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Report

EU State Building Contracts

Early lessons from the EU's new budget support instrument for fragile states

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Key messages

- Early experiences in Mali and South Sudan reveal that the EU's State Building Contracts (SBCs) have proved to be flexible instruments for rapid support to fragile states. There are, however, a number of areas for improvement.
- There exists a design tension in the SBCs between supporting short-term stabilisation or crisis management, and longer-term state-building objectives. This can be resolved by clarifying objectives, and tailoring the instrument to the objectives.
- Volatility is a key characteristic of fragile states, requiring closer and more frequent risk monitoring. Risk management can be improved by ensuring risks are monitored more holistically and regularly, and by adopting a wider definition of political risk.
- The political economy of fragile states – especially fragmented authority within government – can hinder effective political dialogue around budget support. There needs to be sufficient broad buy-in by the partner country, or alternatively, verification that any triggers or indicators are within the control of the main dialogue partner.
- Accompanying SBCs with technical assistance (or complementary support) is a positive step. Nevertheless, a more strategic and flexible approach, which links technical assistance to objectives and which is responsive to changing government requirements, could increase the impact of SBCs.

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Acronyms

ACP	African Caribbean and Pacific Group of States
AfDB	African Development Bank
CAP	World Bank/African Development Bank Common Approach Paper on budget support to fragile states
DCI	Development Cooperation Instrument
DEVCO	European Commission Directorate-General for International Cooperation and Development (EuropeAid)
DRM	Domestic resource mobilisation
EDF	European Development Fund
EEAS	European External Action Service
EU	European Union
FCAS	Fragile and Conflict-Affected States
FT	Fixed Tranches
GBS	General Budget Support
GGDC	Good Governance and Development Contract
IMF	International Monetary Fund
MEF	Ministry of Economics and Finance, Mali
MoFEP	Ministry of Finance and Economic Planning, South Sudan
PFM	Public Financial Management
PSGs	Peace-building and state-building goals (part of the New Deal for Engagement in Fragile States)
SRC	Sector Reform Contract
SPLM/A	Sudan People's Liberation Movement/Army
UNDP	United Nations Development Programme
VT	Variable Tranche

Executive Summary

The European Union (EU) began using State Building Contracts (SBCs) to provide budget support to fragile and conflict affected states in January 2013, following the adoption of the European Commission's guidelines on budget support (European Commission, 2012a).

Over the next five years, the EU plans to use more than two thirds of funding under the 11th European Development Fund and over half from the Development Cooperation Instrument for 2014 to 2020 to assist people in fragile situations (European Commission, 2014a). The State Building Contract is a key instrument in the EU's fragile states toolkit, and thus likely to increase in visibility and importance. At the same time, while most European Member States are gradually shifting away from the use of budget support, they continue to provide fiscal support in fragile states through the EU's SBCs and through budget support-like instruments, such as pooled funds.

The EU's early experience with implementing SBCs could thus provide a useful resource for donor agencies to support their own thinking on providing budget support in fragile states. The aim of this paper is to draw preliminary lessons based on early implementation of two case studies.

This study examines the use of SBCs in two countries – South Sudan and Mali – in 2013 and 2014, to explore and present key insights and lessons from the EU's early experiences with SBCs. The case studies have very different contexts. Mali received budget support until undergoing a political and military crisis in 2012. South Sudan achieved independence in July 2011 following decades of civil war within Sudan, and had not received any budget support prior to that. The country relapsed into internal conflict in December 2013, and the SBC was never implemented. However, both cases reveal common insights that can influence and shape future programming.

Overall, the early evidence from these two countries is encouraging. The SBC has proved to be a flexible instrument, enabling the EU to develop rapid support mechanisms in line with donor commitments in the New Deal for Engagement in Fragile States. In Mali, it enabled the EU to provide rapid support to maintain the budget during periods of extreme crisis and to tackle corruption. Had South Sudan not relapsed into conflict, the SBC would have been part of a broader package of reform supporting a New Deal Compact.

Nevertheless, the two case studies point to certain areas for improvement. The main findings and recommendations of this study are:

1. **The objectives of each SBC should be more clearly stated, and the design of the instrument tailored to these objectives.** There is tension in the design of budget support operations in fragile states between supporting short-term stabilisation to prevent or manage crises, and longer-term, state-building objectives. Greater clarity is needed on the objectives of an SBC. The design of SBCs should be guided by context and whether the primary objective is to provide flexible short-term support to alleviate severe fiscal or economic distress and preventing state collapse, or to support a medium-term objective of strengthening the delivery system and building the state. This issue may be exacerbated by a perceived lack of clarity on how the EU's cooperation would progress beyond the SBC currently in place, i.e. whether it would be followed by further SBCs or progress to other budget support instruments. This is particularly important where an SBC is supporting medium-term improvements. Given the dangers of overloading the instrument with unrealistic expectations, the conditions and indicators of SBCs should be restricted to specific, short-term actions, closely linked to the key objective. These actions should also be guided by a longer-term vision for EU cooperation with individual countries, including potential frameworks for subsequent cooperation. These questions should eventually be clarified within the Budget Support Guidelines.
2. **Volatility is a key characteristic of fragile states, requiring closer and more frequent risk monitoring than in more stable states. The definition of political risk should also be widened.** Evidence shows that SBCs have helped to increase emphasis on risk management in EU budget support to fragile states. Yet, taking account of this greater volatility, the risk monitoring processes around SBCs could be strengthened by ensuring risks are assessed more regularly and proactively. For instance, quarterly light-touch risk reviews and updates could be introduced. There should also be a wider definition of political risk, focusing on risks to the country's political settlement, and analysis of this should involve a variety of different perspectives, including from sources with long-term, country-specific knowledge.
3. **The political economy of fragile states – especially fragmented authority within government – can hinder effective political dialogue.** The SBCs have the Ministries of Finance of recipient countries as natural

interlocutors. Yet governments in fragile states often have fragmented authority, and these Ministries may not have sufficient clout to take decisions alone, even on areas usually considered as their core functions. During the design of SBCs, there needs to be sufficient broad buy-in by the partner country, or alternatively, verification that any triggers or indicators are within the control of the main dialogue partner.

4. **SBCs are accompanied by technical assistance (or complementary support), which is a welcome practice, given the technical and capacity needs of states in fragile situations.** However, the European Commission should review the current complementary support provision both in terms of objectives (to make the support more strategic) and implementation (to make it more flexible and demand-driven).

Introduction

While most European Member States are gradually shifting away from the use of budget support, they continue to provide fiscal support in fragile states through the European Union's (EU) State Building Contracts (SBCs) and through budget support-like instruments, such as pooled funds.

The EU's early experience with implementing SBCs could thus provide a useful resource for donor agencies to support their own thinking on providing budget support in fragile states. The aim of this paper is to draw preliminary lessons based on early implementation of two case studies.

This paper is divided into four sections. Part 1 provides an overview of the policy documents pertaining to the EU's SBCs and their current state of play, to support an understanding of the innovations introduced. Parts 2 and 3 look in detail at the implementation of SBCs in South Sudan and Mali respectively. Part 4 discusses some of the challenges presented and explains the main findings from the two case studies.

The case studies are on the two largest SBCs adopted by the EU in sub-Saharan Africa. They also demonstrate two different situations in which SBCs can be used: Mali as a country in transition after a period of crisis, and South Sudan as a chronically fragile country. The analysis of the case studies aim to highlight more general insights which could influence and shape future programming.

Both case studies draw on in-country interviews with officials from EU institutions and Member States, as well as partner-government representatives, and interviews with officials in Brussels.

1. The challenges posed by fragile and conflict-affected states and the EU's response

Over the last decade, the challenges facing fragile and conflict-affected states (FCAS) have been moving up the agenda of the international community. Both geopolitical and developmental factors have contributed to this increase in strategic attention. From a geopolitical perspective, there has been a growing recognition that FCAS pose a threat in terms of spreading insecurity, terrorism and other disruptive conditions. From a developmental perspective, it has become commonly accepted that the most extreme and stubborn forms of poverty persist in these countries (Collier, 2007), and are likely to be increasingly concentrated there (Kharas and Rogerson, 2012).

The EU signalled broad political emphasis on these challenges as early as 2001, with agreement on the EU Programme for the Prevention of Violent Conflicts which – for the first time – identified conflict prevention as one of the core goals of EU external relations. The 2005 EU Consensus on Development presented its goal of promoting poverty reduction within the context of building a 'more stable, peaceful, prosperous, and equitable world'. The European Commission's 2011 Communication, 'Increasing the impact of EU Development Policy: an Agenda for Change' (European Commission, 2011), subsequently committed the European Commission to scale-up its efforts to tackle insecurity, fragility and the challenges of transition, and their implications for poverty.

In 2012, the EU's development assistance for countries in situations of conflict and fragility totalled €4.9 billion, or 59% of total EU assistance. The EU now plans to use more than two thirds of funding under the 11th European Development Fund (which has a budget of €30.5 billion for 2014-2020) and over half of the Development Cooperation Instrument (which has a total budget of €19.7 billion for 2014-2020) to assist people in fragile situations (European Commission, 2014a).

Historical trends and experiences with EU budget support to FCAS

Budget support – the provision of aid directly to the budgets of government ministries – has been an important feature of the aid landscape over the past 10 to 15 years. Evaluations of budget support have confirmed its effectiveness in promoting closer alignment of aid to country policies, the strengthening of country systems (especially those related to financial management) used for service delivery and in improving aid predictability (IDD and Associates, 2006; Lawson, 2014). There has also been evidence that through these and other impacts on aid management, budget support has contributed to increases in the coverage and utilisation of services in sectors such as health and education (IDD and Associates, 2006; Lawson, 2014). Other evaluations, though, have questioned the efficacy of budget support in addressing challenges relating to the quality of service delivery (Williamson and Dom, 2009) and the limits in its ability to influence the policy and governance context (IOB, 2011).

Given the relatively weak capacity and level of institutional development in fragile states, budget support has a potentially significant role in addressing challenges relating to strengthening systems, reducing aid fragmentation and improving aid predictability in these contexts. However, these contexts pose greater risks for donors and many – especially bilateral agencies – seem increasingly unwilling to provide budget support to fragile states. One factor which may be contributing to this dynamic is a donor-focussed approach to risks and a failure to appreciate risk from the recipient side (Tavakoli and Hedger, 2012).

Budget support has for some time been a significant channel for European Commission-managed assistance to FCAS, especially those in the African, Caribbean and Pacific Group of States (ACP). Under the 9th European Development Fund (2001-2007), 30% of support to ACP countries was provided through budget support, with 48.9% of total budget support commitments made to 19 ACP countries that are on the current OECD list of FCAS

(European Court of Auditors, 2010).[1] Levels of budget support to ACP countries were expected to increase in the 10th EDF (2008-2013), with a significant share committed to ACP FCAS (ECA, 2010).[2] However, growing concerns amongst Member States about this form of aid led to overall levels of budget support falling by one fifth between 2010 and 2012. In 2013, though, EU budget support levels increased to reach levels of c.12% below those in 2010 (OECD, 2014). It is therefore possible that some FCAS would have experienced reductions in budget support from the EU in recent years.

Nonetheless, budget support is a key modality used by the European Commission to ensure the use and strengthening of country systems, a key part of its commitments under the New Deal for Engagement in Fragile States.[3] It is therefore likely to remain a highly relevant aid modality for some years to come.

A range of concerns around the European Commission's use of general budget support have been raised in recent years. A 2011 EU Court of Auditors report into the use of this instrument is of particular significance. This report raised concerns with regard to adapting programmes to the contexts of developing countries, identifying clear strategic objectives, managing risks effectively, assigning expertise in priority areas, and managing policy dialogue (European Court of Auditors, 2010).

