most cases is advanced and structured. The Commission actively contributes to the process involving partner countries and GBS donors that leads to the definition of country-specific performance assessment frameworks. The Commission is committed to the 2007 EU Code of Conduct on Complementarity and Division of Labour in Development Policy and intends to ensure that GBS objectives are consistent with this commitment. The Commission considers that the question of the extent to which GBS programmes should have sectoral objectives should be further explored.



## REPLY OF THE COMMISSION

### 22.

The articulation of specific objectives in financing agreements will be made clearer and more detailed. In addition, the Commission will establish a framework for assessing progress to be achieved over the lifetime of a general budget programme.

### 23.

The Commission welcomes the acknowledgement of the improved clarity and structure of 10th EDF financing agreements which also reflects the Court's observations in the 2008 and 2009 DAS reports and will further develop this approach thereby allowing it to be generalised.

#### 23. (a)

The Commission is refining its guidance to provide a clearer framework for assessing the relevance and credibility of development strategies and PFM reform programmes.

#### 23. (b)

The Commission has recently (June 2010) established a structured approach to identifying key objectives and monitoring progress in PFM reforms. It is exploring how to extend this approach to poverty reduction strategies.

### Box 1 – Selecting and formulating objectives

Weak Commission practice: Nicaragua

The GBS programme in Nicaragua was conceived to support the objectives of the national development plan of the government, with an emphasis on its rural components. The rural focus of the programme is reflected in the indicators selected, which relate to key aspects in relation to the objectives/priorities of the plan. These include child malnutrition, access to drinkable water, access to the public healthcare system and access to land, investments in rural areas and the decentralisation of the public expenditure.

The objectives relating to PFM improvement were defined by the government and GBS donors in the framework of a joint financing agreement for the provision of GBS, including a performance assessment framework. The conditions selected for the release of the programme's tranches, which explicitly refer to both the JFA and the PAF. The Commission agrees that the link between objectives, expected results, indicators and disbursement conditions could be better articulated and is addressing this in the revision of its guidelines.

### 26.

The dynamic approach taken by the Commission is used by the majority of general budget support providers including the IMF, World Bank and EU Member States providing general budget support.

### 27.

The risk of non-utilisation of budget support resources is a synthesis of the risk of non-compliance with the three eligibility criteria for the use of the instrument. The Commission will develop its risk assessment and extend it beyond its current use in the EDF programming phase.

## REPLY OF THE COMMISSION

### 28.

The Commission manages the risks associated with general budget support programmes through the rigorous assessment of the eligibility criteria and, in particular, by monitoring the achievement of agreed performance targets. Where the Commission notes that progress is insufficient, disbursements are withheld until credible reassurances or measures have been established. There is thus no financial risk as such. The Commission intends to develop and extend its risk assessment framework in the context of the revision of its guidelines.

### 29.

Weaknesses in PFM systems may imply potential management and development risk for government funds in the countries concerned. It is for this reason that the Commission and other donors undertake detailed PFM diagnostics, using the internationally recognised PEFA methodology, in advance of each general budget support operation. In addition, the Commission requires that potential general budget support beneficiaries have in place a relevant and credible PFM reform strategy. The implementation of this strategy is closely monitored and reported upon by the Commission in collaboration with other donors, including through the periodic update of the initial PEFA assessment.

### 30.

The existence of corruption hinders aid effectiveness in general and its potential impact is by no means confined to general budget support programmes. What is clear is that the steady improvement in financial control and public procurement systems pursued in the context of general budget support programmes effectively reduces the scope for corruption.

In the Green Paper the Commission addresses the issue of measures the EU should apply if the risk level is considered high with regard to fraud and corruption.

### 32.

The methodologies of the UK and France are based on the same PEFA assessments that the Commission uses. There is therefore no significant difference in the information content of the EC, UK or French PFM assessments. The only major difference lies in the use of the PEFA in the UK and French approach to develop an explicit judgement of fiduciary risk.

