



Feasibility study for a potential use of Budget Support to deliver ESI Funds

Final report



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Abstract

The overall objective of the study was to assess the advantages and disadvantages of a potential use of budget support for the delivery of parts of the ESI Funds, and to assess the feasibility of using a delivery mechanism based on budget support to deliver Cohesion Policy. It took as a point of departure the available evidence on budget support, as implemented in third countries, by the European Commission and other multilateral and bilateral donors. The available evidence and analysis show that the potential benefits of using budget support to deliver ESI Funds are limited, while the risks may be substantial, notably concerning the ability to control the legality and regularity of spending. The study concludes that some aspects of budget support may be relevant and feasible to use to deliver the ESI Funds, such as payment for policy reforms and payment for results. The benefits would likely be generated mainly in the implementation phase of the programming cycle, by alleviating the administrative burden for both the European Commission and Member States.

Key words: Feasibility study, European Funds, ESI Funds, ESF, ERDF, administrative burden, budget support, assurance, results, disbursement linked indicators, standard cost options, policy reform

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EXECUTIVE SUMMARY

The overall objective of the study was to assess the advantages and disadvantages of a potential use of budget support for the delivery of parts of the ESI Funds, and to assess the feasibility of using a delivery mechanism based on budget support to deliver Cohesion Policy. It has taken as a point of departure the available evidence on budget support, as implemented in third countries, by the European Commission and other multilateral and bilateral donors. The findings from the literature review were used to analyse the potential added value and likely disadvantages of using budget support to deliver ESI Funds compared to the existing delivery system of shared management. Through the analysis, the study identified options, including elements of the budget support delivery mechanism, which could be of relevance to implement in an ESI Fund context. Finally, it assessed the likely costs and benefits of implementing these options.

It should be kept in mind that it is difficult to provide strong judgements on the potential value added and likely disadvantages of using budget support compared to the current shared management delivery of ESI Funds, due to the very different context in which the instruments operate (e.g. inside the European Union vs. in international cooperation, the difference in amounts disbursed, the regional focus of ESI Funds etc.). Likewise, the cost benefit analysis is mainly qualitative, based on assumptions, due to lack of hard data on administrative cost of implementing budget support, making it difficult to carry out a robust and full-fledged quantitative assessment of likely costs and benefits.

What is budget support?

For the purposes of this study, budget support is defined as a delivery mechanism which involves a transfer of financial resources to the national budget of a partner country and that will be implemented in accordance with the beneficiary country's budget procedures, financial management system and public procurement system. The provision of budget support is generally accompanied by a policy dialogue between the donor and the partner country to agree on policy actions or development results which budget support should contribute to, and generally also by capacity development and technical assistance. Payments are made based on conditions (as opposed to actions or activities carried out), where performance frameworks with disbursement linked indicators are used to assess progress and achievements towards the agreed objectives of the support.

A defining feature of budget support is that it includes both a financial dimension (transfer of funds to a beneficiary country's Treasury) and an incentive dimension by providing financial incentives to governments to achieve objectives, mostly related to macroeconomic stability, Public Finance Management (PFM), reform implementation and service provision. There is not a single model of budget support operations, but instead a variety of types, which can be differentiated based on the level of earmarking: (i.e. the way the provision of budget support is justified against certain expenditures in the country's budget); the traceability (i.e. funds are identifiable in the expenditure classification of the country's budget); the type of conditionality (i.e. the nature of budget support is partly determined by the scope and nature of conditions for disbursements).

The multiple ways in which these criteria can be combined mean that there is no one-size fits all budget support but rather a multitude of approaches, adapted to the specific context and needs of both donor and partner countries.

For the purposes of this study, four “ideal” types of budget support have been studied and are discussed in the report:

- **General Budget Support (GBS)** is meant to support the implementation of a national development strategy, with the policy dialogue, disbursement conditions and capacity development assistance focused on the overall policy objectives and budget priorities of the partner country.
- **Sector Budget Support (SBS)** is meant to support the implementation of a sector development programme and the policy dialogue, disbursement conditions and capacity development assistance are thus focused on sector specific policy issues and budget allocation priorities. GBS and SBS instruments are mostly distinguished by the nature of the conditions attached to the aid rather than by their financial characteristics.
- **Support for policy action** is meant to support policy reforms. It supports and links disbursements mostly to ‘prior actions’ (i.e. reform/process indicators) to be undertaken by the partner government (and which have to be achieved for disbursements to be made). The distinction between general and sector support is generally not made, as often the policy actions are cross-cutting in nature, and may support prior actions across more than one sector. Support for policy actions can be implemented as a ‘pure’ budget support, i.e. providing a financial transfer to the national budget of a partner country or using different financial modalities (e.g. payments to ring-fenced programmes or top-ups to existing programmes).
- **Payment for Results** approaches is an aid delivery approach in which the donors pay for results or outputs (e.g. a fixed amount for reaching a certain number of children in school, or \$200 for each additional child who completes primary school and takes a standardized test), and in which the recipient (a government entity) has large responsibility for and wide discretion in using funds.

Even if evidence is mixed, the expected positive effects of using budget support modalities on policy dialogue, alignment, results, and transaction costs have been generally more limited than initially envisaged. Regarding policy dialogue, there is limited evidence of improved alignment and quality of the dialogue. In terms of result orientation, budget support operations are usually linked to a Performance Assessment Framework (PAF) that contains not only impact and outcome indicators, but also output, activity and process/input measures; thereby not always being as result oriented as initially intended. In Payment for Results approaches, delivery of outputs and results has strengthened the results focus, even if these approaches also have disadvantages (potential gaming behaviours, concentration on indicators rather than on general performance, difficulty to identify and negotiate indicators, etc.). Generally, budget support approaches are also perceived to have led to a reduction in transaction costs compared to the project modality, but evidence is scarce and gains easily offset by excessively complex assessments procedures and disbursement conditions.

The focus of budget support programmes has been primarily on social sectors. Sector Budget Support, although increasingly used in productive sectors such as energy or agriculture, is predominantly concentrated in service delivery sectors such as health and education. Program for Results operations have slightly different focus, including areas such as health, water and resilience. The availability and easier identification of output or outcome indicators in sectors like health, education, and water can be considered as one factor behind the use of Sector Budget Support or Program for Results types of budget support in these sectors.

Certain sector characteristics affect the effectiveness of budget support, and sectors which are more complex and involve different types of stakeholders are generally considered less suitable for budget support. Private sector involvement is considered a factor which can complicate the use of budget support. In addition, the budget support delivery mechanism is rarely used for large

investments which entail infrastructure, such as transport, due to high value contracts, the risk of corruption and ensuing reputational risk.

Conditions attached to budget support programmes can be classified according to their scope and nature. In the case of General Budget Support, the conditions are multi-sectoral in nature, while in the case of Sector Budget Support, the focus is narrower (sector or sub-sector). Within the Program for Results, the scope of the conditions is generally at the sub-sector or programme levels. Regarding the nature of conditions, the main choice is whether they relate mainly to policy actions and reforms to be undertaken or to specific outputs and results to be reached (or to a mixture of both).

The study has not found examples of using budget support approaches in non-development contexts, and it has so far mainly been used in low- and middle-income countries. DG NEAR increasingly uses budget support in neighbourhood countries to promote reforms, but this is a recent development. It is hence difficult to fully assess results of these efforts yet. First experiences gained on process and results have been integrated into the assessment.

What would be the likely impact and trade-offs of using budget support in ESI Funds?

The objective of this study was to assess the advantages and disadvantages of the potential use of budget support for the delivery of (parts of) the ESI Funds and to assess the feasibility of using budget support type delivery mechanisms in the framework of ESI Funds. Overall, the study concluded that there is little evidence that general or sector budget support delivery of ESI Funds would be more effective and efficient than the current shared management system. Any change would involve significant trade-offs with uncertain outcomes and gains, as summarised below.

Sound financial management and legality and regularity

The use of budget support mechanisms could have a positive impact on sound financial management by enabling managers of EU funds in Member States to face fewer layers of requirements on process and procedures and to spend more time on implementing programmes and on ensuring the efficiency and effectiveness of support. Using budget support mechanisms may however not necessarily lead to increasing sound financial management. The study showed that ESI Funds already have many elements in place to incentivize sound financial management (e.g. performance frameworks, monitoring and evaluation frameworks, use of clear intervention logics, transparent selection procedures, etc.); and a switch to budget support would lead to an unclear and potentially mixed impact on sound financial management.

A clear finding of the study is that implementing budget support in ESI Funds would lead to increased fiduciary risk and a less detailed assurance on legality and regularity of expenditure, when compared to the current ESI Funds delivery system. The assurance would be based mainly on verifying that conditions for support were met, and underlying spending in Member States would not be fully scrutinized. This would have a strong impact on the European Commissions' possibility to provide detailed assurance on the legality and regularity of the expenditures from the EU budget.

This may not automatically translate into higher de-facto risk of irregularities, but would strongly affect the ability to detect and correct them, e.g. the assurance provided on payments made by the Commission to Member States. Underlying fiduciary risk may be particularly complex to address on issues such as the fight against fraud and respect of EU law. Some rules and requirements, in particular regarding state aid and public procurement, apply to all investments and are not specific to ESI Funds, and the use of national system would not change underlying rules. However, the high error rates still associated with the application of state aid and procurement rules indicate that Member States still face many difficulties in correctly interpreting and applying the rules. Full

reliance on national system may therefore result in overall weaker compliance with these rules. Budget support would require a shift in paradigm, in the sense that it would require setting up new arrangements (i.e. using ex-ante assessments for example, or other systemic checks) to ensure that systems to ensure compliance with law are appropriate.

Simplification and accountability

Trade-offs have also been identified between simplification and accountability, as well as between simplification and sound financial management. Since budget support relies on national budget implementation and control procedures, there would be no parallel or additional management and control system for funding of ESI Funds delivered through budget support. This would be a source of simplification. However, the more simplification is pursued – in particular when programme implementation and control rely on national rules – the more difficult it becomes to ensure high levels of accountability, both results and on legality and regularity. Experience from implementing budget support operations in external actions, shows that budget support intends to enhance accountability within the recipient country (e.g. putting an emphasis on parliamentary scrutiny of expenditure, focusing on transparency requirements, etc.) but that it is more difficult to ensure accountability at the level of the donor. The level of accountability may also be quite variable depending on national procedures and practices in place.

Results orientation and performance frameworks

The ESI Funds system for the 2014-2020 programming period already has a performance framework and well-defined structures to monitor it. Result orientation is reflected in the programming phase in the ESI Funds: the intervention logic is explicit, with performance frameworks including financial, output and result indicators with corresponding targets. The evidence on budget support showed that heterogeneous approaches to result orientation were used, with budget support focusing on policy actions/processes but also a mix of outputs, results and process indicators. It is deemed uncertain whether using budget support elements to deliver ESI Funds would actually improve results orientation.

Support to national, regional and/or local levels

Elements such as the level of administrative and budgetary autonomy at the regional and local level are important when it comes to analysing the possibility to implement budget mechanisms not only at national, but also at regional/local level. There is little experience with - and evidence from - budget support applied at regional or local levels. There may be greater scope to implement budget support at regional/local level in the EU than in the development context since the level of administrative capacities in European regions and territories generally are higher than low and middle-income countries where budget support is currently mostly used. It should also be considered that directly providing budget support at regional or lower levels of government may be politically sensitive, and that it could interfere with national systems of budget transfers already in place.

The partnership principle

The effect of using budget support as a delivery mechanism for ESI Funds on the application of the partnership principle would largely depend on existing set-up in Member States. The risk could be a lower level of involvement of relevant partners in decision-making processes. It concerns in particular regional/local authorities, social or private partners and non-government organisations representing civil society, who are important stakeholders in Cohesion policy overall, and for certain types of intervention such as business support and innovation, small scale local development and social inclusion. Their mobilisation would require specific consideration depending on whether budget support would complement or replace current delivery mechanisms.

Using Elements of Budget Support to deliver ESI Funds

Based on the analysis conducted, in addition to fully-fledged budget support, two further options for implementing budget support mechanisms in ESI Funds have been retained for analysis in the study: Payments based on policy actions and Payment based on outputs and results. Whereas a fully-fledged budget support option could be largely inspired from budget support mechanisms used in external actions, the options of Payments based on policy actions and Payments based on outputs and results would need to be designed specifically for ESI Funds. For each of the two options, main implications at the different stages of the programming cycle are presented.

A common feature of the two options is that they aim to shift the basis of reimbursement from the real cost at the project level towards conditions, e.g. output, results and processes at an aggregated level, for example at the level of the programme or of part of the programme.

Payments based on policy conditions

ESI Funds have already contributed to and will continue to contribute to pursuing structural reforms, improving administrative capacity and the effectiveness of government. Along with strengthening infrastructure endowment, human capital, and endogenous potential, payments based on policy actions is a tool that could be used to pursue the objective of supporting reforms and institution building.

The primary rationale of payments based on policy conditions would be to provide incentives to Member States to commit to certain policy actions/processes rather than to cover their cost. The basis for payments would not be based on outputs (for example number of civil servants trained), but rather be linked to policy actions, procedures or processes being implemented. Programming payments based on policy actions could take as starting point existing diagnostics/ dialogue mechanisms, such as Country Specific Recommendations (CSRs) issued to Member States in the framework of the Semester. Sectoral or sub-national obstacles to effective investments could, in turn, be identified during the programming process of ESI Funds (or, for example, during the process of producing position papers for the Commission).

Disbursement linked conditions (progress indicators) should be clearly defined and mechanisms for verification of progress would need to be established. A key challenge would be to put a price tag on the policy action to be undertaken, with the aim to provide sufficient incentives for Member States while avoiding adverse effects. The monitoring of the implementation of policy actions focus on the implementation of the agreed policy actions and of identified indicators of progress (process indicators). Visibility for EU funding may be difficult to achieve, due to the incentive nature of the support. The need for a communication strategy could be assessed on a case by case basis, depending on the type of policy action being supported, and the level of public interest expected.

Payments based on output and results

Payments based on output/results is a delivery approach in which payments are made for results or outputs (e.g. a fixed amount is paid when a number of children in school has been reached), and in which the recipient (a government entity) usually enjoys high level of autonomy for implementing the funds. In this approach, the focus is on results rather than processes to get there.

Output and results based payment requires well defined intervention logics with clear output and results indicators. There should not be a significant time-lag between the intervention itself and the benefits/change it seeks to realise, e.g. more complex interventions where results take a long time to materialise are less suitable for output and results based payments. It is also essential that the link between the intervention and the benefit/change is clear, e.g. that outputs/results achieved can be reasonably attributed to the activities or actions implemented. In principle, disbursement can be linked to any level of the intervention, from activities (number of trainings produced) to outputs (number of people trained) and results (employment of trained people). Results indicators

are, however, more challenging to define and to use for disbursement, since they often entail time-lags and are prone to influence by external factors. A challenge in this type of approach is to define the “right” disbursement indicators depending on the policy area and type of intervention supported. Visibility could be strengthened if Member States are required to make results of EU funding publicly available.

To implement an output and results-based payment system would likely not require significant changes to the current shared management system. It could be done within the existing ESI Funds architecture, using existing authorities responsible for implementation of programmes and controls. It would however require setting up a solid and robust system for data verification and monitoring, to provide information on progress on disbursement linked indicators. A key issue or challenge would be to define the cost or “price” of a specific output or result, and it would be necessary to develop methodologies and guidelines to that aim. The methodologies currently used to calculate standards scales of unit costs could provide inspiration and relevant lessons learnt.

Assessment of administrative costs of implementing Budget Support elements in ESI Funds

The study has analysed the likely impact in terms of administrative costs of introducing a budget support delivery system in ESI Funds or in implementing budget support elements in ESI Funds (e.g. payments on the basis of policy action and payments on the basis of outputs/results). A full quantitative assessment is not feasible in the context of this study due to the lack of relevant and comparable data on administrative costs and burdens incurred notably in the framework of budget support mechanisms.

Overall, the analysis indicates that the overall impact on administrative cost for both the Commission and Member States would be mixed. Implementing budget support or payments based on policy actions or outputs/results would most likely lead to an increase in administrative costs in the programming phase. In payments based on policy action it would require the Commission and Member States to engage in a potentially complex dialogue to define objectives, progress indicators, disbursement conditions, verification mechanisms etc. on an ad hoc basis and adapted to each context. In payments based on outputs and results, programming would also entail defining disbursement linked indicators, calculation of costs and setting up monitoring and data verification systems.

The main gains for both the Commission and Member States would likely be realised in the implementation and control phase. Part of the ESI Funds management and control system would be replaced by national procedures and processes. This would most likely result in a reduction of the administrative cost of controls and audits. Whether beneficiaries would also experience reduced administrative burden is unclear, since it would largely depend on the level of complexity of Member States (and regional or local) public financial management systems. No gains are expected in terms of reporting, monitoring and evaluation. In payments based on outputs and results system, an increase of the administrative cost would be likely, related to the need to ensure robust and valid data collection and verification mechanisms. In payments for policy action resources and skills for monitoring policy conditions would be required at the level of the Commission.

Conclusions

The analysis conducted showed that fully-fledged budget support (sector or general budget support) is not a delivery mode which is considered adequate to deliver the entirety of ESI Funds. ESI Funds cover a broad range of investment areas with different policy objectives and risks and there is no available evidence that delivering the entirety of ESI Funds via budget support would be more effective and efficient than shared management. This is also evidenced by the fact that all donors using the budget support continue to use other types of delivery mechanisms (project or programme based support). A switch to a fully-fledged budget support would entail significant

trade-offs; while it may bring simplification, it would increase the fiduciary risks and could ultimately carry reputational risks for the Commission and EU funding in general. Finally, there is little experience with using budget support mechanisms at sub-national level, which is where most of ESI Funds are delivered. A switch to budget support for the entirety of ESI Funds may therefore lead to a significant weakening of the regional/local dimension of parts of ESI Funds.

Payments based on outputs and results could constitute a simple and effective delivery mechanism for parts of ESI Funds. By putting the focus on achieved outputs and results, this type of approach holds a potential for simplification and to increase result orientation, in areas where outputs and results can clearly be attributed to the implementation of a specific programme. Hence, payments for outputs/results therefore have more potential in some ESI Funds areas than others, and could be explored in areas such as human capital, social inclusion, energy efficiency, part of innovation and business support. Experience from the use of simplified cost options in ESI Funds should be taken into account when designing concrete delivery options in these fields.

Payments for policy action could be added to the ESI Funds delivery portfolio with a view to increasing ESI Funds' effectiveness in addressing a broad range of structural and administrative challenges. Mechanisms that link disbursements to the implementation of policy actions to be undertaken may be interesting to explore when it comes to supporting structural reforms, tackling sub-national or sectoral bottlenecks, or provide support to soft investments (such as capacity building actions or support to the public administration). The detailed design of each payment based on policy actions scheme would have to be tailored to the Member States in question and the issues they face, which could be a challenge to implement.

RÉSUMÉ EXÉCUTIF

L'objectif global de l'étude était d'évaluer les avantages et les inconvénients d'un éventuel recours à l'appui budgétaire pour l'octroi de parties des Fonds structurels et d'investissement européens et d'évaluer la faisabilité du recours à un mécanisme d'octroi s'appuyant sur l'appui budgétaire pour la mise en œuvre d'une Politique de cohésion. L'étude a eu comme point de départ la littérature existante sur l'appui budgétaire, tel que celui-ci a été mis en œuvre dans les pays tiers, par la Commission européenne et par d'autres bailleurs de fonds multilatéraux et bilatéraux. Les résultats de la revue de la littérature ont été utilisés pour analyser l'éventuelle valeur ajoutée et les probables inconvénients du recours à l'appui budgétaire pour l'octroi des Fonds structurels et d'investissement européens par rapport au système d'octroi existant de gestion partagée. Par le biais de l'analyse, l'étude a identifié des options, notamment des éléments inspirés de l'appui budgétaire, dont la mise en œuvre pourrait être pertinente dans un contexte des Fonds structurels et d'investissement européens. Enfin, elle a évalué les coûts et les avantages probables de la mise en œuvre de ces options.

Il convient d'avoir à l'esprit qu'il est difficile d'aboutir à des avis définitifs sur l'éventuelle valeur ajoutée et les probables inconvénients du recours à l'appui budgétaire par rapport à l'octroi de l'actuelle gestion partagée des Fonds structurels et d'investissement européens en raison du contexte différent dans lequel les instruments sont utilisés (par exemple à l'intérieur de l'Union européenne par opposition à la coopération internationale, la différence des montants déboursés, la priorité régionale des Fonds structurels et d'investissement européens, etc.). De même, l'analyse coût/bénéfice est essentiellement qualitative, basée sur des hypothèses, du fait du manque de données concrètes sur les coûts administratifs de la mise en œuvre de l'appui budgétaire, ce qui complique la réalisation d'une évaluation quantitative saine et exhaustive des coûts et des avantages probables.

Qu'est-ce que l'appui budgétaire ?

Pour les besoins de la présente étude, l'appui budgétaire est défini comme un mécanisme d'octroi qui comprend un transfert de ressources financières vers le budget national d'un pays partenaire et qui sera mis en œuvre conformément aux procédures budgétaires, au système de Gestion des finances publiques (GFP) et au système de passation de marchés publics du pays bénéficiaire. L'octroi de l'appui budgétaire est généralement accompagné d'un dialogue politique entre le bailleur de fonds et le pays partenaire afin de convenir des mesures de politique publique ou des résultats en matière de développement que l'appui budgétaire devrait contribuer à obtenir et généralement aussi du renforcement des capacités et de l'assistance technique. Les paiements sont effectués en fonction des conditions (par opposition aux actions ou aux activités réalisées) - des cadres de performance dont les indicateurs sont liés aux décaissements étant utilisés pour évaluer les progrès et l'atteinte des objectifs convenus dans les programmes d'appui.

Un trait caractéristique de l'appui budgétaire est qu'il comprend à la fois une dimension financière (transfert des fonds à la Trésorerie du pays bénéficiaire) et une dimension incitative par la présence d'incitations financières aux gouvernements pour l'atteinte des objectifs, essentiellement liés à la stabilité macroéconomique, à la Gestion des finances publiques, à la mise en œuvre des réformes et à la prestation des services. Il n'existe pas un seul modèle d'opérations d'appui budgétaire, mais plutôt une variété de types, qui se distinguent en fonction du niveau de ciblage : (c'est-à-dire la façon dont l'appui budgétaire est justifié par rapport à certaines dépenses dans le budget du pays) ; la traçabilité (c'est-à-dire que les fonds peuvent être identifiés dans la rubrique dépenses du budget du pays) ; le type de conditionnalité (c'est-à-dire que l'appui budgétaire est partiellement déterminé par le champ et la nature des conditions à remplir pour les décaissements).