In response to these concerns and in order to help deliver on the EU's 'Agenda for Change', the European Commission introduced updated guidelines on the implementation of its budget support in 2012. One of the main objectives of these guidelines is to improve the EU's tailoring of budget support to country contexts, including fragile situations. The guidelines pursue this objective through the introduction of State Building Contracts to provide budget support to fragile contexts, alongside Good Governance and Development Contracts (GGDC) and Sector Reform Contracts (SRCs), to provide general budget support and sector budget support to more stable countries (European Commission, 2012a).

The EU's State Building Contracts

The European Commission's official guidance for the provision of SBCs (European Commission, 2012a) emphasises the importance of assessing the suitability of countries to receive an SBC on a case-by-case basis. The following five components are considered essential to informing the decision to provide an SBC, as well as its subsequent design:

- *An assessment of whether the state can be considered fragile or in a fragile situation/in transition.* This is to ensure this instrument is used in the appropriate contexts, but also to assess what is driving fragility, understand the context more deeply and guide political and policy dialogue.
- *An assessment of the risks and benefits including the identification of mitigating measures.* This should involve assessing the overall political and security situation, the financial risks and the potential cost of non-intervention. This assessment should inform the decision of whether to proceed with an SBC, the design of risk mitigation measures and the approach to political and policy dialogue.
- *A clear purpose linked to state building objectives.* A purpose statement is central to the effort to target state-building objectives more effectively.
- *An indication of the government strategy to be supported by the SBC.* Exploring the government's commitment to the internationally agreed Peace-building and State-building Goals (as defined in the New Deal) is a possible aspect of this assessment, including general policies related to state-building, governance and promoting rights.
- *An indication of wider international support for the provision of budget support, notably from the World Bank and IMF.* This reflects the European Commission's emphasis on promoting internationally coordinated responses and ensuring that macro-economic stability is a key element of SBCs.

The guidance further states that once a country is selected for an SBC, decisions about how much budget support to provide should be based on a qualitative assessment of the following needs and performance criteria:

- Financing needs of the partner country, assessed on the basis of its medium-term fiscal framework and/or the national/sector development strategies.

1 Data on EU budget support disbursements across these countries are not readily available and may differ from commitment figures; in addition, not all of these countries would have been considered FCAS throughout this period, so these figures are not a totally accurate picture of the historical trends in EU budget support

2 48% of support to ACP countries was due to be disbursed through budget support, with 43% of this support committed to 16 ACP countries on the current OECD list of fragile states

3 In November 2011 at the 4th High Level Forum on Aid Effectiveness in Busan, the New Deal for Engagement in Fragile States - a framework of principles and commitments to guide more effective engagement of the international community with fragile and conflict affected states - was endorsed by 44 countries and international organisations, including the European Union. There are three main parts to the New Deal: i) five peace-building and state-building goals (PSGs); ii) five priorities for promoting engagement to support inclusive, country-led transitions out of fragility; iii) five commitments for providing aid and managing reforms for better results (IDPS 2011).

- Commitment from the partner country to allocate national budget resources in line with its development strategy and objectives.
- Effectiveness, value for money and impact of the specific added value that budget support will bring in achieving the partner country's policy objectives.
- Track record and absorption capacity of past disbursements and how effectively agreed objectives were achieved with budget support operations.
- Result orientation in the partner country's development strategy, including a monitoring system.

The official guidance for SBCs also identifies a number of other important elements of this instrument, including:

- *a flexible and forward-looking approach to assessing fundamental values*[4] *and the standard budget support eligibility criteria*[5], reflecting the weaknesses inherent in situations of fragility (with GGDCs and SRCs taking a more standardised and stricter approach to these conditions)
- *the short-term duration of SBCs,* initially 1 to 2 years, with the possibility of extension for a similar period (with GGDCs and SRCs typically in operation for 3 to 6 years)
- *the use of a mix of fixed and variable tranches*, with fixed tranches linked to general eligibility criteria, and variable tranches (or performance tranches) linked to progress against specific indicators; design features also include 'more specific conditions, closer monitoring and more significant dialogue, [and] more technical assistance'
- *the use of technical support to complement financial support,* reflecting institutional/system weaknesses of countries in fragile situations (GGDCs and SDRs also incorporate such elements).

Opportunities and risks

Drawn from a series of interviews with EU officials, Table 1 presents an overview of the insights on opportunities and risks associated with SBCs. It also shows specific characteristics of SBCs and some approaches currently pursued.

The potential for SBCs to support a more rapid, ambitious, strategic and politically informed response to the challenges facing fragile states is prominent amongst the opportunities. This has very significant potential impacts, from intervening to preventing state failure. The risks reflect the challenges of operating in fragile contexts, where capacity and institutions are weak, but also of overloading the budget support process, as well as the short time frame planned for SBCs.

The state of play

To date, SBCs have been adopted in 12 countries and are under preparation in two more (Burkina Faso and Liberia). As of end December 2013, SBCs represented €816 million, with an average SBC roughly double the size of the average budget support contract (€81.6 million versus €42.1 million) (European Commission, 2014a). However, it is worth noting that the Ukraine and Mali SBCs are twice

Table 1: Opportunities and risks of State Building Contracts

Opportunities for SBCs	Risks of SBCs
Formalising a legal basis for budget support operations in fragile states.	Short time frame, undefined exit strategy/next steps. How will the short-term SBCs 'prepare the ground for GGDC or SRCs'? (European Commission, 2012)
Prioritising stability over poverty reduction, in line with the New Deal.	Low capacity at country level to implement: Are SBCs putting extra resources in places with least capacity (i.e. at government and Delegation levels) for political and sector dialogue?
Bringing politics in: political economy analysis of interventions and risk mitigation.	Asking too much of dialogue; potential to overload the instrument with too many objectives.
Making the risks of budget support in fragile states explicit, including the risk of non-intervention.	Risk of over-politicisation, i.e. demand for unrealistic/unsuitable political priorities.
Potential to bring greater coherence to Delegation actions and policy dialogue.	Process and tools could be used for compliance and to protect reputation, rather than for real risk mitigation.
Quicker response from EU institutions to fragile situations; possibility to come in at an early stage.	High potential for failure in a risky environment.
Potential for catalytic effect in raising funds from other donors (especially as a consequence of quick response).	
Increasing sector influence for the EU around Peace and State-Building Goals.[6]	
Potential for visible short-term impact, given potential counterfactual of state failure.	

Source: authors' own assessment

4 In contrast to GGDCs, for which a positive assessment of 'a country's commitment to the fundamental values of human rights, democracy and rule of law' is a pre-condition, the fundamental values assessment is only made during the detailed programme identification phase for SBCs, as part of the risk management framework rather than as a pre-condition (political risk category).

5 All EU budget support programmes are subject to four eligibility criteria: (1) Credible and relevant national/sector policies and reforms; (2) Stable macro-economic framework; (3) Credible and relevant programme to improve public financial management (PFM); (4) Transparency and oversight of the budget (the latter is a new addition in the 2012 Guidelines). These criteria need to be met when a programme is approved, and satisfactory progress needs to have been made at the time of each budget support disbursement.

6 The Peacebuilding and State-building Goals are one of the three main parts to the New Deal for Fragile States, which guides work in fragile and conflict-affected states.

as large as the next largest SBC, and excluding this, the average SBC size is only €65 million.

Despite the existence of formal selection criteria, commentators noted that it is difficult to understand the particular choice of SBC candidates. Our analysis confirmed the conclusions of others that in practice, recipient countries are selected on the basis of a variety of political and technical factors (Hauck et al., 2013), which calls attention to the strongly political nature of this instrument.

Table 2 provides an overview of the SBCs agreed/under preparation to date. The following characteristics of SBCs can be discerned from this table:

- Varying levels of funding. Around €18 million were committed for Guinea Bissau over two years, while €225 million was allocated to Mali and €355 million to Ukraine over two year periods.
- Variable tranches. Almost all the SBCs agreed to date employ variable tranches, which are linked to results achieved in the priority sectors identified for each country. In the two cases where variable tranches were not initially employed (South Sudan and Tunisia – though an additional variable tranche was added to the second Tunisian SBC), the priority sectors were still identified in the programming documents and are detailed below.
- Priority sectors for indicators (based on an analysis of the SBCs for which sector indicators have been identified) include public financial management (PFM), health, justice, education, security, domestic resource mobilisation (DRM), water and corruption. These demonstrate a broadening of interests to non-traditional focus areas, some of which are related to the New Deal's Peace-building and State-building Goals (e.g. security, justice).

Table 2: Overview of State Building Contracts agreed to date or under preparation

Country	Amount and period (calendar years), Fixed/Variable Tranches	Comple-mentary support (CS) component	Priority sectors (Number of indicators chosen for the Variable Tranche)	Disbursements to date	Recipient of budget support in 2010 – 2012?
Burkina Faso	A new SBC is expected for 2015			None	Yes
Burundi	€42m 2013-2015 FT 71%, VT 29%	€2m	DRM (1 indicator) Expenditure rationalisation (1) Health (2) Education (2) Budget execution (1) Audit and control (1) Public procurement (1) Justice (1)	Disbursements: €18m in 2013 €17.2m in 2014	Yes
Central African Republic	€33 million 100% FT	€3m	PFM and salaries	September 2014: €6m December 2014: €24m	Yes
Cote d'Ivoire	€115m for 2012-13, extended by 1 year and by €28m. FT 65%, VT 35% A new SBC is expected for 2015.	No	Consolidation of peace and stabilisation through the improvement of internal security (2 indicators) Justice (2) PFM (4) Health (2)	Disbursements: €55m in 2012, €56m in 2013, €17m in 2014	No
Haiti	€112m 2014-2015 FT 70%, VT 30%	€12m	DRM (1 indicator) Expenditure rationalisation (1) Health (2) Education (2) Budget execution (1) Audit and control (1) Public procurement (1) Justice (1)	Disbursements: €30m in 2014	Yes
Guinea Bissau	€18M for 2014-2015. FT 65%, VT 35%	€2M	Transparency (2) PFM (2) Social sectors (1)	Disbursements: €10m in 2014	No
Liberia	No SBC in 2013 – 2014. Funds from (pre-2013) GBS and SRC were reprogrammed as part of the Ebola crisis response. A new SBC is under preparation for 2015.				Yes
Mali	€225m 2013-2014 FT 67%, VT 33% A new SBC is expected for 2015	€5m	Decentralisation (3 indicators) PFM (audit and external control; 2) Fight against corruption (1) Health (2) Water (1) Food security (4) Justice (2) Employment (1)	Disbursements: €120m in 2013. €95m in 2014	Yes
Madagascar	€78m 2014-2015 1st FT : €65m 2nd FT: €8m VT: €5m FT 93.5%, VT 6,5%	€2m, part of a TA programme for Public Administration Reform of €17m	3 indicators for VT of €5 M: - Health - Security - Governance, fight against corruption. Pre-conditions for FT disbursements in the form of a matrix of measures on PFM and Fight against corruption agreed with the authorities.	Disbursement: €65m in 2014	No
Mauritania	€40m 2013-2014 FT 70%, VT 30%	€6m	PFM and budget transparency (3 indicators) Education (3) Health (3) Security (2)	Disbursements: €22m in 2013	No

Table 2: Overview of State Building Contracts agreed to date or under preparation (continued)

