Tools and methods Series

Guidelines No 2

EuropeAid

Support to Sector Programmes

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

SHORT VERSION

July 2007

EUROPEAN COMMISSION

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ACKNOWLEDGEMENTS

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

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

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

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

ABBREVIATIONS

AF: Action Fiche

CD: Capacity Development

DAC: Development Assistance Committee

FP: Financing Proposal

IF: Identification Fiche

IMF: International Monetary Fund

MoU: Memorandum of Understanding

MTEF: Medium Term Expenditure Framework

PAF: Performance Assessment Framework

PEFA: Public Expenditure and Financial Accountability

PFM: Public Financial Management

PBA: Programme Based Approach

PRSP: Poverty Reduction Strategy Paper

SBS: Sector Budget Support

SP: Sector Programme

SPSP: Sector Policy Support Programme

SWAp: Sector Wide Approach

TA: Technical Assistance

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ABOUT THE GUIDELINES

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

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

The same basic principles of aid effectiveness are reflected in the EC's guidelines for all types of aid – for project aid, for general budget support, and for support to sector approaches. The present guidelines address sector approaches.

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

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

The revised guidelines incorporate the following new features:

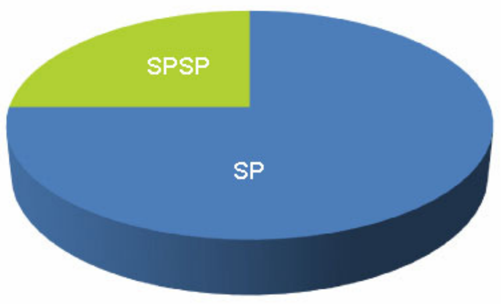
- Harmonisation in terminology and approaches with other donors;
- Refinements of EC policy and design criteria;
- Substantial development of material on each of the seven assessment area
- Widening the scope of the guidelines;
- Updates of EC regulation and procedures;

The guidelines are aimed primarily at the EC's own staff, but they should also be useful to fellow-donors, to partner country staff, and to others involved in development work, both by outlining general principles and by explaining EC policies and procedures. Each section of the guidelines begins by explaining general concepts, then identifying good practice principles and finally explaining the specific policies and procedures of the EC.

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

1. BASIC CONCEPTS AND DEFINITIONS

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



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

As a result of following a Sector Approach, a government progressively develops a **sector programme**[1]**.** Sector programmes are based on three core elements: the sector policy and strategy; the sector budget and its medium term expenditure perspective and the sector coordination framework through which the sector strategy, action plans and budget are reviewed and updated. A sector programme may be declined in a set of actions and activities to implement the sector strategy.

The EC's aid instrument for supporting a sector programme is known as a **Sector Policy Support Programme (SPSP)**[2] .

The sector approach serves as a coordinating framework for government's own activities and for donor support which may take different forms, including projects, technical assistance, and various forms of programmatic aid, including budget support. The EC's favoured financing modality is budget support, but in certain circumstances the best available option may be project support or pooled funding with other donors.

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

Sector Approaches (also known as Sector Wide Approaches – SWAps) are usually seen as programme-based approaches operating at the level of a sector. PBA is defined as follows: [3]

A programme-based approach (PBA) is a way of engaging in development cooperation based on the principle of coordinated support for a locally owned programme of development, such as a national poverty reduction strategy, a **sector programme**, a thematic programme or a programme of a specific organisation.

PBAs have the following features:

- ➔ leadership by the host country
- ➔ a single comprehensive programme and budget framework
- ➔ a formalised process of donor coordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement
- ➔ efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation.

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

*1 Equivalent to a **sector development programme** in the DAC terminology (ibid.).*
*2 The DAC Guidelines refer to a **sector support programme** as the instrument through which an aid agency supports a sector programme*
3 DAC Guidelines on Sector-Wide Approaches " Harmonising Donor Practices for Effective Aid Delivery Vol. 2"

Common principles

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

2. SECTOR APPROACHES: RATIONALE AND OBJECTIVES

Basic issues and responses

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

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

The sector approach aims also to strengthen links between sector and national plans and the integration between recurrent and capital expenditures as well as the coherence between aid and domestic resources. One of the features of the approach is that it brings the sector budget back to the centre of policy making and unifies expenditure programming and management, regardless of the source of funding. In this respect, it initially has been a response to the breakdown of budgetary, organisational and management structures in aid-dependent countries. The deterioration of government systems, while partly the result of political and fiscal crises, has been significantly worsened by the multiplication of stand-alone donor projects, working outside of government systems, often with their own project implementation units (PIUs) and dedicated technical assistance.

EC perspective

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

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

- ➔ To broaden **ownership** of partner countries (government and key national stakeholders) with respect to sectoral policies, strategies and spending, and to increase the **alignment** of external interventions to national policies and priorities.
- ➔ To increase **coherence** between sectoral policy, spending and results (regardless of the source of funding) through greater transparency, wider dialogue and a comprehensive view of the sector.

➔ To **minimise** as far as possible the **transaction costs** associated with the provision of external financing, either by direct adoption of government procedures or through progressive harmonisation of individual donor procedures.

The policy orientation in favour of the sector approach and SBS was formally taken by the EU in November 2000, when the European Parliament and the Council of Ministers approved the communication[4] of the Commission on the policy of the European Community for development cooperation. This policy was thus adopted not only by the European Commission itself but also by the Member States.