Les multiples combinaisons possibles de ces critères impliquent qu'il n'existe pas de modèle unique d'appui budgétaire mais plutôt une multitude d'approches adaptées au contexte spécifique et aux besoins du bailleur de fonds et des pays partenaires. Pour les besoins de la présente étude, quatre types d'appui budgétaire ont été examinés et sont détaillés dans le rapport :

- **L'Appui budgétaire général (ABG)** vise à appuyer la mise en œuvre d'une stratégie de développement nationale, le dialogue politique, les conditions de décaissement et l'assistance en matière de renforcement des capacités étant centrés sur les objectifs de la politique générale et les priorités budgétaires du pays partenaire.
- **L'Appui budgétaire sectoriel (ABS)** vise à appuyer la mise en œuvre du programme de développement d'un secteur et du dialogue politique au niveau du secteur; les conditions de décaissement et l'assistance en matière de renforcement des capacités portent par conséquent sur les questions politiques spécifiques au secteur et les priorités d'affectation budgétaire. Les instruments ABG et ABS se distinguent essentiellement par la nature des conditions liées à l'aide plutôt que par leurs caractéristiques financières.
- **L'Appui pour l'action politique** vise à appuyer les réformes de politique. Il appuie et lie les décaissements essentiellement aux « actions prioritaires » (c'est-à-dire des indicateurs de réforme/processus) à entreprendre par le gouvernement partenaire (et qui doivent être réalisés pour que les décaissements soient effectués). Il n'y a généralement pas de distinction entre l'appui général et l'appui sectoriel, étant donné que les actions politiques sont généralement transversales par nature, et sont susceptibles d'appuyer des actions prioritaires dans plus d'un secteur. L'Appui aux actions politiques peut être simplement mis en œuvre sous la forme d'un appui budgétaire, c'est à dire en fournissant un soutien financier au budget national du pays partenaire ou en utilisant des modalités financières différentes (par exemple les paiements à des programmes circonscrits ou des suppléments aux programmes existants).
- Les approches **Paiement pour les résultats** constituent un mécanisme d'aide selon lequel les bailleurs de fonds paient pour les résultats ou les réalisations (par exemple un montant fixe pour toucher un certain nombre d'enfants scolarisés ou 200 USD pour chaque enfant qui termine le cycle primaire et prend part à un test normalisé) dans lequel le bénéficiaire (une entité gouvernementale) a une grande responsabilité et jouit d'une grande discrétion dans l'utilisation des fonds.

Même si les résultats varient d'une étude à l'autre, les effets positifs attendus du recours aux modalités d'appui budgétaire sur le dialogue politique, l'alignement, les résultats et les coûts de transaction ont été généralement plus limités que les prévisions de départ. En ce qui concerne le dialogue politique, il existe peu d'éléments tendant à démontrer l'amélioration de l'alignement et de la qualité du dialogue. En termes d'orientation vers les résultats, les opérations d'appui budgétaire sont habituellement liées à un Cadre d'évaluation de la performance (CEP) qui contient non seulement l'impact et les indicateurs de résultats, mais aussi la réalisation, l'activité et les mesures du processus/apport. Elles ne sont par conséquent pas aussi orientées vers les résultats que l'indiquaient les prévisions initiales.

Les approches Paiements pour les résultats, présentent aussi des inconvénients (éventuels « comportements de joueur », concentration du dialogue sur les indicateurs plutôt que sur la performance générale, difficulté à identifier et à négocier les indicateurs, etc.). De manière générale, on estime que les approches d'appui budgétaire ont conduit à une réduction des coûts de transaction par rapport à l'approche projet, mais l'évidence est limitée et les gains facilement compensés par des procédures de monitoring et dévaluation ainsi que des conditions de décaissement excessivement complexes.

L'accent des programmes d'appui budgétaire a été essentiellement mis sur les secteurs sociaux. Même s'il est de plus en plus utilisé dans les secteurs productifs tels que l'énergie ou l'agriculture, l'Appui budgétaire sectoriel est essentiellement concentré dans les secteurs de prestation de

services tels que la santé et l'éducation. Les opérations de Programme pour les résultats portent sur des secteurs légèrement différents, notamment la santé, l'eau et la résilience. La disponibilité et une identification plus facile des réalisations ou des indicateurs de résultats dans des secteurs tels que la santé, l'éducation et l'eau peuvent être considérés comme un facteur à la base du recours à l'appui budgétaire ou aux approches de type Programme pour les Résultats dans ces secteurs.

Certaines caractéristiques du secteur affectent l'efficacité de l'appui budgétaire et les secteurs qui sont plus complexes et qui impliquent différents types de parties prenantes sont généralement considérés comme les moins appropriés pour l'appui budgétaire. L'implication du secteur privé est perçue comme un facteur susceptible de compliquer le recours à l'appui budgétaire. En outre, le mécanisme de l'octroi de l'appui budgétaire est rarement utilisé pour de gros investissements qui comprennent des infrastructures telles que les transports, en raison de la valeur des contrats, du risque de corruption et du risque de réputation qui s'y rapportent.

Il est possible de classer les conditions liées aux programmes d'appui budgétaire selon leur champ et leur nature. Dans le cas de l'Appui budgétaire général, les conditions sont multi-sectorielles par nature, tandis que dans le cas de l'Appui budgétaire sectoriel, la focalisation est plus étroite (secteur ou sous-secteur). Avec le Programme pour les résultats, le champ des conditions se trouve généralement au niveau du sous-secteur ou du programme. En ce qui concerne la nature des conditions, le principal choix consiste à savoir si elles se rapportent essentiellement aux actions de politique publiques et aux réformes à entreprendre ou aux réalisations ou résultats spécifiques à atteindre (ou à un mélange des deux).

L'étude n'a pas trouvé d'exemple d'approche de recours à l'appui budgétaire dans des contextes autres que de « développement » et il a été jusqu'ici essentiellement utilisés dans les pays à faibles revenus ou à revenus intermédiaires. La Direction générale du voisinage et des négociations d'élargissement recourt de plus en plus à l'appui budgétaire dans les pays candidats pour promouvoir les réformes, mais il s'agit d'une évolution récente. Il est encore par conséquent difficile de pleinement évaluer les résultats de ces efforts. Les premières expériences acquises sur le processus et les résultats ont été intégrées dans l'étude.

Quel serait l'impact et les compromis probables du recours à l'appui budgétaire des Fonds structurels et d'investissement européens ?

L'objectif de la présente étude était d'évaluer les avantages et les inconvénients d'une éventuelle utilisation de l'appui budgétaire pour l'octroi de (parties des) Fonds structurels et d'investissement européens et d'évaluer la faisabilité du recours à des mécanismes d'octroi de type appui budgétaire dans le cadre des Fonds structurels et d'investissement européens. Dans l'ensemble, l'étude a conclu qu'il existe peu d'éléments permettant de penser que l'utilisation d'appui budgétaire général ou sectoriel des Fonds structurels et d'investissement européens serait plus efficace ou efficiente que l'actuel système de gestion partagée. Tout changement impliquerait des compromis considérables pour des résultats et des gains incertains comme cela est résumé ci-dessous.

Saine gestion financière et légalité et régularité

L'utilisation des mécanismes d'appui budgétaire pourrait avoir comme conséquence une saine gestion financière en permettant aux gestionnaires des fonds de l'UE dans les Etats membres d'être confrontés à moins d'exigences en matière de processus et de procédures, de consacrer plus de temps à la mise en œuvre des programmes et de veiller à l'efficacité et à l'efficacite de l'appui. Le recours aux mécanismes d'appui budgétaire peut toutefois ne pas nécessairement aboutir à une gestion financière plus saine. L'étude a montré que les Fonds structurels et d'investissement européens disposent déjà de nombreux éléments d'incitation à une saine gestion financière (par exemple les cadres de performance, les cadres de suivi et d'évaluation, l'utilisation d'une logique

d'intervention claire, les procédures de sélection transparentes, etc.) ; et un passage à l'appui budgétaire aurait un impact peu clair et potentiellement mitigé sur la saine gestion financière.

L'un des résultats clairs de l'étude est que la mise en œuvre de l'appui budgétaire des Fonds structurels et d'investissement européens conduirait à une augmentation du risque fiduciaire et à la réduction de la garantie relative à la légalité et à la régularité des dépenses, par rapport au système d'octroi actuel des Fonds structurels et d'investissement européens. La garantie se fonderait essentiellement sur la vérification que les conditions pour l'appui ont été satisfaites et que les dépenses sous-jacentes dans les Etats membres ne seraient pas pleinement examinées. Ceci affecterait sérieusement la capacité de la Commission européenne à fournir une garantie par rapport à la légalité et à la régularité des dépenses du budget de l'UE.

Ceci peut ne pas se traduire automatiquement par un risque d'irrégularités de facto plus grand, mais cela affecterait la capacité à les détecter et à les corriger, par exemple la garantie fournie sur les paiements effectués par la Commission aux Etats membres. Le risque fiduciaire sous-jacent peut être particulièrement complexe à gérer par rapport à des questions telles que la lutte contre la fraude et le respect de la législation de l'UE. Certaines règles et exigences, notamment celles relatives à l'aide de l'Etat et aux marchés publics, s'appliquent à tous les investissements et ne sont pas spécifiques aux Fonds structurels et d'investissement européens et l'utilisation du système national ne changerait pas les règles sous-jacentes. Toutefois, les taux élevés d'erreurs encore associés à l'application de l'aide de l'Etat et les règles de passation de marchés publics indiquent que les Etats membres ont encore beaucoup de difficultés à correctement interpréter et à appliquer les règles. Une dépendance totale au système national peut par conséquent aboutir à une observation plus laxiste de ces règles. L'appui budgétaire nécessiterait un changement de paradigme, en ce sens que cela requerrait la prise de nouvelles dispositions (c'est-à-dire l'utilisation des évaluations ex ante par exemple ou d'autres vérifications systémiques) pour veiller à ce que les systèmes censés garantir la bonne observation de la législation soient appropriés.

Simplification et transparence comptable

Des compromis entre la simplification et la transparence comptable ont aussi été identifiés, ainsi qu'entre la simplification et une saine gestion financière. Etant donné que l'appui budgétaire dépend de l'exécution du budget national et des procédures de contrôle, il n'existerait pas de gestion et de contrôle parallèles et additionnels des Fonds structurels et d'investissement européens octroyés à travers l'appui budgétaire. Ceci serait une source de simplification. Toutefois, plus la simplification est recherchée, notamment lorsque la mise en œuvre du programme et du contrôle dépend des règles nationales, plus il est difficile de veiller à des normes strictes de conformité, à la fois en matière de résultats et sur la légalité et la régularité. L'expérience acquise de la mise en œuvre des opérations d'appui budgétaire dans les actions externes indique que l'appui budgétaire vise à améliorer la transparence comptable dans le pays bénéficiaire (par exemple la mise d'un accent sur le contrôle parlementaire des dépenses, en se concentrant sur les exigences de transparence, etc.) mais il est plus difficile de veiller au respect des normes comptables au niveau du bailleur de fonds. Le niveau de respect des normes comptables peut aussi tout à fait varier en fonction des procédures et des pratiques nationales en vigueur.

Orientation vers les résultats et cadres de performance

Le système des Fonds structurels et d'investissement européens pour la période de programmation 2014-2020 dispose déjà d'un cadre de performance et de structures de suivi bien définies. L'orientation vers les résultats se reflète dans la phase de programmation des Fonds structurels et d'investissement européens : la logique d'intervention est claire, les cadres de performance incluent les aspects financiers, les réalisations et les indicateurs de résultats avec les cibles correspondantes. Les études sur l'appui budgétaire ont montré que des approches hétérogènes concernant l'orientation vers les résultats ont été utilisées, l'appui budgétaire mettant l'accent sur les actions/processus mais aussi sur un ensemble de réalisations, de résultats et d'indicateurs du

processus. Il reste à voir si l'utilisation de certains éléments inspirés de l'appui budgétaire pour l'octroi des Fonds structurels et d'investissement européens améliorerait véritablement l'orientation vers les résultats.

Appui aux niveaux national, régional et/ou local

Les éléments tels que le niveau d'autonomie administrative et budgétaire aux niveaux régional et local sont importants lorsqu'il est question d'analyser la possibilité de mettre en œuvre les mécanismes budgétaires non seulement au niveau national mais aussi au niveau régional/local. Il n'existe que peu d'expérience ainsi que peu d'éléments en matière de mise en œuvre d'appui budgétaire aux niveaux régional ou local. Le potentiel pour la mise en œuvre de l'appui budgétaire au niveau régional/local dans l'UE serait plus grand que dans un contexte de développement étant donné que les capacités administratives dans les régions et les territoires européens sont généralement supérieures à celles dans les pays à faibles revenus ou à revenus intermédiaires où l'appui budgétaire est actuellement majoritairement utilisé. Il convient également de tenir compte du fait que l'octroi direct de l'appui budgétaire au niveau régional ou à une échelle inférieure de gouvernement peut être politiquement sensible et qu'il pourrait avoir des interférences avec les systèmes nationaux de transfert budgétaire déjà en place.

Le principe du partenariat

L'effet du recours à l'appui budgétaire comme mécanisme d'octroi des Fonds structurels et d'investissement européens sur l'application du principe de partenariat dépendrait largement des cadres existants dans les Etats membres. Le risque pourrait être un plus faible niveau d'implication de partenaires pertinents dans les processus de prise de décisions. Cela concerne en particulier les autorités régionales/locales, les partenaires privés ou sociaux et les organisations non gouvernementales qui représentent la société civile et qui sont des parties prenantes importantes dans la politique de Cohésion, et certains types d'intervention tel que le soutien aux entreprises et à l'innovation, le développement local à petite échelle et l'inclusion sociale. Leur mobilisation nécessiterait une considération spécifique selon que l'appui budgétaire compléterait ou remplacerait les mécanismes d'octroi actuels.

Utilisation des éléments inspirés de l'appui budgétaire dans le cadre des Fonds structurels et d'investissement européens

Sur la base de l'analyse effectuée, deux options additionnelles aux appuis budgétaires traditionnels ont été retenues pour la mise en œuvre des mécanismes d'appui budgétaire dans le cadre des Fonds structurels et d'investissement européens : Les paiements basés sur les actions de politique publique et les paiements basés sur les réalisations et les résultats. Alors qu'une option d'appui budgétaire « intégrale » pourrait s'inspirer largement des mécanismes d'appui budgétaire utilisés dans les actions extérieures de l'UE, les options de paiements basés sur les actions de politique publique et de paiements basés sur les réalisations et les résultats devraient être conçues spécialement pour les Fonds structurels et d'investissement européens. Pour chacune des deux options, les principales implications au niveau des différentes étapes du cycle de programmation sont présentées.

Une caractéristique commune aux deux options est qu'elles visent à faire passer la base du remboursement du coût réel au niveau du projet aux conditions, par exemple les réalisations, les résultats et les processus à un niveau cumulé, par exemple au niveau du programme ou d'une partie du programme.

Paiements basés sur les conditions de politique publique

Les Fonds structurels et d'investissement européens ont déjà contribué et continueront de contribuer à la poursuite des réformes structurelles, à l'amélioration des capacités administratives et à l'efficacité du gouvernement. En même temps que l'accroissement du financement aux infrastructures, au capital humain et au potentiel endogène, les paiements basés sur les actions politiques constituent un outil qui pourrait être utilisé pour poursuivre l'objectif d'appui aux réformes et au renforcement des institutions.

La raison d'être fondamentale des paiements basés sur les conditions de politique publique serait de fournir des incitations aux Etats membres pour qu'ils s'engagent à certaines actions politiques/processus plutôt que de couvrir leurs coûts. La base des paiements ne serait pas fondée sur les réalisations (par exemple le nombre de fonctionnaires formés), mais plutôt liée aux actions de politique publique, aux procédures ou aux processus en cours de mise en œuvre. Les paiements de programmation basés sur les actions de politique publique pourraient prendre pour point de départ les mécanismes existants de diagnostic / dialogue, tels que les Recommandations spécifiques pour pays émises à l'intention des Etats membres dans le cadre du Semestre européen. Les obstacles sectoriels ou infranationaux à l'efficacité des investissements pourraient, à leur tour, être identifiés pendant le processus de programmation des Fonds structurels et d'investissement européens (ou par exemple pendant le processus de production des documents d'orientation pour la Commission).

Les conditions liées aux décaissements (indicateurs de progrès) doivent être clairement définies et les mécanismes de vérification des progrès devraient être arrêtés. Un défi majeur serait de mettre une étiquette de prix sur l'action de politique publique à entreprendre dans le but de fournir suffisamment d'incitation aux Etats membres tout en évitant les effets indésirables. Le suivi de la mise en œuvre des actions de politique publique met l'accent sur la mise en œuvre des actions de politique publique convenues et sur les indicateurs de progrès identifiés (indicateurs de processus). La visibilité du financement de l'UE peut être difficile à réaliser en raison de la nature incitative de l'appui. Le besoin d'une stratégie de communication pourrait être évalué au cas par cas, en fonction du type d'action de politique publique appuyée et du niveau d'intérêt que le public lui porte.

Paiements basés sur les réalisations et les résultats

Les paiements basés sur les réalisations /les résultats constituent une approche d'octroi dans laquelle les paiements sont effectués pour les résultats ou les réalisations (par exemple un montant fixe est versé lorsqu'un nombre d'enfants scolarisés a été atteint) et dans lequel le bénéficiaire (une entité gouvernementale) jouit habituellement d'un niveau d'autonomie élevé dans l'utilisation des fonds. Dans cette approche, l'accent est mis sur les résultats plutôt que sur les processus pour atteindre ces résultats.

Le paiement basé sur les réalisations et les résultats nécessite habituellement une logique d'intervention bien définie avec des réalisations et des indicateurs de résultats clairs. Il ne devrait pas exister un très grand décalage dans le temps entre l'intervention elle-même et les avantages/le changement qu'elle cherche à réaliser, par exemple les interventions plus complexes dans lesquelles les résultats mettent du temps à se matérialiser sont moins appropriées pour les paiements basés sur les réalisations et les résultats. Il est aussi essentiel que le lien entre l'intervention et l'avantage/changement soit clair, i.e. il faudrait que les réalisations /résultats atteints puissent être raisonnablement attribués aux activités ou aux actions mises en œuvre. En principe, les décaissements peuvent être liés à tout niveau de l'intervention, des activités (nombre de formations réalisées) aux réalisations (nombre de personnes formées) et aux résultats (emploi pour les personnes formées). Les indicateurs de résultats sont, toutefois, plus difficiles à définir et à utiliser pour les décaissements, étant donné qu'ils impliquent souvent des décalages dans le temps et sont aussi vulnérables à l'influence de facteurs externes. Un défi dans ce type d'approche consiste à définir les indicateurs de décaissement « appropriés » en fonction du domaine de la

politique publique et du type d'intervention appuyés. La visibilité pourrait être renforcée si les Etats membres étaient tenus de rendre publics les résultats du financement de l'UE.

La mise en œuvre d'un système de paiement basé sur les réalisations et les résultats ne nécessiterait pas de changements considérables par rapport à l'actuel système de gestion partagée. Cela pourrait être fait dans les limites de l'architecture existante des Fonds structurels et d'investissement européens, en mettant à contribution les autorités en place responsables de la mise en œuvre des programmes et des contrôles. Cela nécessiterait toutefois la mise en place d'un système solide et rigoureux de vérification et de suivi des données afin de fournir des informations sur les progrès relatifs aux indicateurs liés aux décaissements. Une question ou un défi crucial consisterait à définir le coût ou le « prix » d'une réalisation ou d'un résultat spécifique, et il pourrait être nécessaire d'élaborer des méthodologies et des directives à cette fin. Les méthodologies actuellement utilisées pour calculer les échelles de normes des coûts d'unité pourraient servir de source d'inspiration et d'enseignements.

Estimation des coûts administratifs de la mise en œuvre des éléments inspirés de l'appui budgétaire dans les Fonds structurels et d'investissement européens

L'étude a analysé l'impact probable en termes de coûts administratifs de l'introduction d'un système d'octroi d'appui budgétaire dans les Fonds structurels et d'investissement européens ou de la mise en œuvre d'éléments inspirés de l'appui budgétaire dans les Fonds structurels et d'investissement (par exemple les paiements sur la base de l'action politique et les paiements sur la base des réalisations /résultats). Une analyse quantitative complète n'est pas possible dans le contexte de la présente étude en raison du manque de données pertinentes et comparables sur les coûts et fardeaux administratifs engagés notamment dans le cadre des mécanismes de l'appui budgétaire.

Dans l'ensemble, l'analyse indique que l'impact global sur les coûts administratifs pour la Commission et les Etats membres serait mitigé. La mise en œuvre de l'appui budgétaire ou des paiements basés sur les actions politiques ou les réalisations /résultats aboutirait très probablement à une augmentation des coûts administratifs dans la phase de programmation. Pour les paiements basés sur les actions de politique publique, cela nécessiterait que la Commission et les Etats membres s'engagent dans un dialogue potentiellement complexe pour définir les objectifs, les indicateurs de progrès, les conditions de décaissement, les mécanismes de vérification, etc., sur une base ad hoc et adaptée à chaque contexte. En ce qui concerne les paiements basés sur les réalisations et les résultats, la programmation comprendrait aussi la définition des indicateurs liés aux décaissements, les coûts de calcul et la mise sur pied de systèmes de suivi et de vérification de données.

Les principaux gains pour la Commission et les États-membres seraient probablement réalisés dans la mise en œuvre et la phase de contrôle. Une partie de la gestion des Fonds structurels et d'investissement européens et du système de contrôle serait remplacée par les procédures et les processus nationaux. Une telle démarche aurait très probablement pour résultat une réduction des coûts administratifs des contrôles et des audits. L'on ne sait pas si les bénéficiaires connaîtraient aussi une réduction du fardeau administratif, étant donné que cela dépendrait largement du niveau de complexité des systèmes de gestion des finances publiques locaux/régionaux des États-membres. Il n'est attendu aucun gain en termes de publication d'informations, de suivi et d'évaluation : dans un système des paiements basés sur les réalisations et les résultats, une augmentation des coûts administratifs serait probablement liée à la nécessité de veiller à une collecte de données rigoureuse et valable et des mécanismes de vérification. Dans les paiements pour l'action politique cela nécessitera des ressources et des compétences pour suivre les conditions politiques au niveau de la Commission.

Conclusions

L'analyse effectuée a démontré qu'un appui budgétaire « intégral » (Appui budgétaire général ou sectoriel) n'est pas un mode d'octroi qui est considéré adéquat pour l'utilisation des Fonds structurels et d'investissement européens. Les Fonds structurels et d'investissement européens couvrent un large éventail de secteurs d'investissement comportant des objectifs de politique et de risques différents et il n'existe pas d'évidence que l'octroi de l'intégralité des Fonds structurels et d'investissement européens à travers l'appui budgétaire serait plus efficace et efficient que la gestion partagée. Ce constat se vérifie également par le fait que tous les bailleurs de fonds ayant recouru à l'appui budgétaire continuent habituellement de recourir à d'autres types de mécanismes d'octroi (appui à des projets ou à des programmes). Un passage à un appui budgétaire « intégral » supposerait des compromis considérables. Mais alors qu'il peut entraîner la simplification, il pourrait augmenter les risques fiduciaires et pourrait à terme entraîner un risque de réputation pour la Commission et le financement de l'UE en général. Enfin, l'expérience en matière d'utilisation des mécanismes d'appui budgétaire au niveau infranational est limitée, or c'est à ce niveau que l'essentiel des Fonds structurels et d'investissement européens sont orientés. Un passage à l'appui budgétaire pour l'ensemble des Fonds structurels et d'investissement européens peut par conséquent aboutir à un affaiblissement considérable de la dimension régionale/locale des Fonds structurels et d'investissement européens.