The Commission is also further developing its risk assessment framework. It is also making more systematic use of domestic supreme audit institution reports in assessing PFM systems, as explicitly addressed in the revised guidance on PFM reporting issued in June 2010.

### 33.

The Commission agrees to promote greater use of the tools available to complement and deepen the assessments made using the internationally recognised PEFA framework.

The Commission's revised guidance on PFM reporting which was issued in June 2010 explicitly requires reporting on corruption and the Commission will continue to regularly review the scope for additional studies of corruption.

### 34.

Under the authority of the supreme audit institution of a beneficiary country, additional audits and other specific measures are useful for increasing transparency and deepening the existing diagnostics of the PFM system. In this context, the Commission's guidelines on GBS underline the value of selected audits of internal control systems to give further insights into how to focus capacity-building in PFM and mitigate risks. The further development of the Commission's risk assessment framework will provide a more precise approach to identifying key risks and defining appropriate measures for their reduction.

## REPLY OF THE COMMISSION

### 35.

The measures mentioned by the Court (audits, public expenditure tracking surveys and public expenditure reviews) are lengthy processes to design and manage to eventual completion. The development of the Commission's risk assessment framework will provide a more precise approach to identifying key risks and defining appropriate sequencing and prioritisation of measures to manage these risks. In this context, the Commission intends to promote the use of shorter-term measures.

### 36.

The issue of corruption has already been addressed in the revised format for PFM reporting on ongoing programmes which was established in June 2010. Moreover, in the implementation of GBS programmes the emergence of corruption typically leads to a reinforced and intensive dialogue with government on how to respond to the issues. For instance, in Tanzania (2008) and Zambia (2009) this led to the suspension of budget support disbursements pending the elaboration and progress made in action plans in response to specific corruption cases.

### Box 2 – Reducing fiduciary risk

Good Commission practice: Ethiopia

Ethiopia is an interesting example of a programme using decentralised government systems and promoting their strengthening. While it is not implemented by the Commission under the budget support modality, some of the specific features could be applied to GBS programmes.

Weak Commission practice: Paraguay

The preparatory documents of the GBS programme in Paraguay presented an overview of the main PFM weaknesses based on the available diagnostic and discussions with the government services. This analysis was based on the PFM reform plan initiated by the Paraguayan authorities. During its implementation, the programme has been instrumental in addressing the main PFM weaknesses that have been further highlighted by the PEFA diagnostic. The Paraguayan government prepared a thorough PFM reform plan that has, successfully, passed from one executive to the next following the historical change of the 2007 elections. The programme also provides for technical assistance to support the government's reform programme, together with the World Bank and the Inter American Development Bank. Thus there is not financial risk as such.

The Commission will further strengthen its risk management framework and address this in the context of its revision of the general budget support guidelines.

### 37.

In its appraisal of eligibility for a budget support programme the Commission undertakes an assessment of the relevance and credibility of the underlying strategy. This assessment will be made more structured and will be more clearly linked to GBS design. Further guidance will be incorporated into the revised guidelines.

## REPLY OF THE COMMISSION

### 38.

Poverty reduction strategy papers (PRSPs) and their equivalent national strategies are the basis of all Commission aid and not just GBS. More generally, all DAC donors intend to align their aid with PRSPs or their equivalent national strategies. The PRSPs in countries receiving GBS have been subject to IMF/World Bank Joint Staff Advisory reviews, based upon which both institutions have deemed the strategies sufficient basis for concessional lending.

Improving the budgeting process and its linkages with national development strategies is at the centre of PFM reforms supported through GBS programmes. Further efforts are needed to strengthen these linkages.

### 39.

The issues of development risk are normally included in the identification and action fiches under the risk heading. The Commission will make its risk assessment framework more explicit in line with the approach currently taken for fragile states. Further guidance on the assessment of the development risk will be incorporated into the Commission's revised guidelines.

In the case of Uganda, the Commission is currently working with other donors to identify key areas where risk mitigation measures may be appropriate.

