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**Financial, budgetary and administrative matters**

**Review of the UNDP engagement in direct budget support  
and pooled funding**

*Summary*

In its decision 2008/24, the Executive Board endorsed a four-year pilot period to enable UNDP to participate financially in pooled funding and sector budget support arrangements upon the request of programme countries and within certain provisions and limitations. As requested by the Executive Board in its decision, this paper reviews the usefulness and effectiveness of this exercise at the end of the pilot phase.

The review indicates that the provisions of the pilot period provided UNDP country offices with the flexibility they needed to remain key, innovative partners in a changing development cooperation environment at the country level. It allows country offices to: (a) not only advocate for effective development cooperation but also ‘walk the talk’, that is, participate in direct budget support if so requested by the government; (b) enhance the UNDP policy contribution by being part of key policy fora; and (c) leverage UNDP capacity development support. In a direct budget support environment, country offices require flexibility to engage in the whole array of aid modalities on offer. The pilot has contributed to increased national ownership and created more space for quality policy engagement in the respective sectors. The value-added contribution of UNDP lies in particular in its support of national capacities to negotiate, design and manage direct budget support.



*Elements of a decision*

The Executive Board may wish to: (a) agree to maintain the changes in the regulations and rules as contained in document DP/2008/36 beyond the pilot period 2008 to 2012 in order to continue to equip country offices with the needed flexibility in a direct budget support environment, recognizing that these rules and regulations may be further refined, if necessary, in the context of the harmonized regulations and rules currently under consideration at the United Nations; (b) request that the results of the pilot period be shared across UNDP and with members of the United Nations Development Group (UNDG); and (c) encourage UNDP to pursue this approach with the UNDG to ensure synergy and common approaches to direct budget support and pooled funds.

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## **I. Introduction**

1. Over the last decade, direct budget support has become an integral part of the aid modalities portfolio available to programme countries. During its second regular session 2008, the Executive Board adopted decisions 2008/24 and 2008/29 regarding the organization's positions towards direct budget support.
2. As part of those decisions, the Board endorsed a four-year pilot phase to provide UNDP country offices with the option to participate financially in sector budget support and pooled funds under certain provisions. As the pilot period has come to an end, a review of the initiative is due for the first regular session of the Executive Board in January 2013, based on the criteria outlined in the two respective reports to the Executive Board (DP/2008/36 and DP/2008/53).
3. This review is based on a desk study and interviews with relevant stakeholders in programme countries where the pilot was implemented and/or seriously considered. Particular attention is given to the question as to whether UNDP can support country ownership and capacity development through the provisions tested under the pilot initiative. The report concludes with a recommendation for consideration by the Board on whether the provisions of the pilot should be continued and/or integrated into UNDP rules and procedures.
4. The paper consists of five parts. The first part provides a short background on direct budget support as an aid modality and lessons learnt in its use. This is followed by a chapter describing the evolution of UNDP policy towards direct budget support. The centrepiece of the review is chapter four, which looks at experiences from UNDP country offices based on the criteria outlined in documents DP/2008/36 and DP/2008/53. After assessing the demand and outlook for the pilot, the final chapter provides a set of recommendations to the Executive Board.

## **II. Background**

5. While acknowledging that direct budget support is not the core business of UNDP, UNDP recognizes direct budget support as a development finance instrument that can promote national ownership, transparency and alignment of development cooperation with national budget priorities. UNDP is supportive of programme country governments that express increased interest in using direct budget support mechanisms as one of their preferred means to coordinate, manage and monitor development finance directly through national budgets.
6. Payments directly into the budgets of recipient governments are not a novelty. Budgetary assistance dates back to the late 1950s, when it was provided to countries emerging from colonial rule. These direct payments were followed by commodity aid in the 1970s and balance of payment support. In the mid-1990s, debt relief became an important element of direct financial support to developing countries. The Heavily Indebted Poor Country (HIPC) Initiative, which was initiated in 1996, is the most prominent example. Debt relief through HIPC was linked to the poverty reduction strategy papers to ensure that funds freed up by debt relief were used for efforts to reduce poverty in the respective country.
7. In the context of a call for more effective and efficient development assistance, direct budget support emerged as an aid modality in the early 2000s. The

Development Assistance Committee of the Organisation for Economic Co-operation and Development defines direct budget support as a “method of financing a partner country’s budget through a transfer of resources from an external agency to the partner government’s national treasury”. In contrast to project aid, direct budget support is managed exclusively by the recipient’s country systems, such as allocation, budgetary, procurement, accounting and audit processes. Direct budget support can take two forms: (a) general budget support, which is a general contribution to the government’s budget, including balance of payments; and (b) sector budget support, which are contributions targeted towards a sector or a thematic programme. Fund management arrangements under direct budget support can result in a pooled fund arrangement (also called basket funds) relating to a specific sector, thematic programme or plan.