Les paiements pour les réalisations /résultats pourraient constituer un mécanisme simple et efficace de l'octroi de parties des Fonds structurels et d'investissement européens. En mettant l'accent sur les réalisations et sur les résultats, ce type d'approche permet potentiellement une simplification et d'accroître l'orientation vers les résultats, dans les domaines où les réalisations et les résultats peuvent être clairement attribués à la mise en œuvre d'un programme spécifique. Par conséquent, les paiements pour les réalisations /résultats ont plus d'effet dans certains domaines d'utilisation des Fonds structurels et d'investissement européens que dans d'autres et pourraient être testés dans des domaines tels que le capital humain, l'inclusion sociale, l'efficacité énergétique, et en partie dans l'innovation et le soutien aux entreprises. L'expérience acquise de l'utilisation des options simplifiées en matière de coûts des Fonds structurels et d'investissement européens doit être prise en compte lors de la conception des options d'octroi dans ces domaines.

Les paiements pour les actions de politique publique pourraient être ajoutés au portefeuille d'octroi des Fonds structurels et d'investissement européens dans le but d'en augmenter l'efficacité dans la résolution d'un large éventail de difficultés structurelles et administratives. Il peut être intéressant d'examiner les mécanismes qui lient les décaissements à la mise en œuvre des actions de politique publique à entreprendre lorsqu'il s'agit d'appuyer des réformes structurelles, de lever les obstacles infranationaux ou sectoriels ou de fournir un appui aux investissements « légers » (comme les actions en matière de renforcement de capacités ou l'appui à l'administration publique). La conception détaillée de chaque paiement basé sur les actions de politique publique doit être adaptée aux Etats membres en question et aux défis auxquels ils sont confrontés, ce qui peut se révéler difficile à mettre en œuvre.

1. INTRODUCTION

This report constitutes the draft final report of the “Feasibility study for a potential use of Budget Support to deliver ESI Funds”. The overall objective of the study was to assess the advantages and disadvantages of a potential use of budget support for the delivery of parts of the ESI Funds, and to assess the feasibility of a delivery mechanism based on budget support to deliver Cohesion Policy.

For the purposes of this study, budget support is understood as a delivery mechanism which involves a transfer of financial resources to the national budget of a partner country and that will be implemented in accordance with this country's budget procedures, financial management system and public procurement system. This budgetary transfer is accompanied by intense policy dialogue, conditionalities, technical assistance and/or capacity building.

In its nature the **study is explorative**, e.g. it has analysed and assessed if budget support, in theory, could be a relevant instrument to use in delivering the ESI Funds. It needs to be acknowledged that it is innately difficult to provide strong judgements on the value added of using budget support compared to the current shared management delivery of ESI Funds, due to the very different context the instruments operate in.

The current report is a synthesis of interim deliverables produced in the study. It contains the following sections.

- Chapter 1 provides an overview of budget support as an aid modality used in development cooperation, based on an extensive literature review, interviews and case studies.
- Chapter 2 assesses the feasibility of using budget support to deliver ESI Funds, drawing on experiences from development cooperation and relating them to the ESI Funds context, highlighting likely trade-offs and challenges. It concludes with an analysis of the potential value added of using budget support mechanisms in ESI Funds delivery.
- Chapter 3 outlines two options for using budget support mechanisms in ESI Funds, based on the analysis undertaken and applying experiences from budget support operations in the ESI Funds context.
- Chapter 4 provides an assessment of likely changes to administrative costs for involved stakeholders, if budget support mechanisms were to be used to deliver ESI Funds. The assessment is mainly qualitative due to lack of robust and comparable data.

In Appendix to the report, a complete list of literature reviewed in the study can be found.

The study was carried out by a multidisciplinary team, consisting of Karin Attstrom from Ramboll (DK), Jonathan Wolsey and Suzanne Tossings from Ecorys (NL), Silvia Vignetti, Emanuela Sirtori, Julie Pellegrin and Louis Colnot from CSIL (IT).

2. BUDGET SUPPORT AS AN AID MODALITY

This section summarizes some of the key conclusions emanating from the overview of budget support. This section summarizes some of the key findings related to the types of budget support approaches available. The main conclusion in that respect is that while budget support programmes all share common key features (use of country systems, use of performance measurement), there is a variety of budget support approaches which have been implemented. The choice of the approach reflects the preferences of donors, as well as the context and the sectors in which the programmes operate.

2.1 Budget support includes a financial and incentive dimensions

Budget support is a transfer of funds to the budget of a partner country. The OECD-DAC, in what is the most commonly used definition of budget support, defines it as a method of financing a partner country's budget through a transfer of resources from an external financing agency to the partner government's national treasury. The funds thus transferred are managed in accordance with the recipient's budgetary procedures (OECD, 2006)¹. The major budget support providers define the instrument broadly similarly. In its 2017 Budget Support Guidelines² (p.15), the EC specifies that Budget support involves the transfer of financial resources to the National Treasury of a partner country, following the fulfilment by the latter of the agreed conditions for payment set out in the contract. Transfers are made in euros to a Government account held at the Central Bank and then converted into local currency to the National Treasury Account. From those definitions, one can deduce that the defining characteristic of budget support relates to its financial dimension: it is a transfer of additional (foreign exchange) resources to a country and subsequently to that country's treasury.

Budget support has also an incentive dimension. Budget support is however more than a financial transfer of resources. It is also intended – through conditionality and dialogue - to give financial incentives to governments to achieve objectives, mostly related to macroeconomic stability, Public Finance Management (PFM), reform implementation and service provision. In that vein, the provision of budget support is accompanied by a policy dialogue with a partner country to agree on the reforms or development results which budget support can contribute to, and generally also by capacity development/technical assistance. The 2017 EC Budget Support Guidelines make that distinction between the financial and non-financial dimension of budget support rather explicit. In that respect, budget support is often referred to as a package, consisting not only of a financial transfer, but also of policy dialogue, performance assessment and capacity development. The fact that budget support has these multiple dimensions (i.e. transferring additional resources but also giving financial incentives) has often complicated the analysis of budget support.

Different applications and combinations of the financial and incentive dimensions imply that there is a large spectrum of budget support approaches. Donors have applied the financial and incentive dimensions of budget support differently. There is not a single model of budget support operations, but instead a variety of types, which can mostly be differentiated on the basis of the following criteria:

- The level of earmarking: (i.e. the way the provision of budget support is justified against certain expenditures in the country's budget)

¹ OECD (2006). Harmonising Donor Practices for Effective Aid Delivery, DAC Guidelines and Reference Series, OECD 2006

² European Commission (2017). Budget Support Guidelines – DG DEVCO and DG NEAR, Brussels, September 2017

- The traceability (i.e. funds are identifiable in the expenditure classification of the country's budget).
- The type of conditionality (i.e. the nature of budget support is partly determined by the scope and nature of conditions for disbursements).

The multiple ways in which these criteria can be combined mean that there is no one-size fits all budget support but rather a multitude of approaches (discussed in the next section).

2.2 There are not one but multiple types of budget support

The standard distinction is between general and sector budget support. For a long period – until new approaches were developed (see below), budget support has been mostly provided either as General Budget Support (GBS) or as Sector Budget Support (SBS). The OECD specifies that General Budget Support is meant to support the implementation of a national development strategy, with the policy dialogue, disbursement conditions and capacity development assistance focused on the overall policy objectives and budget priorities of the partner country. On the other hand, Sector Budget Support is aimed at supporting the implementation of a sector development programme, with the policy dialogue, disbursement conditions and capacity development assistance thus focused on sector specific policy issues and budget allocation priorities (OECD, 2006). The two instruments are therefore mostly distinguished by the nature of the conditions attached to the aid rather than by their financial characteristics. Reflecting this, some donors, such as the World Bank (WB), do not make an explicit difference between sector and cross-sector/general budget support operations. Box 1 below outlines the main features of general and sector budget support approaches for the EU and the World Bank, the two largest budget support providers.

Box 1: comparing the EC sector and general budget support with the World Bank Development Policy Loans

The **European Commission** provides budget support in a combination of fixed tranches linked to the eligibility criteria, and variable tranches linked to progress in meeting (annual) targets related to outcome or output indicators (health, education, public financial management, etc.). Targets related to policy actions may also be used. Any undisbursed amount is in principle reallocated to other programmes within the same country. The support is conditional upon the country meeting a set of eligibility conditions in macroeconomic policy, PFM and public policy. The support is un-earmarked and provided either as General Budget Support or Sector Budget Support (under the current terminology outlined in the 2017 EC Budget Support Guidelines, General Budget Support could be associated to the EC's Sustainable Development Goals Contracts and its Resilience Building Contracts while Sector Budget Support could be associated to Sector Reform Performance Contracts).

As for the **World Bank**, the main instrument it uses to provide budget support is Development Policy Loans (DPL), which was introduced in 2005. Development Policy Loans are loans (often including a significant grant component) which may be extended either to member countries, or to sub-national governments of members, provided that they have budgetary and legislative autonomy. Development Policy Loans differ from the EC budget support operations in that they support and link disbursements mostly to 'prior actions' (i.e. reform/process indicators) to be undertaken by the partner government (and which have to be achieved in order for disbursements to be made). Also, the distinction between general and sector budget support is not made in Development Policy Loans. Often, they are cross-cutting in nature, as they support prior actions across more than one sector.

"Payment for Results" aid (or cash on delivery) is a more recent type of budget support.

Payment for Results aid, for which Cash on Delivery (COD) aid is the most common type, is an aid delivery approach in which the donors pay for outcomes or outputs (e.g., a fixed amount for reaching a certain number of children in school, or \$200 for each additional child who completes primary school and takes a standardized test), and in which the recipient (a government entity) has full responsibility for and discretion in using funds. The donors in this approach thus take a

'hands-off' stance towards the beneficiary's policies. Cash on delivery funds are sometimes transferred into the budget of a government entity and use country systems; that's why they can be considered as a form of budget support (although they are typically not called as such). Cash on delivery mechanisms may also be implemented without budgetary transfer. Other characteristics of Payment for Results generally include the fact that outcome/output measures or units of progress are verified independently and are disseminated publicly. One challenge for such approaches relates to the need to select well-defined and verifiable tangible indicators – given the difficulties in that respect, the disbursement-linked indicators in Payment for Results programmes consist in most cases of a mix between output/results and process indicators.

The World Bank's Program for Results (PforR) is a good example of Payment for Results aid³. In 2012, the World Bank introduced a new instrument, the Program-for-Results. Program for Results aimed to fill a gap by offering 'programme support', with its two other modalities, Development Policy Financing and Investment Project Financing, addressing respectively policy and project support needs. Program for Results places more direct emphasis on results by making them the basis for disbursement of funds. Under the Program for Results, financing proceeds are disbursed upon the achievement of verified results specified as disbursement-linked indicators. Money is not traced, and the disbursements are not dependent upon or attributable to individual transactions or expenditures. All Program for Results operations set out a results framework that includes defined objectives and indicators that the government can monitor, measure, and report on routinely. For every programme, the World Bank identifies an Implementing Agency, which is in charge of collecting data on indicators, and a Verification Agency which is in charge to verify the satisfactory achievement of results and to report them to the World Bank. Based on this the World Bank authorizes the payment.

Payment for Results aid objectives are partly aligned to the objectives of more traditional forms of budget support, but also represent an alternative to traditional budget support. A key objective of Payment for Results Aid is to support accountability and transparency in development spending: Payment for Results Aid is meant at increasing recipient governments' accountability to their citizens for delivering the services that they need, rather than increasing accountability to donor agencies for implementing a plan that was funded up front. Payment for Results approaches are partly a response to the perceived intrusiveness of traditional budget support approaches. From that perspective, Payment for Results aid proponents have also advocated for the complete removals of eligibility conditions (besides a good measure of progress and a credible way to verify it).

2.3 Results have not been uniform across the different budget support approaches

In traditional approaches, such as General Budget Support, expected positive effects on policy dialogue, alignment, results, and transaction costs have been more limited than initially envisaged. This is the case partly because donors have often been reluctant to take a 'hands-off' approach in the management of these types of operations. Less ambitious and slightly more focused budget support operations, in the form of (often earmarked) Sector Budget Support supporting sector or sub-sector strategies or programmes or more recently Payment for Results interventions, have gained prominence as a result. Table 1 summarises the respective achievements of the different approaches. A category of budget support is presented in the table as "budget support with policy action" to reflect the World Bank's Development Policy Loans approaches as opposed to EC General Budget Support.

³ The UK's Department for International Development (DFID) is also engaging increasingly in COD-related approaches. Recently, it has developed the Results Based Aid (RBA) instrument as an alternative to other forms of financial aid. RBA is only disbursed to governments if pre-agreed outcomes or outputs have been delivered

Table 1: Four approaches to budget support and their respective achievements (synthesis of evidence by authors)

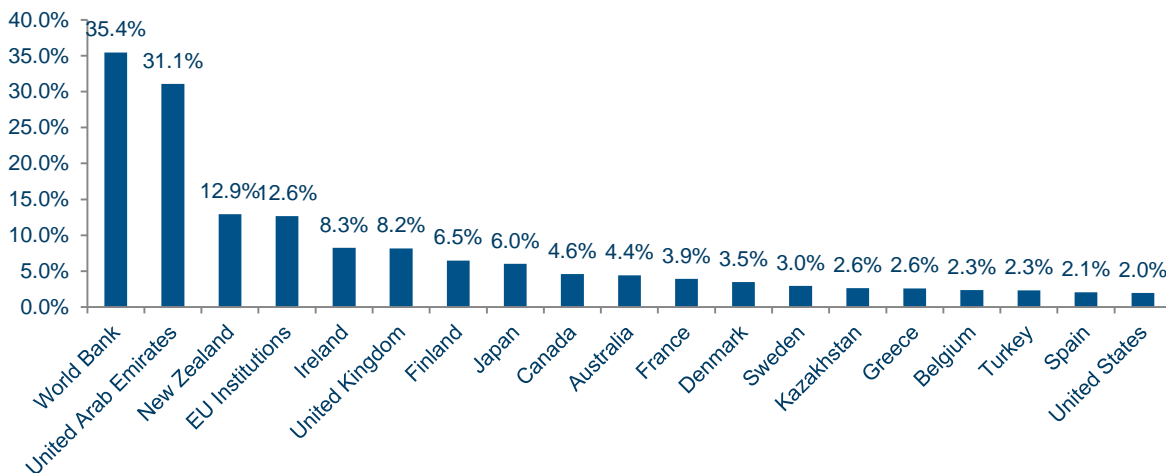
	Aligning to government policies	Enhancing policy dialogue	Enhancing the focus on 'results'	Reducing transaction costs	Strengthened financial management using country systems	The expected broader impacts of budget support	Sector focus	LIC/MIC
General budget support	Effective alignment to national development plans or poverty reduction strategies, although a risk of governments adjusting their policies to donor preferences is present.	GBS has led to a formalization of policy dialogue, but the quality and impact of policy dialogue has generally been mixed.	GBS is usually linked to a Performance Assessment Framework (PAF) that contains indicators, which may constitute a mixture of outcome, output, activity and process/input measures. Such structures often did not exist before.	GBS is perceived to have led to a reduction in transaction costs compared to the project modality, but is likely to have been modest due to quality of harmonisation, excessively complex assessments and disbursement conditions.	An important objective of GBS was that it could enhance domestic accountability and PFM, but this has not been automatic due to weak administrative capacities of countries, and beneficiaries focusing more on being accountable to donors.	Poverty reduction and expansion in service delivery was expected. Impact on poverty reduction limited, but expansion of service delivery one of the main results of GBS.	N/A	Mostly used in Low Income Countries; its use has significantly declined.
Budget support with policy actions	Donor requires prior actions to be achieved, not necessarily fully aligned to government policies	Policy dialogue partly used as a tool to ensure achievement of policy actions; policy changes as a condition for budget support.	Not a focus on outputs or outcomes, but on policy changes (reform/process indicators).	Broadly same conclusion as GBS. Review of policy actions can be relatively transaction-heavy process.	Uses country systems, but this is not the focus of the instrument	Strong focus on building the institutions and legal frameworks, with mixed results. Financial impact on service delivery.	World Bank DPOs focus on mostly on cross-cutting sectors such as public-sector governance and rule of law	Has been used in both LICs and MICs.

	Aligning to government policies	Enhancing policy dialogue	Enhancing the focus on 'results'	Reducing transaction costs	Strengthened financial management using country systems	The expected broader impacts of budget support	Sector focus	LIC/MIC
SBS for sector strategies or programmes	Effective alignment to sector policies, typically SWAPs, although a risk of governments adjusting their policies to donor preferences is present, especially in LICs.	SBS policy dialogue takes place within the framework of government-led SWAPs, but the impact of SBS on that dialogue has been mixed. Quality of dialogue partly dependent on sector expertise of the donors, which has been mixed.	In case of SBS, efforts were made to align SBS performance to the SWAP's monitoring structures and processes, but this was sometimes only partially achieved.	SBS is perceived to have led to a reduction in transaction costs, but is likely to have been modest, similarly to GBS. One factor has been the sometimes lack of alignment between SBS and SWAP structures, as well as the existence of parallel projects.	Extent of use of country systems has varied, with frequent use of earmarking/traceability/additional reporting or auditing requirements. Evidence on progress in financial management mixed.	SBS has helped expand service delivery, but has been less helpful in addressing the issues underlying poor quality of services.	SBS has been predominantly used in service delivery sectors such as health and education, although there has been more focus lately on productive sectors and on institutional reforms.	In MICs, the use of SBS has been predominant compared to GBS.
"Payment for results" approach	Gives recipients more flexibility in policy approach. The approach pays for improved performance.	Policy dialogue is not an explicit part of the approach, although discussions with the recipient do take place during the programming phase. Donors take a more "hands-off" approach.	Strong focus on results. Donors pay for outcomes or outputs (these can sometimes include policy actions), and transfer ownership and responsibilities for strategies to the recipient country.	Potentially low transaction costs for both the donor and the recipient, as there is less need for policy dialogue structures. However, cost of independent verification exercises (for assessment of indicators) can be high.	Disbursement usually through government systems to a specific programme, giving recipients the flexibility in the use of the funds. Approach meant to make recipient governments primarily accountable to own citizens and not to donors.	Objectives limited to performance indicators (related to mostly service delivery) in the programme of intervention.	The World Bank PforRs focus mostly on health, water and resilience programmes.	Used in both MICs and LICs, only limited experience with it until now.

2.4 Differences between donors in their budget support approaches

There are large variations in the extent to which donors use budget support. Figure 1, which shows overall budget support as a percentage of bilateral ODA over the past years (2011-2014), highlights that the World Bank is the largest provider as a percentage of its aid portfolio (more than a third of its total portfolio). The EC is also one of the largest users of budget support, however according to OECD data the total share is only 12.6% of its bilateral ODA (EC data shows of share of around 20% for the same years).⁴ Except for the UAE and New Zealand, other large donors all provide 5% or less of their bilateral ODA through the budget support modality.

Figure 1: Total budget support as % of bilateral ODA disbursed 2011-2014 (OECD database, 2016; WB, 2015b⁵)



Budget support donors combine budget support with other types of delivery mechanisms. All multilateral and bilateral donors studied organise their aid delivery system around a portfolio of instruments – they combine budget support with the use of other modalities, e.g. support for specific projects or programmes. Donor choices of instruments (e.g. between projects, programme support and budget support and between types of budget support approaches) cannot be fully explained, since many factors play a role in donor's decisions. However, some patterns of use can be identified. In general, the choice of modality depends on the objectives to be reached, donor related preferences and domestic accountability issues (this is further discussed in the next section).

There are also differences in the types of budget support approaches used across donor agencies. As discussed at the beginning of this conclusion, there are significant differences between donors in terms of the level and types of budget support approach used, from general budget support operations to small traceable budget support programmes. Not all budget support operations are grants, for example the World Bank uses budget support for disbursement of loans. Between and within donor agencies, there is also a large differentiation in terms of the objectives of their budget support operations and the sectors in which they operate, with some programmes having a strong 'institutional change' dimension and others a more 'service delivery' objective. Meanwhile, most programmes operate at the central government level – subnational budget support remains very uncommon, although there are some examples

⁴ When the OECD refers to EU Institutions in its statistics, it refers to the total amount of funds available to EU institutions, including the EIB.

⁵ World Bank (2015b). "Annual Report 2015". World Bank: Washington, D.C.

2.5 The decision to use budget support reflects multiple factors.

The objectives of the donors partly explain their choice of modality, but aid modality preferences and domestic accountability issues also play an important role. Differences between donors in the use of the instrument partly reflect the different objectives to be reached. The table below matches the type of instruments with the expected objectives. Table 2 also outlines (as further discussed in section 1.4) that the type of instrument can also be influenced by the sector of intervention.

Table 2: Use of different types of budget support according to objectives (synthesis of evidence by authors)

Objectives	Instruments used most commonly	Main thematic sectors concerned
Create specific large-scale physical/social infrastructure necessary for growth	Project support (including via blending facilities)	"Hard" large-scale infrastructures (transport, environnement...)
Support the delivery of a sector programme (focused on sector delivery)	Sector or programme approaches (e.g. SBS, PFR...)	Sectors strategies in areas such as health, education, water.
Support policy and institutional actions	Budget support focusing on policy actions	Structural/administrative reforms
Support for an overall development policy	General budget support	No thematic sector

2.6 Differences in the scope and nature of the conditions for disbursement

Conditions attached to budget support programmes can be classified according to their scope and nature.

For the scope, the main variable is whether conditions relate to the implementation of the overall national budget or to a specific sector or sub-sector. This mostly depends on the type of approach used (general budget support/sector or sub-sector support/programme support). In the case of General Budget Support, the conditions will be multi-sectoral in nature, while in the case of sector budget support, the focus will be more narrow (sector or sub-sector). With Program for Results, the scope of the conditions is generally at the sub-sector or programme level.

Regarding the nature of conditions, the main choice is whether they relate mainly to policy actions/structural reforms to be undertaken or to specific (sector) outputs/outcomes to be reached (or to a mixture of both).

In terms of the nature of conditions, one of the forms of conditions is process or policy action indicators or 'priority actions': this has long been the approach favoured by agencies like the World Bank. The World Bank's Development Policy Loans focus for instance on discrete (prior) actions that are under the direct control of governments, and they generally link disbursements to evidence that those actions have been taken. If those actions are not met, the amount disbursed is reduced (or alternatively, the disbursement awaits the realization of the action). The prior actions for the Energy Efficiency Development Policy Loan in Poland are shown in

Table 3 below.