As regards Paraguay, the risks identified by the Commission's study for GBS of June 2005 were used as background for formulation. The government of Paraguay adopted in 2006 its new poverty strategy approach that intended to address the weaknesses found. The GBS programme was conceived to support the implementation of this strategy (and notably institutional building, interinstitutional coordination and social investment prioritisation).

### 43.

The Commission will review how it decides amounts programmed for general budget support (see paragraph 44), including through the consultation based on the Green Paper on budget support, in view of introducing a more structured approach that will include a more explicit assessment of expected benefits and risks. More precise objectives will contribute to this assessment. This remains a complex matter that will have to take into account the overall objectives of GBS operations and the global framework of the Commission's cooperation with the partner country.

### 44.

Within the overall amount allocated to a partner country's indicative programme, the financial size of the potential GBS envelope depends on the importance of the expected benefits such as the achievement of the overall objectives of the CSP and the more specific ones in the focal areas of cooperation. The potential GBS envelope may be adapted in the light of the assessment of risk. The proposed amount is the result of dialogue and negotiation with the partner countries and Member States and takes into account other important dimensions, such as the government's track record with effectively managing budget support, the presence of other budget support providers, the degree of coordination and opportunity for policy dialogue.

### 47.

The Commission welcomes the Court's recognition of the generally good predictability of its general budget support payments and of their alignment with country budget cycles and calendars.

## REPLY OF THE COMMISSION

### 51–55.

The Commission's capacity-building support is increasingly provided in line with the principles of the recent Backbone Strategy on Technical Cooperation. This strategy sets a framework for assessment and identification of the needs. In many cases capacity-building support including to supreme audit institutions, parliaments or in health or education sectors is provided through separate programmes to ensure the programmes are well planned, the funds are better allocated and spent on time. Moreover analysis of capacity development needs must always take account of other donors' programmes and of the necessary division of labour in each sector.

### 57.

Often GBS programmes funds allocated to capacity-building support are only partially committed. Consequently, the Commission has increasingly delivered such capacity-building programmes through separate programmes, subject to specific identification and formulation phases. However, capacity development programmes have their own challenges and usually require several years before bringing sustainable results.

#### **Box 3 – Capacity-building support**

Weak Commission practice: Benin

The link between the EU general budget support to the PFM system in Benin and other donors' support has only been possible since 2006. It is the result of the development of the strategic framework 'gestion budgétaire axée sur les résultats' (CAR-GBAR) initiated by the Commission. It was a lengthy and demanding process which was financed by the Commission capacity-building support programme for the reform towards public management by objectives.

In the framework of the 10th EDF, the EC is providing capacity-building support to the government PFM action plan based on the PEFA assessment followed by a needs assessment. This support is in a separate financing agreement but focuses on the main PFM areas discussed between the government and the general budget support donor group. The EC will implement the project with the financial support of three Member States.

#### **Box 4 – Selection of conditions**

Weak Commission practice: Benin

- Indicators and targets for the education sector in Benin were set up by the government in its national development strategy and agreed within the education working group where the Commission is a member. Indicators and targets refer to quantifiable issues and do not include systematically qualitative aspects. Analyses developed by the government and the donors in the joint annual reviews are also used by the Delegation to assess overall performance.
- The exclusion (neutralisation) of two health indicators in the calculation of the variable tranche for 2006 was a pragmatic response to this issue in order to ensure continued policy coherence. This arose out of an intense discussion with the government and other development partners in the framework of regular dialogue on general budget support.

## REPLY OF THE COMMISSION

— Not all PFM-related weaknesses can be addressed in budget support variable tranches but need to be addressed through the PFM general conditions, in capacity-building and through policy dialogue. Coordination with other donors in these matters is also of importance (e.g. in Benin tax collection is closely followed by the IMF). Up until 2009 tax collection in Benin was less of a problem due to the then positive macroeconomic environment, which explains why this indicator was not selected in 2008. It should be noted that external control is followed in the framework of the PFM reform programme.