Country	Amount and period (calendar years), Fixed/Variable Tranches	Comple-mentary support (CS) component	Priority sectors (Number of indicators chosen for the Variable Tranche)	Disbursements to date	Recipient of budget support in 2010 – 2012?
Sierra Leone	€34m 2013-2014 FT 70%, VT 30% A new SBC is expected for 2015	€1.6m	PFM (expenditure management; 7 indicators) Health sector (2 indicators), Education sector (1) Domestic Resource Mobilisation (including mineral resources revenues; 3) Mineral sector governance (2)	Disbursements: €12m in 2013 €22,63m in 2014 (disbursement redesigned due to Ebola crisis).	Yes
South Sudan	€85m 2013-2015 FT 100% 1st FT €50m, 2nd FT €30m.	€5m	No variable tranche, but pre-conditions for fixed tranche focus on the following: at technical level, the conduction of a rolling audit of the Electronic Payroll System which would provide reasonable assurances of its efficiency and effectiveness; at programming level, the agreement on an IMF Staff Monitored Programme and a New Deal Compact, as well as the adoption of legislative frameworks on public procurement and management of oil revenues; at wider level, a positive reassessment of the risk management framework that would confirm that political, PFM, developmental, macroeconomic and corruption indicators had not deteriorated.	No Committed in 2013, Financing Agreement signed on 13/12/2013 but not implemented due to outbreak of violence (non-satisfaction of prior conditions). Amount currently being reallocated to other activities, though capacity building component is being used.	No
Togo	€30m 2013-2014 FT 82%, VT 18%	Not in original programme*	PFM (3 indicators) National statistical system (1) National public administration reform (1) Health (1) Water and sanitation (1)	Disbursements: €14m in 2013	Yes
Tunisia	2012 SBC 1: €63m (fully disbursed). 2013 SBC 2: €110m 2014: SBC3	€5m (2013 – 2014)	No variable tranche, but monitoring focussed on the following two pillars: (i) democratic governance (political reform, justice, corruption, and media; 18 indicators) and (ii) economic reform (public private partnership, procurement, microfinance framework, public accounting reform, and access to budgetary information; 9 indicators).	Disbursements: SBC 1 - 2012 €63m SBC 2: 2013: €35m 2014: €75 m SBC3: No disbursement.	Yes
Ukraine	€355 m 2014-2015 FT 70%, VT 30%	None	Short-term economic stabilisation; reforms in the context of the Association Agreement/ Deep Comprehensive Free Trade Area (governance, corruption, judiciary reform and public administration reform).	2014: 250m	Yes

Source: Based on European Commission (2014), various European Commission Action Fiches and conversations with officials. Last updated January 2015.

** Togo's SBC was prepared before the new Guidelines were approved, so complementary support may have been given through other projects, but was not included in the SBC programme, as is now recommended. The same may be true for Cote d'Ivoire, which was the first SBC prepared under the new Guidelines.*

2. The State Building Contract in South Sudan

South Sudan's SBC was signed in December 2013. It consisted of €80 million in financial support, divided into two fixed tranches of €50 million and €30 million. The support was targeted at financing salary transfers to sub-national government for education and health workers, together with €5 million of complementary PFM technical assistance. This support was conceptualised as part of a broader set of international commitments to South Sudan as part of a New Deal Compact (International Monetary Fund (IMF), World Bank and African Development Bank (AfDB) budget support, and a longer-term Multi-Donor Pooled Fund). This support would have been the first budget support South Sudan received. Previously, all support provided was off-budget project support (with only the World Bank providing on-budget project support). However, South Sudan relapsed into conflict and as a result the SBC was not implemented, with the exception of the complementary technical assistance, which the government requested to go ahead in the areas of the country not affected by conflict.

This case study sets out the context for the SBC, its justification and design, the process of political dialogue with government, and the approach to risk management and donor coordination. The main finding relates to the tensions in the design of the SBC, between the short-term nature of the instrument, and the aspiration to support longer-term state-building processes, and between the SBC being nominally general budget support, and the need in practice to mitigate high fiduciary risks by targeting funds at specific sector expenditures. These tensions may result in SBCs stretching policy dialogue with weak fragile states across both broader macroeconomic and PFM functions and sector-specific reforms. This suggests that the European Commission may use or design the SBC instrument differently to deal with these different goals in fragile states. In terms of risk management, the fact that the EU budget support design process must clearly set out the risks of non-intervention, was highlighted as good practice. The political volatility of fragile states, which South Sudan has demonstrated, suggests that there may need to be more robust procedures for updating the risk register during the design process that might allow changing risks to be identified. It also suggests that local staff or others with long-term country knowledge, where this is not available within the Delegation, the European Commission Directorate-General for International Cooperation and Development (DEVCO) or the European External Action Service (EEAS), be more involved in assessing political risks. Other findings highlight the difficulty of political engagement with fragmented governments, as well as the importance of coordinating with other donors.

Context

South Sudan became independent from Sudan on 9 July 2011, following a referendum on secession on 9 January 2011. The arrangements for these were set out in the Comprehensive Peace Agreement, signed between the Government of Sudan and the Sudan People's Liberation Movement/Army (SPLM/A) on 9 January 2005, following over two decades of civil war.

Experience of war left South Sudan severely undeveloped.[7] The poverty rate stood at 51%. 83% of the population lived in rural areas, and nearly three-quarters depended on crop farming or animal husbandry as their primary source of livelihood. Literacy rates were only 27% and only half of school-age children were in primary school.[8] The under-five mortality and maternal mortality rates were some of the highest in the world.[9]

At independence, key bilateral issues – such as border demarcation, security arrangements, and oil pipeline fees – remained unresolved between Sudan and the new Republic of South Sudan. When South Sudan seceded it took with it around three quarters of Sudan's oil production. However, the oil pipelines and other infrastructure required to export the oil, are in the north, with the pipeline terminus at Port Sudan. There was no agreement on the fees that South Sudan would pay to Sudan for use of this infrastructure, and negotiations to resolve these issues dragged on. In January 2012, South Sudan accused Sudan of 'stealing'

7 All the following figures are taken from SSCCSE (2011)

8 The Net Enrolment Rate for primary school in 2009 was 48%.

9 In 2006, the U5 mortality rate was at 135 per 1000 births, and maternal mortality rate was 2054 per 100,000 live births.

Box 1: Timeline of South Sudan

July 2011	South Sudan becomes independent
January 2012	South Sudan announces it will shut down oil production following the failure to reach agreements with Sudan
April 2012	South Sudan troops temporarily occupy the oilfield and border town of Heglig
June 2012	European Commissions adopts National Indicative Programme 2011-2013 for South Sudan
September 2012	South Sudan and Sudan reach protocol agreements, including on resuming oil production
November 2012	Initial EU decision to proceed with State Building Contract
March 2013	South Sudan and Sudan reach agreement on resumption of oil production.
April 2013	South Sudan Economic Partners Forum
	State Building Contract Concept Note finalised
June 2013	Sudan threatens to shut down oil pipelines over alleged South Sudanese support for rebels in Sudan
July 2013	SBC Action Fiche presented to the EDF Committee.
	President of South Sudan sacks Vice-President and entire Cabinet.
August 2013	President of South Sudan appoints a new Vice-President and Cabinet, including a new Minister of Finance.
November 2013	South Sudan's Central Bank devalues the South Sudan Pound to reach parity with the parallel rate. However, this was reversed the next day after Parliament rejected the decision.
December 2013	SBC Financing Agreement signed by South Sudanese Minister of Finance.
	Fighting breaks out in Juba following a dispute between factions in the Presidential Guard and rapidly spreads.

oil for its own use and for export, and shut down oil production in response.

Oil revenues accounted for over 90% of South Sudan's revenues, and this decision thus immediately placed South Sudan in a dire fiscal position. In response, the Government adopted austerity cuts in its 2012/13 budget. Oil exports are also South Sudan's main source of foreign exchange. This decline in foreign exchange was reflected in a significant decline in the parallel market foreign exchange rate from 3.5 to 5.5 in the first six months of 2012 (the official rate was maintained at three), together with increases in inflation, which remained at an average of over 40% over 2012 and 2013.

During the oil shutdown, negotiations between Sudan and South Sudan proceeded. These were slow moving as border tensions escalated, culminating in the Southern troops briefly occupying the disputed oil field and border town of Heglig. This step also led to a marked deterioration in relations between the international community and South Sudan.

In September 2012, Sudan and South Sudan reached a protocol agreement on outstanding issues, including resumption of oil production, but there was no agreement on how the protocol was to be implemented, meaning oil production did not restart. However, the signing of the agreements marked a turn in the relations between South Sudan and its international partners.

There was further progress by March 2013, when South Sudan reached agreement with Sudan on an implementation matrix for the Protocol Agreement, including resumption of oil production. The improved relationship with the international community was reflected at the South Sudan Economic Partners Forum in Washington DC, which 'marked the start of an enhanced partnership to strengthen governance, political inclusiveness and sustainable development in South Sudan' (State Department, 2013) and where government and donors agreed on the outlines of a New Deal Compact. Donor commitments included:

- An IMF Staff Monitored Programme, complemented by around $47 million from the IMF Rapid Credit Facility. Key conditions were on reforms in the macroeconomic policy framework, in particular the unification of the official and parallel exchange rates, as well as on key benchmarks in public financial management.
- Budget support from the World Bank (around $10 to $30 million, with potential to increase to $100 million), the AfDB (approximately $10 million) and the EU's SBC

(approximately $110 million) to address the fiscal gap in 2013/14.
- A longer term Multi-Donor Pooled Fund to provide more medium-term programmatic support to the scaling up of social service provision and reforms.

Progress was made on developing the Compact through the remainder of 2013, including consultations in all 10 of South Sudan's states. However, there was a major setback to the support envisaged in November 2013. One of the key conditions under the IMF Staff Monitored Programme was unification of the official and parallel exchange rate announced by the Bank of South Sudan on 11 November. However, Parliament summoned the Governor of the Central Bank the following day and directed that the official rate change should be reversed. He complied with this directive.

Furthermore, this period was marked by an escalation of internal political tensions in South Sudan. In July 2013, President Salva Kiir sacked his entire cabinet, including the Vice-President Riek Machar, who had already indicated his desire to challenge Kiir for the leadership of the ruling party, the Sudan Peoples' Liberation Movement (SPLM). Kiir also suspended the party's influential Secretary General, Pagan Amum, who had previously been South Sudan's chief negotiator with Sudan.

Violence broke out in December 2013, when tensions within the Presidential Guard led to fighting during an SPLM National Liberation Council meeting, which saw confrontation between the President and figures who stood in opposition to him.[10] The violence spread rapidly across South Sudan as several army units defected, and civilian militias that had been active during the war, were remobilised.

Justification for the State Building Contract

The initial rationale behind the SBC was to provide financial support to South Sudan as it established itself and dealt with the consequences of the dispute over pipeline fees with Sudan. In this sense, it was more about 'preventing collapse' than 'state-building'.[11] The European Commission's main concern was to support macroeconomic and fiscal stability and to ensure that the government had sufficient funds to continue expenditure on social sectors. The Commission was not alone in this concern, and a key step for proceeding was the knowledge that it was acting jointly with other multilaterals that were also considering providing financial or budget support (IMF, World Bank and AfDB).[12]

However, the progress in the negotiations between South Sudan and Sudan, and the reengagement of international partners, changed the rationale – moving from a rescue mission to being part of a broader dialogue on reform with the government, under a New Deal Compact. As the SBC concept note stated, '[t]he SBC is part and parcel of a wider joint donor response to South Sudan's economic and financial situation ... All these instruments must be seen as fully complementary and operating under a single comprehensive policy framework'. The Action Fiche stated that '… the SBC will contribute in a coordinated way to providing leverage and additional support to the aims and objectives of the New Deal Compact'.