Table 3: Prior actions in the World Bank's Energy Efficiency Development Policy Loan in Poland (2011)

Policy area	Prior actions
Policy area 1: Developing the legal framework to support the Energy Efficiency Strategy.	- Approval in 2011 of the Energy Efficiency Law
Policy area 2: Decrease Supply-side Energy Use	- Provide incentives to increase the share of cogeneration by allowing co-generators to price their bulk heat up to the average price of heat produced by heat-only boilers.
Policy area 3: Improvements in Demand-Side Energy Efficiency	- Issuance of a draft regulatory statement which covered all the key areas of implementation of Smart Meters - Allocation of PLN 200 million for financing the Thermo-Modernization and Renovation Fund in fiscal year 2011. - Introduction of the Electronic Tolling System (ETS) for heavy vehicles on major national roads section.
Policy area 4: Renewable Energy	- Submission of the government's National Renewable Energy Action Plan (NREAP) to the EC

Another approach in terms of the nature of conditions, which is exemplified by the variable tranche of the EC or DFID's performance tranche, is to have a proportion of the budget support, in the order of 50% over the last few years in the case of the EC, to be disbursed in proportion to the percentage of outcome or output indicators in a Performance Assessment Framework (PAF) or a sector performance framework that have been met. An example of such variable tranche is illustrated in Table 4 (taken from the Employment Creation Programme in South Africa). The narrative used by donors around these performance tranches is one of rewarding good performance although recipient governments may also see it as a sanction. Any undisbursed amount is in principle reallocated to other programmes within the same country.

Finally, it should be noted that the indicators used in result-based aid, including Program for Results, are often relatively similar with the ones used in the EC's variable tranches. Box 2 lists the disbursement-linked indicators in a World Bank Program for Results in Morocco (National Initiative for Human Development Phase 2).

Table 4: Key performance areas and indicators for variable tranches: South Africa – Employment Creation, Sector Policy Support to the Economic Cluster Programme of Action (EC – 2009/14) – Result areas 1 and 2.

Key performance areas/indicators for variable tranches	Baseline (Financial year 2008/09)	Target 2009/10 – 2 nd Variable Tranche	Target 2010/11 – 3 rd Variable Tranche
Result area 1: Creating more quality jobs for the economically marginalised			
Expanded Public Works Programme. Number of work opportunities.	282,000	Annual target 500,000	Annual target 600,000
Increase the number of trained (with diploma) black agricultural entrepreneurs (focus on vulnerable groups) in the agricultural sector by providing a package of support services to prospective farmers.	3000	Annual target 6,500	Annual target 10,000
Increase financial support to retail financial intermediaries for on lending to the enterprising poor. Annual target 2009/10: R25 million	R 21 million	Annual target R 25 million	Annual target R 30 million
Result area 2: Improving business enabling environment			
Industry Forum held annually.	3	Minimum 3	Minimum 3

Key performance areas/indicators for variable tranches	Baseline (Financial year 2008/09)	Target 2009/10 – 2 nd Variable Tranche	Target 2010/11 – 3 rd Variable Tranche
National roll out of the Business Investment Climate Process Including Red Tape Reduction at both provincial and district levels.	0	3 provinces 15 district municipalities	5 provinces 23 district municipalities
Small enterprises accessing quality professional business development and technology services from Small Enterprise Development Agency (SEDA) and other agencies (annual basis).	169,150	200,000	230,000
Trade and Industry Chamber Strategic Sessions – National Economic Development and Labour Council.	2 sessions	Minimum 2 sessions	Minimum 2 sessions

Box 2: Example of Program for Results Disbursement-Linked Indicators: (National Initiative for Human Development (INDH) Phase 2 – Morocco, 2012/16).⁶

DLI-1 (RI-1). Percentage of girls who reside in the educational dormitories (Dar Taliba) graduating to the next grade;

DLI-2 (RI-2). Percentage of the population provided with access to improved water supply in targeted rural communes by the Program;

DLI-3 (RI-3). Percentage of income-generating activities implemented by cooperatives, associations or companies (sociétés de personnes) which are viable two years after having benefited from financing under the Program;

DLI-4 (RI-6). Percentage of infrastructure projects financed under the Program judged by the auditors as conforming to technical specifications, after final commissioning;

DLI-5 (RI-8). #5.1: Percentage of women in the following local governance bodies: CLDH and CPDH; and #5.2: Percentage of youth (18–35 years old) in the following local governance bodies: CLDH and CPDH;

DLI-6 (RI-9). Percentage of projects under the rural and urban subprograms of the Program contracted by local government (communes and Conseil d'Arrondissement), associations, or cooperatives;

DLI-7 (RI-14). Percentage of provinces and prefectorates in the Program Area which have put in place a plan of action to address audit recommendations;

DLI-8 (RI-15). Percentage of priority audit recommendations included in action plans which are implemented; and

DLI-9 (RI-17). #9.1: Preparation of Environmental and Social Guide related to the Program; and #9.2: Percentage of key actors (DAS and local facilitation teams) trained in the use of such guide on environmental and social safeguards.

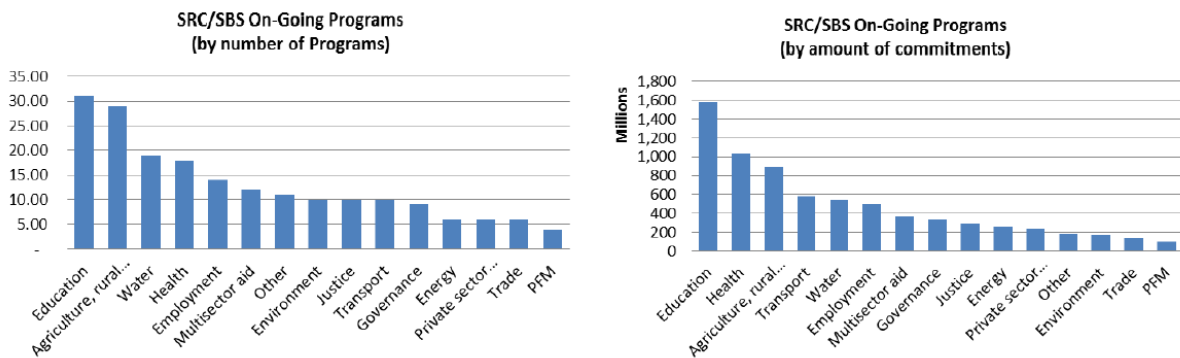
The 'level' of indicator used (i.e. closer to the input or the policy result expected) is partially based on the characteristics of the targeted policy field. It should be noted also that disbursement linked indicators (which would serve as a basis for payment) are not always the same as indicators used to monitor and evaluate the policy.

⁶ For each DLI, a target is established, the achievement of which will determine if the payment is made.

2.7 Sector focus of budget support programmes

The focus of budget support programmes has been primarily on social sectors. Sector Budget Support, although increasingly used in productive sectors such as energy or agriculture, is predominantly concentrated in service delivery sectors such as health and education (see Figure 2 below for composition of EC Sector Budget Support), while the World Bank's DPL tend to be more cross-cutting in nature, focusing mostly on public sector governance and rule of law. Program for Results operations focus more on health, water and resilience programmes. The availability and easier identification of output or outcome indicators in sectors like health, education, and water can be considered as one factor behind the bigger use of Sector Budget Support or Program for Results types of budget support in those sectors.

Figure 2: Sector composition of EC Sector Budget Supports in 2015 (EC, 2015)⁷



Certain sector characteristics affect the effectiveness of budget support. Based on the budget support 'intervention logic', the sector of intervention should not be a critical factor for the effectiveness of a budget support programme. Nevertheless, there are certain characteristics within sectors that can contribute to a higher or lower effectiveness of budget support, both from an incentive and financial impact perspective. A review by the authors of the evaluations of the EC cooperation in various sectors in recent years provides some elements of response in that regard. The main findings can be summarised as below:

- Some sectors are more complex/fragmented than others (i.e. health, transport, agriculture) and/or have an important role for the market (agriculture), making the establishment of a clear sector policy dialogue more challenging, which complicates budget support operations.
- Some sectors (education and health) benefit from significant donor support, making the use of harmonised aid modalities such as budget support more necessary than in other sectors.
- Even in sectors where budget support is seen as more successful (such as education), the impact on the quality of service delivery and institutional reforms is generally considered as relatively modest.
- Some sectors (in particular transport) are seen as particularly vulnerable to PFM and governance issues, due to the presence of high value contracts, making donors more hesitant to use budget support. On the other hand, a sector like transport is relatively (financial) resource-intensive, making budget support an attractive tool to absorb the large amounts of funds allocated in such a sector, as opposed to multiple smaller-sized projects.
- The evaluations provide little information about the financial impact of budget support across sectors.

⁷ European Commission (2015). "Budget Support: Financial Implementation, Risk Assessment, and Selected Poverty, Macroeconomic and Fiscal Results". DG DEVCO.

Budget support is rarely used for large investments alone. As table 2 underscores, this also means that budget support mechanisms are not commonly used to finance large infrastructure. When it comes to investing in "hard" large scale infrastructure, most donors tend to use the project modality. This may be explained by several factors, including: higher reputational risks for the donor on large value investments (large share of the budget, visible projects); risks to legality and regularity, notably around the issue of public procurement; and the fact that large infrastructure projects largely follow the project approach (project pipelines). Budget support, when used in the infrastructure sector, generally supports a well-defined reform agenda in the sector.

2.8 Use of similar instruments in non-development context

The findings and budget support approaches presented in this chapter partly reflect the peculiar (and challenging) contexts and development stages of the countries in which budget support has been used: Low Income Countries (LICs) and Middle-Income Countries (MICs). They also reflect the political realities affecting relations between donor countries and aid recipients. They may differ in other contexts such as EU countries.

Should budget support be transposed into a different context and used for different objectives, some of the characteristics to be applied would differ from those presented above. There are undoubtedly elements of the budget approach that are more suited to a development background and the political context of donor/recipient countries relations, such as the heavy scrutiny on public finance management, than to an OECD country background. The subsequent chapter will assess which of the elements outlined are more/less appropriate in a different context.

The large variety of budget support approaches implemented, as described above, offers some flexibility should budget support be used for ESI Funds. Inevitably, some types of budget support may be more relevant for a context such as ESI Funds than others. Approaches defined as payment by results and to some extent Sector Budget Support supporting sector strategies or programmes attempt to address some of the shortcomings identified in more traditional forms of budget support, in particular the continued heavy interference by donors' in the recipient's policy processes (and the associated transaction costs). They also aim to ensure accountability through rigorous results focus. While yet to be comprehensively tested, the potential of approaches such as payment by results may be higher in OECD contexts such as ESI Funds, where the level of policy ownership is generally stronger and the allowed degree of intrusion of the 'donor' into the recipient's affairs may be more limited than in traditional budget support contexts.

3. BUDGET SUPPORT IN ESI FUNDS: LIKELY IMPACT AND TRADE-OFFS

As described in earlier sections, there are several types of budget support, and no “one size fits all” mechanism exists. When considering the feasibility to use of budget support to deliver ESI Funds, it is important to keep in mind certain features which are fundamentally different in the EU versus development context.

- The amounts of support disbursed through ESI Funds are considerably larger than any current budget support operation. As an example, the total payments made by DEVCO in year 2016 was EUR 6,579 million⁸ and by DG NEAR EUR 3,077 million⁹, a total of 9,656 million, out of which EUR 1,729¹⁰ million was budget support (18% of total payments). Total payments made by DG REGIO in 2016 was EUR 29,004 million¹¹ and by DG EMPL EUR 8,795 million¹², giving a total of EUR 37,799 million, e.g. the payments made from ERDF and ESF combined in 2016 were nearly four times what was being disbursed to support third countries, all modalities combined.
- EU Cohesion policy is mainly delivered at the regional level, whereas most budget support has been delivered at national levels. The implications of delivering budget support at the sub-national level are not fully understood, and there is little experience to draw on from international cooperation. This makes it difficult to assess the feasibility of using budget support to deliver Cohesion policy.
- The EU is a political and economic Union, based on a Treaty defining the role and relations between the Union and Member States. The EU budget is partly funded through contributions from the Member States. In development cooperation, most funding are grants, with no prior contribution from the recipient country (albeit co-funding mechanisms exists). Hence, the relationship between the European Commission and Member States is very different from the relation between donors and recipient countries, both from a financial and political perspective.

In the following sections the feasibility of using budget support in ESI Funds is being discussed. The review showed that studies and evaluations of budget support operations have not provided conclusive evidence on several of the expected benefits of using budget support (see Table 2). While there are some indications that it has contributed to strengthen the focus on results and reduced transaction costs, other expected benefits such as enhanced policy dialogue and alignment with government policies appear more difficult to verify.

The analysis aims to highlight the trade-offs which would be inherent if budget support were to be used to deliver ESI Funds. Certain aspects or features of the funding may be strengthened, and others are likely to be significantly weakened, compared to the current shared management delivery system in place. Due to the nature of the instrument, budget support would inevitably lead to less control and assurance on legality and regularity of the spending.

3.1 Sound financial management and assurance on legality and regularity

Likely impacts of using budget support on assurance on legality and regularity

A clear finding of the study is that implementing budget support in ESI Funds would lead to increased fiduciary risk and a less detailed assurance on legality and regularity of expenditure, when compared to the current ESI Funds delivery system. The assurance would be based mainly on verifying that conditions for support were met, and underlying spending in Member States would not be fully scrutinized. This would have a strong impact on the European Commissions’ possibility to provide detailed assurance on

⁸ https://ec.europa.eu/info/publications/annual-activity-report-2016-international-cooperation-and-development_en

⁹ https://ec.europa.eu/info/publications/annual-activity-report-2016-neighbourhood-and-enlargement-negotiations_en

¹⁰ https://ec.europa.eu/europeaid/budget-support-trends-and-results-2017_en

¹¹ https://ec.europa.eu/info/publications/annual-activity-report-2016-regional-and-urban-policy_en

¹² https://ec.europa.eu/info/publications/annual-activity-report-2016-employment-social-affairs-and-inclusion_en

the legality and regularity of the expenditures from the EU budget. This may not automatically translate into higher de-facto risk of irregularities but would strongly affect the ability to detect and correct them, e.g. the assurance provided on payments made by the Commission to Member States. Underlying fiduciary risk on issues may be particularly complex to address on issues such as the fight against fraud and respect of EU law. Some rules and requirements, in particular those regarding state aid and public procurement, apply to all investments and are not specific to ESI Funds, so that the use of national system would not change underlying rules. However, the high error rates still associated with the application of state aid and procurement rules indicate that Member States still face many difficulties in correctly interpreting and applying the rules. Full reliance on national system may therefore result in overall weaker compliance with these rules.

The European Commission has set up a wide range of control mechanisms and tools contributing to a high level of assurance of the legality and regularity of expenditures funded by ESI Funds. According to Article 59(2) of the Financial Regulation applicable to the EU general budget (966/2012), Member States shall take all necessary measures, including legislative, regulatory and administrative, to protect the EU's financial interests, namely by preventing, detecting and also correcting irregularities and fraud. The ESI Funds multi-level management system, based on strong internal control and full traceability of expenditure, is designed to ensure that all the relevant rules are complied with.

In the current system, the Commission provides assurances on legality and regularity to budgetary authorities, by systematically examining the available control results and indicators from different sources, including the results of its own audits and communicated audits from programme audit authorities, as well as the observations and recommendations issued by internal auditors, the European Court of Auditors and OLAF. These elements are assessed to determine their impact on the management's assurance on legality and regularity.

Results are examined per Operational Programme and a common denominator is traceability and control of individual operations and expenditures as means to obtain assurance, through management verifications, on-the-spot controls and audits. In the current system, financial corrections can be imposed if ESI funds are affected by an error, irregularity or fraud. The origin and scope of errors can be identified and ascertained by auditing the relevant expenditure, thanks to full traceability of EU funds. Through these mechanisms corrective capacity is ensured.

All in all, the current system enables the Commission to prevent and detect irregularities and carry out financial corrections, if necessary, thus providing a high level of assurance on legality and regularity on the underlying transaction at the expenditure level to the budgetary authorities.

In a budget support delivery of ESI Funds investments, the focus of the assurance mechanisms would be transferred from the level of individual transactions to the conditions for payment. The assurance would be based on controlling that conditions are met, i.e. control of regularity and legality of payments would concern the payment from the EC to Member States, and not the subsequent spending in Member States of the EU budget.

If ESI Funds were fully delivered according to Member States' procedures, the management and control system would no longer be based on full traceability of EU funding at the most detailed level of implementation. Instead, the fiduciary risk would have to be assessed, possibly based on ex-ante assessment focusing on issues such as budget reliability, transparency of public finance, management of assets and liabilities, policy-based fiscal strategy and budgeting, predictability and budget execution, procurement, accounting and reporting (e.g. quality and timeliness of budget reports and annual financial statements), as well as the robustness and quality of the statistical system. In PforR approaches, it is the programme itself that is being assessed, e.g. the involved institutions and the delivery mechanisms, monitoring arrangements etc.

Since the assurance mechanisms would shift their focus from the level of operations to the level of aggregated conditions for payment, the Commission would not be able to control and provide assurance on individual operations and expenditures. The assurance would be provided through risk management on the underlying PFM system and the conditions being met, whether it is conditions in terms of achieving tangible targets, or more intangible conditions related to processes and reforms. Systematic and detailed first level checks at operation level (verification by Managing Authorities) would not be applicable anymore and instead national procedures would be used.

The EU funds would not be traceable in the national/regional budgets and an audit trail as comprehensive and detailed as in the current ESI Funds framework would be impossible to implement. This would make checks on legality and regularity of expenditure at the level of operations funded by ESI Funds, such as expenditures, eligibility criteria, horizontal objectives and compliance with public procurement and states aid rules, impossible. National audits would still take place but would normally cover overall public expenditure (i.e. not EU funds specifically) and it would be impossible to identify errors or irregularities related specifically to the EU budget.

As the literature review showed, there are certain types of budget support which can provide some level of traceability. In sector budget support, it is possible to consider stronger traceability by allocating EU funds to specific budget lines, which can subsequently be subjected to audit and verifications of expenditures as disbursement conditions for the budget support funding. However, integrating earmarking and traceability into budget support programmes has proven heavy to implement due to the very cumbersome procedures involved.

Cash on Delivery, such as Program for Results (PforR) by the World Bank, is another modality of the budget support family which allows for some traceability. Since payments are made based on achievements of agreed results and targets, it provides assurance that funds have been spent on targeted activities or expenditures, which can be considered a form of earmarking. However, PforR modalities do generally not require a full audit-trail of expenditures or impose controls on how results were achieved (for example control of eligibility of expenditure, state aid and procurement), as this is the responsibility of the beneficiary. Ex-ante assessments are carried out (as in other budget support modalities) mainly to assess the overall eligibility criteria and fiduciary risk, combined with regular monitoring of risks (national audits, reports, external assessments) during implementation. The focus of the control mechanisms is generally on verification of indicators reported, and not on the expenditures incurred.

In principle, it could be feasible to implement budget support in ESI Funds with strong safeguards and traceability, for example by requiring separate accounts which enable audit of expenditures funded from the EU budget.

Even if mechanisms for traceability and earmarking were introduced, they could still not provide the same level of assurance on expenditure as in the current system. Traceability mechanisms have been adopted in some circumstances to keep more control on how donor's resources are used. They included the following steps:

- the identification, jointly with the partner government, of the budget lines to be targeted;
- the verification of spending against these agreed budget lines through a formal financial and procedural audit of expenditure data and supporting documentation necessary for the auditor to give an opinion on the amount of targeted budget support to be provided;
- disbursement of budget support using the conclusions of the audit as the justification for making the budget support payment.

However, such additional control mechanisms would clearly contradict the rationale for using budget support, namely to increase ownership, simplification and flexibility. Evidence from the literature review shows that the practice of financial and procedural audit of expenditure has been discontinued in the budget support context. Such audits were conducted for example as part of the EC traceable budget support approach used up to 2007. As reported by Schmidt (2005), traceable and earmarked budget

support was extremely cumbersome for both the donor and the partner countries (while also detrimental to domestic accountability), and for this reason abandoned.

It is not possible to assess whether some traceability of ESI Funds delivered through budget support would be more or less effective and efficient than the current ESI Funds system of shared management. However, it is clear that introducing traceability mechanisms in budget support would imply additional reporting and audit requirements which, in turn, would partly offset any advantage in terms of simplification achieved with a budget support delivery system.

To conclude, to deliver ESI Funds through a budget support modality would lead to significantly reduced possibility for the Commission to provide assurance on the legality and regularity of expenditures. The monitoring of sound financial management, legality and regularity would have to be provided through national financial management systems and procedures. The Commission would primarily get information on the functioning of national/regional/sectoral public financial management procedures, through fiduciary risk assessments and possibly ex-ante conditionalities/eligibility criteria for support. In a results-based payment system, some ex-post assurance would be provided through disbursements linked to achievements, thereby reducing the risk of inefficient spending, since only the actual results produced would be reimbursed.

With this conclusion, it is important to underline that a less assurance on expenditures does not necessarily result in higher fiduciary risks. Less detailed assurance means that the Commission would have fewer guarantees due to structural changes in the delivery system, especially regarding control and correction mechanisms. This does not automatically translate into higher de-facto risk of irregularities but will strongly affect the ability to detect and correct them, i.e. the assurance provided on payments. A number of trade-offs exist in relation to this, as outlined and further discussed below.

Likely impacts of using budget support on sound financial management

One rationale for using budget support in development cooperation was to bring about gains in efficiency and possibly lead to more effective spending. Moving away from a focus on inputs and processes was intended to leave more space available for managers to focus on sound financial management issues, rather than procedures. Along the same lines, the rationale for using "results-oriented" approaches was to increase the accountability for results, rather than processes. In addition, fungibility and higher flexibility of expenditures aimed at ensuring an effective use of resources at the level of the overall budget (rather than at the level of individual spending programmes or projects). Finally, one main feature of budget support systems is the dialogue on policies and public financial management. This dialogue usually takes place at high level (strategic orientations) and is expected to foster sound financial management.

It is difficult to say to what extent budget support mechanisms in ESI Funds would have an impact on sound financial management.

On the one hand, budget support mechanisms could have a positive impact on sound financial management by enabling managers of EU funds in Member States to spend more time on implementing programmes and on ensuring the efficiency and effectiveness of support. If fungibility is possible, it may also give Member States more flexibility in making strategic use of different financing sources. For example, when the same area of investment is funded by several sources (several national funding sources and ESI Funds/other EU funds), fungibility and higher flexibility of expenditure could possibly lead to synergies.

On the other hand, fungibility increases the risk of funds being used to pay for recurrent expenditure or to flow to budgetary areas which do not fall within the scope of EU priorities. At the same time, priority setting and budgetary procedures in Member States can already be considered solid (compared to developing countries), and overall effectiveness of spending could be improved.

In a budget support delivery system, elements which are currently in place to foster sound financial management in ESI Funds at the level of the programme and individual operations would also disappear: these include, for example, the existence of monitoring committees involving all relevant partners, provisions related to selection criteria and procedures to select individual operations, which will benefit from EU support, and requirements to have detailed performance frameworks linked to programmes.