### 62.

Policy dialogue rooted in a partner country's own budgetary and policy processes is essential to ensure that the policy measures needed to achieve agreed targets are identified, discussed and fully resourced. Such dialogue helps to ensure a clearer link between the use of resources (including budget support) and achieving results, and much needs to be done to make it more effective. Ensuring the coherence between targets and resources is a government responsibility that the Commission and other development partners can only influence indirectly. Nevertheless, the Commission pursues this issue actively in the context of its regular dialogue with partner governments.

### 63.

The Commission and other development partners aim to ensure that baselines and targets are clear, realistic and ambitious. At the same time, the importance of respecting country ownership requires that the targets set are the ultimate responsibility of the national authorities.

In certain cases, such as in Paraguay, targets that are no different from the baseline are appropriate when the aim is to preserve an already good performance in the face of a rising population.

### 65.

The Commission has, each time that it appeared necessary, opted to provide an additional tranche to address relevant development and reform issues, and to give further impetus to the reform process and the policy dialogue through additional conditions.

### 66.

The Commission welcomes the Court's recognition of the improvement in its analysis under the 10th EDF. Concerning PFM, the Commission will improve its guidance in order to set out precise reform objectives in the field of PFM and to improve PFM monitoring.

### 67.

Where data is known to be unreliable the Commission does not use this in variable tranche targets.

In case serious deficiencies are identified in the national statistical systems, support to relevant capacity-building measures is systematically considered by the Commission.

Although performance against targets is measured annually, it is more appropriate to assess the incentive effect of variable tranche targets over the medium term when trends can be observed and progress confirmed. At the same time, a more medium-term perspective for measuring such targets, such as under the MDG contracts, allows a better appreciation of progress.

## REPLY OF THE COMMISSION

### 70.

Commission dialogue on GBS is framed by the architecture of its programmes, in particular general and specific conditions, and by the joint donor framework within which GBS is delivered. In 2009, 74 % of GBS funds disbursed to ACP countries were in the framework of a memorandum of understanding that defines the timing and the modality of dialogue. In the same year, 77 % of disbursements' progress was assessed following a common performance assessment framework agreed and monitored with the partner governments and 81 % of disbursements were informed by a joint government-donor structured dialogue mostly documented in *aide-memoire*, where the Commission actively participates.

### 71.

Although the Commission's guidelines on GBS give some indications on how to conduct policy dialogue with the partner country and with other stakeholders, the Commission is considering a more strategic approach to policy dialogue. Effective policy dialogue depends on many complex country-specific aspects that cannot always be anticipated. At the same time, the Commission will continue to provide a comprehensive series of training programmes on the priority areas related to general budget support programmes which are targeted at staff with direct responsibility for managing such programmes.

### 72.

The Commission acknowledges that guidance on dialogue can always be improved and work is currently being undertaken on this aspect of guidance to Delegations.

### 73.

A critical factor in ensuring successful dialogue on the national budget and PFM is the staff expertise in Delegations. Where GBS programmes have defined objectives which are not sufficiently covered by such expertise, the Commission increasingly uses division of labour arrangements with Member States and other partners whilst retaining full responsibility for the management of its programmes. In any case, over the medium term the Commission seeks to ensure that critical areas of expertise are covered through recruitment and the rotation exercise.

### 74.

The capacities and expertise of the Delegation are of utmost importance for the proper management of general budget support operations. The presence of qualified staff on the ground is essential to pursuing the regular policy dialogue that is fundamental to the general budget support instrument. For this reason, the Commission carefully reviews staffing situations with regard to the appropriate skills needed for dealing with general budget support. However, the allocation of staff is constrained by the provisions of the financial framework and the anticipated zero growth in Commission staff.

### 75.

The Commission requires sufficient expertise to actively participate in dialogue related to GBS programmes. For such programmes, a broad-based staff profile is appropriate. In this way, the Commission is able to actively follow key issues of sectoral dialogue in the context of monitoring overall progress in poverty reduction. In Benin, the Delegation participates in the education and health sectors' reviews as well as in the discussions on these sectors' performance during the joint annual review.