8. Aggregated global data on the volume of direct budget support is difficult to obtain. Data on indicator 9 (*programme-based approaches*, of which direct budget support is a part) from the Survey on Monitoring the Paris Declaration can be used as a cautious proxy. According to the 2011 survey, \$16.9 million, or 23 per cent, of assistance provided by participating donors was delivered in the form of budget support to 78 countries and territories. Overall, there seems to be a slight increase in programme-based assistance in recent years (sample of 34 countries). In 2005, 35 per cent of surveyed official development assistance (ODA) was programme-based. In 2007, this number dropped to 34 per cent while it increased again to 37 per cent in 2010.

9. Recent evaluations and studies, most of them done at the country level, present a mixed review of direct budget support and call for more realistic and pragmatic approaches. Direct budget support is neither a panacea for poverty reduction nor will it disappear in the foreseeable future. Direct budget support needs to be viewed as what it is: *one* of the financing instruments available to developing countries and development partners.

10. For recipient countries, the rationale for receiving assistance in the form of budget support is above all increased ownership. Some countries state direct budget support as a preferred aid modality in their aid policies while others see it as one element in their mix of aid modalities. Overall, the success of direct budget support hinges on strong political will as well as the capacities of the government to manage the related processes. There is evidence that in the presence of direct budget support, the financial management system of the recipient countries improve (see, for example, *Providing Budget Support to Developing Countries*, United Kingdom Department for International Development (DFID), 2008). While direct budget support offers the prospect of more flexibility for the recipient country, it does not necessarily lead to reduced volatility. In fact, direct budget support can be withdrawn or suspended for political reasons and/or because agreed benchmarks have not been met.

11. From the viewpoint of development partners, the rationale for channelling assistance in the form of direct budget support is to strengthen national ownership, increase alignment and free up capacities through reduced transaction costs. The rise of budget support is also linked to the internal pressure on development partners to reduce administrative costs. While some donors channel major shares of their official development assistance in the form of budget support (for example, the European Commission, Sweden, the United Kingdom), other countries take a more cautious approach (for example, through pilot exercises). Emerging development

cooperation providers generally do not contribute to direct budget support mechanisms.

### **III. Evolution of the UNDP policy towards direct budget support**

12. With the rise of direct budget support and the considerable attention given to this aid modality both at the global and country level, the General Assembly, in its resolution 59/250 on the Triennial Comprehensive Policy Review of Operational Activities for Development (TCPR) in 2004, asked the United Nations system to “support national capacities for the management of various aid modalities, including system-wide approaches and budget support”. In its 2007 TCPR resolution 62/208 (paragraph 103), the General Assembly explicitly “encourages that the United Nations development system be invited to participate, ex officio, in current and new aid modalities and coordination mechanisms at the request of the programme country, and invites the United Nations development system to enhance its participation in this regard”.

13. It became clear that UNDP, as a major development partner and following the above-mentioned resolutions, needed to articulate a policy regarding budget support. In 2008, UNDP presented two reports to its Board: UNDP engagement in direct budget support and pooled funds (DP/2008/36) and the follow-up report, the role of UNDP in the changing aid environment at the country level (DP/2008/53). Both reports highlight that UNDP comparative advantage does not lie in financial contributions but in support to national capacity development.

14. While general budget support was ruled out, the reports suggested that UNDP should consider involvement in sector budget support and pooled funding. The rationale for UNDP engagement in sector budget support and pooled funds was to respond to growing country demands for capacity development and for expanded inclusion of UNDP in efforts towards harmonization and alignment. It was also recommended that UNDP should only engage in pooled funding in areas or sectors in which it was already present through a separate project (see DP/2008/36).

15. The supplementary report laid out four different options for UNDP country offices’ engagement in sector budget support and pooled funds, in response to a programme country’s request for support to capacity development and for expanded inclusion of UNDP in efforts towards harmonization and alignment (see paragraph 17, DP/2008/53). They may alternatively be used in combination, if so required. UNDP support can take the form of a capacity development initiative and policy advisory services through:

- (a) Using a standard UNDP project for policy advisory and capacity development support;
- (b) Managing a pooled fund upon request by the government;
- (c) Signing on to a sector budget support fund or a pooled fund as non-fund provider or “signatory without fiduciary obligation” or becoming a non-signatory with observer status in the respective partnership group;
- (d) Allocating a financial contribution to a sector budget support fund or to a pooled fund managed by a government entity, or to a pooled fund in its mandated areas managed by a United Nations fund, programme or specialized agency.