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

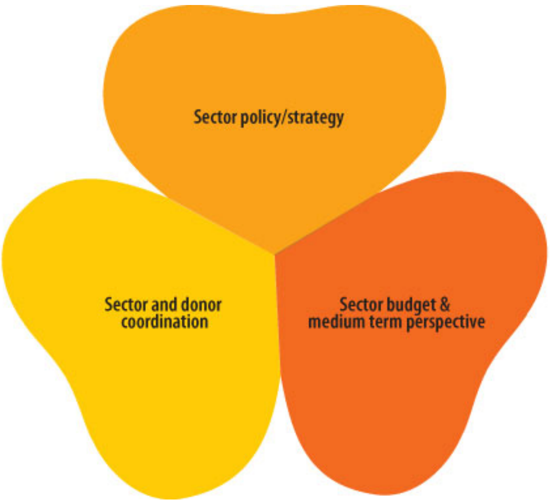
Sector support is well integrated into the provisions of the new financing instruments. The "Regulation of the European Parliament and of the Council establishing a financial instrument for development cooperation" confirms key principles underlying sector approaches and indicates that the Community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

3. THE MAIN ELEMENTS OF A SECTOR PROGRAMME

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

3.1 Core Elements

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



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

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

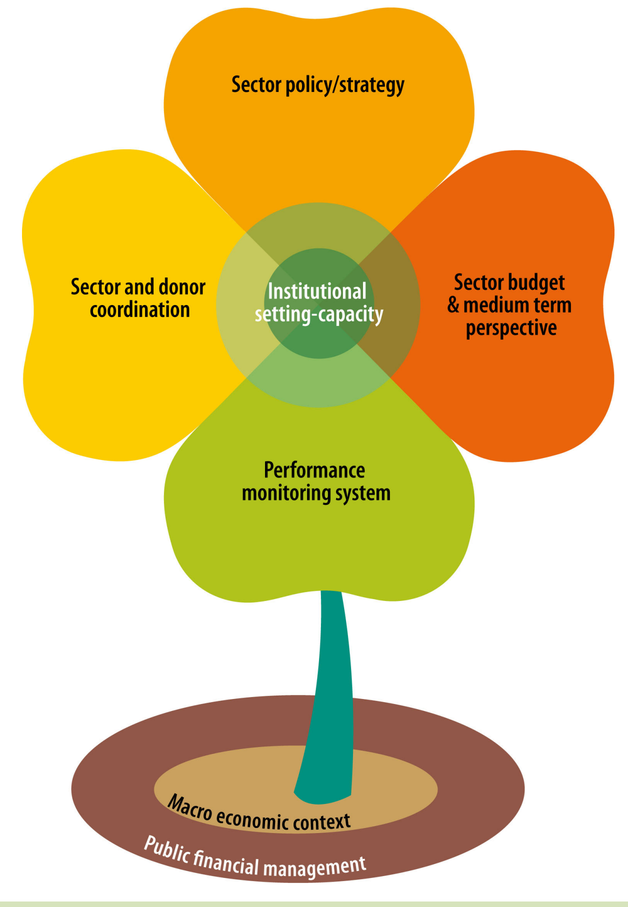
3. A **sector coordination framework**, under the government's leadership comprising i) coordination of national stakeholders including governmental (central agencies and other concerned ministries and agencies) and non-governmental actors; ii) coordination with and among donors.

***Other two key elements** include:*

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

   Concern for government capacity has always been one of the driving forces behind sector approaches, which aim to reinforce national systems by using them. The need for pro-active capacity development strategies is also recognised. There is growing appreciation that sector programmes are heavily influenced by the broader institutional setting, and that capacity development needs to be a more central concern. The present guidelines give these aspects a fuller treatment. Broader governance concerns also cut across all the elements of a sector programme[5].

Box 1: Key Elements of a Sector Programme



5. A **performance monitoring system** with a focus on results and feedback into management and policy.

   This frequently involves a sectoral performance assessment framework (PAF) consisting of a set of input, output, outcome and possibly impact indicators. The evolution of the PAF is periodically monitored to assess progress towards the achievement of the sector's policy and strategic objectives. The monitoring system provides key elements to steer policy dialogue and is part and parcel of the overall policy process. The choice of indicators must reflect all the important dimensions of the sector being monitored.

   To summarise a sector programme includes five key elements: The sector policy and strategy, the sector budget and its medium term perspective, a sector and donor coordination framework, institutions and capacity development and a performance monitoring system.

Two additional contextual elements influence performance of a sector programme:

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

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

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5 Parallel to the revision of these guidelines, and consistent with them, the Commission is preparing methodological guidance to assist delegation staff and partners to mainstream and specify governance concerns and aspirations in sector support operations.

EC perspective

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

3.2 Sector Policy and Strategy

The sector policy is the first building block of a sector programme. It is a statement of government's objectives within a sector and a summary of how they will be achieved. In practice, key sector policies are not always consolidated in a single document, though this can help transparency and strategy formulation. The **sector strategy**, often presented in the form of a strategic plan or similar document, describes how the government intends to implement the sector policy over a medium-term perspective (usually 3-5 years). It should be directly reflected in annual sector budgets.

Good practice

As the DAC guidelines on SWAp indicate:

> *"A coherent and consistently applied sector policy is at the heart of any successful SWAp and focuses the partner government, donors and other stakeholders on achieving collective results. It must be derived from, and consistent with, the partner government's overall strategic objectives and strategic framework (including the poverty reduction strategy)".*

It is important to keep a process perspective on sector policy, as highlighted by the DAC guidelines:

> *"Strive for a good sector policy and strategy, rather than a perfect one. The sector policy document will not be a rigid blueprint. It will establish basic principles, objectives and strategies for the sector. It will acknowledge that detailed policies and resource allocations will continue to evolve. Accordingly, there should be a defined process and schedule for regularly updating the document and rolling it forward. A transparent process for review and revision helps to establish a cycle that strikes a balance between planning and implementation".*

EC perspective

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

3.3 Sector Budget and its Medium Term Perspective

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

Good practice

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

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

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

EC perspective

Within Sector approaches the EC promotes the link between policy and budget. Sector budgets need to fit into disciplined aggregate government expenditure plans, and annual spending needs to be conditioned by a medium-term perspective on resource availability, priorities and the balance between recurrent and capital expenditures, as well as between different sub-sectors. Ideally, and eventually, this would take the form of a Medium Term Expenditure Framework, strongly rooted in the political and budgetary process of the government. However, it does not make sense to demand a "sector MTEF" prematurely[6]. The development of a sector MTEF is a gradual process that should focus first on building sound bases, such as a credible annual budget, mechanisms to ensure that all expenditure programmes are prioritised within the existing resource envelope, agreed national and sectoral policies and the definition of aggregate fiscal objectives.