To conclude, a switch to budget support in ESI Funds would entail a trade-off between assurance on legality and regularity and sound financial management. Whereas the use of budget support would have a negative impact on the capacity of the Commission to deliver assurance on legality and regularity of expenditure, it may contribute to freeing more space for policy dialogue and accountability on results. Yet, the scope of potential gains in terms of sound financial management are difficult to assess, since ESI Funds in shared management also foresee a number of mechanisms to ensure sound financial management, notably at the level of individual programmes and projects, which would disappear with a change of system.

3.2 Simplification and accountability

Potential for simplification in ESI Funds

Reaching high levels of accountability, both in terms of results and on legality and regularity inevitably leads to some degree of complexity. The number of layers of control installed may also generate errors due to different interpretation or understanding of rules.

The management of ESI Funds is generally perceived by beneficiaries and programme implementing bodies as quite complex. Some recent literature considers that the situation has worsened over the last programming periods, with additional regulatory requirements being added (EPRC, 2016). This situation entails the risk that potential beneficiaries are dissuaded from applying for funding from ESI Funds, which may have an impact on the attractiveness of ESI Funds and their expected contribution to the Treaty and Europe 2020 objectives. In this context, the need for simplification is one of the main challenges for the 2014-2020 programming period and beyond. The aim is to reduce the ESI Funds administrative costs and burden at all levels, and in particular for Managing Authorities and beneficiaries.

The EC has adopted several measures to simplify ESI Funds management. Various reforms were already introduced in the past years with a view to simplify different elements of the shared-management system and reduce the associated administrative burden. Examples of key changes that have been introduced in the current programming period are the following:

- Harmonization of the rules of the different Funds,
- Making reporting duties lighter,
- Clarification of eligibility and reimbursement rules and introduction of simplified cost options,
- Promotion of e-Cohesion initiatives,
- Strengthening of the proportionality principles in various cases, for instance by reducing the audit and control over small scale operations.

Nevertheless, there is widespread consensus that simplification remains a critical issue and that there is scope for a more radical simplification.

One advantage of using the budget support in delivering funding from ESI Funds is assumed to be simplification of financial management and control in the implementation phase. Since budget support relies on national budget implementation and control procedures, there would be no specific management and control system for ESI Funds delivered through budget support. Issues linked with the potential duplication of procedures and rules would be removed. Other simplification areas could relate to the arrangements to ensure transparency concerning beneficiaries and individual operations (and associated communications and visibility duties), as well as selection arrangements, including eligibility conditions.

Monitoring and reporting duties would largely remain unchanged (especially in the case of PforR), and even, in some cases be increased. Depending on domestic practices and on requirements spelled out in the budget support agreement, the monitoring system may be less or more complex than the one currently in place. In any case, monitoring of financial indicators would no longer take place. Indicators would concentrate on key implementation steps, outputs, outcomes and possibly processes or policy actions. To some extent, policy dialogue could address the monitoring and reporting duties, for example by identifying areas for improvement in terms of selection procedures, monitoring, or transparency, without the detailed levels of requirements and complex procedures as in the current delivery system. This could bring about a significant reduction of transaction costs from the perspective of final beneficiaries.

All in all, the simplification potential would very much depend on national rules; with the highest simplification potential in Member States where national control and audit procedures require fewer resources. The size of simplification advantages would also depend on the share of ESI Funds, which is delivered through budget support.

As the evidence from the literature review shows, gains from simplifications of the delivery system of ESI Funds through budget support mechanisms could take different forms:

- Absorption may be increased at the start of the programming period, since budget support mechanisms usually have lower start-up costs than projects (this has also been observed in the ODA context, where budget support allowed major donors to respond to absorption pressures during the period 2000-2010);
- Legal certainty may partially increase, by reducing complexity associated with the need to apply a range of regulations, delegated and implementing acts and guidelines at EU level, thereby reducing the risk of divergent interpretations from different governance levels;
- Potential reduction of the error rate, thanks to the possibility to apply national rules, thus reducing the risk of misinterpretation, which is one of the main reasons for irregularities (European Court of Auditor 2014, 2015a);
- Potentially stronger focus on results, by cutting the administrative time and costs of fund management and control and concentrate efforts to achieve milestones and results agreed ex-ante with the Commission.

Finally, from the point of view of the donor, i.e. in the ESI Funds case, the European Commission level, it is difficult to say whether the introduction of budget support would lead to simplification or not. There is only limited evidence from the development context showing that budget support mechanisms entail lower transaction costs. The literature review indicates that donors tend to bear lower administrative and financial costs to implement budget support activities per unit of aid disbursed compared to project-based approaches. However, the reduction of transaction costs obtained by using budget support is considered modest. It is also uneven, depending on the policy area and the type of budget support adopted. The use of traceability arrangements in sector budget support, for example, negatively influences the reduction in transaction costs. It is also to be noted that in the development context, no equivalent of "shared management" exists, where duties and responsibilities are shared between two levels according to rules specifically designed for that purpose.

Trade-off between simplification and accountability

Trade-offs exist between simplification and accountability, as well as between simplification and sound financial management. The more simplification is pursued – in particular when programme implementation and control fully follow national rules – the more difficult it becomes to ensure high levels of accountability, both on legality and regularity, and on results. In a budget support delivery system, irregular expenses at the level of individual operations would be difficult to identify and impossible to recover. In the same vein, ineligible operations (e.g. which do not fall within the priorities of the programme) would not be identified.

There are also limits to the extent to which budget support could contribute to ESI Funds simplification. Some EU rules, particularly those regarding state aid and public procurement, apply to all investments and are not specific to ESI Funds. These rules would have to be complied with in any case (e.g. directives are transposed into national law), but the level of check and control on the actual compliance with these rules at the level of individual projects would depend on national systems. The high error rate associated with the application of state aid and procurement rules indicates that Member States still face many difficulties in correctly interpreting and applying the rules. Budget support would require a shift in paradigm, in the sense that it would require relying on existing arrangements to ensure compliance as there would not be dedicated controls set-up in the framework of an ESI Funds delivery system.

Another limit is that simplification obtained through budget support in terms of management and control may be partially offset by more intense exchanges at strategic levels. The literature review and interviews carried out highlighted that the reduction in transaction cost observed when aid is delivered through budget support is usually more limited than expected by donors and recipient governments. One reason relates to the higher focus on strategic priority, target setting and policy dialogue. This puts a burden on recipient's administrations (in development cooperation usually line ministries and ministries of Finance), which off-set the gains derived from a simpler implementation system. In addition, according to the literature review, the nature of transaction costs also changes with budget support. As greater attention is dedicated to policy rather than programme management tasks, it requires a different skill set, both at the level of the donor and the level of the recipient, but not necessarily less staff.

Finally, the parallel existence of different delivery systems also has a cost. If budget support mechanisms would coexist with shared management, simplification may be reduced. The actual level of simplification would also depend on the amount of ESI Funds channelled via budget support.

3.3 Focusing on inputs, outputs, results and/or policy actions

One of the expectations behind the use budget support mechanisms is to increase the performance orientation of a policy. Spending programmes which involve a high number of rules to be complied with face the risk that "compliance" becomes the objective rather than actually reaching results and meeting the programmes' targets. As highlighted for instance by the European Court of Audit (2014), "because there is so much emphasis on spending the EU budget ('the input orientated approach'), those managing the activities and projects often focus on compliance with the conditions for getting and using the money, regardless of the results achieved". By contrast, it is therefore expected that less rules would leave more time to focus on achieving results.

There are no clear-cut differences between result frameworks across types of budget support approaches, although some tend to put more emphasis on policy actions (reforms achieved, processes), and some more on outputs or outcomes (PfR or sector budget support), even if PfoR approaches and sector budget support may also use process/reform related indicators in their performance frameworks. Evidence from the literature review suggests that result frameworks in budget support vary and that this partly reflects differences in the policy objectives pursued by the different types of contracts. The evidence also showed that for similar types of instruments there was a heterogeneity in the type of result approaches used. For example, general budget support result frameworks often include a mix of outcome, output, activity and process/input indicators. They also tend to cover various sectors within the development strategy. In budget support for policy action, which is linked to the implementation of structural/institutional reforms, the result framework exclusively or almost exclusively focuses on policy changes in terms of reforms or processes. Both general budget support and budget support for policy action may include in their result framework indicators related to macroeconomic and budget management, to PFM system and public-sector governance. Sector budget support result frameworks tend to be aligned to the result frameworks of the underlying sector strategy and include more often outcome indicators related to the use of sector public goods. In PfoR the result framework is usually centred on the definition of programme outputs and

outcomes related to service delivery on which the recipient country has full ownership and responsibility, even if "results" indicators in PforR programmes very often also entail process or reform related indicators.

ESI Funds programmes already have performance frameworks, with limited scope for improvements through a budget support approach. The ESI Funds system for the 2014-2020 programming period has a performance framework and well-defined structures to monitor it. Result orientation is reflected in the programming phase in the ESI Funds: the intervention logic is explicit, with performance frameworks including financial, output and result indicators with corresponding targets. This was less the case in the 2007-2013 programming period, a point which was highlighted in the recent ex-post evaluation of ERDF and CF (EC, 2016). While results orientation has been addressed in a more systematic way in the new regulatory framework 2014-2020, the performance framework indicators are currently not linked to disbursement of funds, which mostly occur based on real cost or simplified costs (except for the performance reserve). Switching to a budget support approach would therefore probably provide little value added in terms of setting up and monitoring performance frameworks, but the policy dialogue may put more emphasis on results achieved and it would link payments from the Commission to Member States to the achievement of these indicators.

Although efforts have been made by donors to establish and monitor result indicators, this remains a difficult exercise. Even in cases of contracts with a strong focus on "results", such as the World Bank PforR, "result" indicators are usually a mix of process/output and outcome indicators. Using result indicators to assess programme effectiveness is adequate where intervention logics are clear, where there is little time-lag between the input and the production of the result, and where external factors do not influence the results too much.

A switch to budget support in ESI Funds may also require reducing the number of indicators to be agreed upon and reported (otherwise the administrative burden may increase in a disproportionate manner). From the perspective of the EC, this may imply a more strategic form of performance orientation building on reinforced policy dialogue with the MS, but it could also entail a risk that policy dialogue becomes focused on indicators linked to disbursement, thereby losing track of the bigger policy picture.

3.4 Support to national, regional and/or local levels and the partnership principle

The literature review shows that there is little experience with - and evidence from - budget support applied at regional or local levels. Decentralised budget support has been implemented in a small number of cases to support place-based development policies, where the participation of decentralised/local authorities in delivering services at regional/local level has been given more attention during the last few years.

In the development context, budget support has often been provided to central governments because central governments usually have higher administrative capacity and enjoy budgetary and administrative autonomy. The preference of donors to have national governments as counterparts in budget support policy dialogue and implementation is often also linked to concerns about fiduciary risks at decentralised level and capacity to monitor implementation. Finally, it is also in part due to the nature of the objective of the policies concerned (or the type of reforms that are supported).

There is probably greater scope to implement budget support at regional/local level in the EU than in the development context since the level of administrative capacities in European regions and territories is higher. However, given the more limited experience in implementing budget support at regional and local levels, efforts would need to be made to design mechanisms and tools tailored to a regional/local approach. It should also be considered that directly providing budget support at regional or lower levels of government may be politically sensitive as it could interfere with national systems of budget transfers already in place.

The possibility to implement budget support at regional/local level in the ESI Funds context would depend on the level of regional administrative and budgetary autonomy. It may be more difficult, if not impossible to provide direct financial transfers to regional/local budgets if no or only partial budgetary and legislative autonomy exists in some territories. The feasibility for regional/local level support would also depend on the type of budget support concerned. For example, PforR approaches could be adopted at regional/local level even in the absence of budgetary autonomy by using a programme approach under the responsibility of regional/local authorities. By concentrating payment when outputs and/or results materialise, PforR approaches can be very flexible in adapting to local conditions of governance. On the contrary, general budget support and budget support for policy actions appear to be better suited to the national level due to the scope of the policy areas covered. Sector budget support might be delivered at regional level, but is likely to require high administrative and budgetary autonomy in the sector concerned.

There is a high degree of heterogeneity throughout Member States and regions as far as administrative and budgetary autonomy is concerned. As described in European Commission (2010c):

- a) Federal States (Germany, Austria and Belgium) are characterised by a central government and regional authorities with own legislative and administrative competences respectively;
- b) Countries such as Italy and Spain can be considered regionalised. They have established an intermediate level of government with a wide set of competences (including RDI support, health protection, civil protection, large scales transport infrastructures) and enjoy financial autonomy as regards revenues and expenditures.
- c) Scandinavian countries (Sweden, Finland and Denmark) are unitary countries where local governments have a wide range of responsibilities in relation to regional development. Sub-national governments in these countries enjoy a significant degree of fiscal autonomy.
- d) Unitary States, where the central government is predominant, can be found among both the EU15 (France, Portugal, the UK, Greece, Ireland, The Netherlands and Luxembourg) and the EU12 (Czech Republic, Hungary, Poland, Bulgaria, Cyprus, Estonia, Latvia, Lithuania, Malta, Romania, Slovakia and Slovenia). At the sub-national level there may be administrative self-governance, or not. Still, in this category of countries, some regional authorities have a key role in programming, project selection and implementation of ESI Funds programmes (France, Portugal and Poland for example).

Sub-national governments play an important role in relation to capital expenditure particularly in federal and regionalised states where more than two third of total capital investment are undertaken at the sub-national level.

The feasibility of using budget support to deliver ESI Funds at regional level in the ESI Funds context also depends on the type of policies or reforms concerned. The key condition would be to focus on policy areas where regions have corresponding competence to justify policy dialogue with regional government authorities, and for which expected results are under the region's influence. This would differ from Member State to Member State. Statistics on capital formation disaggregated by economic function show that sub-national governments on average carry out expenditure especially on economic affairs (including transport, telecommunications, agriculture and fishing, energy, and industry), housing and community amenities, education and recreation and culture (European Commission, 2010c). Sector budget support may be better suited in these sectors in order to support regional sector strategies, contributing to sector reforms or deliver local public services. PforR could also be suitable for local public service delivery (e.g. local public transport, or health), SME development strategy and endogenous local development plans, provided clear output indicators can be defined and regional authorities can be held accountable for results.

While existing budget support approaches involve partnership between mainly a donor and the national government, ESI Funds delivery partnership has a much wider and deeper meaning. In the ESI Funds context, in addition to regional and national public authorities, other EU, national and subnational actors

are involved in the design, implementation, monitoring and evaluation of programmes, including economic and social partners and non-government organisations representing civil society. Consultation, participation and dialogue with partners aim to enhance commitment, broader expertise, greater transparency and improved efficiency of the policy delivery process. Member States are currently obliged to organise a partnership at all the levels (Art. 5 Reg. 1303/2013). Partnership principles and criteria must be included in the Partnership Agreement and are subject to the Commission decision of approval.

In budget support, donors welcome the involvement of stakeholders in the decision and implementation process. Although sometimes a condition in the agreement, there are usually no binding requirements on a partnership to be organised. The types of partners involved depend on the type of budget support. With general budget support and budget support for policy action, the key role is played by the national authorities, usually the Ministry of Finance, with a strong political commitment at Parliamentary level. For sector budget support and PforR, other line ministries and stakeholders can be involved. In development cooperation, budget support is a relatively untested area as far as partnerships are concerned (compared to the project-based approach).

The effect of a budget support delivery on the application of the partnership principle in ESI Funds would depend on existing set-ups at Member States level. Member States would have to rely on their own mechanisms to ensure the involvement of stakeholders in the policy dialogue and decision-making process. The EC could require specific consultation procedures to be set up (a conditionality/eligibility requirement concerning partnership could be introduced). In general, since budget support allows recipient countries to rely on their own procedures to ensure participation of stakeholders, the advantage it may bring would be in terms of simplification and increased Member State ownership.

The risk could be insufficient involvement of relevant partners in the decision-making process regarding the definition of specific policy objectives and types of interventions. This concerns in particular regional/local authorities, social or private partners and non-government organisations representing civil society, who are important stakeholders in Cohesion policy and for certain types of intervention such as business support and innovation, small scale local development and social inclusion. They are currently the key stakeholders implementing ERDF and ESF. How to maintain their mobilisation would require specific consideration in a budget support delivery of ESI Funds.

3.5 Conclusions on the potential value added of using budget support elements for ESI Funds

The objective of this study was to assess the advantages and disadvantages of the potential use of budget support for the delivery of (or parts of) the ESI Funds and to assess the feasibility of using budget support type delivery mechanisms in the framework of ESI Funds.

As has been mentioned throughout the report, it is innately difficult to provide strong judgements on the value added of using budget support compared to the current shared management delivery of ESI Funds. To a large extent it is a theoretical exercise, since the context in which ESI Funds are implemented is very different from where development cooperation operates.

That said, it can be concluded that there is **little concrete evidence that general or sector budget support delivery of ESI Funds would be more effective and efficient than the current shared management system**. Any change would involve trade-offs with uncertain outcomes and gains. The followings sections summarise main findings from the analysis of the potential added value of budget support mechanisms for ESI Funds and the related disadvantages and risks.

3.5.1 The dual nature of budget support

Budget support operations have a financial and a condition/incentive dimension. There is no universally agreed definition of which elements constitute the "budget support package". However, definitions usually highlight the dual nature of budget support¹³: it usually entails 1/ a financial dimension- it involves a transfer of financial resources to the Treasury of partner countries which are used in accordance with the public financial management system of the partner country; and 2/ a condition/incentive dimension- disbursements are made on basis of the fulfilment of a certain set of conditions for payment, which are the subject of policy dialogue.

There are large differences in how donors implement both the financial dimension and the condition/incentive dimension. No single model of budget support operation exists across donors. Each donor has developed its own budget support or budget support inspired instrument, depending on objectives to be reached, donor related preferences and domestic accountability issues. A broad range of budget support and budget support type instruments have therefore been included in this study. For instance, instruments of the "results" family, which use country systems, link disbursements with the achievement of certain results, but do not necessarily flow to the National Treasury of the partner country, have also been included in the analysis.

The scope and nature of conditions for disbursements and the related policy dialogue are key. Conditions attached to budget support programmes can be classified according to 1/ their scope, i.e. do the conditions relate to the implementation of the budget as a whole or to a specific sector or sub-sector; and 2/ the nature of condition, i.e. do the conditions to be achieved relate mainly to policy actions/structural reforms to be undertaken or to specific (sector) outputs/outcomes to be reached (or to a mixture of both). For example, the World Bank's "development policy financing" instrument involves conditions relating mainly to policy actions/structural reforms to be undertaken by partner countries; whereas the Bank's "programme for results", links disbursements mainly to the achievement of outputs/outcomes in specific national (regional or local) programmes. Table 5 below provides a basic mapping of a few EC, World Bank and IMF instruments according to the scope and nature of conditions attached.

Table 5 Basic mapping of delivery mechanisms according to the type of condition for payment

Nature of the condition \ Scope of the condition	Macroeconomic stability	Mainly policy action oriented	Mainly output/results oriented
	Conditions linked to the overall implementation of the budget	IMF: Balance of payment support	World Bank: Development Policy financing governance contracts
Linked to the implementation of measures in a specific sector			EC: Sector reform contract World Bank: Programme for results

¹³ In its Green Paper on the Future of Budget Support (EC, 2010b, p.3), the EC provided the following definition of budget support: it is a "transfer of financial resources of an external financing agency to the National Treasury of a partner country, following the respect by the latter of agreed conditions for payment. The financial resources thus received are part of the global resources of the partner country, and consequently used in accordance with the public financial management system of the partner country."

3.5.2 Advantages, disadvantages and risks related to the financial and condition/incentive dimensions of budget support mechanisms

The following points have been identified as potential advantages of using budget support type mechanisms, compared with the current ESI Funds delivery mechanisms:

- Budget support mechanisms shift the focus from the input (real cost approach) to the policy objectives pursued and the related results;
- When implemented with a sector focus, budget support focuses on sector strategies throughout their lifecycle, from formulation to implementation and ex-post assessment, explicitly linking disbursements with their actual implementation;
- Budget support can be used as a delivery modality to support policy actions and institutional development. Latest research (including in the 7th Cohesion report) show that structural reforms and the quality of local governance are important for investment policies to be successfully implemented;
- Budget support mechanisms focus on strengthening domestic accountability at a systemic level instead of focusing on project level control thereby contributing to an overall improvement of existing public finance systems, instead of developing donor sponsored parallel systems of excellence;

It should be noted that the first three of these advantages relate to the condition/incentive dimension of budget support instruments.

Budget support mechanisms also have disadvantages and risks. The following ones have been identified as being the most significant compared with the existing ESI Funds delivery mechanisms:

- Budget support is an instrument associated with high fiduciary risk. After disbursement, no distinction is made between national and donor resources. This implies that donor funds are disbursed using the same public financial systems as national funds and that resources are fungible (i.e. they may be used for different purposes than the ones initially intended).
- Donors may face challenges in ensuring accountability towards their budgetary authority. In budget support systems accountability is entirely based on national structures, making it more difficult for the donor to set up accountability chains at home and to ensure visibility of the investment/funding.
- Policy dialogue is a prominent feature of budget support; yet there is little evidence as to what extent it has really been conducive in improving policies and in delivering results.
- There is little evidence that transactions costs in budget support approaches are lower than with other aid modalities. However, there are indications that resource needs are different compared with a traditional project approach: budget support tends to be more resource intensive during the programming phase and less resource intensive during programme implementation.

To be noted that the first two points relate to the financial dimension of budget support- type mechanisms; whereas the third one is linked to the condition/incentive dimension of the instrument.

Overall, if a general analysis of common features of budget support instruments enables us to sketch out a few main advantages and disadvantages of using budget support type delivery mechanisms, it also reveals that advantages, disadvantages and risks would vary largely depending on two main variables:

- The area of intervention /nature of the investment: different areas of intervention / types of investments entail different risks and challenges;
- **The actual design of budget support operations**: the literature review and case studies have shown that budget support operations vary a great deal between donors and operations. The actual characteristics of budget support operations, and choices made on the two dimensions

(financial and condition/incentive) have a great impact on the analysis of the potential usefulness of the instrument for ESI Funds.

The financial dimension of budget support has limited added value in the EU context. Main expectations and added value related to the financial dimension of budget support in developing countries include: increasing the aid predictability, increasing (budget) flexibility through fungibility of resources, achieving a better alignment of donor support with national policies, establishing dialogue on budgetary allocations (in particular pro-poor policies), dealing with capacity and absorption challenges when using the project modality. Most of these issues are of less relevance for the EU context, thereby reducing the added value of the financial dimension of budget support (i.e. "budget transfers" vs. "transfers to a programme").

Use of or reliance on national public financial management systems may prove interesting in the ESI Funds context. One of the aspects of the financial dimension of budget support may be of more interest for the ESI Funds context: the use of, or the reliance on, national public financial management systems. Budget support mechanisms use country systems (and are often selected by donors and recipients for this reason). In addition to the potential simplification and streamlining of programme's management, the literature and case studies provide some evidence that this has resulted in improving public financial management systems and domestic accountability. In instruments such as the World Bank's programme for results, dialogue on public financial management aspects is less prominent, but the instrument is often selected by beneficiary countries because of the possibility it offers to rely on national systems.