16. Following Board decision 2008/29, UNDP drafted operational guidelines — UNDP engagement in sector budget support and pooled funding, guidelines and procedures for country offices and headquarter units 2009 — that reflect the approved amendments to the financial regulations and rules, so that the implementation of the pilot policy could commence. The guidelines were made available to all staff in May 2009.

17. This report will focus on analyzing UNDP experiences regarding option (d) on financial support to sector budget support or pooled funds. The report will *not* review the other three options available to UNDP country offices in detail. However, it is useful to note that the guidelines on direct budget support have also been used to enable UNDP, through its Multi-Partner Trust Fund Office, to respond to requests from governments to manage pooled funds, notably in the area of climate change. So far, four national governments (Democratic Republic of Congo, Ecuador, Ethiopia and Mali) have requested UNDP support in this particular area.

18. The first of these national funds, the Yasuní Ishpingo Tambococha Tiputini (Yasuni ITT) Trust Fund, was established in August 2010 to facilitate the receipt of contributions from the international community in support of Ecuador's decision to permanently forego the extraction of the Yasuni ITT oil fields located in one of the most important and diverse biological reserves in the world and home to its indigenous people. In response to a request by the Government of Ecuador, UNDP developed a legal instrument and related operational procedures that enabled it to provide fund management services to the Government. The legal arrangements involve a modified management service agreement along with the UNDG standard administrative arrangement, both of which have been concluded with the Government and donors contributing to the Yasuni ITT, respectively. Contributions received from donors are transferred by the UNDP Multi-Partner Trust Fund Office directly to national partners in the framework of the UNDP Executive Board approved guidelines for sector budget support and pooled funding mentioned above. The national implementing organizations will assume full programmatic and financial accountability for the funds disbursed to them by UNDP on the instruction of the government led the Yasuni Steering Committee. Such funds are administered by each Yasuni Fund recipient and implementing organization in accordance with the national regulatory framework, provided that national financial regulations and rules do not contravene the principle of UNDP financial regulations and rules.

#### **IV. Experiences from UNDP country offices**

19. The experience during the pilot period from 2008 to 2012 has shown that the provisions of Executive Board decisions 2008/24 and 2008/29 enable UNDP to more responsively and flexibly engage with developing countries' preferred financing instruments in a changing development cooperation environment. It has also offered new opportunities for UNDP to position itself as a technical partner in critical areas — by having a voice in substantive policy negotiations and by offering technical support on substantive issues where the Government is lacking capacity as well as on managerial issues geared towards improving the effectiveness of development cooperation.

20. Between 2008 and 2012, UNDP country offices received expressions of interest to contribute financially to direct budget support from the governments of Burkina Faso, Cambodia, Mozambique, Nepal, Rwanda, Uganda and a few other

countries. However, after examining the possibilities, the government and UNDP in all countries except Burkina Faso opted for a more tailored capacity development response in support of budget support mechanisms, rather than UNDP providing budget support alongside other donors. In those settings, UNDP often provides support to the Ministry of Finance and/or Planning to improve aid coordination and strengthen mutual accountability for development results (for example in Rwanda, Mozambique and Nepal).

21. In several instances, such as in Cambodia, the government and development partners overall agreed to take a flexible approach to programme-based approaches where the key emphasis is put on steering, decision-making and coordination. At the same time, funding modalities are kept flexible and parallel funding arrangements are allowed in addition to pooled funding or use of national budgetary and treasury systems. In countries where the government and UNDP have considered options for direct budget support, UNDP and/or the United Nations country team have usually become an associate member of the general budget support donor group or have an observer status without fiduciary obligation.

22. Burkina Faso started to use direct budget support in 2005. In 2011, total budget support amounted to \$371 million or 32.4 per cent of total ODA, against 30.5 per cent of ODA in 2010. In 2008, the UNDP country office received a request from the Government of Burkina Faso to participate in sector budget support. The request was approved in 2009 for two projects in priority areas established by the Government, which fall within the core mandate of UNDP (HIV/AIDS, human rights promotion). The UNDP contribution to sector budget support in Burkina Faso for 2011 in the area of HIV/AIDS amounted to 85,000,000 CFA francs (or \$174,885 out of a total contribution of 926,415,770 CFA francs or \$1,906,073). This represented 9.18 per cent of HIV/AIDS sector budget funds. The amount, funded from regular resources, was below the cap of 10 per cent of the annual authorized spending limit of core funds contained in the resource planning framework endorsed by the Board in its decision 2008/24. The performance of the HIV/AIDS pooled fund has been rated high, both in delivery rates and absorption. It should also be noted that UNDP plays an important role in supporting the government efforts to increase the effectiveness of development cooperation. The UNDP contribution to pooled funds is also seen as UNDP “walking the talk”, fostering trust among partners and strengthening the organization’s credibility at the country level.