3.4 Sector and Donor Coordination

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

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

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

Good practice

A basic principle is that sector coordination mechanisms should not substitute for, or override, the general structures and responsibilities of the partner government. Thus the national budgetary process should be the principal mechanism for allocating public resources (including aid), and the national parliament should be the source of authority for approving national policies, plans and budgets. Where weak governments and high levels of aid dependency have eroded this principle, a key objective of sector approaches and other aid coordination arrangements should be that they help to restore appropriate lines of national accountability.

As well as being government-led, the sector coordination arrangements need to be consistent with the structure and responsibilities of the national government. This means, in particular, that:: i) the line Ministry is the main responsible for the implementation of the sector programme; ii) the Ministry of Finance (and the Ministry of Planning, where separate) must be involved and have a clear role; iii) the responsibility assignments and lines of accountability defined in the country’s decentralisation system should be respected and iv) when practical, the sector coordination mechanisms should be connected to the wider framework of coordination and dialogue around the PRS.

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6 The 2003 version of these guidelines made a "sector MTEF" a defining characteristic of a sector programme. The present guidelines take a more nuanced and practical approach to improvements in sector budgeting and the policy-budget link.

EC perspective

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

4. DEVELOPING AND STRENGTHENING A SECTOR PROGRAMME

4.1 Overall Approach

The sector approach is a process in which the sector programme is continually refined and improved. In a few cases the EC may be involved in the development of a completely new sector programme. Much more commonly, EC staff will face questions about whether to support, and how to strengthen, a process that has already begun.

Many of the same principles apply to the initial establishment and to the subsequent strengthening of a sector approach.

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

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

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

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

tranches. Donors must have similar time horizons, and must be prepared to commit long-term predictable resources. Address all stages of the planning and budgeting cycle for the programme, and build in a strong "results" orientation.

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

4.2 Harmonisation and Transaction Costs

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

Disappointments with harmonisation often result because "ideal solutions" have been sought from the outset, which bring together all aspects of harmonisation into one unified process, typically structured around the establishment of a single pool fund for the financing of the programme. Experience suggests that this is not the most effective way to achieve progress towards harmonisation. Rather it is important to ask: Which aspects of harmonisation are likely to bring the greatest benefits? How will the costs of introducing different aspects of harmonisation compare? In the light of costs and benefits, what is the most appropriate sequencing of harmonisation processes? In assessing the benefits of reduced transaction costs, the primary concern is the reduction in transaction costs borne by government. Gains in this area may in the short term entail increased transactions costs for donors.

5. ISSUES IN SECTOR APPROACHES

5.1 When Can Sector Approaches Be Successfully Applied?

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

- **Broad consensus between Government and donors** on key policy and management issues for the sector.
- **A single dominant sector ministry and manageable institutional relationships.** Strong and effective leadership at sector ministry has been an important factor in most successful SWAps. Sector programmes have worked most effectively where they are defined in terms of the area of budget responsibility of a single sector ministry. Sector programmes are also often easier to manage where there is a relatively small group of significant donors in the sector.
- **An experienced "lead donor" or lead group of donors.** Sector programmes usually need a lead donor and preferably a lead group of donors[7] willing to support government in managing donor and stakeholder coordination through good advice and through bringing other donors "into line" when necessary.
- **Incentives that are compatible with the objectives of a sector approach.** A sector approach is more likely to be successful if there are civil service and other government-wide reforms in place to create incen-

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

tives and performance-related rewards for the stakeholders. This makes it easier to attract staff and to counteract the incentives to retain project bureaucracies. Conversely, problems are likely to occur if the sector strategy involves cutting the budget or cutting staff in the ministry which is to take the lead role in implementing it.

➔ **Incentives that are compatible with the objectives of a sector approach.** A SA is more likely to be successful if there are civil service and other government-wide reforms in place to create incentives and performance-related rewards for the stakeholders. This makes it easier to attract staff and to counteract the incentives to retain project bureaucracies. Conversely, problems are likely to occur if the sector strategy involves cutting the budget or cutting staff in the ministry which is to take the lead role in implementing it.

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

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

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

Linking sector programmes to national strategies

No sector approach is fully self-contained. There are many interlocking issues across sectors, and addressing systemic issues (e.g. in capacity or PFM) will often require coordinated action across government.

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

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

5.2 Sector Approaches in "Non-Traditional Sectors"

More and more countries are adopting sector approaches to the management of "sectors" characterised by significant inter-sectoral aspects and the involvement of many organisations (e.g. rural development, justice, environment, water management). But implementation may be more difficult in the absence of some the above ingredients

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

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

5.3 Sector Approaches and Decentralisation

Sector approaches often focus on sectors where public delivery of basic services is a major element. This often involves local governments as well as the sector ministries of the central governments. Exact arrangements vary greatly between countries, and are likely to be more elaborate in federal states. The distribution of responsibilities (devolved or decentralised) between different levels of government is a crucial factor in considering the scope of a sector approach and who should participate in its coordination arrangements. Getting the right balance between accountability at central and local levels is a major challenge for SWAp processes.

Donors need to be careful that they do not inadvertently reinforce centralising tendencies by working too narrowly with the central agencies of government. Careful mapping of institutional responsibilities is crucial, as is taking into account any ongoing process of decentralisation (which may itself be supported in a programmatic way). See also the EC reference document – **"Supporting Decentralisation and Local Governance in Third Countries"**.

5.4 A New Focus on Capacity Development

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

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

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

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

The Paris Declaration states that

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

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

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

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

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

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

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

A key principle is that capacity development must be driven by results, not by donor-funded inputs. By focusing on results rather than CD activities or inputs, donors can also keep an arms length distance to the nitty-gritty processes taking place inside the organisations, and thereby they can better avoid undermining the essential ownership of the CD process.

5.5 Roles of Different Stakeholders

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

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

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

6. ABOUT SECTOR POLICY SUPPORT PROGRAMMES

This chapter of the guidelines gives specific advice to EC staff on how to design an SPSP, with special attention to the choice of appropriate financing modality. Relevant EC policies and design principles are explained. Annex 1 to the guidelines presents more in-depth guidance related to each phase of the SPSP cycle.