## REPLY OF THE COMMISSION

### 76.

It is the Commission's standard practice to accompany each disbursement with an information letter to the national authorities. Such letters typically highlight key areas to be pursued in further dialogue.

### 77.

A more strategic approach to policy dialogue will enhance the prospects of success. The documentation of dialogue is an important factor in ensuring sustainability and impact. The revised guidelines will foresee the better documentation of the dialogue.

### Box 5 – Dialogue

Weak Commission practice: Paraguay

In Paraguay, country circumstances have largely affected the dialogue between the donor community and the government. Consequently, the Commission's efforts to reach coordination mechanisms have yielded mitigated results. This was due, in particular, to the context of the elections, resulting in a fundamental change of the government and its political orientations and, then, to the installation of the newly elected government which affected initiatives during 18 months of programme implementation.

In this context, the technical dialogue within the programme was focused on performance indicators and the Commission participated actively in the dialogue on the development of the social policy of the government which included the Social Protection Network (meetings, workshops, international experts, publication of the policy).

### 78.

The joint annual reports on development cooperation with ACP countries that are produced and published each year on the implementation of country strategy papers and national indicative programmes in ACP countries give an updated and accurate account of the status of implementation of all programmes, including general budget support. This includes the presentation of possible difficulties encountered during implementation.

### 81.

The Commission only proceeds with general budget support when the necessary conditions are in place. For this reason, it considers that all of the potential benefits can indeed be realised, although reporting on the impact of general budget support presents significant challenges.

The Commission is not alone in facing this issue while the strong demand from external stakeholders for more in-depth reporting is recognised. The Commission takes these challenges seriously and is working to develop more informative reporting. It is expected that as budget support evaluations progress they will increasingly feed into the Commission's annual reports on the management of external assistance.

The Commission carefully reviews staffing situations with regard to the appropriate skills needed for dealing with general budget support. However, the allocation of staff is constrained by the provisions of the financial framework and the anticipated zero growth in Commission staff.



## REPLY OF THE COMMISSION

### 82.

The Commission considers that the ultimate impact of GBS on poverty reduction depends on the specific circumstances in each country. It also depends on the effective management of GBS programmes. Following the core principles of the Paris Declaration and OECD good practice in the design and management of general budget support enhances impact.

### 84.

Internal reporting on general budget support is being further developed. Nevertheless the question of impact will remain a challenge due to the difficulty in attributing results to inputs under the general budget support modality. At the same time, the 'Results oriented monitoring system' has also been revised to cover sector policy support programmes, which also include sector budget support. Consideration is being given as to how to extend this to GBS. In addition, the Commission is working on a database containing historical data of all budget support programmes including the indicators monitored.

### 85.

Independent evaluations of country programmes carried out in 20 countries where budget support has been a significant feature have been published by the Commission.

### 86.

The Commission is moving ahead to establish a body of evaluation evidence in order to better understand critical factors for success and the nature of the impact on development objectives.

The OECD/DAC joint evaluation undertaken in 2006 provided evidence of GBS contributing to improved service delivery but did not extend this analysis to an assessment of impact on final beneficiaries. In response to this, the Commission has since taken a prominent leadership role in developing a new budget support evaluation methodology (for GBS and SBS) which clearly sets out the main channels through which budget support contributes to development objectives, including the impact on final beneficiaries. The methodology was approved by OECD/DAC members in 2009 and is in the process of being tested in three countries. The results of the test will allow the further refinement of the methodology with a view to commencing periodic joint evaluations (among OECD/DAC members) from 2011 onwards.

Given the multiple and complex factors at work in delivering sustainable poverty reduction it is unrealistic to expect any evaluation methodology of development aid can fully resolve the issue of how to attribute results to development programmes. This fundamental issue is not unique to general budget support and the inherent challenges in the evaluation of such interventions have been recognised by the Court's reports related to Structural Funds.