The initial justification for the SBC reflects some of the early thinking that it should be designed as a flexible, fast-disbursing instrument. However, it still took one year between the decision to go ahead and the signing of the financing agreement. It should be noted that the reasons for this delay were mainly due to external factors, rather than internal Commission procedures. Some Member States were sceptical of the proposal, with concerns over South Sudan's human rights record, governance, and fiduciary risks. Concern over these risks was eased by the concept of the SBC being part of a broader New Deal Compact that would address the human rights and governance concerns (European Commission, 2013a). In the absence of these concerns, the European Commission would have been able to move faster.[13]

Outline of the State Building Contract

The general objective of the SBC was 'to contribute to the eradication of poverty through the promotion of sustainable and inclusive growth and the consolidation of democracy by supporting the Government's macroeconomic stability programme and thereby mitigate the risk of further social tensions resulting in widespread violence'. The specific objective was 'to protect the gains achieved in the social sectors … by partly covering the salaries of workers in the education and health sectors … during fiscal years 2013/14 and 2014/15. This will be done in exchange for a commitment from the Government to pursue a number of key policies that set the country on a trajectory of economic, social and political reform' (European Commission, 2013a & 2013b). These key policies, as set out in the disbursement conditions, include agreement with the IMF on a Staff Monitored Programme, passage of the Petroleum Management Revenue Bill, the Public Procurement

10 Most notably former Vice-President Riek Machar, suspended SPLM Secretary General Pagan Amum, and the wife of the deceased founder of the SPLM/A, Rebecca Nyandeng.

11 This reflects a tension in the State Building Contract instrument. Whereas state-building is a long-term multi-year process, the State Building Contract is designed to be a short-term (1 to2 year) instrument.

12 Interviews with European Commission officials in Brussels and Juba.

13 Interviews with European Commission officials in Brussels and Juba.

Box 2: Key statistics of the South Sudan State Building Contract

Amount: €80 million over 2013 and 2014, plus €5 million complementary assistance.

General objective:
To contribute to the eradication of poverty through the promotion of sustainable and inclusive growth and the consolidation of democracy by supporting the Government's macroeconomic stability programme and thereby mitigate the risk of further social tensions resulting in widespread violence.

Specific objectives:
To protect the gains achieved in the social sectors since the signature of the Comprehensive Peace Agreement in 2005 by partly covering the salaries of workers in the education and health sectors, inscribed in the Government's payroll system, during fiscal years 2013/14 and 2014/15.

Expected results:
- Contribute to the implementation of the Government's fiscal, economic and development agenda.
- A new partnership between the international community and the Government, culminating in the conclusion of a Compact based on New Deal principles before the end of 2013.
- Consolidate the stability-oriented macroeconomic policy framework, extending fiscal discipline in the medium term, and effecting further budget increases for the health and education sectors in the fiscal year 2014/15 on top of those seen in 2013/14.
- Strengthen the Government's public financial management system, including by improving its regulatory framework for the management of natural resources, (notably oil), and public procurement system, as well as enhancing the capacities for their implementation.
- Establish the framework for a more enabling environment for the operation of civil society organisations and non-state actors, including the media.
- Enhance the transparency of the budgetary process and the political involvement and oversight throughout budget implementation on the basis of regular financial reports.
- Through the complementary support, provide reasonable assurances that the SBC is implemented according to sound financial management, and that the South Sudan Electronic Payroll System (EPS), and associated monitoring and verification mechanisms, are systematically used.

Source: *Author's own summary of the European Commission Action Fiche (European Commission, 2013a)*

and Disposal of Assets Bill, and the Anti-Corruption Commission Bill into law, as well as the conclusion of a New Deal Compact with international partners and a further increase in the education and health budgets in the next fiscal year (European Commission, 2013a).

The allocation to the SBC was €80 million, plus an additional €5 million for complementary support. The funds were to be targeted to specific budget lines for basic social services, namely conditional salary transfers to sub-national government for education and health staff, during the fiscal years 2013/14 and 2014/15.

The complementary support was focused on building the capacity of State and Local Governments to manage the finances of local service delivery – the area the SBC funds were earmarked for. Specifically, the complementary support focused on improving payroll management at the state and county level at which most teachers and health workers are paid.

Design of the State Building Contract

In 2013/14, total government spending was around €2.3 billion.[14] The SBC support was thus equivalent to around 4% of total expenditure. The combined spending of the Ministries of Education and Health was around €135 million and the SBC support would have been equivalent to just under 60% of annual education and health spending, and equivalent to around 135% of annual expenditure on salary transfers by these two ministries. Over the course of two fiscal years, the SBC could thus have been expected to fund most of the spending on this budget line.

14 All figures are taken from *MoFEP 2014* and converted to Euros at an exchange rate of 3.98. Of course, had the exchange rate been devalued, the SBC support would have been worth around 50% more in South Sudanese Pounds.

15 These were to 'contribute to the implementation of the Government's fiscal, economic and development agenda', specifically to support the conclusion of a New Deal Compact, implementation of a stability-oriented macroeconomic policy framework, extending fiscal discipline in the medium term, and increases in the health and education sectors, strengthening the Government's public financial management system (including management of natural resources and procurement), to establish a more enabling environment for the civil society organisations and non-state actors, including the media, and to enhance the transparency of the budgetary process and the political oversight of budget implementation.

There are two tensions in the South Sudan SBC that became apparent during this case study. The first tension relates to the general design of the instrument itself. The second tension relates to the specific design of the SBC in South Sudan.

The first tension is between the declared objectives of the SBC to 'transition processes towards development and democratic governance' (European Commission, 2013a), versus the short-term nature of the instrument. Whereas state-building is an inherently complex, long-term process, SBCs provide flexible, short-term support. This makes the instrument ideal to provide a safety net of emergency assistance that could help prevent fiscal or economic collapse. However, it is important to be clear that this is state-building as preventing collapse, rather than state-building as supporting policy reforms and systems building.

The second tension is between the general and specific objectives in the South Sudan SBC, and how these translate into disbursement conditions which reflect the policy actions the instrument is trying to support. The general objective and expected results[15], together with most of the disbursement conditions, relate to supporting inclusive growth and macroeconomic stability, and thus to an emphasis on macroeconomic and PFM reforms. However, the specific objective was quite different: to support specified budget lines under the Ministries of Education and Health.[16] In line with this objective, there were a set of 'additional measures'[17] and disbursement conditions on the second tranche of a financial audit of the Ministries' targeted budget lines.

Thus, the European Commission could find itself negotiating detailed actions on sectoral and sub-national PFM as well as the broader macroeconomic and PFM conditions initially set for disbursement. This, in turn, could lead to cases where the main part of government engaging with the European Commission may be the Ministry of Finance, yet a sector Ministry could find itself required to undertake a number of reforms in a process it may feel it was never a central part of. The risk is that spreading policy dialogue with government across such a broad area limits the prospects for success in both. This risk may be especially high in the often fragmented and dysfunctional governments of fragile states, as discussed further below.

If there appears to be a risk that the European Commission's influence could be spread over too large an area, then one consideration to assess will be the potential leverage the European Commission could exert over different sectors. In South Sudan, the SBC would have been a relatively large contribution to social sector budgets, but a relatively small contribution to South Sudan's overall budget. In such a situation, the relative 'exchange of commitments' that the Commission could obtain would be expected to be larger in these sectors than for cross-cutting macroeconomic and PFM reform. It is questionable how far this is a general issue across fragile states, as South Sudan is relatively unique in being a fragile post-conflict state with large revenues. However, it is possible that this configuration will become more common with the emergence of a set of middle-income fragile states.

These considerations suggest that SBCs will need to be designed differently, depending on whether it is providing relatively short-term, flexible support to respond to crisis situations, or more medium-term system-building support.

It is also worth noting that the existing complementary support provides a further reason why the SBC could be an effective instrument for the development of sustainable government systems for service delivery, a key element of state-building. Supporting fragile states to do this requires long-term and deep engagement with a sector to support it to identify and overcome the problems faced. There are good reasons to think this is best done through a combination of targeted or sector budget support together with technical assistance. Technical assistance alone is commonly thought of being an ineffective instrument of aid (Easterly & Futze, 2008). However, there are good reasons to think it could be more effective if paired as part of a programme of budget support. Firstly, the purpose would be to support reforms the government has committed to under the budget support programme, and secondly donors have a greater incentive to monitor the outputs of the technical assistance in terms of improvements in government systems, as donor funding will be utilising these same systems. Without the relationships provided by budget support, technical assistance may simply be badly targeted or insufficiently monitored to be effective.

The complementary support planned under the SBC closely matches these criteria. It is directly targeted on improving the management of funds in the budget lines targeted by the SBC. The SBC would have supported conditional transfers to sub-national governments for the salaries of education and health staff, and the technical assistance is providing support to these sub-national governments to improve their financial and payroll management. Furthermore, the Ministry of Finance in South Sudan receives a large amount of technical assistance from a number of providers, and the complementary

16 This design feature came about from the need to address fiduciary risks, described further below. The possibility of making SBC budget support 'targeted (if necessary)' was mentioned in the European Commission budget support guidelines (European Commission, 2012a).

17 These included an audit of the Electronic Payroll System prior to the disbursement of the first tranche in order specify any measures required to address weaknesses, and 'rolling audits and public expenditure tracking surveys to ensure discipline in salary transfers and inform plans to reinforce the EPS' (European Commission, 2013a, p.13).

18 Interviews with Government officials in Juba.

19 Source: Draft New Deal Compact for South Sudan, Annex A: New Deal Compact Policy Matrix

assistance was thus well-targeted by being directed to sub-national governments that received far less technical assistance, rather than entering an already crowded field. The value of this technical assistance is demonstrated by that fact it went ahead even when the State Building Contract did not.

Negotiation of the State Building Contract

Discussions with the Government generally focused on a fairly narrow group of key people in the Ministry of Finance.[18] However, there was a much larger process of dialogue aimed at developing the New Deal Compact, which took place in all 10 of South Sudan's states (*Guardian*, 2012). This was focused on identifying priority areas to develop benchmarks for the Compact, rather than on the SBC itself. However, the specific actions identified as benchmarks under the Justice (Anti-corruption and Accountability) and Revenue and Services (Public financial management, including oil revenue management) sections in the draft New Deal Compact included most of the disbursement conditions.[19]

Undertaking dialogue with government in fragile states, such as South Sudan, can be extremely difficult for two reasons, both of which are external to the European Commission. Firstly, government-donor relations are not institutionalised. This makes it harder to identify appropriate fora and occasions on which a broader dialogue can be initiated. It also means that potentially key partners in government might have little understanding of donor modalities and the division of labour between donors.[20] South Sudan had not previously received budget support, so there was no precedent in either government or the donor community on how such a dialogue should be handled. In South Sudan, the New Deal dialogue may have stood in for a broader political dialogue on many key issues of concern, but it did not allow for any detailed discussion of the SBC between a wider group of Ministers and senior civil servants in South Sudan.

Secondly, and more fundamentally, the government itself may be far from a unitary actor, making genuine government-donor political dialogue difficult. Some have suggested that whilst the Ministry of Finance promotes an outward appearance of functionality in its dealings with donors, the real decisions are made through backdoor dealings between South Sudanese officials, concealed from donor view (Larson et al., 2013).

Table 3: Risks of non-intervention and intervention in South Sudan

Risks of non-intervention	Risks of intervention
Damaging effects of unfinanced balance of payments and fiscal gaps, including the effect on continued basic service delivery (non-payment of salaries for education and health workers), which can only be filled by direct macroeconomic support. Further expenditure cuts and higher inflation could lead to increased social tensions and conflict. The SBC is the only mechanism at the Commission's disposal to have a positive influence on government's appetite for reforms, which would otherwise be missed. Alternative modalities for spending EU funds on education and health are unlikely to be effective in the short run if education and health workers were absent due to lack of salaries.	High and substantial risks in all the areas assessed. Political: human rights, democracy, rule of law and security. Developmental: implementation capacity of government. Macroeconomic: risks from oil production being halted again and the associated exchange rate and inflation risks. Public financial management: poor reporting, absence of procurement legislation and backlog of audit report. Fraud and corruption: no track record of tackling large cases.