Implementing the financial dimension of budget support at regional or local levels is technically challenging. Budget support usually involves a transfer of financial resources to the Treasury of partner countries, which is to be budgeted in accordance with national practices. This does not prevent budget support mechanisms to be implemented at the regional/local level. However, it presents significant challenges. Technically, funding can either be directly transferred at the regional (or local) level, or it can be paid in the national treasury and then be transferred to the regional/local level using national transfer mechanisms. Both options present some challenges:

- If funding is to be transferred directly at the regional (or local) level, recipient bodies need to enjoy the necessary administrative autonomy to receive funding directly into their budget. Direct budgetary transfers to a sub-national level of government may also be politically sensitive and have an impact on internal transfers between levels of government.
- Transfers into the national treasury also appear to present some challenges for policy areas where the territorial and place-based approach is key. The need to set up processes for internal transfers may also complicate the use of the instrument and limit the benefits in terms of budgetary margin of manoeuvre at the level of the recipient.

Several potential advantages of budget support mechanisms may also be reaped using ring-fenced payments to programmes. Following growing criticisms of classical budget support (implemented in its general form, as a general support to the overall implementation of the budget) and due to political constraints (i.e. some partner countries not willing to let donors have a say in their national budgetary procedures), new forms of budget support type instruments have been designed. These would be, for instance, the World Bank's Programme for Results or DFID's 'non-budget support financial aid', which have many of the common characteristics of budget support (e.g. use of partner governments' public financial management system, focus on aggregated results or processes instead of individual projects...) but do not flow to the Treasury of the partner countries (they usually flow to ring-fenced partly or fully donor financed programmes). These approaches appear as most promising for investments in the EU context. When it comes to supporting reforms or policy actions, budget support modalities may also be envisaged.

The financial dimension of budget support mechanisms has an impact on accountability and assurance. In budget support mechanisms, accountability is entirely based on national structures, making it more difficult for the donor to set up accountability chains. In practical terms, using national

accountability mechanisms for ESI Funds would imply that less information would be available at the level of the Commission and of budgetary authorities on both the financial and operational implementation of the EU budget. In the same vein, assurance as to the correct application of EU law could not be obtained to the same level as in the current ESI Funds system in a budget support inspired system.

3.5.3 The condition/incentive dimension of budget support mechanisms

Some mechanisms linked with the condition/incentive dimension of budget support are worth exploring further. Three broad areas have been identified as potentially particularly interesting for ESI Funds:

- Mechanisms used to shift from the focus from inputs (real cost approach) to policy objectives pursued and aggregated outputs and results;
- Mechanisms to monitor the implementation of (sectoral) strategies, usually combined with policy dialogue
- Mechanisms to support policy actions and/or institutional development.

Not all these mechanisms have an added value for investments in all areas of intervention relevant for ESI Funds. Five broad categories of intervention areas commonly used when assessing the impact of Cohesion policy¹⁴ have been distinguished in the framework of this study:

- investment in human capital¹⁵;
- support to innovation and businesses¹⁶;
- large-scale infrastructure¹⁷;
- small scale local development¹⁸;
- capacity building/administrative reform¹⁹;

The literature review, case studies and interviews demonstrated that not all the mechanisms listed above have an added value in each of these areas of intervention.

Budget support mechanisms are usually not used to invest in large infrastructure. When it comes to investing into "hard" large scale projects, like infrastructure, most donors tend to use the "project" modality and to reimburse based on real costs. This may be explained by several factors, including: higher reputational risks for the donor on large value investments (large share of the budget,

¹⁴ This classification is in line with that used in macroeconomic models used for simulation of Cohesion policy impacts, such as Quest or Rhomolo. See, for instance, section 5 of "The impact of cohesion policy 2007-2013: model simulations with Quest III", Work Package 14a of the Ex post evaluation of Cohesion Policy programmes 2007-2013, http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/expost2013/wp14a_final_report_en.pdf

¹⁵ These are investments which are typically by public administration. While the results of these interventions in terms of output indicators (e.g. number of people trained) are easy to observe and measure, effects take time to materialise and socio-economic changes resulting from it (e.g. increased employment) only becomes apparent in the medium to long term. In addition, sectoral and national public administration reforms, measured in terms of processes and policy actions, are conducive to the materialisation of such effects.

¹⁶ this category includes a broad range of interventions in the fields of business support and RDI implemented by multiple partners (e.g. SMEs, Higher Education Institutes, research providers...) While the results in terms of output indicators (e.g. number of firm assisted) are easy to observe and measure as soon as the project has been implemented, the outcomes (e.g. increase in business added value) materialise over time, long after the end of the projects. This is also an area of intervention where failure needs to be tolerated (i.e. good frontier projects may fail) and where policy learning is particularly important.

¹⁷ This category includes investments in physical assets for the delivery of public services and goods in the fields of transport, telecommunications, environment, energy and social infrastructures. Individual projects involve high amounts and usually require public procurement. As soon as projects are implemented physical outputs are observable (e.g. n. of Km of road). However, effects (e.g. increased accessibility and mobility, decrease in travel time) normally require a medium to long timespan to materialise and are strongly influenced by network effects and national/sectoral regulatory frameworks.

¹⁸ This category is quite broad and involves a combination of multi-sector interventions with a variety of objectives and beneficiaries. Interventions can include either hard or soft measures or a combination of the two. The main feature of this category is its local (rural or urban) nature, usually linked with a local place-based strategy. The identification and measurement of effects may be difficult, especially when a number of inter-related soft measures are involved.

¹⁹ This category concerns spending to reinforce administrative capacity and to support administrative reforms. They are implemented by public administrations in order to produce changes mainly in terms of output and processes. The process change constitutes at the same time the output and the intended result.

visible projects); risks to legality and regularity, notably around the issue of public procurement; and the fact that large infrastructure projects largely follow the project approach (project pipelines).

Policy action-oriented conditions may be worth exploring to support structural reforms and/or process oriented actions. Mechanisms to links disbursements to the implementation of reforms or policy actions to be undertaken by the recipient may be interesting to explore when it comes to supporting structural reforms or to support specific processes. Soft investments (such as capacity building actions or support to the public administration) may also be supported partially using policy related payment conditions. The literature review and case studies have shown that the selection of structural reforms to be supported and practical modalities of support are particularly important for such an instrument to work. This would need to be considered when designing a potential instrument to be used under ESI Funds. Elements such as the nature of structural reforms (i.e. rather consensual reform or facing a lot of resistance, big reform or small incremental changes), the areas concerned (i.e. reforms related to the labour market, business environment and regulation, etc.) and stakeholders involved would need to be considered when designing concrete options, so that the suitability of using policy oriented conditions for disbursement should be assessed on a case by case basis. A mechanism of payments based on the fulfilment of policy actions may be used to support reforms or incremental policy changes/ optimization process in thematic areas linked with investments carried out under ESI Funds.

Payment conditions linked to aggregated outputs and results may be worth exploring in areas where there is a clear intervention logic and where outputs/results are quantifiable. By putting the focus on achieved outputs and results, this type of approach has an important potential to increase result orientation and simplification. However, these approaches have better chances to work in areas when outputs and results are (relatively) easily attributed to the implementation of a specific programme and where their costing is possible in a relatively simple way. This may be possible in areas such as human capital, and to some extent in the areas of innovation and business support, and for parts of energy efficiency measures (where outputs are clearly measurable and easily attributable to the action), measures of social inclusion, etc. The table below summarises results of an initial assessment of the suitability of output/results based conditions for payment in different areas of intervention.

Table 6 Suitability of output/result based conditions for payment in different areas of intervention

Nature of the condition Area of Intervention	Mainly output/results oriented
Investment in human capital	Suitable
Support to innovation and businesses	Moderately suitable
Large-scale infrastructure	Unsuitable
Small scale local development	Partially suitable
Capacity building/ administrative reform	Partially suitable

Based on the analysis conducted, three options for implementing budget support mechanisms in ESI Funds were retained for the remaining parts of the study:

1. Fully-fledged (sector) budget support (as outlined in preceding sections)
2. Payments based on policy actions
3. Payment for outputs/results

Whereas the fully-fledged budget support option would not require any significant adaptation compared to budget support mechanisms used in external actions, the options of payments based on policy actions and payments for outputs/results would need to be created specifically for ESI Funds.

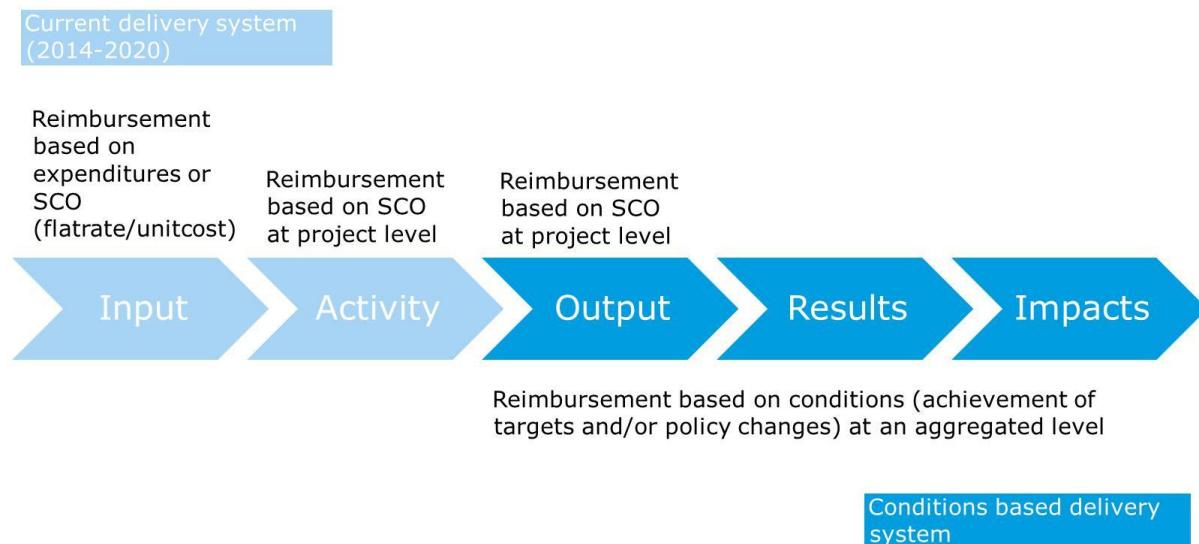
The following section outlines in more detail how these two options could be implemented in the ESI Funds.

4. USING ELEMENTS OF BUDGET SUPPORT TO DELIVER ESI FUNDS

One of the main elements of the budget support which could be integrated in ESI Funds is the possibility of linking payments to specific conditions (relating to policy actions or to output/results rather than to specific projects) being fulfilled by Member States, rather than reimbursing expenditures incurred at the level of individual projects.

Figure 3 illustrates the level of reimbursement of costs in the current ESI Funds delivery system, thereby identifies possibilities for moving towards payments at a more aggregated level. As illustrated in the figure, payments based on policy and/or output/results conditions rather than expenditures entail a shift towards paying for aggregated achievements and not reimbursing costs incurred at the level of individual projects. Simplified costs options (SCOs) have already enabled reimbursement by the European Commission (EC) based on deliverables/outputs rather than expenditures. However, the SCOs have so far been used mostly at the level of individual projects, and not at an aggregated level.

Figure 3 Current system versus condition based payments



Simplified cost options were first introduced in the delivery system of some ESI Funds in the 2007-2013 period, mostly with an intention to reduce administrative costs, errors and uncertainty related to ex-post expenditure claims. The first simplified cost options to be introduced were flat rates for indirect costs in the ESF (as a means to simplify reimbursement). In 2009 SCOs were extended to ERDF, and broadened to also include unit costs and lump sums. Throughout the period 2007-2013, the use of SCO was optional to Member States, and the uptake was fairly limited, with high variation between Member States.

In the 2014-2020 period, Article 67 of the CPR provides which SCO can be used for the ERDF/CF, ESF and EMFF, notably flat rate financing, standard scales of unit costs and lump sums. It is mostly optional to use, with the exception of ESF operations below 50,000 Euro of public support to be paid to the beneficiary. Following the entry into force of the revision of the common provisions regulation which was undertaken in the framework of the mid-term review/revision of the MFF, obligatory use of simplified cost options for smaller operations financed from ERDF will also be introduced (with a transition phase). The EC does usually not pre-approve Member States' calculation methods for this first generation of simplified cost option and simplified cost is usually applied both for the payment to beneficiaries and for the payment between the commission and the Member State.

With the 2014-2020 programming period, an additional possibility has been introduced in the ESF, with Article 14(1) of the ESF Regulation making it possible for SCOs under the form of standard scales of unit costs and lump sums to be adopted by the Commission via a delegated act. One of the advantages of this method is that it enables Member States to get full legal certainty concerning the use of approved SCOs. Another difference of this provision is that it enables decoupling of payments from the Commission to Member States (using SCOs) from payments from the Member States to beneficiaries (using SCOs or real cost at the discretion of Member States). The delegated act providing maximum legal certainty, with considerable simplification potential has been quickly taken up by Member States.

A recent study by DG REGIO²⁰ examined the use of SCOs in the early implementation of ESI Funds and found that while the uptake of SCOs has improved since the last programming period, there are still large differences between ESI Funds and between Member States. It is estimated that approximately 36% of the ESF budget is implemented using SCOs, while for ERDF/CF the share is only 2%. The same study estimates that the reduction of administrative cost and administrative burden when applying SCOs is considerable, between 1.2% and 1.7 % reduction for Managing Authorities and 4.5% to 6.3% reduction for beneficiaries, compared to the real cost approach (in average across all funds). The reasons reported for using SCOs were primarily related to simplification, but also higher legal certainty and less risk of errors, while the main reasons for not using SCOs were the perceived complexity and time necessary to implement the SCOs.

To sum up, the use of SCOs has already led to simplification and reduction in administrative costs in ESI Funds, but there is still potential for further improvement. Currently SCOs apply mostly to individual project level, and in most cases, the reimbursement mechanisms from Member States to beneficiaries need to follow the same approach as the payments from the EC to Member States (except when using a delegated act in ESF, Article 14(1)).

If payments were made on a more aggregate level (e.g. covering several projects aiming at the same objectives, for example re-integration of long-term unemployed on the labour market), based on agreed targets and indicators (conditions), payments from the EC to Member States could be decoupled from Member State payments to individual beneficiaries. This could also potentially lead to further simplification and result orientation in the implementation of the funds.

The revision of the common provisions regulation which was undertaken in the framework of the mid-term review/revision of the MFF also included a provision which enables payments based on conditions. A delegated act will set out the approach. The approach will be piloted in the 2014-2020 programming period in a limited number of policy areas, such as energy efficiency. This revision was not yet in force at the time of finalizing this study.

Systems where payments are carried out based on conditions and achievements at an aggregated level, being either policy actions and/or outputs/results, have similarities with budget support in particular when it comes to the incentive dimension.

²⁰ http://ec.europa.eu/regional_policy/en/information/publications/studies/2017/use-of-new-provisions-on-simplification-during-the-early-implementation-phase-of-esif

The following sections outline two options built on using elements of budget support in the existing delivery system. The main principles of each option are briefly described, and key features are outlined in relation to the following areas:

1. What would the main feature of the programming be?
2. Would eligibility conditions and/or pre-conditions be necessary?
3. On which basis would payments be made?
4. How would reporting, monitoring and evaluation work?
5. What would control and audit cover?
6. How would visibility be ensured?

4.1 Payments based on policy actions

Structural reforms and institution building is an important element of development strategies:

As underlined in the 7th Cohesion report, improving the quality of government and implementing structural reforms may have an impact on growth. According to the report, large potential benefits in terms of GDP, productivity and employment growth can be obtained through structural reforms relating in particular to market competition and regulation, taxation, the labour market, unemployment benefits and investment in human capital and R&D.²¹

The report also provides evidence that institutional capacity affects policy performance and that improving institutions may have an important impact on the effectiveness of policy making. Since, the quality of government matters for regional development across the EU, the institutional dimension becomes an important element of development strategies.

The need to strengthen the link between policy reforms and the EU budget to foster convergence is also emphasised in the recently adopted Reflection Paper on Deepening of the Economic and Monetary Union.

ESI Funds have contributed to and will continue to contribute to pursuing structural reforms, improving administrative capacity and the effectiveness of government. Along with strengthening infrastructure endowment, human capital, and endogenous potential, payments based on policy actions is a tool that could be used to pursue this objective of supporting reforms and institution building.

Existing elements promoting structural changes in Cohesion policy and lessons learnt:

Cohesion policy has already been contributing to tackling structural challenges in the current and past programming periods. In the current 2014-2020 programming period, the following elements can be mentioned:

- **Macro-economic conditionality:**
Macro-economic conditionality is enshrined in Article 23 of the Common Provisions Regulation and organised across two distinct strands:

1/ First strand:

The Commission may request a Member State to adjust its Partnership agreement and operational programmes to support the implementation of relevant country specific recommendations (CSRs) which fall into the scope of ESI Funds and render themselves to multi-annual investments. In 2014-2020, the CSRs issued in the framework of the European semester were a central part of negotiations with Member States. This has been a key novelty compared to previous period. A significant number of CSRs have been addressed covering areas such as

²¹ See the 7th Cohesion report, and, for more details Varga J. and J. in't Veld (2014).

innovation, energy and transport, health care, skills and education, and the reform of the public administration.

However, in the current system, only those CSRs which can be supported through multi-annual investments can be taken into account. More complex structural reforms or reforms that are not directly linked to multi-annual investment programmes, such as labour market reforms or reforms to improve competition in the service sector and which require regulatory and/or administrative changes rather than investment, could not be taken into account.

2/ Second strand:

The Commission shall propose to the Council the suspension of commitments if the Council decides that a Member State has not taken effective action to address (i) its excessive deficit or (ii) in two successive cases its excessive macroeconomic imbalances. The Commission shall also propose such a suspension in case of non-compliance with an economic adjustment programme. The second strand has not been used at the timing of finalising this study.

- **Ex-ante conditionalities:**

Ex-ante conditionalities have been introduced for the first time in the Common Provisions Regulation in the 2014-2020 programming period. They constitute minimum conditions to be in place at national level for ESI Funds to be implemented in an effective and efficient manner. In the 2014-2020 programming period, they include mostly correct transposition and application of EU level legislative frameworks and existence of national strategic plans in areas supported by funds. They are therefore directly linked to the implementation of the ESI Funds.

Several lessons can be drawn from the application of 2014-2020 ex-ante conditionalities: ex-ante conditionalities proved effective to reinforce ESI Funds implementation and they sometimes contributed to larger structural reforms directly (e.g. some ex-ante conditionalities required explicit changes in strategy, new policy developments or legal changes). The linkage between ex-ante conditionalities and the CSRs/structural reforms has varied a lot across policy areas and across national and regional contexts, but ex-ante conditionalities have been conceived more as enabling conditions directly linked with investments than as elements triggering structural reforms.

- **Thematic Objective 11 – enhancing institutional capacity and efficient public administration:**

In the ongoing programming period, thematic objective 11, which has a total allocation of €6,445 million for the 2014-2020 period, includes investments in the institutional capacity and efficiency of public administrations and public services (carried out at national, regional and/or local levels) with a view to support reforms, better regulation and good governance and capacity building actions for all stakeholders delivering education, lifelong learning, training and employment, and social policies. Actions that can be supported are categorised according to three broad dimensions: 1/ Structures and processes: e.g. legal, regulatory and constitutional changes; public participation initiatives; process reviews; introduction of new business models and management practices; de-centralisation; devolution or re-structuring of institutions; impact assessment; evaluation, monitoring and audit etc.; 2/ Human resources: e.g. modernising recruitment and incentive policies; better management of human resources, including division of tasks and responsibilities; retention, appraisal, motivation, empowerment, career development and incentives for personal development etc. and 3/ Service delivery: e.g. optimising and re-engineering business processes, diversification of the channels for the delivery of services, systems and tools related to e-government, service benchmarking and ombudsman procedures.

To be noted that many the current elements of the 2014-2020 programming period are 'negative' incentives (payments suspensions), whereas payments on the basis of policy actions also would enable the use of 'positive' incentives.

Different types of policy actions – scope and nature of main structural and administrative challenges:

Effective policy implementation is subject to a number of challenges, which are of different forms. The nature and scope of policy actions needed (i.e. consensual or facing a lot of resistance), the sector or area concerned (i.e. the labour market, business environment and regulation, etc.), the level of the policy actions (i.e. national/subnational level) and stakeholders involved would need to be considered when designing concrete options, so that the suitability of using policy oriented conditions for the disbursement of ESI Funds should be assessed on a case by case basis.

The nature and scope of structural and administrative challenges should also be explored, since they can partly be addressed with different policy responses. The following types of structural and administrative challenges can be identified:

- **Structural reforms:**

These are big ticket reforms, which contribute to resilience of domestic economies, have positive spill-over effects on other Member states and potentially have a very important impact on growth in the long run. The reforms are identified in the framework of the European Semester process and they are usually at national level. The reforms can concern sectors/ areas in which ESI Funds operate, such as a reform to improve the business environment or human capital-related and public administration related reforms, or they can cover sectors/areas not directly linked with ESI Funds such as tax reforms, the development of capital markets, and judiciary reforms.

Example of structural reform:

Improving the access to finance and the business environment could be an example of structural reform to implement. CSRs in this area usually mention actions to implement (improving the access to finance for small and medium enterprises, removing administrative and regulatory barriers to business, removing barriers to investment...) reforms to improve the business environment that are directly related to ESI Funds in the areas of competitiveness and innovation.

- **Sectoral/sub-national obstacles to effective investments:**

These are obstacles or bottlenecks, including institutional bottlenecks, which are either of sectoral relevance or which are mostly relevant at the sub-national level. These influence strongly the regional environment and hamper social and economic cohesion at sector and subnational level. They are of core interest for cohesion policy.

Example of sectoral / sub-national obstacles to effective investments:

Implementation of broadband coverage in white areas in some regions of Europe is hampered by municipalities' practice to apply fees for occupation of public road. In sparsely populated areas, such operating costs undermine the profitability of any operator, even in the case of highly subsidised infrastructure. In such a case, changes in municipal practice/ fees could be tackled via payments based on policy actions and may contribute to removing a sub-national obstacle to the effectiveness of funding. It may also contribute to implementing more effective investments in the areas of broadband via ESI Funds.

- **Enabling conditions:**

These are fundamental enabling conditions for effective and efficient investments. They include relevant strategic policy and EU level legislative frameworks as minimum conditions to be in place at national level. They are identical for all Member States. They may contribute positively to structural reforms but may not represent sufficient incentives to trigger politically difficult structural reforms. They cover only minimum conditions applicable to areas where there is investment by ESI Funds.