### 88.

The Commission's revised guidelines issued in June 2010 explicitly address this point of PFM reporting. The revised PFM report sets out a framework whereby progress can be assessed on an annual basis against initial reform expectations.

## REPLY OF THE COMMISSION

### CONCLUSIONS AND RECOMMENDATIONS

**89.**

The Commission focuses strongly on improvements in PFM systems as this is a key factor in reducing corruption.

In line with the further development of its risk assessment framework, the Commission will be better able to report on key risks as they evolve during the implementation of its general budget support programmes.

**90.**

It is clear that PEFA is not a risk assessment tool as such, even if it enables identification of main PFM weaknesses. PEFA is a diagnostic instrument to set the baseline for the partner country's PFM system and to serve as a basis for dialogue on PFM reform.

**91.**

The Commission has already taken steps to bolster the coverage of general budget support in its 2010 Annual Report and is ready to further develop this in the light of feedback from stakeholders.

**93.**

The Commission considers that its methodology for providing general budget support is in line with key OECD principles and best practice applied by other major general budget support providers, particularly in Europe. The Commission is continually striving to improve the methodology of its approach to general budget support following lessons learned at internal level by all donors providing general budget support. In this context the Commission is revising its guidelines in order to deepen the assessment of eligibility and ensure that evidence for general budget support decisions are presented in a more precise and formalised way. The revised guidelines will also strengthen the approach to the management issues that the Court identifies in this report. At a later stage they will also be amended to take into account the conclusions and recommendations of the debate launched by the Commission at EU level with the publication of the Green Paper on budget support.

## REPLY OF THE COMMISSION

### 95.

The Commission appreciates the Court's recommendations, both from recent annual reports and this audit, and is refining and deepening the scope of its methodological guidelines for budget support to address these observations. In this respect the Commission has already strengthened the basis for its country-based reporting on public financial management in order to provide a more precise and formalised basis for monitoring this critical aspect of general budget support eligibility. The revision of the guidelines is expected to be finalised in 2011 and is expected to address or deepen the following key areas:

- refinement of the allocation criteria for general budget support programming;
- rationalisation of the general budget support intervention logic to improve the definition of objectives;
- defining the preliminary analysis needed for the identification of performance indicators;
- development of a risk framework;
- establishing a framework for monitoring progress to be achieved over the lifetime of a general budget programme in national and sectoral poverty reduction and reform strategies;
- incorporation of the principles of the Backbone Strategy on Technical Cooperation for capacity development;
- outline the strategic approach to dialogue guidance;
- identify key reporting requirements.

In addition, the revised evaluation methodology will be finalised.

### 96.

The objectives of GBS programmes derive directly from the objectives of the national development and poverty reduction strategies which they are designed to support. Such strategies are comprehensive in their coverage of the various dimensions of poverty afflicting a given country. In order to monitor progress in a country's poverty reduction programmes, the Commission's approach, in line with that of other donors, is to take account of progress against an agreed set of objectives derived from the national strategy. The Commission agrees that the specific objectives should be more precise and better tailored to the particular circumstances of the country.

#### **Recommendation 1 – Selection and formulation of objectives and expected results of GBS programmes**

##### **(a)**

The Commission will ensure better complementarity between GBS and other Commission programmes.

##### **(b)**

The Commission agrees that programmes should be better tailored to the particular circumstances of the country.

##### **(c)**

The ongoing revision to the guidelines on general budget support is developing a more precise framework for monitoring progress in national/sectoral strategies and public financial management.

##### **(d)**

The revised guidelines will provide more detailed guidance on the intervention logic underlying the general budget support programmes in order to better articulate the link between objectives and results.

## REPLY OF THE COMMISSION

**97.**

The dynamic approach taken by the Commission is used by the majority of other general budget support providers including the IMF, World Bank and EU Member States.