Sources: European Commission (2013a; interviews with officials)

Both these considerations suggest that the European Commission should ensure that its own dialogue is well coordinated and draw on EEAS expertise in assessing key partners to engage with.[21] It also means that in the design of the SBC, it is a challenge for Commission officials to ensure that the Ministry of Finance, as their main dialogue partner, has exclusive control over the conditions.

Risk management

The design process for EU budget support operations requires consideration of all risks, including those of non-intervention[22], and does not only consider narrow fiduciary risks. Those identified for South Sudan are summarised

20 The Action Fiche noted that the coordination structures set out in South Sudan's Aid Strategy had been de facto replaced by a parallel structure chaired by the Vice-President, who was then sacked.

21 The UK All Party Parliamentary Group for Sudan and South Sudan has criticised the international engagement in South Sudan in general for having too much of a disconnect between diplomatic actors and development actors (All Party Parliamentary Group for Sudan and South Sudan, 2015). The reconfiguration of EU institutions in creating the EEAS should put the European Commission in a particularly strong position to effectively respond to this critique.

22 The Concept Note (European Commission, 2013c) sets out the risks of non-intervention., which included the potentially damaging effects if South Sudan had unfinanced balance of payments and fiscal gaps, the potential to miss a chance to influence government's appetite to pursue reforms, and the fact that no other EU instrument could have these effects. The Action Fiche (European Commission, 2013a) sets out a consideration of the balance between the risks and the expected benefits/results.

in Table 3. This is particularly important in fragile states, where risks are clearly higher, and thus it is essential to undertake this kind of broad risk assessment rather than focusing on the narrower concept of fiduciary risk alone. In fragile or crisis situations, this explicit weighing of the risks of action against non-action is clearly helpful in formulating the decision-making process and in weighing the different types of risk against each other.

However, the concern with how to mitigate fiduciary risk played a major role in shaping the design of the programme. Funds were targeted at conditional salary transfers for education and health as the Government's payroll system could provide audit trails and verification mechanisms. Furthermore, the Financing Agreement required additional monitoring and verification measures to strengthen the payroll system, such as rolling audits and tracking surveys.

The SBC instrument allows the European Commission to tolerate higher risks than with other budget support instruments (in terms of going ahead with the budget support even where several risks are found to be high and substantial). The Budget Support Steering Committee, chaired by the Director General of Development Cooperation, ultimately decides which risks can be tolerated. Although the balance of risks may have been perceived incorrectly in this case, it should not be taken as criticism: toleration of higher risk inevitably implies toleration of failure.

This, however, is not to say that this experience does not hold any lessons. The UK All Party Parliamentary Group for Sudan and South Sudan has noted that at the same time the New Deal Contract was being developed, the domestic political environment was seriously deteriorating, and has criticised the international engagement in South Sudan in general for having too much of a disconnect between diplomatic actors and development actors (All Party Parliamentary Group for Sudan and South Sudan, 2015). The fact that it was political risks, in the form of the break-up of the elite political settlement within the ruling party, followed by a rapid escalation of violence, that proved to be the biggest risks for all forms of donor engagement in South Sudan, raises three questions:

1. Is the political analysis focusing on the right risks? There are undoubtedly large risks to human rights, democracy, rule of law and security, in many fragile states. However, the South Sudan case suggests a more explicit analysis of the robustness of the elite political settlement might also be required.
2. Given that fragile states are characteristically volatile, and the political situation in South Sudan deteriorated during the design process, should there be more robust procedures for updating the risk register during the design process which might help identify changing risks?
3. Given the EEAS also sits on the Budget Support Steering Committee, what is its role in providing judgement on political risks?

Donor coordination

As set out in an internal concept note, by the second quarter of 2013, the European Commission was part of a broader coalition of donors forging a new relationship with South Sudan through the development of a New Deal Compact, including budget support from the IMF, World Bank and AfDB. At the time the SBC was initially under consideration, no bilateral donor was offering direct financial support, and the EU offered a far greater amount than any other donor. This reflected both the deterioration in relations between the international community and South Sudan over the Heglig incident, as well as the scepticism of some Member States towards budget support. However, the improvement in relations following the agreements between Sudan and South Sudan, as well as the resulting increase in international engagement, meant that by the time the SBC was fully developed, it was solidly within a broader framework of coordinated donor action.

3. The State Building Contract in Mali

The high-profile political crisis in Mali, which resulted in French military intervention in January 2013, created a strong sense of urgency within the EU. The largest SBC in Africa to date was identified, designed, adopted and disbursed within five months, ahead of July elections which were viewed as successful. The EU officials interviewed therefore considered it to be a good example of the speed, agility and political responsiveness of the newly-created SBC. Yet it remains uncertain whether it could be replicated in a less high-profile situation.

Implementation problems became apparent in the spring of 2014, when a corruption scandal linked to certain military contracts (including the purchase of a presidential jet) unfolded in the Malian press. The EU took part in a coordinated response led by the IMF, together with other in-country budget support donors, which included probing into the contracts in question and withholding disbursements (due to the eligibility criterion of an 'on-track' IMF programme not being present). The Government's resulting responses to the scandal were considered very positive and enabled the final disbursement in 2014.

Context

Prior to the 2012 coup, Mali had been a high recipient of donor aid and was considered a relatively stable democracy, with a well-organised aid system comprising of significant amounts of budget support, organised donor coordination and functioning sector groups. Mali was also one of Africa's strong economic performers in the decade preceding 2012, with a growth rate of c. 5.5% on average between 2001 and 2011, compared to an average of 3.9% for West African Economic and Monetary Union members (Cuc, 2013). Despite remaining one of the poorest countries in the world (ranked 176 out of 187 on the Human Development Index), poverty rates decreased from 55.6% in 2001 to 43.6% in 2010 (European Commission, 2013c).

With hindsight, donors now believe the overall stability masked the deep corruption of a regime increasingly unable to manage its functions (Moss, 2014) This state weakness, combined with pressures from a new coalition of alliances claiming territory in northern Mali, led to the coup in March 2012 (see Box 3).

After the coup, all the major donors, including the EU, suspended aid to the Government (European Commission, 2012b), which led to a decrease of almost one quarter in the Malian budget.[23] However, the Ministry of Finance was able to maintain an austerity budget and kept paying civil service salaries and external arrears throughout the crisis period. Internal arrears to national suppliers suffered heavily, as did the investment budget.

January 2013 was a turning point. President Traore asked France for military intervention, after Islamist fighters captured the central town of Konna and threatened to march on the capital. French troops rapidly captured Gao and Timbuktu and at the end of the month entered Kidal. A key political document, the Roadmap for the Transition, was drafted by the Malian interim government and adopted by the parliamentary assembly at the end of January 2013 (Mali, 2013). It included planning for elections on 31 July 2013, and for opening negotiations with the north of the country. This Roadmap permitted EU development cooperation to reengage with the country and was swiftly followed in February 2013 by the announcement of an EU Training Mission to help strengthen the Malian army, with the participation of 23 states under the auspices of the EEAS (Diplomatie, 2013; EEAS, 2014).

Very shortly after the French military intervention in January 2013, European Commission officials were instructed to restructure the entire suspended EDF portfolio and to use the SBC instrument to its full potential. This meant that the amount previously allocated to general budget support was increased by unused project aid.[24] The EU SBC identification mission took place over a week in February 2013. As the instrument only came into force on 1 January 2013, this was one of the first SBCs, and at €225 million, is also the largest to date (as of end 2014).

23 About €500m of aid were frozen, of which €200m were budget support. The budget in 2012 was €1.5bn compared to €2.17bn in 2011. The decrease of the budget was seen as mainly due to aid cuts but also to disruptions in other sources of revenue (European Commission, 2013c).

24 As a very rough estimate, the SBC is likely an increase of around €75m compared to what may have been planned under general budget support for the 2012 to 2014 period i.e. there was a significant increase in amount and it was spread over two years instead of three.

Box 3: Timeline of the Mali crisis

March 2012	President Amadou Toumani Toure is ousted in coup by a previously unknown, US-trained captain, one month before planned elections. The main complaint is that the army is ill-equipped to fight rebels in the north.
	Tuareg rebels and Islamists seize north of country. African Union suspends Mali.
April 2012	Military hands over to a civilian interim government, led by President Dioncounda Traore.
May 2012	Alleged 'second' coup attempt by supporters of ousted President Toure in Bamako. Junta reasserts control.
	The Tuareg MNLA and Islamist Ansar Dine rebel groups merge and declare northern Mali to be an Islamic state. Ansar Dine begins to impose Islamic law in Timbuktu. Al-Qaeda in North Africa endorses the deal.
June-July 2012	Ansar Dine and its Al-Qaeda ally turn on the MNLA and capture the main northern cities of Timbuktu, Kidal and Gao. They begin to destroy Muslim shrines that offend their puritan views, including tombs in Timbuktu.
August 2012	In order to satisfy regional demands for a transition from military-dominated rule, Prime Minister Cheick Modibo Diarra forms a new government of national unity.
November 2012	The West African regional grouping, Ecowas, agrees a coordinated military expedition to recapture the north, with UN and African Union backing. Preparations are expected to take several months.
December 2012	Prime Minister Cheick Modibo Diarra resigns, allegedly under pressure from army leaders who oppose plans for Ecowas military intervention. President Traore appoints a presidential official, Django Sissoko, to succeed him. The UN and US threaten sanctions.
January 2013	President Traore asks France for help, after Islamist fighters captured the central town of Konna and planned to march on the capital. French troops rapidly capture Gao and Timbuktu and at the end of the month enter Kidal, the last major rebel-held town. The Malian national assembly endorses a Roadmap for Transition. European countries pledge in February to help retrain the Malian army (EU Training Mission).
April 2013	France begins withdrawal of troops. A regional African force helps the Malian army provide security.
May 2013	The international donor conference held in Brussels, co-presided by EU Commission President José Manuel Barroso and the Malian President Dioncounda Traoré, pledges €3.2bn to help rebuild Mali.
June 2013	Government signs peace deal with Tuareg nationalist rebels to pave way for elections. Rebels agree to hand over northern town of Kidal that they captured after French troops forced out Islamists in January.
July-August 2013	Ibrahim Boubacar Keita wins presidential elections at the end of July, defeating Moussa Mara. France formally hands over responsibility for security in the north to the Minusma UN force. President Keita appoints banking specialist Oumar Tatam Ly as Prime Minister in September.
December 2013	Parliamentary elections give President Keita's RPM 115 out of 147 seats. France announces 60 % reduction in troops deployed in Mali to 1,000 by March 2014.
April 2014	President Keita appoints former rival Moussa Mara prime minister in a bid to curb instability in the north.
May 2014	Fragile truce with Tuareg MNLA separatists breaks down in north. Separatists seize control of Kidal city and the town of Menaka, Agelhok, Anefis and Tessalit.
September 2014	Government, separatists begin new round of talks in Algeria to try end conflict over northern Mali, or Azawad as the secessionists call it.
	Separatist MNLA opens an 'Azawad embassy' in the Netherlands.

Box 3 (continued)

October 2014	Nine UN peacekeepers killed in the north-east - the deadliest attack so far on its mission in Mali.

Sources: New York Times, 2014; Guardian, 2013; BBC, 2014

Justification for the State Building Contract

There was general consensus amongst those interviewed for this paper that the justification for an SBC was facilitated by the strong political backing from the international community to ease the country's transition back to democracy. Within the European Commission, the high level interest (including from several heads of state and the Commission President José Manuel Barroso) is considered likely to have helped one of the fastest SBC approval processes to date.