Example of enabling conditions:

The 2014-2020 ex-ante conditionality for transport investments requires the existence of a comprehensive plan or framework for transport investment in accordance with the Member States' institutional set up which supports infrastructure development and improves connectivity to the TEN-T comprehensive and core networks. This means that prior to any transport investment a comprehensive strategy would need to be in place. Such masterplans would need to take account and may sometimes even trigger regulatory and/or institutional changes but it not a sufficient trigger to carry out a large (and potentially difficult) reform of the transport sector (e.g. tackling elements such modification of the operational and institutional aspect of the railway sector, for example).

- **Investments in institution building, capacity building and efficient public administration:**

These are (mostly soft) investments made to support institution building, capacity building and efficient public administration. These investments may accompany or be necessary to tackle any of the structural challenges listed above.

Payments based on the fulfilment of policy actions may be a relevant mechanism to support all these types of structural and administrative challenges. However, the detailed design of each payment based on policy actions scheme would have to be tailored to the type of challenge faced.

In all cases, element such as ownership at Member State and/or sub-national level of the policy action(s) to be implemented is crucial. Different levels of institutional and political complexity relating to policy actions, maturity of policy process and administrative capacity to implement actions/processes also have to be taken into account when designing detailed mechanisms.

General elements to be considered when designing detailed options for payments based on policy actions:

- Payments based on policy action may be worth exploring to tackle structural and administrative challenges.
- Structural and administrative challenges vary in terms of scope and nature. Specific features of these challenges need to be considered when designing detailed policy options for payments based on policy actions.
- Structural challenges include big ticket structural reforms, but also sub-national and/or sectoral bottlenecks.
- Payments based on policy actions/processes may also be used as a disbursement modality for parts of soft investments tackling institutional building issues and efficient public administration.
- When designing detailed modalities, it is important to consider where the main focus of the instrument needs to be. In most cases, payments based on policy actions are used to focus on the incentive dimension (rather than to supporting the cost of tackling structural and administrative challenges).
- Ownership of policy actions to be implemented is important, which rather points towards a model, where this delivery system is voluntary rather than compulsory.

The following paragraphs describe common features of payments based on policy actions mechanisms. Whenever relevant, potential differences when it comes to tackling different structural and administrative challenges will be highlighted. However, the design of one or several fully-fledged policy options would need to be undertaken in more details based on policy objectives pursued.

4.1.1 Programming

Programming payments based on policy actions would take as starting point existing diagnostics and dialogue mechanisms. For big ticket structural reforms, Country Specific Recommendations (CSRs) issued to Member States in the framework of the Semester could be used. Sectoral or sub-national obstacles to effective investments could, in turn, be identified during the programming process of ESI Funds (or, for example, during the process of producing position papers for the Commission).

To ensure ownership a limited number of structural and administrative challenges should be identified. They should be subject to a programming/contracting exercise, whereby relevant policy actions to be undertaken are identified in dialogue between Member States and the EC. A contract, embedded in existing documents (partnership agreements, or operational programmes, or national reform programmes, etc.) or in newly created documents should outline objective of policy actions to be undertaken, exact measures to be implemented and a timeline. Negotiations would focus on selecting policy actions that address relevant structural and administrative challenges, individual steps to be implemented and the necessary time-frame.

As policy actions may require long terms efforts, support would need to cover several years, and when relevant, interim payments based on progress indicators or milestones should be identified. Any disbursement linked conditions (progress indicators) should be clearly defined and mechanisms for verification of progress should be established. Some form of reimbursement mechanism may be envisaged, in order to mitigate the risk of “back tracking” on policy actions or stalling once payment has been released.

It is difficult to put a price tag on policy actions. As indicated earlier in the report, the primary rationale of payments based on policy conditions is more to provide incentives to commit to certain policy actions/processes rather than to cover their cost. However, mechanisms, methodologies and/or criteria to determine the size of the incentive would have to be designed on a case by case basis for each fund/ policy area where this modality of payment is used.

4.1.2 Eligibility conditions and preconditions

In a system of payments based on policy actions, no specific pre-conditions would be necessary apart from the existence of diagnostics / dialogue mechanisms enabling to identify necessary policy actions. For big ticket structural reforms, the CSRs could be used as a starting point. For other types of structural and administrative challenge, programming processes and/or other dialogue fora could be used.

The existence of a shared diagnostic of issues to be tackled is important, since this contributed to increasing ownership of required policy actions.

Given the strengthening of the economic governance in the EU over the last decade as a response to the economic crisis (e.g. macroeconomic conditionality in the ESI Funds), the payments based on policy actions could also be linked with respecting the conditions of the Stability and Growth Pact.

4.1.3 Basis for payments in payments based on policy actions

In the case of a system of payments based on policy actions, payments would not be based on outputs (for example number of civil servants trained), but rather be linked to policy actions, procedures or processes being implemented.

Payments schedules would be established at the programming stage. They would include intermediate and final payments, linked with the achievement of milestones and policy actions targeted. It may also include mechanisms for reimbursement in case of a back-track after payment.

4.1.4 Arrangements for reporting, monitoring and evaluation

This option would be subject to different monitoring and evaluation framework compared to investment expenditures. The monitoring of the implementation of policy actions would take place in policy dialogue fora and review mechanisms agreed between the EC and the Member State or the relevant body. It would focus on monitoring of the implementation of the agreed policy actions and of identified indicators of progress. For big structural reforms, policy actions could be linked to the European Semester and the annual review of CSR implementation.

Evaluation of support could be undertaken ex-post, to assess the contribution of EC support to policy changes. The actual impact of the incentive may be difficult to evaluate using standard evaluation methods, e.g. to what extent the incentive has contributed to observed policy changes and what has been the impact of these changes. In the case of transversal reforms, which essentially intend to improve the policy environment across sectors, evaluation may not be straightforward, and results may be difficult to link to EC support. Evaluations budget support in third countries have shown that the link between the support provided and reforms is difficult to establish.

4.1.5 Control and audits

In payments based on policy conditions, assurance mechanisms would focus on whether the conditions for payment are fulfilled, e.g. if disbursement linked indicators and targets have been met by the Member State.

The issue of assurance would be less prominent than for investment expenditures, as the payments would not be linked to investment expenditures, but it would be more of an incentive nature.

4.1.6 Visibility

Visibility for EU funding may be difficult to achieve, due to the incentive nature of the support. The need for a communication strategy could be assessed on a case by case basis, depending on the type of policy action being supported, and the level of public interest in them. Some structural reforms may be sensitive and controversial, which may call for a cautious communication strategy. In any case, communication issues should be discussed when agreeing on the policy actions to be targeted. Elements such as why is a reform needed and what types of communication needs are going to occur should be discussed. The EU visibility should then be addressed on that basis.

4.2 Payments based on outputs and results

Payments based on output/results is a delivery approach used in development cooperation in which donors pay for results or outputs (e.g. a fixed amount is paid when a number of children in school has been reached), and in which the recipient (a government entity) usually enjoys high level of autonomy for implementing the funds. In this approach, donors usually take a rather 'hands-off' stance towards the beneficiary's practices for implementation – focusing on results rather than processes to get there. Other characteristics of payments based on outputs/results generally include that output/results measures or units of progress are verified by an independent body and are disseminated publicly.

Output and results-based payment requires well-defined intervention logics with clear output and results indicators, which can be achieved without a significant time lag between the intervention itself and the benefit/change it seeks to realise. It is also essential that the link between the intervention and the benefit/change is clear, e.g. that outputs/results achieved can be reasonably attributed to the activities or actions implemented. In principle, disbursement can be linked to any level of the intervention, from activities (number of trainings produced) to outputs (number of people trained) and results (employment of trained people). Results indicators are, however, more challenging to define and use for disbursement, since they often entail significant time lags (the time necessary between activities implemented and the results observed) and are also prone to influence by external factors. A challenge is to define the "right" disbursement indicators depending on the policy area and type of intervention supported.

In relation to ESI Funds, which span across different policy fields and sectors, this type of approach would be more suitable for some investment areas than others. A screening of all investment areas would probably be needed in order to identify sub-areas, which may be relevant for outputs/results-based payments. Depending on the policy areas, the appropriate level for payment (i.e. activities, outputs or results) would need to be determined.

The responsibility to achieve agreed outputs and results would be placed on the relevant Member State authority. One of the advantages of such an approach is that it can be used within ring-fenced programmes. For ESI Funds, these could be the current OP structure. Disbursement linked indicators could be set at the level of the programme, for parts of a programme or at the level of a group of operations. Such an approach may also enable implementing entities to use their own procedures to disburse funding to final beneficiaries/projects.

The rationale for using output/results-based payment approaches is thus more related to increasing efficiency and reducing the administrative burden, rather than policy dialogue. In a certain sense it could be seen as a prolongation or continuation of the process of simplification which is already underway with simplified cost options, but shifting the focus to a more aggregate level, instead of focusing on individual projects.

4.2.1 Programming

In a delivery system which applies payments based on aggregated outputs/results, the programming could follow the same principles as currently in ESI Funds, with Partnership Agreements and fund specific Operational Programmes, e.g. payments based on outputs/results could become a reimbursement modality. It would require the EC to define types of actions (or criteria for types of actions) which would be "eligible" for funding through payments based on outputs/results. The main criteria to define which actions could be covered by such reimbursement modalities could include: areas where well defined, sound and robust intervention logic can be developed, where outputs/results largely fall under the control of the implementing body and where time lags and external factors are limited. In order to reap significant simplifications, significant amount of expenditures/budget should be covered.

At the programming stage Member States and the EC would negotiate which part(s) of a programme are to implement with output/results-based payments. Detailed mechanisms would need to be elaborated at the level of Operational Programmes, adapted to the type of actions, the context and implementation mechanisms. Important aspects to consider, irrespective of the investment area, would include:

- Methodology to cost the output/result
- Definition of disbursement-linked indicators, including baselines
- Share or ratio of funding linked to specific output / results and intermediate milestones
- Definition of payment tranches and preliminary timing
- Interim payments and reimbursement conditions
- Data requirements and verification systems for disbursement linked indicators

A key issue or challenge in this approach will be to define the cost or price of the output/result. In development cooperation, the rationale in payments based on outputs/results is generally not to reimburse the actual costs of producing an output/result, but rather to establish an amount which creates an appropriate incentive for the partner country to achieve the agreed objectives. While providing incentives may be relevant in an EU context, it would be a significant shift for ESI Funds which is currently based mainly on reimbursement of real costs or of proxy of real cost (simplified cost options). Hence, the approach to define costs of disbursement linked indicators would likely aim to establish a proxy for real costs of producing the agreed aggregated outputs/results, rather than creating an incentive. The incentive dimension may also be explored with performance tranches.

The methodology and principles for costing would need to be clearly defined in the legal framework, to provide sufficient legal certainty to Member States. In a system with payment on aggregated and standardised disbursement linked indicators, the cost or price for aggregated outputs/results will need to be defined ex-ante, including principles for revisions. This would be done in the programming phase, based on a clearly defined fair, equitable and verifiable methodology²², as is the case with SCOs currently in use.

The methodologies used for SCO (flat rates, standard scales of unit costs and lump sums) include statistical analysis of historical costs, calculations methods used in national policies and draft budgets. Methodologies to calculate the cost of reaching certain outputs/results could be based on the same types of methodologies: e.g. use of historical data, statistical data, etc. If the objective is to provide legal certainty to Member States to ensure uptake of the instrument, methodologies used, and aggregated costs to be reimbursed, would need to be reviewed ex-ante. The maximum legal certain would be reached if the methodologies and corresponding aggregated costs are agreed upon by the EC and member States authorities as part of the programming process.

One of the advantages of such delivery mechanisms is that it could fully be implemented in shared management, e.g. Managing Authorities would implement the outputs/results-based payment part of their Operational Programmes.

4.2.2 Eligibility conditions and preconditions

In a delivery system based on payments for outputs/results, eligibility would mainly concern the type of action targeted by the support. As mentioned above in the section on programming, clear criteria will be needed to define which type of actions could be supported through this option.

Certain mechanisms would need to be developed or strengthened, such as systems for verification of disbursement linked indicators which are particularly important in outputs/results-based approaches. Member States would need to have systems in place to collect and verify data used in disbursement linked indicators.

Data collection systems should meet requirements such as;

- Sufficient quality and reliability of data (including baseline data)
- Timeliness of data
- Integrity and security of the data system
- Procedures and processes to verify disbursement linked data

Conditions on data collection, data management and verification could be included in the legal framework, as part of ex-ante conditionalities or discussed in the framework of individual schemes. Independence of the data collection, verification and monitoring function from the implementing body should be required to ensure accountability.

Similarly, as in the case of payments based on policy actions, the conditions linked to the economic governance of the EU could also be envisaged.

4.2.3 Basis for payments

Payment conditions would need to be adapted to the policy field targeted. When the intervention logic is complex (e.g. marginalised target groups, multiple stakeholders involved), the payments would most likely need to be based on activities or operations/outputs rather than results. The same is valid for interventions which are highly sensitive to external factors, such innovation, research and business development. In some cases, a stronger focus could be put on results, when the intervention logic is clear, results are easily quantifiable. This would be the case, for example, in energy efficiency area

²² Article 67(5) (a) CPR.

(where results – energy savings – can relatively easily be quantified and tracked) and in certain types of investment in human capital.

In combination with the payments based on fulfilled conditions, a share of funding could be made available as interim payments. Such interim payments should be based on pre-defined milestones/key implementation steps. Mechanisms for reimbursement of support and revisions of targets should be foreseen, as implementation may over- or under-perform due to unforeseen factors.

Results targets would need to consider deadweight, e.g. what the development would have been without the intervention and what the expected “added value” of the intervention is²³. This would need to be done on a case by case basis, for example by using historical data to estimate the costs of producing a certain result.

4.2.4 Arrangements for reporting, monitoring and evaluation

In this option, there would not be a need for major changes to the monitoring and evaluation framework already in place in ESI Funds. Payments based on outputs/results would mainly entail a shift in how the EC reimburse Member States, from real costs to conditions. It would likely not affect actual operations, or entail changes to the OP structure or implementation bodies, and thus the need to adapt the monitoring and evaluation system would be limited.

However, there would be a need to ensure that the monitoring systems are sufficiently robust to enable tracking of outputs and results, in particular related to disbursement linked indicators. It would also be necessary to put in place mechanisms for verification of the data collected on disbursement linked indicators. This could be organised using existing management and control systems (for examples checks and audits done by the managing authority and audit authority) or putting in place a dedicated approach for payments based on outputs/conditions (e.g. use of an independent verifying body).

Specific arrangements for monitoring and evaluation could be elaborated to enable drawing lessons from interventions funded through output/results-based payments. Results based payment approaches may provide an opportunity to compare across similar interventions and carry out counterfactual evaluations, to explore to what extent the reimbursement method chosen had an impact on results achieved.

4.2.5 Control and audits

An option of payments based on outputs/results could be integrated in the current assurance model used in ESI Funds. It would partially shift the focus of the assurance from control of expenditures to control of whether the conditions for payment were actually fulfilled. This requires a robust and reliable system to collect data on disbursement linked indicators and mechanisms to audit it. Verifications that the conditions for payment were met could be included in the existing management and control system (e.g. they could be carried out by managing authorities and audit authorities, for example); or may be carried out using a dedicated external verification body. Audit would focus on verifying that the conditions for payment have been fulfilled, e.g. that outputs/results have been reached. The audit would also need to cover the data collection system, to ensure that underlying data is complete, accurate and reliable.

Requirements on the data collection system and methodology could be a part of the legal framework, an ex-ante conditionality or discussed for each individual output/result based scheme.

²³ For example, in an intervention targeting unemployed individuals, a certain number of individuals would have found employment without taking part in the intervention, this is the deadweight. With the intervention more individuals are able to enter employment, which constitutes the real added value.

4.2.6 Visibility

In an ESI Funds context, this option would probably make EU support less visible at the individual project level, since individual projects would be funded through national systems, and EC payments would only occur at aggregated level. It would however be possible to require communication and public dissemination of results at the aggregated level, as a means to ensure visibility of the EU support.

Programmes using payments based on outputs/results in development cooperation generally include a requirement that outputs/results measures or units are disseminated publicly. Communication provides transparency through public dissemination of the content of the support, the amount of progress, and the payment details for each increment of progress. Similar requirements could be put in place in an ESI Funds context, which would ensure visibility of the support, and also strengthen accountability and transparency of EU funding. A communication strategy, including the systems and tools necessary to disseminate information publicly, would need to be developed and implemented by the Member States.

5. ADMINISTRATIVE COSTS OF IMPLEMENTING BUDGET SUPPORT IN ESI FUNDS

Many parameters need to be taken into account when switching to a new delivery system or modifying features of an existing one. It is especially the case for the administrative costs of operating the delivery system for stakeholders involved at all levels. The adoption of budget support mechanisms in the delivery of ESI Funds would certainly have an impact on both administrative costs at the level of the Commission and Member States authorities and on administrative burdens incurred by beneficiaries. Administrative costs are defined as “costs incurred by enterprises, the voluntary sector, public authorities and citizens in meeting legal obligations to provide information on their action or production, either to public authorities or to private parties”²⁴. More specifically in the context of this study, administrative costs are those necessary for the fulfilment of administrative tasks undertaken by the Commission services, national and regional authorities, beneficiaries in the whole ESI Funds programme cycle (thus covering programming, implementation, control and audit, monitoring and evaluation of the ESI Funds)²⁵.

This section analyses the likely impact in terms of administrative costs of introducing a budget support delivery system or of some of its elements (e.g. payments on the basis of policy action or payments on the basis of outputs/results) in the existing ESI Funds mechanisms. The section makes a comparison with administrative costs and burdens incurred in the current ESI Funds delivery system and it is based on studies on administrative costs and burdens incurred in ESI Funds, studies and literature on budget support, evidence collected and discussed during the course of the study, interaction with Commission services and experience of the team members. A full quantitative assessment is not feasible in the context of this study due to the lack of relevant and comparable data on administrative costs and burdens incurred in the framework of budget support and due to uncertainties linked to Member States’ choices²⁶. The qualitative dimension of the analysis has thus been strengthened, with the aim to establish the likely direction of changes and elements to be taken into account when concretely designing budget support options for ESI Funds.

The sections below distinguish administrative costs faced by the Commission, Member States authorities and beneficiaries.

5.1 Administrative costs at the level of Commission services

Even though budget support is widely used, there is only limited evidence available concerning administrative costs borne at the level of the donor when using such an aid modality²⁷. In addition, only a few sources provide elements of comparison between administrative costs incurred at the level of the donor when using the budget support modality and administrative costs incurred at donor’s level when using the project/programme approach. It is therefore difficult to conclude on the likely impact that introducing budget support mechanisms in ESI Funds would have on administrative costs for the Commission.

Administrative costs borne by the European Commission in the current shared managed system are already significantly low (e.g. for ERDF and CF they amount to about 0.2% of disbursed funds on average for the last three years)²⁸. This particularly low level of administrative costs can be explained by several elements, ranging from the unique features of the shared management system, which was designed specifically to enable management of funds across levels of government, to the high amounts disbursed.

²⁴ European Commission (2015), “Better Regulation Toolbox”, p. 347. (see <https://tinyurl.com/ydhq9ea6>)

²⁵ This definition is adapted to the context of this study, based on the 2012 study “Measuring the impact of changing regulatory requirements to administrative cost and administrative burden of managing EU Structural Funds (ERDF and Cohesion Funds)” (<https://tinyurl.com/chcscxw>)

²⁶ These factors are explicitly highlighted as a major source of challenges in the “Better Regulation Guidelines”, p.27.

²⁷ For instance, the DEval report (2017), “What do we know about the effectiveness of Budget Support” highlights the lack of evidence on the costs for the donors (see <https://tinyurl.com/y9u2vuv2>, p. 41 for transaction costs)

²⁸ Ranging from 0.15% in 2014 (AAR DG REGIO 2014, <https://tinyurl.com/yb8nw5ss>, p. 74) to 0.26% in 2016 (AAR DG REGIO 2016, <https://tinyurl.com/y97j6mau>, p. 84)

Considering this already low level of administrative costs, any further reduction of administrative seems difficult to achieve.

For Commission DGs which implement budget support modalities (DG DEVCO and DG NEAR), budget support appears as a cost-effective way of implementing the EU budget: DG NEAR reports administrative costs of implementing budget support of about 2.32% of the budget disbursed in 2016²⁹. Figures reported by DG DEVCO are similar. For both DGs these figures are significantly higher than costs calculated by DG REGIO to implement the current shared management system for the ERDF and CF (amounting to 0.26% of the total 2016 payments³⁰). This suggests that many factors need to be taken into account when comparing the administrative costs generated by two different delivery systems at the level of the donor, for example:

- both DG DEVCO and DG NEAR operate in contexts which are very different from the context in which ESI Funds are disbursed. Elements such as the level of development and administrative capacity certainly have an impact on the cost of managing aid operations for the donor.
- budget support operations in external aid are also much smaller in absolute amounts than ESI flows within the EU, which may have different implications on the cost of implementation, as further discussed below.

Overall, the costs of implementing budget support for the donor are potentially quite variable. Administrative costs to design and manage a budget support operation certainly depend on features of individual operations. Elements such as the number and nature of eligibility conditions, disbursement indicators and their verification protocols, or the actual level of ambition of policy dialogue have a direct impact on the cost of designing and managing a budget support operation for the donor. Because of the characteristics of ESI Funds (wide range of investments, many actors involved across layers of government, exogenous factors) and political sensitivity, budget support operations would probably be quite complex operations, which may entail higher administrative costs than in external aid.

This also suggests that administrative costs for the Commission would evolve in a budget support system compared to shared management. Additional administrative costs would be mainly related to a strengthened programming phase, with possibly complex and challenging negotiations. At the same time, as implementation as well as controls and audits would increasingly rely on national public financial management systems, the related costs would likely decrease for the Commission. It is unclear what the overall impact on administrative costs for the Commission would be.

As with any novelty, there is also some evidence that switching to a budget support system generates some start-up costs. This is evidenced, for example, in the mid-term evaluation of IPA II: "The programming of sector budget support has been a novelty in IPA II, requiring in-depth investigations and long-lasting considerations at planning stage. All these significant changes in the way how pre-accession support shall be programmed and implemented had so far some negative effects on speedy programming and contracting".³¹

Finally, it should be highlighted that the implementation of different budget support elements would probably have a differentiated impact on administrative costs at the level of the Commission. Evidence from studies on previous simplification and result-orientation efforts in ESI Funds³² suggest that the payment for outputs/results option may have the potential to reduce administrative costs. For example, the implementation of Simplified Cost Options has enabled a reduction of administrative costs at all levels

²⁹ AAR NEAR 2016, p. 55 (<https://tinyurl.com/yascc3br>)

³⁰ AAR DG REGIO, 2016, p. 84. (<https://tinyurl.com/y97j6mau>)

³¹ see https://ec.europa.eu/europeaid/sites/devco/files/ipa-ii-eval-final-report-vol-i_en.pdf, page 18

³² These technical methods are alternatives to real costs in order to reduce administrative burdens, see for more details: European Commission (2012), "Simplifying Cohesion Policy for 2014-2020" (<https://tinyurl.com/y7kpkooep>)

in the current ESI Funds system³³. While the definition of outputs/results to be achieved on a case by case basis may generate some administrative work, lessons could be drawn from existing attempts to standardise outputs/results and from systems to be put in place for that purpose in the legislative framework³⁴. This may mitigate the complexity of programming for payment for outputs/results. For other types of budget support or for payments on the basis of policy action, negotiations on a case by case basis would still be needed and if the legislative framework could provide for an overall framework, standardisation or economies of scale are more difficult to reach.