As acknowledged by the Court in paragraph 34, the Commission uses a number of risk mitigation measures. For instance, where the Commission notes that compliance with eligibility is no longer met, disbursements are withheld until credible reassurances or measures have been established. However, the Commission accepts that the risk management framework should be strengthened and better structured.

### **Recommendation 2 – Management of the main risks to the effectiveness of GBS programmes**

The Commission will further strengthen its risk management framework and address this in the context of its revision of the general budget support guidelines.

**(a)**

The Commission will seek to assess all key risks at the outset of GBS programmes and update them regularly during programme implementation.

**(b)**

- The Commission's revised guidance on PFM reporting which was issued in June 2010 directly addresses this recommendation.
- The Commission agrees to promote greater use of the tools available to complement and deepen the assessments made using the internationally recognised PEFA framework.
- The Commission's revised guidance on PFM reporting which was issued in June 2010 explicitly requires reporting on corruption and the Commission will continue to regularly review the scope for additional studies of corruption.

**(c)**

The Commission is developing revised guidance to deepen its assessment of the credibility and relevance of national and sector development strategies which will include links to the budget.

**(d)**

The Commission will consider how to identify and incorporate appropriate risk mitigation measures in the context of its revised risk framework. In this context, the Commission has taken note of the UK guidelines to which the Court refers in paragraph 32.

**98.**

The Commission ensures that it follows OECD Good Practice Guidance on general budget support in order to maximise the potential benefits of general budget support.

**(a)**

The Commission will review how it decides amounts programmed for budget support through the consultation based on the Green Paper on budget support, in view of introducing a more precise approach in the future.

**(b)**

As acknowledged by the Court, the Commission's Backbone Strategy on Technical Cooperation is intended to improve the effectiveness of its capacity-building support.

## REPLY OF THE COMMISSION

**(c)**

The Commission has introduced result-based conditions in budget support and has integrated important lessons learned over the years. It is currently reviewing its experience, including the extent to which countries find result-based conditions an effective incentive to perform better, through the consultation Green Paper on the future of EU budget support. In this context the Green Paper aims to establish how conditions can best contribute to policy dialogue and promote and capture progress in partner countries' development results.

**(d)**

Policy dialogue is central to any general budget support programme. This is typically based on a multi-donor framework in which the Commission is actively engaged. A more strategic approach to the management and documentation of policy dialogue, along with continued attention to training will further enhance the effectiveness of dialogue. In the context of both the Green Paper and in ongoing discussions with EU Member States, the Commission is in the process of reflecting on how to optimise the potential impact of policy dialogue in the context of general budget support programmes.

### **Recommendation 3 – Financial resources**

The Commission intends to review the criteria that inform decisions on amounts programmed for general budget support through the consultation based on the Green Paper in view of introducing a more structured approach in the future.

**(a)**

The Commission intends to develop a revised approach to this issue following the consultations under the Green Paper.

**(b)**

The Commission intends to develop a revised approach to this issue following the consultations under the Green Paper.

### **Recommendation 4 – Capacity-building support**

The Commission's capacity-building support is provided on demand-led basis which has recently been formalised in the Backbone Strategy on Technical Cooperation. This strategy sets a framework for assessment and identification of the needs.

**(a)**

The Commission will ensure that its needs assessment framework is applied on a systematic basis.

**(b)**

Based on the outcome of the needs assessment exercises, the Commission will seek to provide capacity-building support to areas where its impact will be maximised.

**(c)**

The Commission has increased in recent years its capacity-building support to supreme audit institutions, parliaments and anti-corruption bodies as well as to other areas where appropriate. The Commission will continue to provide complementary support to areas other than PFM where appropriate.

## REPLY OF THE COMMISSION

### Recommendation 5 – Conditions

**(a)**

In the context of its revision to the general budget support guidelines the Commission will develop a clear set of issues to take into consideration when assessing the appropriate balance between fixed and variable tranches in the design of general budget support programmes.