If the political support was significant in terms of facilitating the speed of approval and the relatively large amount committed, it does not take away from the fact that the country situation was in many ways a textbook example of a typical situation for a SBC: a previously relatively stable country seeking to emerge from a period of crisis.

The Action Fiche justified the SBC in terms of assisting in the transition and the government to maintain its basic functions (see Table 2).[25] Its general objective covers the double challenge of easing transition while fighting poverty (European Commission, 2013c).

In hindsight, the main immediate result of the SBC – cited by both government and Commission officials – was to give the treasury a 'breath of fresh air', permitting the payment of internal arrears to suppliers. This in turn increased liquidity in the national banks, and could have contributed to increased interim government credibility at a key political moment. More concretely, the return of budget support donors permitted the Malian national assembly to adopt a revised annual budget in May 2013, which included an increase in projected income of 42.71% (the equivalent of circa €650 million, of which the EU contribution through budget support was €120 million) and an increase in expenditure of 38.53% (*Assemblée nationale*, 2013a & 2013b).[26] The first disbursement of the SBC took place in June 2013 and the elections took place as planned at the end of July.

Outline of the State Building Contract

Box 4 outlines the main objectives and expected results of the SBC as stated in the European Commission decision document. All but one of the variable tranche indicators were achieved by the end of 2014, so the amount of €215 million (out of a maximum total of €220 million) was disbursed. Complementary support has not yet been fully programmed as the deadline for contracting is 2016.

Negotiation of the State Building Contract

By all accounts, the formal negotiation of the SBC happened in record time, with the identification mission taking place in one week in February 2013, and the programme agreed and the first tranche disbursed by June of the same year.

Negotiations in Mali

While the speed of preparation did mean negotiations happened quickly, for the most part officials in the Commission and in the Ministry of Economics and Finance[27] (MEF) felt the indicators were fairly representative of government priorities at the time and as such could be agreed on within this timeframe. There were some minor concerns about two particular indicators[28], but for the most part there was consensus that the indicators chosen were relevant and fair.

While Delegation capacity was lower than normal at the time due to many officials having been evacuated for security reasons, the identification mission included technical staff from EU headquarters that were able to

25 Mali is not a member of the g7+ Group of Fragile States and as such not a signatory of the New Deal for Fragile States; hence the New Deal Principles were not explicitly named in the Action Fiche.

26 The Commission also tracked a doubling of the electoral budget, and very significant increases in allocations to food security stocks, to subsidies for seeds and fertilisers (in time for the agricultural season), and to local authorities (Source: correspondence with European Commission officials). It was not possible to verify this as part of this study. These areas are all clear priorities to support the transition, and as a result have the potential for significant impact.

27 It was not possible to interview officials in other ministries given the limited timeframe of this research mission.

28 One particular indicator (which was in the end only partially achieved) was apparently chosen despite the services concerned saying it was unrealistic, and some considered the indicator for budget allocations to the decentralisation investment agency (ANICT) to be both non-results oriented and an infringement on government sovereignty to allocate its budget to its chosen priority areas. Nonetheless, the European Commission insisted on the relevance of these two indicators for restoring service provision in the north of the country.

Box 4: Key statistics of the Mali State Building Contract

Amount: €220 million over 2013 and 2014, plus €5 million complementary assistance

General objective:

To support the government in the implementation of its Roadmap for Transition, as well as in the fight against poverty and for the promotion of sustainable and inclusive growth, and strengthened governance.

Specific objectives:

1. Increase the financial capacities of the government in order to reinforce macroeconomic stability and its capacities to act in favour of development.
2. Improve governance and in particular public financial management, including control and budgetary transparency.
3. Support the efforts of government to carry out its basic functions on all of the national territory, in particular basic social services (health and water) and the economic recovery through job creation.

Expected results:

- Satisfactory implementation of the Roadmap for Transition.
- Credible presidential and legislative elections take place.
- Macroeconomic stability is assured
- Improved public financial management, particularly in the domains of internal and external controls, and public procurement. The national budget (the revised 2013 budget and 2014 budget) reflects the priority objectives for transition.
- Budgetary transparency is improved.

Results expected as part of the sector dialogue if the variable tranche indicators are achieved:

- PFM: internal and external audit and control system is clarified and strengthened. A sample of significant public contracts is audited by the Auditor General's office (Bureau du Vérificateur General), in order to improve the system and check compliance.
- Health: The Mali central medical store (Pharmacie Populaire du Mali) pays arrears, restores stocks and improves its management system.
- Employment: Labour-intensive jobs are created in the construction and civil engineering sectors.
- Decentralisation: Funds are made available to the ANICT (agence nationale d'investissement des collectivités territoriales) to facilitate the functioning of the decentralised structures and the provision of services in local communities, including those in the north.
- Justice: Justice services are restored in the regions of Gao, Timbuktu and Kidal, and the fight against impunity is supported by the return of a minimum number of officials in these three regions to ensure the re-establishment of basic justice.
- Water: Improved water provision in the three main northern towns, Gao, Timbuktu and Kidal.
- Food security: The national emergency reserves (Stock national de sécurité) are reconstituted and agricultural inputs (including the provision of seeds, fertilisers etc) are facilitated by the government. A structural reform of the national food crisis prevention system commences.

***Source:** Author's own translation/summary of the European Commission Action Fiche (European Commission, 2013c)* support the remaining Delegation officials. Certainly, all of the sectors in the Delegation were involved in the negotiation of the SBC and some recorded that having an indicator in the SBC had given them extra clout, which remains important in driving reforms forward.

The MEF had retained much of its personnel during the crisis and managed to contain the fiscal situation despite the sharp drop in revenues. Salaries were paid throughout the crisis, and external debt repayment continued. The officials in the MEF were used to negotiating with donors on budget support operations and there is no evidence of limited capacity.

Negotiations in Brussels

In Brussels, some tensions were felt between the nature of the SBC as an instrument and the expectations of certain Member States being expressed through the Council, such as demands for the SBC to ensure rebels' engagement in the peace process and government commitments to 'fundamental values', which was well beyond its remit. At a technical level, Commission officials were clearly aware of the composition of the instrument, i.e. that it is risky and that it cannot bring peace, although it can ease fiscal pressure on the state. In order to appease these concerns, the first year payment was split in two tranches, with the second only being disbursed after the elections were recognised.

Risk management

The main risks and mitigating measures identified in the Action Fiche (European Commission, 2013c) were related to political risks (including the institutional fragility of the army) and economic risks (including high corruption opportunities).

As part of the SBC process, the Delegation compiled a 'risk assessment framework' matrix, and has updated it for each disbursement as required by the process. All relevant sections of the Delegation – including the political section which reports to the EEAS – were involved in completing the matrix. DEVCO procedures require the matrix to be reviewed by various thematic and geographical units in Brussels. It is then submitted for approval for both commitment and disbursement by the Budget Support Steering Committee.

This 'risk assessment framework' is therefore updated according to internal programming needs, and not as risks change. It is not regularly consulted and is considered simply another form to fill in as part of Brussels-owned procedures.

In contrast, two of the bilateral donors in Bamako – Canada and France – used quarterly risk reviews. These were the subject of detailed discussions with headquarters, and resulted in action if the risk levels changed e.g. choosing whether to continue with projects in certain areas or not, or in the case of France, to determine the levels of interest in development loans.

This is not, however, to say that the EU Delegation is poorly informed or unaware of risks. It has a significant political section in the Delegation in Mali (three or four people) in addition to the large numbers of technical staff, backed up by the EEAS and DEVCO officials in Brussels, so both political and implementation risks can be monitored.

Donor coordination

Mali has retained relatively strong donor coordination and dialogue systems, which clearly simplifies the task of coordination.

The Government and budget support donors were unanimous in their assessment of a good working relationship with the EU, good coordination and good collaboration. Likewise, even though the EU's SBC dwarfed other budget support contributions (see Table 3 below), EU officials were clearly aware both of the need to coordinate closely with the multilateral and bilateral budget support donors, and of the additional power of having Member States on board with the process.

During the September 2014 IMF mission, the EU and the World Bank were permitted to participate in most of the meetings and it was, in fact, described by some as being a 'joint IMF-World Bank-EU mission'. EU officials in Brussels mentioned that coordination with the IMF and World Bank in particular was stronger since the advent of the SBCs.[29]

Implementation

The EU meets monthly with all the Ministries concerned to track the SBC variable tranche disbursement indicators. Although this type of meeting could seem like the type of project transaction cost that budget support is meant to avoid, Ministry of Finance officials actually consider it a useful forum to ensure follow up by the other ministries involved with the variable tranche indicators.

There are various other donor coordination and PFM sector thematic meetings which the EU actively participates in, and in some cases the EU was mentioned as being one of the donors more closely following certain PFM issues, such as quarterly treasury planning. Relations with senior MEF officials appear cordial and permit regular formal and informal catch-ups on what is happening in the MEF.

Some EU officials expressed disappointment that the crisis situation had not led to more incentives for reform within the administration, but rather a continuation of business as usual. The Government, on the other hand,

29 Not only in Mali, but also in other countries.

reasoned that a crisis was not the moment to initiate sweeping reforms. This highlights the tension between short-term crisis relief and institutional survival, and medium-term reform needs.

Two aspects that influenced the SBC implementation are worth looking at in more detail: the 2014 private jet scandal and the complementary support provided as part of the SBC.

Private jet scandal

An IMF review mission took place in May 2014: Mali's performance under the ECF programme was said to be 'on track, with the exception of tax revenue' and the IMF mission chief, Christian Josz, publicly stated an intention for the IMF Executive Board to discuss the review in June 2014 (IMF 2014). A positive review in June was a prior condition for the 2014 budget support disbursements of all the budget support donors present in Mali.

Shortly afterwards, local media reported that a presidential jet worth between $34 and $40 million had been purchased, and that a state guarantee of $200 million had been given for defense procurement.[30] Neither of these contracts had been approved as part of the budget process.

In the following months, an IMF investigation found that both contracts were procured under a generous interpretation of 'Article 8' of the public procurement code, which permitted exemptions for certain military purchases. The military supply contracts appear to have involved significant overbilling (up to $48 million, as estimated in a report by Mali's auditor general, released in October) and excessive financing fees, as most of the payments were due to take place in 2015 and 2016 (Touré et al., 2014; Reuters, 2014). The presidential jet, meanwhile, was rumoured to be leased out to meet maintenance costs, as it is not in permanent use by the President (Koaci, 2014).

As news of these two irregular events unfolded, the EU and all the budget support donors delayed decisions on their disbursements, with significant effects on Malian liquidity. Finance Minister Bouare Fily Sissoko said these delays caused Mali's debt burden to rise by 30% and the Government was forced to go to the financial markets instead (Reuters, 2014). Due in large part to sustained pressure by the budget support donors – led formally by the IMF – the government dealt with these allegations in record time and proposed the following remedial measures:

1. The publication of a scathing report by the Auditor General on these two contracts.
2. A redefinition of the scope of 'Article 8' of the public procurement code, which specifies and limits which types of military purchases may be procured outside of normal procurement practices.
3. Cancellation of the irregular contracts which had not yet been executed and paid for.
4. Approval of a revised 2014 budget which would include the non-budgeted items, and a tighter control system for 'non-budgeted expenditures' in future years.
5. A formal government response on how to follow up on the report (namely to avoid the impunity of individuals clearly named as fraudulent).

The EU and other observers view these strong signals against corrupt practices as a significant success for the SBC (and for budget support in Mali in general), as they suspect that government response would not have been so open, quick or strong without the financial leverage. According to Commission officials interviewed, this sort of leverage would have been impossible if all EU aid was implemented through a traditional project modality instead of budget support.