6.1 Characteristics and Implementation Modalities

Where a sector approach is in the early stages of development, a fully-fledged SPSP may not be feasible. However, the EC can help move things forward (a) by providing support to the early stages of developing a sector approach and formulating a credible sector programme; and (b) by reconfiguring the existing EC programme to make it more programmatic and compatible with the nascent sector approach.

Once a Government has started the development of a sector programme, an SPSP is the contribution that the Commission makes to the implementation of that programme. It differs substantially from a classic EC project. It forms part of a sector programme designed by Government and follows procedures and management systems specific to that programme.

Sector-specific issues will affect the design of any SPSP (e.g. in assessing which aspects of policy the SPSP should seek to reinforce through its performance criteria). The EC's sector-specific policies and guidelines are set out in various separate documents. The present guidelines deal with the generic characteristics of an SPSP, and one of the most important issues is the choice of financing modality.

The main characteristics of an SPSP are as follows:

- ➔ An SPSP contributes to the funding of the sector programme, and consequently shares its objectives. Regardless of the financing modality chosen, no activities outside of the sector programme may be financed through an SPSP.

- The financial contribution made through an SPSP should be included within the envelope of available financing with a medium-term perspective for the sector.
- The monitoring system for the SPSP should be the same as that for the sector programme as a whole.
- An SPSP should add value to a sector programme by supporting its objective and its reform-agenda. As such it should be a flexible instrument which can accompany processes.

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

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

It is also possible to provide financing through some combination of these modalities. However, wherever the circumstances are right and eligibility criteria are met, the use of SBS is the favoured financing modality of the Commission.

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

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

Special attention is paid to coherence – between different elements of the EC's country programme, between the support from different donors, and, above all, between aid and the country-owned development strategy. Particular care needs to be taken to ensure that proper accountability for aid resources does not undermine the accountability of government to its own national stakeholders.

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

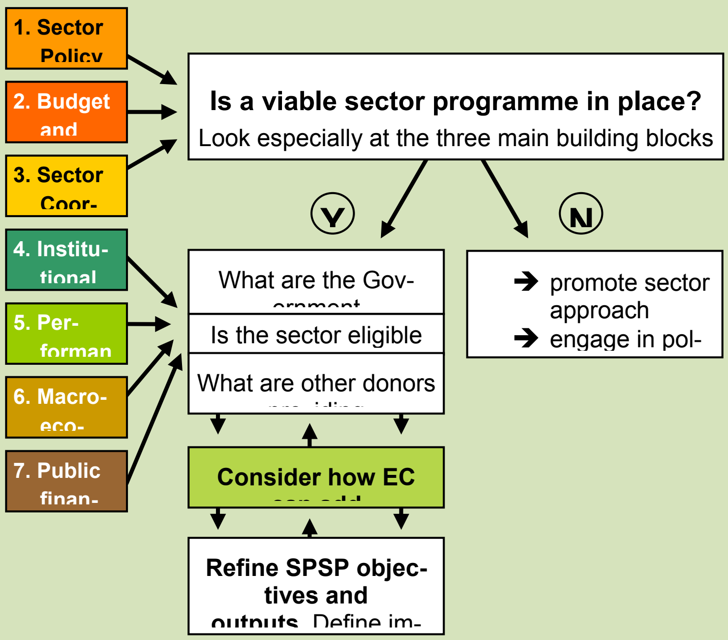
6.2 Designing an SPSP

The design of an SPSP, its objectives and implementation modalities, takes into account and depends on the stage of development of the sector programme as assessed through its key elements. All of the Key Assessment Areas as described in section 3.1 are relevant. It also takes into account the support that other donors are providing to the sector programme, and reflects the Government's preferences concerning the focus and the implementation modalities of EC support

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

Designing an SPSP is a process as illustrated in Box 2 below. The assessment of the three building blocks of the sector programme (sector policy, sector budget, sector coordination and management) will determine whether there is already a viable sector programme in place. If there is not (yet) a viable sector programme, the EC would engage in policy dialogue, promote the development of a sector approach, and seek to align EC project support with the developing sector approach If it is judged to be a viable sector programme, the design of the SPSP proceeds.

Box 2: The Process of Designing an SPSP



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

The Goal

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

SPSP objectives: adding value to the sector programme

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

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

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

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

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

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

6.3 Sector Budget Support – the Favoured Financing Modality

The EC favours the use of SBS when conditions are right.

Sector budget support is the transfer of financial resources from an external financing agency to the National Treasury of a partner country in support of a sector programme. Donor funds are blended with domestic resources and used in accordance with the public financial management system of the partner country. In a context of dialogue on the overall implementation of the s**ector programme**, the transfer of funds takes place following fulfilment by the partner country of agreed **conditions** for payment.

Supporting a sector programme, or the implementation of a sector policy, is a process that involves promoting coherence between policy, budgeting, institutional reforms and sector results. SBS is an appropriate tool to support these processes.

Whether the use of SBS is possible, depends on the outcome of the assessment of three eligibility criteria. The EC gives a dynamic and rigorous interpretation of these **eligibility criteria**: (i) a well defined policy is in place or under implementation; (ii) a credible and relevant programme to improve public financial management is in place or under implementation; (iii) a stability-oriented macroeconomic policy is in place or under implementation.

Box 3: Rationale for the Three Eligibility Criteria for Sector Budget Support

The rationale for the three eligibility criteria is as follows:

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

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

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

Resources transferred with SBS become part of the global resources of the partner country and are managed according to the partner country's own public financial management system. Public financial management is concerned with the planning, spending, reporting and auditing of public money as well as assessing the extent to which plans are implemented and whether a budget is comprehensive and transparently prepared and executed. As a result the country's public financial management system is a key factor in determining the efficiency and effectiveness with which budget resources contribute to achieving the objectives of the sector policy

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

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

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

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

If possible, SBS should be used in ways that establish a virtuous cycle, in which the use of initially weak but improving government systems helps to strengthen them further.

Because of their crucial role, eligibility criteria matter at all stages of the cycle of operations, from programming through to implementation. The guidelines provide further insights in the interpretation of the eligibility criteria and what needs to be established to demonstrate eligibility.