**(b)**

The Commission welcomes the acknowledgement of the improved clarity and structure of 10th EDF financing agreements in paragraph 23 which also reflects the Court's observations in the 2008 and 2009 DAS reports. It is intended that the revised guidelines will further consolidate this approach.

**(c)**

It is the partner government's responsibility to set indicators and targets, and assess the expected impact of actions and the budget planned to achieve the targets, although the Commission assesses the quality, measurability and realism of targets and engages in a dialogue on these issues. The revised general budget support guidelines will provide more detailed guidance on the design of variable tranches taking into account this recommendation.

**(d)**

The Commission seeks to ensure that all disbursement decisions are made on the basis of a more structured and formalised demonstration of satisfactory progress.

### Recommendation 6 – Dialogue

The Commission agrees that a more strategic approach to policy dialogue enhances the prospects of success of its general budget support programmes. At the same time, the management and documentation of such dialogue is an important factor in ensuring its sustainability and impact.

**(a)**

The Commission intends to define a dialogue strategy and is addressing this in the context of the revised general budget support guidelines.

**(b)**

The Commission is aware of the importance of the availability of relevant expertise and addresses this issue in the context of the rotation of staff, recruitment of contract agents and the development of additional training courses. The presence of qualified staff on the ground is essential to pursuing the regular policy dialogue that is fundamental to the general budget support instrument. However, the allocation of staff is constrained by the provisions of the financial framework and the anticipated zero growth in Commission staff.

**(c)**

The Commission will examine how best to summarise the multiple country dialogues in which it is involved in its annual report on the management of external assistance.

## REPLY OF THE COMMISSION

**99.**

The Commission publishes a wide range of reporting covering budget support issues such as the annual report on external assistance, country fiches on budget support sent to Member States and the European Parliament, country evaluations and, in ACP countries, the joint annual reports on the implementation of the CSP.

The Commission is not alone in facing the important challenge of reporting comprehensively on the impact of general budget support. Nevertheless the strong demand from external stakeholders for such reporting is recognised. The Commission takes these challenges seriously and is working to develop more informative reporting on the results of its GBS programmes.

### **Recommendation 7 – Reporting on whether GBS is meeting its objectives**

**(a)**

The Commission agrees that it should more systematically monitor and report on progress and the new guidelines will address this.

**(b)**

The Commission has taken the lead in developing an evaluation methodology and is in the process of testing it in collaboration with donor partners and recipient governments.

**(c)**

The Commission intends to clearly distinguish between delivery processes and results in its reporting on aid effectiveness. The Commission is working on this aspect in the context of the revision of its guidelines.

**(d)**

It is expected that as evaluations progress they will increasingly feed into the Commission's annual reports on the management of external assistance. In the meantime, the Commission has already taken steps to bolster the coverage of budget support in its 2010 Annual Report and through additional country information on budget support provided to Member States and the European Parliament. The Commission is ready to further develop its reporting on budget support in the light of feedback from stakeholders.





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IN THIS REPORT, THE COURT ASSESSES WHETHER THE COMMISSION MANAGES ITS GENERAL BUDGET SUPPORT PROGRAMMES EFFECTIVELY. FOR THIS PURPOSE, THE COURT EXAMINED WHETHER THE COMMISSION APPROPRIATELY SELECTS AND FORMULATES THE OBJECTIVES OF ITS GENERAL BUDGET SUPPORT PROGRAMMES, APPROPRIATELY MANAGES THE MAIN RISKS TO THEIR EFFECTIVENESS, EFFECTIVELY DESIGNS AND IMPLEMENTS THESE PROGRAMMES AND REPORTS IN A CLEAR, EXHAUSTIVE AND ACCURATE MANNER ON THE ACHIEVEMENT OF THEIR OBJECTIVES. THE COURT MAKES RECOMMENDATIONS THAT AIM AT IMPROVING THE METHODOLOGY AND MANAGEMENT OF GENERAL BUDGET SUPPORT PROGRAMMES IN ORDER TO INCREASE THEIR LIKELY EFFECTIVENESS.



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