There were some concerns within Government that these remedial actions were made under pressure, and may have led to a loss of state credibility (e.g. through the unilateral cancellation of contracts). However, for the main part, the actors interviewed felt that this external pressure enabled the MEF to take control of the public procurement code back from the military, and to improve corruption mitigation in Mali overall.

Complementary support

The complementary support is composed of a mix of different ad hoc technical assistance needs related to the SBC indicators (linked to both the fixed and variable tranches), and can be used until 2016. Although it is not yet fully committed, the Delegation estimates that just over a third of the assistance will be in the area of PFM, including the cost of five joint audits with the Auditor General. The other major technical assistance area is food security, in the form of a full-time technical assistant to help with the restructuring of the national food crisis prevention mechanism.

Delegation officials considered the SBC complementary support to be no different from the general technical cooperation funds under a project approach, which the Delegation directly contract and manage, and which can be used for both technical assistance and studies. While the majority of the interventions seem individually useful and contextually appropriate – especially in the light of limited explicit government demand for PFM technical assistance – this type of ad hoc, specific support linked to the SBC

30 'I learned about the plane by reading the local media', said Op de Beke, a senior economist at the IMF. 'It had not been mentioned by the government when our team carried out its review in March." (*Guardian*, 2014b)

Table 4: Budget support to Mali

Approximate General Budget Support amount in Euro[32] in 2013 - 2014	Donor / instrument	Amount in original currency	Date of first disbursement
€ 220 million	EU State Building Contract	€225m of which €5m Complementary Assistance	June 2013
€ 85 million	World Bank / Recovery And Reform Support Credit	2013: $50m 2014: $63m	December 2013
€62 million	African Development Bank/ standard budget support instrument	2013: 40 million Units of Account 2014: 15 million Units of Account	October 2013
€ 48.5 million	IMF Rapid Credit Facility and Extended Credit Facility	RCF: Two loans totaling $ 33.8 million in 2013 ECF: a 3 year programme, of which $ 9.2 million was disbursed in 2014	February 2013
€ 26 million (approx.)	France (Agence Française de Développement) / budget support	2013: one-off €15m payment 2014-2019: approx. €11m per year foreseen (All of these are a mix of budget support gifts & loans, and debt conversions)	October 2013
€6.5m	Denmark (Danida) / Development Contract	DKK 50 million	December 2013
Comparators: 2013 Malian budget of 1,465 billion FCFA, circa € 2,235 million 2014 Malian budget of 1,560 billion FCFA, circa € 2,385 million			

Sources: IMF website, AfDB website, Danish Ministry of Foreign Affairs website, interviews with officials of the institutions involved, Maliweb (2013) and Maliactu (2013).

indicators seems to run the risk of being a piecemeal and donor-centric approach to spending a substantial sum of money. A more strategic approach to changing technical needs during a crisis period – particularly more flexibility and quicker responses than allowed by the piece-by-piece contracting by the Delegation – could be a more effective option to complement the SBC.

On the Government's side, there was limited awareness of the EU's complementary support. Within the MEF, there was a general understanding that the EU did not do much capacity building, while officials felt well served by the IMF regional technical assistance centre (AFRITAC – which the EU partially funds), as well as other donor support.[31]

The question is, had the Government been left to identify its own priority technical assistance needs and implementation modalities in light of the Roadmap for the Transition, would it have indicated little or no need for technical assistance for its transition priorities? Even if no large-scale, strategic technical assistance needs were identified, more ad hoc, responsive and demand-driven technical assistance could have been facilitated through increased government control of the support and through out-of-the-box thinking on what complementary assistance might involve.

What is unique about the SBC?

EU officials identified four key characteristics which made the SBC stand out: (i) its ability to operate despite high fiduciary risk, (ii) its rapidity, (iii) its flexibility in terms of conditions and variable tranche indicators, and (iv) its

31 It was not possible to interview Malian officials in other SBC priority sectors to determine their perceived need for Technical Assistance.

32 Exchange rates used: EUR:USD 1:1.3276 (2013 yearly average as per OANDA.com)

size. In comparison with other budget support donors' instruments in Mali during the same period (see Table 4), it would seem the latter characteristic is most unique to the SBC in Mali, while the first three, although significant, are not unique to the EU's approach. However, it may be that the EU underestimates its own influence as both political actor and multilateral donor, as well as its relatively large sector knowledge, especially in the Justice and Security sectors, which other budget-support-giving multilaterals have little or no access to.

With clout as both a political actor and a multilateral donor, multilateral and bilateral donors agreed that the EU was the primary actor able to ascertain whether individuals involved in the corruption scandal would actually be brought to justice. The multilaterals felt themselves unable to comment on political and legal matters, as these were outside their remit. Bilateral donors, meanwhile, argued that as a representative of 28 Member States, the EU Ambassador could bring a significantly stronger message – as well as the financial incentives to enforce it – than any one national ambassador. Furthermore, in contrast to other donors, the EU has relatively large sector knowledge beyond PFM, especially in sensitive areas such as the Justice and Security sectors. According to various other in-country actors, this gives it wider influence than may initially have been expected of a budget support programme.

Note on potential alternatives to general budget support

In order to draw a distinction with the 'high-risk' approach taken by the donors noted in Table 4, it is worth considering two other ways in which donors chose to give non-project support to Mali.

Denmark, Spain and The Netherlands contributed to a 'National Stabilisation Fund' managed by the United Nations Development Programme (UNDP). The Government considers this pool fund to be (targeted) budget support. It finances specific budget operations (in the areas of agriculture, education, health and infrastructure rehabilitation) with specific ex ante controls, and an ex post audit at the end. Nevertheless, some officials implied that there were delays in fund disbursements and that an underspend was predicted.

Canada suspended its sector budget support programmes in health and education in 2012, and lifted the suspension (i.e. to continue the three-year planned contracts after a two to three year break) at the beginning of 2015, following the satisfactory conclusion of the September 2014 IMF mission.

The fact that both these instruments had a significant disbursement lag (of potentially over a year) would indicate that they are less speedy post-crisis options.

4. Findings from the two case studies

South Sudan and Mali were both high profile states in fragile situations when the SBC was launched as an instrument in early 2013. The EU was deploying a variety of diplomatic and aid instruments in both countries to address the crisis situations, of which the SBC was a key element. The provision of budget support through the SBC was seen as a form of aid which also sent a political signal of support to the two governments, and which could have inspired bilateral donors to start or resume support. A summary of the key features are presented in Table 5.

In the case of South Sudan, the renewed outbreak of conflict meant the SBC was not implemented, though at present the complementary support is still being programmed. In Mali, the final tranche of the SBC was disbursed in December 2014.

Overall, the early evidence from these two countries is encouraging. The SBC has proved to be a flexible instrument, enabling the EU to develop rapid support mechanisms in line with donor commitments in the New Deal. In Mali, the instrument enabled the EU to provide rapid support to maintain the budget during an extreme crisis period and to tackle corruption. In South Sudan, EU support as part of broader package of reform would have supported a New Deal Compact, had this gone ahead.

The EU is well placed to provide general budget support in fragile states, given the size of its aid budget and its capacity as both a political and a technical actor. The size of the EU aid budget and the variety of instruments at its disposal also mean the EU has ‘a seat at the table’ in the discussion of government policies. During transition or post-crisis periods, this could translate into a certain amount of influence over how new policies are designed and implemented. Nevertheless, whether this capacity for ‘political dialogue’ reaches beyond the Ministry of Finance is unclear.

The implementation of SBCs demonstrates that the EU is remedying some of the weaknesses of budget aid to fragile states identified in the World Bank/African Development Bank Common Approach Paper (CAP) (World Bank/AfDB, 2011). The preparation phase of an SBC requires consideration of a far broader range of risks,

Table 5: Comparison of South Sudan and Mali State Building Contracts

	South Sudan	Mali
Amount	€85m, of which €5m complementary support (CS)	€225m, of which €5m complementary support (CS)
Period	2 years	2 years
Current status	SBC not implemented following renewed conflict; CS being programmed nonetheless	SBC fully disbursed; CS still being used until 2016
Modality	To support salaries of health and education workers through government payroll system.	General budget support payments to treasury. 67% Fixed Tranche, 33% Variable Tranche.
Other key EU actions	One of the lead donors on the New Deal Compact process. Lead donor on Rural Development Civil society support	EU Training Mission and EUCAP mission for the fight against terrorism Large-scale support for food security, water and sanitation 2013 elections Civil society support Project modality in other key sectors where conditions have not been met to move to a sectoral support approach (agriculture, road and infrastructure, and decentralisation)

including the risks of non-intervention, as recommended by the CAP. Similarly, the CAP recommends donors find 'non-legalistic, non-bureaucratic methods' of improving donor coordination. This was particularly demonstrated in Mali during the joint missions by the EU, IMF and World Bank.

Nevertheless, the EU should continue to explore how to make best use of this new instrument. This study identified four areas of improvement in the design and use of the SBC.

1. Resolving the design tensions within State Building Contracts

The two case studies show a difference in terms of fragility, with South Sudan representing a (long-term) fragile state, and Mali being considered to be 'in a fragile situation/ in transition' (European Commission, 2012a). This distinction between 'support to exit long-term fragility' and 'support to transition after a crisis', is a key design tension in the SBC Guidance. The Guidance is (perhaps deliberately) unclear as to whether the SBC is intended to prevent state collapse, provide basic services, or build the state's long-term capacity.

In order to analyse this tension, Dom and Gordon's (2011) distinction between three different objectives for budget support to fragile states is relevant. These are roughly reflected in the specific objectives of SBCs defined in the European Commission Guidelines (2012), though with slightly expanded aspirations, as shown in Table 6 below.

In the case of Mali, the SBC was used mainly for macro-fiscal stabilisation and restoring basic functions in the first year, with an increase in the variable tranche proportion incentivising some specific policy reforms in the second year. Nonetheless, the policy reforms selected were relatively straightforward, realistic and well-suited to the post-crisis situation, and were based on the Malian government's Roadmap for Transition. The challenge will be to get the balance right if a second SBC is selected for Mali, setting indicators that are specific and immediate enough to be relevant to the instrument.

In South Sudan, the SBC was initially justified for macro-fiscal stabilisation in order to show political support to the new government of a new country as it negotiated the conditions of independence from the Republic of Sudan. It was also intended to ensure the Government had funds to sustain basic services. However, due to fiduciary concerns, the disbursement indicators included audit and potential reforms to sectoral payroll processes. Although the SBC was unable to be implemented, it is likely that – in such a fragile situation – this multiplicity of objectives would have spread potential EU leverage too thinly. A key judgement to be weighed is whether South Sudan is a special case, or whether more generally, spreading SBC aims simultaneously across all three objectives above leads to a situation where a fragile state's reform capacity, and the EU's leverage, is effectively over-burdened. Instead, there may need to be careful thinking about the trade-offs between the different goals of a SBC, and those that can realistically be achieved. As Dom and Gordon (2011) note, '[s]everal types of needs may coexist and require a mix of different types of support'. The SBC should not be overburdened.

It is important to clearly identify which objective a SBC has the primary purpose of supporting – and then tailoring its design and indicators accordingly. Clarity on the primary objective of an SBC could lead to clearer guidance on the design of the instrument. For example:

1. A short-term objective of **preventing state collapse** would mean the SBC was designed as a flexible short-term instrument to alleviate severe fiscal or economic distress. An SBC focused on stabilisation would avoid ear-marking and would function more like the rapid-disbursing balance-of-payments support of the IMF. Complementary support may be less important and would probably only occur after the disbursement was made (as this should have been done rapidly). This would help lay a platform for recovery, but would likely not involve a variable tranche as expectations for indicators would be low.
2. A medium-term objective of strengthening the delivery systems, **building the state** would lead to an SBC that looked more like traditional general budget support operations, with indicator-linked variable tranches, correlated complementary support, and could involve targeting on specific sectors.