23. Benchmark questions for the qualitative review of the UNDP pilot phase allowing country offices to participate financially in sector budget support and pooled funds were outlined in the two Board documents DP/2008/36 (paragraph 28) and DP/2008/53 (paragraph 24). They can be grouped into the following areas: (a) policy and partnerships; (b) ownership; (c) use of country systems; (d) mutual accountability; (e) predictability; and (f) harmonization and alignment.

## Box 1

**Summary of benchmarks outlined in documents DP/2008/36 and DP/2008/53**

<i>Area</i>	<i>Benchmark(s)</i>
Policy and partnerships	<ul style="list-style-type: none"> <li>▪ Has UNDP entry enhanced the impact of UNDP policy and capacity development contributions?</li> <li>▪ Have there been measurable increases in investments in capacity development, and national priority given to it, in the areas of direct budget support and pooled fund engagement?</li> <li>▪ What has been the impact on relations with government and donor partners, including with the national aid coordination mechanism?</li> <li>▪ Has UNDP engagement contributed to a greater policy and advocacy role for UNDP in the given area?</li> </ul>
Ownership	<ul style="list-style-type: none"> <li>▪ Has UNDP participation further strengthened country ownership? If yes, what is the evidence?</li> </ul>
Use of country systems	<ul style="list-style-type: none"> <li>▪ Has UNDP engagement in sector budget support and pooled funds contributed to increased use of country systems and strengthened capacities of relevant country systems, for example, in procurement, public financial management and audit?</li> </ul>
Mutual accountability	<ul style="list-style-type: none"> <li>▪ Has the sector budget support and pooled funds enhanced the performance and accountability of programme countries' public financial management systems?</li> <li>▪ Was there sound monitoring and oversight in the respective fund, in keeping with the relevant memorandum of understanding?</li> <li>▪ Is the harmonized cash transfer or another agreed capacity assessment instrument being used? And are these results being monitored with regard to improvements in national programme and financial management and monitoring capacities?</li> </ul>
Predictability	<ul style="list-style-type: none"> <li>▪ Have the sector budget support and pooled funds been delivered in a way that enhances the predictability of resources and reduces their volatility?</li> </ul>
Harmonization and alignment	<ul style="list-style-type: none"> <li>▪ Has UNDP engagement in sector budget support and pooled funds made a difference in harmonization and alignment at the country level?</li> <li>▪ Has UNDP participation led to increased rationality, cost-effectiveness and reduced transaction costs in the management of development assistance? Has it freed up capacities? If yes, how?</li> </ul>

24. In terms of *policy and partnership*, the policy provisions for UNDP engagement in direct budget support and pooled funds have paved the way for more quality policy dialogue. The entry of UNDP into such an arrangement has enhanced the impact of the organization's policy contributions. It has also strengthened and increased partnerships with government partners, civil society and other development partners. For example, in Burkina Faso, participation in pooled funds was of strategic importance. It ensured that UNDP can continue to play a catalytic policy function and strengthen its advocacy role in its mandate areas within a sector programme and attendant harmonized policy dialogue frameworks. As a result of the HIV/AIDS pooled fund and respective advocacy, the rights of minority and specific groups with regards to HIV/AIDS have been integrated in the national strategy for HIV/AIDS. Participation in the pooled funding arrangement thus opened a vital policy space in terms of scaling up critical development interventions. Similarly, the pooled fund in the area of human rights has provided UNDP with an opportunity to engage in high-level policy dialogue with government and heads of diplomatic missions that are partners to the pooled fund modality.

25. The policy's provisions have also helped to strengthen *national ownership* in the countries where it was used. The respective steering committees are usually chaired by government with the participation of development partners, civil society and the private sector. With the option of participating in sector budget support or a pooled fund, UNDP is able to align to the programme country's preferred aid modalities. Given that financial contributions are channelled through national systems, ownership of the processes (for example, public financial management, public procurement, budgetary oversight, audit) is guaranteed. An evaluation of the HIV/AIDS pooled fund in Burkina Faso concluded that the pooled fund had comparative advantages over other funding modalities and encouraged development partners to maintain and increase their commitment to the process.