An important element in SBS is the allocation of funds between fixed and variable tranches. Fixed tranches are the most predictable components of SBS as they can be released provided general conditions, and the eligibility criteria, are satisfied. Fixed tranches are "all or nothing" and can only be disbursed entirely if related conditions are satisfied. The potential benefits of using variable tranches is the possibility of partial payment for partial performance which avoids damaging "stop-go" in aid disbursement and therefore enhances the credibility of disbursement conditions. Variable tranches are more apt to promote a focus on performance and results. SBS as used by the EC is a **result-based approach**, an approach that links the disbursement of variable tranches to the achievement of targets for agreed outcome indicators.

Although additionality is a key feature of many SBS operations, it is not a defining element of all SBS. The degree and type of additionality that is demanded to SBS depends on the specific objectives of the support programme. The guidelines provide insights into how additionality, if desirable, can be measured.

Both General Budget Support (GBS) and SBS (SBS) consist of a transfer of funds to the National Treasury of a partner country, but they are distinct aid modalities because they have different objectives. GBS aims to support the partner country national development policy, its macroeconomic stability, and overall PFM improvement. SBS aims to accelerate progress towards the country's sectoral goals. The difference in objectives is reflected in dialogue and conditions, which in SBS focus mainly on sector related issues. SBS facilitates a deeper technical engagement with sector policy and implementation issues in a focused dialogue with a broad range of sector stakeholders than is possible through GBS. These stakeholders may be national actors (local governments, NGOs, private sector organisations) and international partners who may not be involved in GBS.

Strong articulation between GBS and SBS is necessary when both are provided to the same partner country.

6.4 Pool Funding

Financial contributions to pool funds, or basket funds, represent another form of financing of a sector programme.

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

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

Pool funds may be distinguished in terms of three criteria:

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

Box 4: EC Regulations on Pool Funding (Co-Financing)

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

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

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

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

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

It would be a mistake to see donor pooled funding as the only suitable stepping-stone towards full SBS when SBS is not yet possible. Experience shows that pooled funding arrangements often have high transaction costs and some of the same disadvantages as projects in terms of by-passing and undermining government systems. Each context has to be carefully examined, but when the criteria for SBS are not met, project support that follows PBA principles as far as possible may be a better option than pooled funding. It should also be recalled that unified programming and reporting systems can feasibly be established while continuing to utilise project modalities. This may permit a direct move to budget support at a later stage, if the necessary conditions can be met. Thus, the option of continuing to use Commission procurement and grant award procedures should be considered, if there appears to be a good prospect over the medium term to move to budget support.

6.5 EC Project Procedures

The third financing modality for an SPSP is through the Commission's project procedures, the EC procurement and grant award procedures. Here the specific EC procedures relevant to the region in question are utilised to finance earmarked activities defined in the sector programme.

Such project procedures are appropriate where:

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

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

At first sight, it might appear that there is little to distinguish the use of specific procedures in support of an SPSP from their use in normal project activities. In terms of financial procedures and obligations, there is no difference but in objectives and mode of operation there are fundamental distinctions: the objectives of promoting ownership, coherence and harmonisation should figure prominently in the design of the SPSP and must be reflected in the mode of implementation and monitoring; the focus of the SPSP must be on the sector as a whole and on the results achieved at the level of the sector; the activities financed through an SPSP must be an identifiable part of the sector programme designed by government; the SPSP must follow the sector programme management systems.

6.6 Implementing an SPSP

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

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

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

Ensuring continuous policy dialogue and effective sector coordination

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

While dialogue between government and donors is important in the design phase of the sector programme, it is even more important in the implementation phase. Several unpredictable events such personnel changes within the lead ministry, start of a decentralisation process, new donors supporting the sector, have the potential to affect the sector programme. It is only by maintaining an open line of communication between government, donors and other relevant stakeholders that the effect of such events can be addressed. Dialogue therefore needs to be regular but it needs also to be effective, meaning that the debate spreads from the broader development strategy down through to service delivery levels and community participation

Monitoring the SPSP

The progress of the SPSP is monitored through the overall performance measurement and monitoring mechanism established for the sector programme. This implies active participation in all of the agreed monitoring mechanisms. The main requirements include: reviewing progress with the achievement of sector goals; reviewing progress with the development of the sector programme, utilising the milestones agreed within the programme; tracking development and implementation of the sector budget as well as it medium-term perspective, comparing actual expenditures with those foreseen and assessing the evolution of overall spending in the light of planned shares of expenditure; verifying compliance with any conditions agreed within the sector programme, including specific audit requirements; participating in half-yearly or annual review meetings for the sector programme as well as in mid-term reviews, and contributing to the drafting and negotiation of the resulting aide-memoires between stakeholders. This also refers to indicators 9 and 10 of the Paris Declaration asking respectively for common arrangements for monitoring and reduction of the number of separate diagnostic reviews.

7. THE SEVEN KEY AREAS OF ASSESSMENT

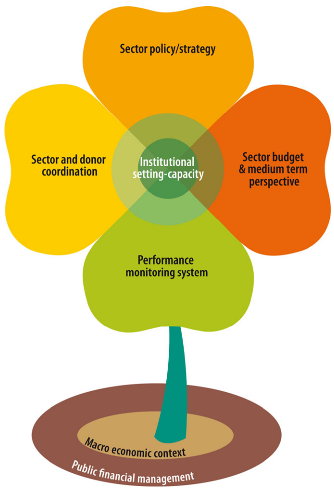
As mentioned above, EC decisions about whether and how to support a sector programme are based on assessments in seven key areas:

The five elements of a sector programme

1. The sector policy and overall strategic framework
2. The budget and it medium-term perspectives
3. Sector and donor coordination systems
4. The institutional setting and existing capacities
5. Performance monitoring

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

6. The macroeconomic framework
7. Public financial management (PFM) systems



The guidelines provide an insight into the basic concepts that are relevant to each assessment, identify key issues to be addressed and point to additional sources for more detailed guidance. The aim is to assist programme managers throughout the cycle of operations of EC support in reviewing the quality of sector programmes and deciding on appropriate support modalities.

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

There are many overlaps between these assessments (for example, there are obvious connections between sector expenditure strategy, the macroeconomic assessment and the review of public finance management; all the other assessments may feed into the institutional and capacity assessment, and so forth).