In either case, a medium-term perspective on the future direction (or different potential future directions) of EU

Table 6: Objectives of budget support to fragile states

Objectives of budget support to fragile states	…as reflected in the European Commission Budget Support Guidelines
Macro-fiscal stabilisation	'Improve financial capability of [government] to restore peace, macro-economic stability and to achieve short-term policy objectives'
Restoring basic functions	'Ensuring vital state functions (notably the provision of peace and security, payment of civil service salaries, provision of core administrative functions and minimum basic services)'
Incentivising policy reforms	'Foster a transition process towards development and democratic governance'

Source: Dom and Gordon (2011); European Commission (2012a) cooperation with the country should be explicit. This is particularly important where an SBC is supporting medium-term improvements, and reliability and predictability of support may be essential for progress (Dom and Gordon, 2011). European Commission officials are thus already rightly considering questions such as: what duration should a SBC be? Is a one to three year timeframe always long enough? What can come after an SBC: another SBC, an SRC, or a GGDC? Can an SBC realistically 'prepare the ground' for GGDC or SRCs? These questions will eventually need to be clarified within the Budget Support Guidelines.

Recommendation: the objectives of each SBC should be more clearly stated, and the design of the instrument tailored to these objectives. Given the dangers of overloading the instrument with unrealistic expectations of its potential, the conditions and indicators of SBCs should be restricted to specific, short-term actions, closely linked to the key objective. These actions should also be guided by a longer-term vision for EU cooperation with individual countries, including potential frameworks for subsequent cooperation.

2. Addressing weaknesses in risk monitoring around State Building Contracts

The SBC provides a legal basis for the European Commission to take on high levels of risk and uncertainty in its operations. This serves the useful purpose of legitimising risk taking within agreed bureaucratic rules, even when Member States are unwilling or unable to do so. In addition, consideration of risks is now formalised through a Risk Management Framework matrix, which is prepared in-country, quality controlled by various departments at European Commission headquarters, and validated in the Budget Support Steering Committee. One important element in both the SBC Concept Note and the Risk Management Framework is the analysis of not only the various political, macroeconomic, developmental, PFM and corruption/fraud risks involved[33], but also of the risks of non-intervention. Mitigation measures are also identified, though it is recognised that these do not significantly alter the risk level.

However, the Risk Management Framework is only updated during identification and on disbursement. As volatility is a key characteristic of fragile situations, more regular (e.g. quarterly) light touch reviews, and updates after any key political events, would ensure that emerging risks and changes in the environment in which the SBC is to be implemented are regularly monitored. In reviews of risk, a variety of perspectives should be taken into account. For example, local staff or others with long-term country knowledge in analysis should be involved, especially where this is not available within the Delegation, DEVCO or the EEAS. It may be that reviews should simply involve a cover sheet or summary note (rather than a re-write of the full Risk Management Framework matrix), in order to focus on the 'live' nature of the discussion and to facilitate continuous use and updating.

In South Sudan, the political situation deteriorated following the sacking of the Vice-President, ultimately culminating in the outbreak of armed violence and the fragmentation of much of the military along ethnic lines. This risk of the effective collapse of the elite political settlement was not foreseen. This event was a surprise to the development community as a whole, and not just to the EU, though it is worth asking whether local staff or others with long-term local knowledge would have been able to identify this potential risk.[34] It is worth considering whether the correct questions are being asked in the political risks section in the SBC risk matrix to ensure these risks are being considered.

In Mali, high risks of corruption were identified and when these materialised in the second year of the programme, the EU responded in an agile and relevant manner. One of the mitigation factors decided at the beginning of the programme was to fund five audits with the Auditor General's office (through the complementary support funding). However, none of the interviewees made any connection between the Risk Management Framework itself and this mitigation measure.

Thus, whilst the evidence of the two case studies does not necessarily show poor risk awareness and adaptability in practice, it does suggest the following options for strengthening the SBC risk monitoring and management processes:

1. Clarifying the responsibility and leadership for the Risk Management Framework. Section 3.4.2 of the Budget Support Guidelines allocates formal responsibility with the Geographical Directors, but does not establish clarity of leadership and purpose.
2. Instilling regular light-touch reviews of risk, at least every quarter and when new key events take place, to ensure the flexibility and robustness of risk mitigation strategies. This would not necessarily involve redrafting the risk matrix (the purpose is to reassess risk, not to fill in a template) but could, for instance, be a programmed conference call dedicated to discussing risk.
3. Ensuring that the regular reviews are more than a box-ticking exercise: these should involve discussion amongst all sections of the Delegation and with headquarters, in order to be able to proactively assess

33 These are the five categories of risks covered in the Risk Management Framework.

34 Hence the criticism by the UK All Party Parliamentary Group for Sudan and South Sudan of the international engagement in South Sudan in general for having too much of a disconnect between diplomatic actors and development actors (All Party Parliamentary Group for Sudan and South Sudan, 2015).

changes in risk levels across the different categories of risk, and potential mitigating actions.

4. Altering the Country Risk Profile (the summary part of the Risk Assessment Framework) to include an 'alarm bells' section, which would trigger decision points if certain risks were to materialise.
5. Improving analysis of political risks through explicit analysis of risks to the political settlement, and involving local staff or others with long-term country knowledge in the analysis and review of risk, especially where this is not available within the Delegation, DEVCO or the EEAS.

Recommendation: The European Commission should improve the SBC risk management framework and processes by ensuring risks are monitored more regularly and proactively, and by widening its definition of political risk.

3. Understanding the political economy of fragile states and its implications for political dialogue

In addition to the risks of the break-down of the broader political settlement, another feature of the political economy of fragile states that needs to be taken into account is that fragmented authority within government can hinder effective political dialogue. Governments of fragile states are often fractured and dysfunctional, hence underlying assumptions need to be carefully considered. The SBCs have as natural interlocutors the Ministries of Finance of recipient countries, and these do not necessarily wield power at higher political levels, or within line ministries on whom variable tranche indicators often depend.

The Mali case study found that although Mali suffered a significant crisis in 2012, many of its bureaucratic structures remained stable. The Minister of Finance during the crisis was considered very effective and most of the Ministry officials in Bamako remained in place. The continuity can be seen in the financial management of the crisis period, where civil servant salaries continued to be paid and only investments and arrears (primarily internal, some external) suffered.[35] Furthermore, Mali had well organised government-donor dialogue and donor coordination structures. Prior to the crisis, Mali was not considered a fragile state[36] and may have had higher bureaucratic capacity than may be found in other fragile situations. As such, negotiation and implementation of the SBC has run fairly smoothly.

In contrast, government-donor dialogue in South Sudan was not well institutionalised, nor were donor coordination structures. South Sudan had not previously received budget support. The lack of means to institutionalise decisions and decision-making, both within government and between government and donors, made dialogue difficult.[37]

In coping with such a challenging environment, EU Delegations must first take the fragmented authority within government into account. Although the ministries of finance may be the main interlocutor, these may not have sufficient clout to take decisions alone, even on areas usually considered as their core functions.

EU Delegations should be able to avoid taking a short-term time horizon, even where other donors do. This is shown in both the Mali and South Sudan case studies. In both countries, the Delegations were in the front rank of institutions providing support to the governments of these fragile states, and ahead of many Member States. This shows the potential for Delegations to '…be the best of both worlds – offering the long-term approach embodied in Commission instruments, as well as the political and security expertise of the EU Member States' (ETTG, 2014).

Recommendation: During the design of SBCs, there needs to be sufficient broad buy-in by the partner country, or alternatively, verification that any triggers or indicators are within the control of the main dialogue partner.

4. Ensuring strategic and flexible complementary support

While EU budget support programmes in fragile states have historically been accompanied by some technical assistance, the SBC guidance formally identified the need for technical support to complement financial support, and it is now recommended that all SBCs contain complementary support. This re-design is a positive step, given the capacity constraints present in fragile situations.

Both the South Sudan and the Mali SBCs had a €5 million allocation for complementary support. Although the 'off-track- status of the IMF programme prevented the SBC in South Sudan from being implemented, the complementary support component was maintained and implemented in 2014. It will continue in 2015. The assistance is for local government PFM, which is an essential component in supporting the long-run

35 It is interesting to note the stability of the Mali bureaucracy throughout the crisis, and this may imply lessons for technical support to the bureaucracy during times of crisis: in Mali, EU technical assistance was halted in 2012 until cooperation restarted in 2013. It may be useful to analyse further whether these gaps in technical assistance had effects and whether it would have been useful to maintain technical assistance during the crisis period, as is currently happening in South Sudan. This is further examined in the next recommendation.

36 Mali is not a member of the g7+ Group of Fragile States, or a signatory of the New Deal. However, it is on the WB-AfDB-ADB harmonised list of fragile states, and on the OECD fragile states list, since 2014 (World Bank, 2013 & 2014; OECD, 2012 & 2013).

37 Another key difference of course was the financial significance of the SBC amount: in Mali, the SBC disbursements represented a 'breath of fresh air' for an aid-reliant country whose revenues had significantly fallen during the crisis. South Sudan's SBC was planned while it was under austerity following the oil shut-down, but by the time it was being signed, the oil was flowing again, so the amount had less significance.

improvement of the delivery of basic health and education services by local governments. This sets a positive precedent, since capacity-building in one area should not necessarily be derailed by a lack of progress on other elements of a SBC.

In Mali, the complementary support envelope has been programmed much like the usual technical cooperation funds under a project approach, with discrete contracts individually managed by staff in the Delegation. These pieces of work are chosen ad hoc, on the basis of gap filling and pushing forward specific policy changes related to achieving the SBC variable tranche indicators in all the sectors covered by the SBC. This type of approach runs the risk of being a piecemeal and donor-centric approach to spending what is in effect a large sum of money. In a post-crisis situation, a more strategic approach could have been envisaged in order to change the technical needs in all priority sectors, such as more flexibility and quick responses than the Delegation's piece-by-piece contracting allows, and more demand-driven assistance facilitated through increased government control of the support.

The two case studies, together with an analysis of Table 2, also raise questions about the process for deciding the amounts set aside for complementary support. While 'rough and ready' identification of complementary support needs presumably facilitated speedier approval of the SBCs, South Sudan's chronic capacity problems may reasonably have required more investment than required in Mali. It may be that Delegations are subject to incentives to increase complementary assistance funds – which they control – at the cost of financial support to the government. This should obviously not be the case.

In both cases, the identification and contracting of complementary support is taking place with a time lag compared to the planned/actual SBC disbursements. If the technical assistance is to support the objectives of the SBC and build the systems through which SBC funds flow, then this delay will hinder these aims. If possible, complementary support should start within the same time period as the first SBC disbursement, and should have the ability to be responsive to changing government requirements.

Furthermore, linking complementary support more clearly to strategic SBC objectives – whether they are avoiding state collapse or building state capacity – would be a relatively easy change to make, but one which could increase the impact of SBCs.

Recommendation: The European Commission should review the current complementary support provision, both in terms of objectives – to make the support more strategic – and implementation – to make it more flexible and demand-driven.

Future directions

This paper has attempted to contribute to the body of information available on the implementation of the SBCs to date. Given that this remains small, further research on implementation in other countries, and on cross-country comparisons, would be beneficial, in particular given the wide variety of contexts in which SBCs are being implemented.

To build on the findings and recommendations of this review, and any further analysis, it will be important for the European Commission to also seek feedback from countries where SBCs have been implemented. This dialogue could take place through the New Deal process[38], which provides an opportunity for fragile states to work with the international community to promote more effective partnerships.

38 Although, as already mentioned, not all SBC recipients are part of the New Deal process.

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