26. Similar to other development partners, UNDP engagement in direct budget support and pooled funds has contributed to increased *use of country systems* and *strengthened national capacities* of the relevant country systems. In fact, the prevalent weak use of country systems is a major impediment to making development cooperation more effective. Many programme countries have worked hard to strengthen their country systems, yet development partners do not fully use national systems, as documented in the periodic Survey on Monitoring the Paris Declaration on Aid Effectiveness. In Burkina Faso, for example, assessments of the national public financial management system conducted by the World Bank based Public Expenditure and Financial Accountability Program in 2010 and related HACT macro-assessment point to a system that is globally satisfactory, with no major fiduciary risks regarding transfer of resources to partners. However, the effectiveness of audits through the *Cour des Comptes* remains weak, requiring further capacity development support. By channelling more funds through direct budget support, the systems will be used and can be further strengthened. The 2011 evaluation of the HIV/AIDS pooled fund in Burkina Faso showed that procurement procedures worked in fact satisfactorily.

27. Evidence from the country level suggests that participation in sector budget support and/or pooled fund mechanism strengthens *mutual accountability* between national stakeholders and development partners. Before engaging in the respective mechanisms, UNDP undertakes an analysis of the management structure of the mechanism, with a particular focus on national capacities. In Burkina Faso, a

procedural manual was developed by the Government and all participating development partners to govern the management of resources under the common pooled fund. A steering committee was established to monitor the mechanism and review activity reports.

28. There is some indication that participation in sector budget support or pooled fund mechanism contributes positively to *predictability* of development resources. In Burkina Faso, the presence of pooled funds has also been credited with not only meeting the resource mobilization target but exceeding it (by 8 per cent).

29. With regard to *harmonization and alignment*, participation in sector budget support and pooled funding has helped to decrease the administrative burden of involved stakeholders at the local level, particularly for government counterparts. Continuing support to capacity development can more easily be integrated into existing structures, as parallel project implementation units are no longer needed in the presence of a sector budget support and/or pooled fund mechanism.

30. Issues that country offices are struggling with regarding effective engagement in a direct budget support and pooled funding environment include: (a) the financial cap, which can mean that not all UNDP support in the respective sector can be channelled through the pooled fund but that additional projects need to be established; (b) the centralized decision-making process, which takes a long time, potentially harming the reputation of UNDP at the country level; (c) approaches to direct budget support are not harmonized across United Nations organizations; for example, UNICEF does not have any limitations on contributions to direct budget support; and (d) the directive policy framework, including UNDP financial regulations and rules, might impose an additional administrative burden on national counterparts (for example, in Burkina Faso, the HIV/AIDS pooled fund reports every six months, but the UNDP regulations and rules stipulate reporting every three months).

## V. Demand and outlook

31. While the number of interested countries remains small, those that seek UNDP financial involvement are strongly interested. For example, the UNDP country office in Burkina Faso has been requested to stay involved in current pooled funding mechanisms and participate in an additional pooled fund.

32. While the advantages and disadvantages of direct budget support have become clearer in recent years and reviews have been mixed, it remains an important part of the spectrum of funding modalities available to programme countries. If UNDP wants to remain a critical partner in a direct budget support environment, country offices must be empowered to respond to requests from respective programme country governments, both in terms of policy and funding modalities.

33. In order to foster learning within UNDP and across United Nations funds, programmes and specialized agencies, sharing of experiences and lessons learnt will be vital. The results of the qualitative review of the four year pilot should thus be shared on UNDP and United Nations knowledge networks to increase institutional learning and foster exchange of experiences across United Nations organizations.

## **VI. Recommendations to the Executive Board**

34. As the Executive Board suggested in 2008, UNDP programme countries do not consider sector budget support as a core competency of UNDP and do not demand it very often. However, they consider it a useful and practical option to have. If requested, the policy enables UNDP to be more flexible and responsive to government needs and approaches to donor coordination in a direct budget support environment. This ensures that UNDP can remain a critical and innovative partner and offer a tailored response to government requests.

35. The reputation of UNDP as a flexible and responsive development partner has benefited from the direct budget support pilot, including by enabling UNDP to respond to requests from governments to manage national pooled funds. Programme countries generally appreciate the possibility of UNDP engagement in this area and reviews by the Multilateral Organization Performance Assessment Network (MOPAN) and other assessments of UNDP performance have positively noted the existence of the policy (see MOPAN reviews and UNDP and UNDG responses to implementing the Paris Declaration on Aid Effectiveness).

36. In terms of risk management, the experience of the past four years shows that the fiduciary risk of UNDP financial contributions to direct budget support funds is minimal. This is mainly a result of the ceiling of \$100,000 on target for resource assignment from the core (TRAC) allocations and the low level of demand.