Also, many of the assessments are also required for other aspects of EC work (e.g. a macroeconomic assessment will have been undertaken as part of CSP preparation and to support any GBS the EC provides; a PFM assessment also forms an essential part of any GBS operation, and so on. Those working on SPSPs should first of all draw on, and if necessary update, existing assessments. Wherever there are relevant pre-existing studies and materials, these should be drawn upon.

Whenever possible, the EC works jointly with other donors, as well as with the partner government, on such assessments, and does so in ways that support the development of partner country capacity. The assessment required at the design stage of an SPSP is part of a continual process of monitoring and review of key issues.

There are few, if any, absolute criteria involved in the assessments. Balanced judgements are required, which identify opportunities as well as risks, and which assess the direction of change as well as current levels of performance.

7.1 The Sector Policy

Relevance and scope of this assessment

A coherent and consistently applied sector policy is the heart of any successful sector programme. Issues to be assessed include the quality of the policy and its consistency with government’s own national strategic objectives and with the Commission’s objectives of development co-operation.

Sector policy and strategy may be summarised in a single over-arching sector policy document and plan of action or it may draw on a number of key documents. In either case it is important to go behind the current policy documents and consider the policy processes from which they emerge, the record of implementation, and key trends in policy and strategy development.

What needs to be established

The sector policy and strategy must derive from, and be consistent with, the overall strategic objectives of government and the overall strategic framework (for example, the PRSP). In addition, it should also be linked to a credible sector budget (itself a distinct but closely connected assessment area). In other words the policy and strategy need to be operational**.**

Assessment will draw on relevant sector-specific guidance, but the DAC's general criteria for sector policy documents are always relevant.

Thus, a good policy document will:

- ➔ **Be authored by the government** (not the donors) and fit clearly into the government’s policy and planning system; it will be aligned with the national PRS and endorsed at a high political level.
- ➔ **Have a strong results orientation**, establishing clear sector goals and providing the essential framework for subsequent monitoring, with a focus on sector objectives and their impact on poverty reduction.
- ➔ **Explicitly address the role of government in the sector** – distinguishing regulatory functions from service delivery and noting the complementary roles to be played by communities, non-governmental organisations (NGOs) and the private sector.
- ➔ **Define the allocation of responsibilities across government** (between i) the main sector ministry, other line ministries that may be involved, and the central planning and finance ministries; and ii) the different tiers of central and local government), focus on implementation capacity constraints, and identify the principal requirements for institutional reform and capacity development.
- ➔ **Focus on the whole sector’s resource requirements**, including recurrent as well as capital expenditures, and demonstrating the sustainability of proposed public expenditures; it will address the effective-

ness of existing policies and expenditures, and not simply submit a subset ("a shopping list") of additional activities for donor finance.

- **Set out clear mechanisms for monitoring, review and updating of the policy document**, and identify the principal areas where further research and analysis may be required.

There will always be room for improvement in policies and strategies. Hence it is equally important to assess the policy process, including which stakeholders are involved and the mechanisms for review of performance and learning from experience.

Implications for EC support to the sector programme

While policies must be nationally owned to be effective, the EC and other donors must be able to endorse overall policy directions, and a shared understanding of strengths and weaknesses is an important foundation for such an endorsement.

For the EC to support a sector programme, the sector policy and strategy must be credible and generally consistent with EC objectives. However, in line with its concern for national ownership, the EC does not seek to micro-manage the detail of policy; its emphasis is on ensuring that progress towards broadly common objectives can be monitored through appropriate performance indicators.

Thus the policy and strategy assessment has direct implications for:

- the scale and scope of EC support to the sector programme;
- identifying areas that EC and other partners may wish to contribute through support to policy analysis and performance monitoring;
- support modalities to be adopted by the EC: a high degree of consensus over objectives, and a credible strategy that is well operationalised, will make it more likely that SBS can be provided.

There are obvious cross-links to the assessments of sector expenditure strategy, to sector coordination systems, to performance assessment frameworks, and to the institutional and capacity assessment.

7.2 Sector Budget and its Medium Term Perspective

Relevance and scope of this assessment

A good sector strategy is more than a public spending plan, since it will address other policy issues and the role of non-government actors, but the link between policies and public expenditures is crucial. The focus of this assessment is on the pattern of public resource allocations and expenditures for the sector, taking account of all sources of funding, and examining the underlying processes of resource allocation and use as well as the formal budgets.

The assessment will draw on existing analytical studies; public expenditure reviews and similar studies are an especially useful source.

What needs to be established

The first edition of these guidelines (in 2003) made the existence of a "sector MTEF" an eligibility criterion for sector budget support. Experience showed that this requirement was unrealistic. An isolated "sector MTEF" is not helpful: it has to fit into an overall system for strategic prioritisation of public expenditures. There was a danger that the stipulation would lead to superficial paper exercises that did not get to grips with the practicalities of budgeting in the sector context. The present guidelines adopt an approach that is more sensitive to sector context, including the PFM environment and institutional capacities.

The principles of effective public expenditure management are well understood. At the same time, it is recognised that it takes time to strengthen weak systems for planning and budgeting, and that sustainable progress requires a phased approach.

The assessment of sector budgets involves reviewing the pattern of existing and planned expenditures in the sector, but also an analysis of the budgeting process and its stage of development. (This analysis should dovetail with the PFM assessment described below.) The guidelines provide useful insights into the analysis of the sector budget as well as the process of placing the sector budget in a multi- year perspective. The notions of budget classification systems, Medium Term Fiscal Framework and (Sector) Medium Term expenditure Framework are explained.

Aspects of sector budget and budget systems to review could include:

- pattern of sector expenditures and revenues (including distribution across different ministries and tiers of government)
- historical trends and projections
- budget discipline, allocative and operational efficiency
- comprehensiveness of budgets (influence of aid flows) and integrity of the sector budget process.

The objective should be to assess whether the country is making progress and is committed to increasing the coherence between the sector policy and the budget, building sound budgeting and placing the budget in a multi-year perspective, taking into account its current situation and technical capacity.