5.2 Administrative costs at the level of Member States

Literature and empirical evidence on administrative costs borne by partner governments when implementing budget support operations are more numerous than those analysing costs for donors³⁵. The following section highlights key findings. These findings come primarily from the experience of middle-income countries, which are closer to EU countries. It has to be reminded, though, that these may vary when applied to the EU context.

As the budget support mechanisms rely primarily on national systems rather than on ad hoc delivery systems (especially during the implementation phase), differences between Member States/ regions public financial management systems are expected to be the main determinant of the magnitude and distribution of changes in administrative costs. For this reason, the effect of using budget support mechanisms on administrative costs is ambiguous at the level of Member States. If core tasks related to allocating funding to individual projects and project management of investment expenditure would still have to be carried out, the use of national systems would most likely reduce costs incurred in the implementation phase and on controls and audits. On contrary, programming and, to a lesser extent, monitoring and evaluation would likely generate additional administrative costs for the Member States, to a different extent depending on the chosen option:

- In the sector budget support option, given the importance of strategic aspects and the related policy dialogue, programming would likely lead to relatively higher costs for Member States/regions. Monitoring and Evaluation would also lead to a slight increase of costs because of the likely complexity of evaluations (based on sector causal chains) and their role in showing the achievement of outputs/results linked to payment disbursement.
- In the payment for output/results option, programming would likely increase costs related to the definition of outputs/results indicators and payment conditions related to that. This increase could be mitigated if processes/methodologies to define payments conditions and the related indicators triggering payment are sufficiently specified and standardised in the legislative framework³⁶, as highlighted above. In the monitoring and evaluation phase, costs are likely to slightly increase in particular due to requirements linked to disbursement indicators and increasingly complex evaluations.
- In the payment based on policy action option, costs incurred at the programming stage would most likely increase due to political and technical conversations to identify policy action to be targeted and to discuss elements which are going to trigger payments. This increase could be mitigated by a close alignment with existing procedures (CSR, European Semester). Costs for monitoring and evaluation would most likely slightly increase because of requirements linked to assessing whether disbursement conditions are being fulfilled and because of increasingly complex evaluations.

³³ See for instance the Spatial Foresight/SWECO/T33 (2017), Study on the “use of new provisions on simplification during the early implementation phase of the European Structural and Investment (ESI) Funds”. (<https://tinyurl.com/ybj746ow>)

³⁴ See for instance the Commission Delegated Regulation (EU) 2017/90 of 31 October 2016 amending Delegated Regulation (EU) 2015/2195 on supplementing Regulation (EU) No 1304/2013 of the European Parliament and of the Council on the European Social Fund, regarding the definition of standard scales of unit costs and lump sums for reimbursement of expenditure by the Commission to Member States.

³⁵ Also see for example the DEval report (2017), “What do we know about the effectiveness of Budget Support” (<https://tinyurl.com/y9u2vuv2>)

³⁶ Evidence from the current ESIF system regarding standard scales of unit costs and lump sums for reimbursement of expenditure by the Commission to Member States suggests that a standardised framework similar to the required one in the Payment for Results option is achievable (see: <https://tinyurl.com/ycr2tmzp> or <https://tinyurl.com/ycr2tmzp>)

In all three options, a reduction of administrative costs at the level of the Member States/ regions would be more likely to materialise during the implementation phase and for controls and audits. It would especially be the case for the sector budget support option, which would fully use national public financial management systems. For payment for outputs/results and payment based on policy action, the decrease would depend on the exact architecture of the delivery system (especially to what extent use is made of national public financial management systems and to what extent additional requirements are built into the EU delivery systems).

5.3 Aspects to be considered when designing budget support elements for ESI Funds

There are a number of more general considerations that are likely to affect administrative costs at the level of both the Commission and Member States/regions if budget support or budget support inspired options were to be used. They relate notably to the distinguishing features of ESI Funds.

The context of ESI Funds is characterised by a high degree of complexity: a wide range of investments, a multilevel governance system, the presence of exogenous influences and potentially high political sensitivity. These elements are not always part of budget support operations in the external action context. In addition, the EU-Member State political and administrative relationships are different within the EU than in the context of a donor-recipient relationship. Complexity, historical relationships and political sensitivity would likely result in increased overall administrative costs in the context of ESI Funds compared to the external action context.

The size of budget support operations in Cohesion Policy could also be a driver of changes in administrative costs. There is limited evidence on the patterns linking administrative costs to the total expenditure under budget support mechanisms. Indeed, the share of administrative costs could be proportional to the total budget, increase less than proportionally ("economies of scale")³⁷, especially for large disbursement, or even more than proportionally ("diseconomies of scale", especially if the start-up costs –see below- are not compensated by the amounts delivered through Budget Support). With this important uncertainty, the decision on the amount of funding to be channelled via budget support or budget support inspired mechanisms could have an important impact on the evolution of administrative costs.

In addition, the transition towards a budget support system would induce specific start-up costs³⁸ to set up a new system and this needs to be added to the operating costs to run a delivery system. Capacity issues might notably generate substantial start-up costs because of the need to develop different skills related to strategic programming for all the considered options. The existence of start-up costs implies that the effects on administrative costs of introducing budget support or budget support inspired mechanisms would likely change over time. For instance, empirical evidence has shown that partner governments typically experience increased costs during the transition towards budget support, with a reversal tendency as policy-learning progress and processes become routines³⁹. However, the split between start-up and operating costs would probably depend on the specific option chosen. For example, the continuation of the current OP structure could help mitigate start-up costs for payment for outputs/results or payment for policy action, if they are introduced into an otherwise not significantly changed management and control system.

Individual features of the three considered budget support options, particularly regarding their operational designs (e.g. eligibility conditions, disbursement indicators, degree of ambition of the policy dialogue, organisation of the implementation...) might lead to different levels of change in administrative costs. It is especially the case for the payment for outputs/results and for payment for policy action.

³⁷ At the Commission level, economies of scale are considered likely to be achievable if large disbursement in ESIF are conducted via Budget Support

³⁸ See for instance European Commission (2017), "External evaluation of the Instrument for Pre-Accession Assistance IPA II". (<https://tinyurl.com/y89rfrwh>)

³⁹ For transaction costs, see the DEval report (2017) "What do we know about the effectiveness of Budget Support", p. 19. (<https://tinyurl.com/y9u2vuv2>)

Under these two options, it would be possible to, at least partially, retain the current ESI Funds system, whereas introducing fully-fledged sector budget support, if not applied to the whole of ESI Funds, would mean introducing a new parallel delivery system. In case of the latter, the co-existence of two systems could lead to additional costs. The option to completely replace the existing shared management system with budget support would not entail additional costs due to the coexistence of two systems. However, as evidenced in the previous tasks of the study, the use of full-fledged budget support does not appear to be a suitable option for all types of investments carried out under ESI Funds. Since the possibility that Budget Support would completely replace the current shared management system does not seem to be realistic, all three options identified are likely to be either additional to the existing shared management system (this would be the case for the fully-fledged sector budget support and potentially for payment for policy action – if the system is not embedded into the existing ESI Funds delivery system) or could be embedded into the existing shared management system (this could be the case for payment based on outputs/results and potentially for payment for policy action, if embedded into existing features of the ESI Funds system).

Considering all these aspects, a clear-cut reduction of administrative costs in the short-run could not be the primary rationale to shift the ESI Funds delivery system towards budget support mechanisms. In the medium to long-term, individual features of the budget support option chosen would determine the level of administrative costs generated at the different administrative levels.

5.4 Administrative costs at the level of beneficiaries

The adoption of budget support mechanisms would have an ambiguous effect on administrative costs for beneficiaries. The direction of changes and their scope would differ quite significantly depending on features of the national public financial management systems under the three identified policy options. High variability would thus be expected between Member States, to be partly explained by national preferences in relevant trade-offs (e.g. simplicity-flexibility versus assurance level) and administrative organisation. The specificities of each policy option would however be likely to favour diverging effects on beneficiaries:

- The sector budget support option would have an ambiguous effect on the beneficiaries, but with potential for simplification. As rules and process would almost entirely depend on the Member States a risk of gold-plating would exist.
- The payments for outputs/results option could induce a significant reduction of administrative burden for beneficiaries. However, since disbursements would be linked to aggregated outcome/results which also depend on the behaviour of beneficiaries, a possibility would exist that (part of) the risk of non-achieving the aggregated targets would be transferred to beneficiaries.
- The payment for policy action option would likely have neutral effects on administrative costs for beneficiaries. In such a delivery system there would be no or a loose connection between individual projects and policy conditions linked to structural reforms. In fact, these reforms would mainly reflect the behaviour of the Public Administration itself.

To sum up the main findings, the following tables provide more details on the qualitative assessment of the likely evolution of administrative costs for the European Commission and the Member States/regions by main phases of the programme cycle (programming, implementation, controls and audits, monitoring and evaluation). They are based on a colour code system (red: increase, grey: neutral or ambiguous, green: decrease) presenting the projected evolution of administrative costs. When sufficient evidence is available, additional details on the magnitude of the expected evolution is provided.

Table 7 Assessment of the evolution of administrative costs for the European Commission under the three policy options

Programme Phase	Sector Budget Support – tasks and projected evolution of administrative costs	Payment for Results – tasks and projected evolution of administrative costs	Policy Action – tasks and projected evolution of administrative costs
Programming	<p>Programming negotiations would focus on the strategic dimensions for the relevant sectors. It would imply more emphasis on policy dialogue between the Commission and the Member States (e.g. negotiation on payment tranches and schedule).</p> <p>Additionally, ex-ante assessments would be more critical and burdensome for the Commission (e.g. ex-ante assessment of the public financial management system).</p> <p>As a consequence, administrative costs related to programming would be likely to rise significantly for the European Commission.</p>	<p>Negotiations between the European Commission and the Member States would cover elements such as eligible actions or technical issues (e.g. costing, selection of indicators, existence of an adapted data collection system...). The extent and difficulty of these negotiations would notably depend on the extent to which the legislation provides an open or relatively closed framework.</p> <p>As a consequence, a slight increase in costs would be likely for the European Commission, especially during the first programming period.</p>	<p>The European Commission would have to negotiate with the Member States elements such as Country Specific Recommendations to be targeted and design of the structural reforms contracts (including the design of the incentive mechanisms).</p> <p>The negotiations are expected to be more challenging than in the current system, given the complex and political nature of conditions. However, programming would be in the continuity of existing processes (notably the CSR).</p> <p>As a consequence, a slight increase in costs would be likely for the European Commission.</p>
Implementation	<p>As funds would flow directly into the national budget, the responsibilities of the European Commission during implementation would be limited. Periodical reviews by the Commission would still be necessary, but lighter than in the ESI Funds system (reports would be more focused than the current annual implementation reports, e.g. on information related to payment tranches).</p> <p>This could lead to a limited decrease in costs for the European Commission.</p>	<p>As the core of this Budget Support option would be the achievement of specified outputs/results, the European Commission would have limited responsibilities in the implementation of projects per se.</p> <p>The costs for the European Commission would likely decrease, with a magnitude depending on the exact operational design (e.g. whether schemes are included in current OP structure or organised differently).</p>	<p>As the core of this Budget Support option would be the implementation of agreed-upon policy conditions (e.g. progress in implementing structural reforms), the European Commission would have limited responsibilities in the implementation phase.</p> <p>The costs for the European Commission would likely decrease, with a magnitude depending on the exact operational design.</p>
Controls and Audits	<p>The role of the European Commission would shift from detailed audits and controls of expenditure to reviewing national budget execution and audit reports of the sector.</p> <p>As a consequence, costs would likely decrease for the Commission, at the expense of assurance.</p>	<p>The role of the European Commission would shift from detailed audits and controls of expenditure to reviewing the achievement of selected indicators.</p> <p>Assurance processes would still have to be organised (focusing mainly on the achievement of conditions and on the underlying system to collect and aggregated data).</p>	<p>The role of the European Commission would shift from detailed audits and controls of expenditure to reviewing the progress of policy conditions. It would not consider expenditure per se.</p> <p>As a consequence, costs would likely decrease for the Commission.</p>

Programme Phase	Sector Budget Support – tasks and projected evolution of administrative costs	Payment for Results – tasks and projected evolution of administrative costs	Policy Action – tasks and projected evolution of administrative costs
		As a consequence, costs would likely remain stable for the Commission.	
Reporting, Monitoring and Evaluation	<p>The European Commission would focus on monitoring and reviewing the entire sector (strategic level), with comparable involvement than in the current system (e.g. periodic reviews). Monitoring of sectors, including data gathering and statistics would become key. The type of evaluation would change significantly.</p> <p>As a consequence, the costs for the European Commission would likely slightly increase.</p>	<p>The European Commission would focus on monitoring and reviewing the progress of outcomes/results. The reliability of indicators and systems to collect data would be central and would likely require important monitoring. The type of evaluation would change significantly</p> <p>As a consequence, the costs for the European Commission would likely slightly increase.</p>	<p>The European Commission would focus on monitoring of policy progress, with comparable involvement than in the current system (e.g. periodic reviews). Even though the type of evaluation would change significantly, the role of the European Commission should remain similar.</p> <p>As a consequence, the costs for the European Commission would likely be similar.</p>

Table 8 Assessment of the evolution of administrative costs for the Member States/regions under the three policy options

Programme phase	Sector Budget Support – tasks and projected evolution of administrative costs	Payment for results – tasks and projected evolution of administrative costs	Policy Action – tasks and projected evolution of administrative costs
Programming	<p>Programming negotiations would focus on the strategic dimensions for the relevant sectors. It would imply more emphasis on policy dialogue between the Commission and the Member States/regions (e.g. negotiation on payment tranches and schedule). Coordination costs between various levels of government (national/regional/local) and between sectoral bodies and horizontal bodies would be substantial.</p> <p>As a consequence, administrative costs related to programming would be likely to rise quite significantly for the Member States.</p>	<p>Negotiations between the European Commission and the Member States would cover elements such as eligible actions or technical issues (e.g. costing, selection of disbursement indicators, existence of an adapted data collection system...). The extent and difficulty of these negotiations would notably depend on the extent to which the legislation provides an open or relatively closed framework.</p> <p>As a consequence, a slight increase in costs would be likely for the Member States, especially during the first programming period.</p>	<p>The European Commission would have to negotiate with the Member States elements such as Country Specific Recommendations to be targeted, design of the structural reforms contracts (including the design of the incentive mechanisms).</p> <p>The negotiations are expected to be more challenging than in the current system, given the complex and political nature of conditions. However, programming would be in the continuity of existing processes (notably the CSR).</p> <p>As a consequence, a slight increase in costs would be likely for the Member States.</p>
Implementation	<p>The Member States would have full responsibility for the implementation of projects/funds under this budget support option. Tasks such as project selection and project monitoring would still have to be carried out, but under purely national rules.</p> <p>The use of national public financial management systems would be likely to lower costs (no requirements for a parallel system with specific rules). The magnitude of changes would depend on the Member States.</p>	<p>The Member States would be responsible for the implementation of projects/funds under this option, potentially using national public financial management systems or the current ESI Funds structure (Operational Programmes).</p> <p>The costs for the Member States would likely decrease, with a magnitude depending on the exact operational design.</p>	<p>The Member States would be responsible for the implementation of projects/funds under this option, potentially using national public financial management systems or the current ESI Funds structure (Operational Programmes).</p> <p>The costs for the Member States would likely decrease, with a magnitude depending on the exact operational design.</p>
Controls and Audits	<p>Audits and controls would be entirely performed in the framework of the national public financial management systems of the Member States. A summary at the sector level could form the basis for EU assurance.</p> <p>The effect on costs for the Member States would therefore likely be ambiguous.</p>	<p>Required controls and audits for the Cohesion Policy would shift from real costs to output and/or result indicators.</p> <p>Regular financial controls and audits would still be conducted in the framework of the national public financial management systems of the Member States.</p> <p>The effect on costs for the Member States would therefore likely be ambiguous.</p>	<p>Required controls and audits for the Cohesion Policy would shift from real costs to the progress of structural reforms.</p> <p>Regular financial controls and audits would still be conducted in the framework of the national public financial management systems of the Member States.</p> <p>The effect on costs for the Member States would therefore likely be ambiguous.</p>

Programme phase	Sector Budget Support – tasks and projected evolution of administrative costs	Payment for results – tasks and projected evolution of administrative costs	Policy Action – tasks and projected evolution of administrative costs
Reporting, Monitoring and Evaluation	<p>The Member States would focus the monitoring on strategic sector results rather than on real costs. They would also present their progress to the Commission during reviews.</p> <p>The Member States would likely have to conduct more complex evaluations (causal links within a sector). These changes would likely slightly increase the costs for the Member States.</p>	<p>The Member States would have to maintain a monitoring and reporting system in line with the requirements related to the disbursement indicators.</p> <p>The Member States would likely have to conduct more complex evaluations (outcome/result-oriented). These changes would likely slightly increase the costs for the Member States.</p>	<p>The Member States would focus the monitoring on the progress of structural reforms (most likely at the national level). However, reporting would still be a significant task. Reviews would take place with the European Commission.</p> <p>Evaluations may become more complex (e.g. contribution of the incentive to the structural reforms). These changes would likely slightly increase the costs for the Member States.</p>

6. SUMMARY OF OPTIONS ACCORDING TO THE ASSESSMENT CRITERIA

The different budget support or budget support inspired options can be compared using the six assessment criteria developed during this study (task 3). It allows capturing main strengths and weaknesses of each of the three options at one glance.

Table 9 Comparison of policy options in terms of assessment criteria

Assessment criteria	Fully fledged (sector) Budget Support	Payment for outputs/results	Payment for policy action
Strategic framework	<p>Sectoral approach which aims at shifting the focus on sector policy objectives +</p> <p>Policy adequacy for all areas covered by ESI Funds not demonstrated (e.g. not adequate for all types of investments, e.g. large investments in hard infrastructure) -</p> <p>Technically challenging to implement at regional/local level; may also be politically sensitive -</p>	<p>Shift from inputs to outputs/results +</p> <p>Appropriate mostly in sectors with a clear intervention logic and enough control over outputs/results -</p>	<p>Improvement of reform incentive, thereby tackling underlying obstacles to effective investments +</p> <p>May be politically sensitive -</p>
Good governance	<p>No clear advantages for partnership issues =</p> <p>Fully flexible delivery (national systems) +</p> <p>Regional/local dimension weakened -</p>	<p>No clear advantages for partnership issues =</p> <p>Flexible delivery (can be fully embedded in existing shared management) +</p> <p>Regional/local dimension depending on design of the instrument =</p>	<p>No clear advantages for partnership issues =</p> <p>Flexible delivery (could be embedded in shared management) +</p> <p>Regional/local dimension depending on design of the instrument =</p>

Sound financial management	Sound financial management depending on the quality of policy dialogue and of underlying systems = Ambiguous effect on administrative costs, start-up costs likely =	Sound financial management partly depending on the quality of underlying systems = Slight reduction in administrative costs after an initial phase +	Focus on incentivising reforms which intend to increase the long term effectiveness of investments + Administrative costs depending on the set up (likely to be lower if embedded in the existing system) =
Legality and regularity	Very high fiduciary risk, no traceability of funds, fungibility issues and reputational risk - Evidence of improvements of national public finance systems in external aid exists, but unclear whether these would materialise in a non-development context =	Some increase in the fiduciary risk - Assurance provided at the level of aggregated results +	Ambiguous effect on fiduciary risk, fungibility issues depending on the design of the instrument, reputational risk =
Simplification	Potential simplification depending on Member States national public financial management systems +	Real simplification based on evidence from the use of simplified cost options +	New dimension of support (process and reform-oriented), neutral on simplification =
Result orientation	Focus on strategic orientations; less information on operations, more information on outcomes and policy processes =	Strongly result-oriented, as disbursements directly linked to aggregated outputs/results +	Results less the focus than improvements in policy processes, which the aim to increase long term effectiveness of investments =

Main take-away from the assessment of the feasibility of the three options for ESI Funds can be summarized as follows:

Fully-fledged budget support is not a delivery mode, which is adequate to deliver the entirety of ESI Funds. ESI Funds cover a broad range of investment areas with different policy objectives and risks. Budget support is not adequate to deliver all types of investments across all of them. For example, there is clear evidence that budget support mechanisms are not adequate to deliver large investments in hard infrastructure. There is no evidence that delivering the entirety of ESI Funds via budget support would be more effective and efficient than shared management. A switch to a fully-fledged budget support would entail trade-offs which need to be taken into account: if the use of budget support entails a significant potential for simplification, the impact on sound financial management and result orientation of ESI Funds would be mixed, while accountability issues, fiduciary risk, including reputational risk for the EU budget would increase significantly. The impact on administrative costs is mixed, with a likely overall increase of

administrative costs for the Commission and a mixed picture for Member States and beneficiaries. Finally, there is little experience with using budget support mechanisms at sub-national level. While budget support at sub-national levels is possible, it is technically challenging and potentially politically sensitive. A switch to budget support for the entirety of ESI Funds may therefore lead to a significant weakening of the regional/local dimension of parts of ESI Funds.

Payments for outputs/results could constitute a simple and effective delivery mechanism for parts of ESI Funds. By putting the focus on achieved outputs and results, this type of approach has an important potential for simplification and to increase result-orientation. However, these approaches are not easily implementable in all areas. Payments for outputs/results are adequate when outputs and results can clearly be attributed to the implementation of a specific programme, where there is sufficient control of implementing bodies over outputs and results to be generated, when time-lags are not too important and where the impact of external factors is not too important. Payments for outputs/results therefore have more potential in some ESI Funds areas than others. They could be explored, for example, in areas such as human capital, social inclusion, energy efficiency, rural development, part of innovation and business support. Experience from the use of simplified cost options in ESI Funds should be taken into account when designing concrete delivery options in these fields.

Payments for policy action could be added to the ESI Funds delivery portfolio with a view to increasing ESI Funds' effectiveness in addressing a broad range of structural and administrative challenges. Mechanisms to link disbursements to the implementation of policy action to be undertaken may be interesting to explore when it comes to supporting structural reforms, tackling sub-national or sectoral bottlenecks, or provide support to soft investments (such as capacity building actions or support to the public administration). The detailed design of each payment based on policy action scheme would have to be tailored to policy objectives of each ESI Fund and to the type of structural and administrative challenges faced. In all cases, element such as ownership at Member State and/or sub-national level of policy action to be implemented, administrative capacity to implement actions/processes and political sensitivity have to be taken into account when designing detailed mechanisms.

APPENDIX 1
REVIEWED LITERATURE

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