Implications for EC support to the sector programme

This assessment feeds into the overall judgment on credibility of the sector programme. It is especially relevant to the choice of financing modality. The assessment will also yield insights about which policy and analysis issues should be prioritised, and about needs for institutional strengthening and capacity development (cf. the specific assessment in this field).

There will also be implications for the complementarity between GBS and SBS (GBS to promote improvement of budgeting at aggregate level, and overall PFM strengthening, in synergy with better expenditure analysis and planning for the sector). Strengthening sector budgeting has to be seen as one part of a broader process of strengthening overall budgeting for the whole of government, and this in turn is part of the process of strengthening wider PFM systems.

7.3 Sector and Donor Coordination

Relevance and scope of this assessment

Government leadership and systematic coordination of stakeholders are among the defining characteristics of a sector approach.

The sector approach is a process, through which the sector programme will be continually refined and improved. Its operation depends on trust and flexibility, and a high degree of collaborative working, especially in the review of performance. Therefore the effectiveness of coordination mechanisms is crucial.

It is important to maintain a conceptual distinction between sector coordination, and aid coordination (which also involves how donors coordinate among themselves).

What needs to be established

There is not a single right model, but the assessment will need to consider:

- overall sector coordination (including the extent to which sector coordination is linked to central agencies of government, especially MOF; also relevant decentralised governments/agencies as well as non-state actor); at both political and technical levels;
- extent of stakeholder consultation
- special arrangements for donor involvement; extent to which roles are agreed and codified in a memorandum of understanding, linked to the national planning and budget calendar

It is important not to stop at superficial analyses of "poor coordination" and prescribe more committees etc. There needs to be a deeper understanding of incentives to coordinate (e.g. cf. importance of unified budget process with genuine competition for resources is an important factor), and also of the capacity implications/transaction costs of demands for dialogue and coordination. There will invariably be a variety of coordination and management mechanisms, e.g. for overall policy direction, technical management and review, and specialist standing and ad hoc working groups. It is important to be clear about the substantive purpose and the immediate objectives of each body; this will help in determining who should be involved, and the division of labour between different forums. Good practice also requires a good articulation between the documents, the rules the forums and the calendar of events that constitute the management framework for a sector approach. Moreover, sector processes need to be synchronised with wider national ones, not least with the governments' overall planning and budgeting calendar.

Implications for EC support to the sector programme

Considerations may be different according to the stage of development of the sector approach. In its early stages, there may be an assessment whether the approach is sufficiently developed to justify an EC SPSP, and how EC can help to further the process. Later, assess how well sector management is working and, always, how it can be strengthened – always bearing in mind the danger of donors inadvertently undermining national ownership and accountability.

The EC may be able to help in providing technical support to the coordination bodies – but collaborate with other donors and guard against arrangements that undermine rather than reinforce mainstream government systems.

This assessment will have cross-links with the institutional and capacity assessment, and the assessments of performance monitoring and sector policy process.

7.4 The Institutional Setting and Capacity Issues

Relevance and scope of this assessment

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

The sector approach reflects a belief that an important way to strengthen national systems is to use them, not to bypass them. However, this built-in orientation towards systemic capacity development needs to be complemented by an explicit appreciation of capacity issues and a pro-active approach towards capacity development.

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

It is crucial to involve partner country and organisations in the assessment. If an assessment is deemed to demand EC- or donor-contracted TA, ToR should anyhow preferably be drafted by government and endorsed by donors. The team should work under the authority of the sector organisations that they are assessing. Inclusion of local or regional specialised management consultants may often strengthen an assessment team’s ability to assess context factors and informal aspects.

What needs to be established

The suggested approach to institutional and capacity assessment is fully spelt out in the Reference Document on "Institutional assessment and Capacity Development"[8], and is supported by working tools such as standard terms of reference and checklist.

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

Care has to be taken not to approach this analysis from a position where the present capacity is mainly assessed with the lenses of how the capacity should ideally be. This may lead to a superficial "gap" analysis which explains nothing:

It is also necessary to look beyond what is directly observable in organisations and come to grips with the informal aspects of organisations, and the power and loyalty issues that foster or constrain capacity.

Implications for EC support to the sector programme

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

Lessons from experiences and promising practices in this area show that in dealing with institutions and capacity development the partner government's leadership is key and donors can only play a supportive role. A donor-driven analysis may fail to create a climate of open and trustful dialogue and it may prevent a clear ownership of the analysis by the key national stakeholders. Without this ownership, even the most technically proficient and excellent capacity assessment is unlikely to be used as foundation for subsequent capacity development.

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

7.5 Performance Monitoring Systems

Relevance and scope of this assessment

The trend towards stronger results-orientation is reflected in the Paris declaration. This is not simply a matter of aid effectiveness but of applying modern management principles to the deployment of all resources.

What needs to be established

Be careful not to focus only on a few isolated indicators, important though these may be (cf. MDGs). The starting point is to understand the strengths and weaknesses of performance assessment systems in place, and seek to strengthen an evidence-based results focus for the whole sector. Ideally, sector performance systems will be nested in overall monitoring and review of the national plan/PRSP etc

8 *http://www.cc.cec/dgintranet/europeaid/activities/adm/capacity_development/guidance_en.htm*

Analysis should include the political ownership as well as the technical quality of performance systems and results orientation. This assessment will help to identify ways in which all partners in the sector approach should seek to support and strengthen performance systems.

The wider analysis should precede and feed into the identification of possible indicators to which EC sector support should be linked. The guidelines include general criteria for the selection of such indicators (including SMART characteristics, focus on outcomes but provision of short term management information on inputs and outputs as well as performance measurement of outcomes, derivation from national policy/strategy documents, monitoring through national systems etc, appropriate desegregation by gender, socio-economic group and other relevant categories etc). It is always necessary to strike a balance between what is ideal and is practical.

The guidelines highlight that the process of agreeing targets is itself important, and should engage all major stakeholders, including the managers who have to deliver performance and the statisticians who may have to measure it.

Results-orientation is meant to align incentives with desired performance. Special care is needed to ensure that selected indicators properly reflect sector objectives and become part of domestic sector management processes.

Implications for EC support to the sector programme

There is particular interest in performance indicators that can link EC support to results. However, alongside a strong focus on outcomes, attention and support needs to be given to (the development of) a comprehensive overall system for performance monitoring involving managerial feedback and review on all links in the causal chain. Targets should be drawn from national documents for targets and national systems for monitoring of results should be used as much as possible.

There may be direct links to possibilities for support by EC and other donors in the strengthening of national capacity for monitoring and analysis. There may also be scope for the EC to support national accountability via civil society or client-accountability mechanisms.

There are direct cross-links to sector budgets as well as to coordination systems, since policy documents, annual sector reviews etc should all draw on and feed into common performance systems.

7.6 The Macroeconomic Framework

Relevance and scope of this assessment

A weak macroeconomic environment can easily derail sector programmes, e.g. if revenue shortfalls undermine public expenditure plans, or if the policy environment is damaged by economic instability.

Given that Budget Support has been adopted by the Commission as the preferred form of financing for sector programmes, the analysis of the macroeconomic situation also has a special significance for the choice of SPSP financing modality.

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

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

In almost all cases, a sector assessment will be able to draw on (and perhaps update) an existing macro assessment, since such an assessment is required (a) for the CSP, and (b) for the preparation of any GBS operation. And the EC assessment will draw on heavily on IMF's reports – through Article IV consultations, the reporting associated with a PRGF, or other "signalling" reports.

What needs to be established

A primary concern is to assess the stability of the macroeconomic situation, and the outlook for public finances and private investment. In turn, this will provide the basis to assess the realism and appropriateness of public expenditure plans at the sector level.

If SBS is to be used as a financing modality, one of the eligibility criteria is that a stability-oriented macroeconomic policy is in place or under implementation.

The assessment relies on the following main elements:

- A summary of the main past and expected trends in macroeconomic variables
- The existence of a stability oriented reform programme where appropriate.
- The relationship between the partner country and the IMF.
- A review of any macroeconomic topics that might be of special relevance to the sector (e.g. macroeconomic aspects of "scaling up" to meet the MDGs).

Implications for EC support to the sector programme

The macroeconomic assessment is directly relevant to the possibility of using the SBS modality.

It is indirectly relevant to other key assessments:

- it will indicate the quality of some aspects of public finance management;
- it will provide a context for assessing the sustainability of sector expenditure plans, and some of the risks the sector faces.

7.7 Public Finance Management

Relevance and scope of this assessment

Public financial management is concerned with the planning, spending, reporting and auditing of public money as well as assessing the extent to which plans are implemented and whether a budget is comprehensive and transparently prepared and executed. As a result the country's public financial management system determines the efficiency and effectiveness with which budget resources contribute to achieving the objectives of the sector policy.

In the past there has been a plethora of different PFM assessments by different donors and/or for slightly different purposes. The performance measurement framework developed by the Public Expenditure and Financial Accountability (PEFA) initiative now offers the possibility of standardisation among donors in a transparent assessment and can feed into the formulation of PFM reform strategies by the partner government. The PEFA framework is now the EC's tool of choice (to be used in collaboration with other donors to the maximum extent possible).

What needs to be established

If the SBS is to be used as a financing modality, one of the eligibility criteria is hat a credible and relevant programme to improve PFM is in place or under implementation.

The analysis should be based on:

- an *overall assessment of PFM* using the requirements set out in the Commission's guidelines on the Programming, Design & Management of General Budget Support; and
- an *additional assessment at the level of sector PFM only* where specific public financial management systems and rules are in place at the sector level.

The overall PFM assessment

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

- An assessment of the quality of overall PFM systems, for which the EC tool of choice is as mentioned above, PEFA. This performance measurement framework consists of the analysis of 28 indicators covering six essential dimensions of PFM systems: (i) credibility of the budget, (ii) comprehensiveness and transparency of the budget, (iii) policy-based budgeting, (iv) predictability and control in budget execution, (v) accounting, recording and reporting, and (vi) external scrutiny and audit. It also includes three indicators on donor practices.
- An assessment of the PFM reform process, that should focus on:
  - the relevance and degree of implementation of the reform strategy (and related action plan);
  - the relevance and degree of coordination and implementation of the capacity development programmes that may be financed by the donors to support the reform of public financial management; and
  - evidence of the national authorities' political will, commitment and endeavours to improve PFM performance.

Besides eligibility requirements it is always desirable to check whether there are sector-specific PFM issues that require special attention and could be usefully supported by the EC. Sector PERs and public expenditure tracking studies are among the sources of relevant sector insights.

The sector PFM assessment

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

Implications for EC support to the sector programme

Use of budget support as the financing modality for an SPSP requires an assessment of the eligibility criteria based on the two elements noted – the quality of the PFM **system**, and the credibility of the PFM **reform process**.

The PFM assessment has obvious cross-links to the macro assessment, the assessment of the sector expenditure framework, and the institutional and capacity assessment. Many of the issues around PFM improvement need to be tackled at a government-wide level. Care is needed to avoid sector initiatives that may be unhelpful in the context of a coherent overall PFM strategy; at the same time, sector experiences and concerns can usefully feed into broader strategy and create demand for wider reforms. Hence there are also implications for sector coordination arrangements and their articulation with wider coordination processes.

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

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

8. THE CYCLE OF OPERATIONS FOR A SPSP

Annex 1 of the guidelines translates general policies and design principles into the specific EC procedures and documentation requirements for each phase of the SPSP cycle.

The successive phases are:

- the programming phase;
- the identification phase;
- the formulation phase;
- the financing phase;
- the implementation and monitoring phase; and
- the evaluation phase.

The phases are similar to those that apply for project support but a broader sector perspective is always present. To differing degrees, the processes and EC documents for each phase draw on the seven main assessment areas discussed in the final part of the guidelines.

WEB REFERENCES

EU LINKS

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

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

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

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

LINKS TO SPECIFIC EC DOCUMENTS :

EuropeAid internet site presenting Guidelines and Reference Documents :
http://ec.europa.eu/europeaid/multimedia/publications/index_en.htm (functioning from September 07 on). The documents will be posted under the "Tools and Methods Series" menu.

EU Consensus on Development

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

EU AID: Delivering more, better and faster

DAC LINKS

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

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

Paris Declaration on Aid Effectiveness

OTHERS

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

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