Report

Use of country systems in fragile states

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Key messages

- Extreme poverty is forecast to become increasingly concentrated in fragile states. The New Deal for Fragile States aims to improve international engagement with fragile states, and includes commitments to increase the use of country systems.
- The political economy of fragile states is unlikely to be conducive to the use of country systems. Donors thus face a trade-off between the fiduciary risk of using country systems and the risk of undermining the state by bypassing country systems.
- This can be addressed by better assessing where country systems can be used and better mitigating risk through improved programme design. Rather than rely on broad, backward-looking indicators, identify where risks are manageable and acceptable. Additional safeguards can be applied to allow extensive use of government systems.
- Pooled funding can help donors share risk, coordinate support and reduce overhead costs. However, the design of a pooled funds must be carefully tailored to reflect the specific context and objectives of the fund.

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Abbreviations and acronyms

CABRI	Collaborative Africa Budget Reform Initiative
CPIA	Country Policy and Institutional Assessment framework
DAC	Development Assistance Committee (OECD)
FARA	Fixed Amount Reimbursement Agreement
GAC	General Audit Commission
GPEDC	Global Partnership for Effective Development Cooperation
IDPS	International Dialogue on Peacebuilding and Statebuilding
MDTF	Multi-donor trust fund
MTEF	Medium-term expenditure framework
OECD	Organisation for Economic Co-operation and Development
PCPI	Post-Conflict Performance Indicators framework
PEA	Political-economy analysis
PEFA	Public Expenditure and Financial Accountability framework
PFM	Public financial management
PI	Performance indicator (for PEFA framework)
PIU	Project Implementation Unit
PRSP	Poverty Reduction Strategy Paper

Executive summary

Extreme poverty is forecast to become increasingly concentrated in fragile states. At the same time that fragile states have moved up the development agenda, development thinking has increasingly focused on the importance of effective institutions to deliver broad-based economic and social development. Thus the New Deal for Fragile States reaffirms commitments made in the Paris Declaration and Accra Agenda for Action to use and strengthen country systems to generate sustainable progress. Whilst donors have made progress on better engaging with fragile states, supporting fragility assessments, national plans and compacts, less progress has been made on increasing the use of country systems and strengthening national capacities.

The political economy of fragile states is unlikely to be conducive to the use of country systems. The low quality of country systems in many fragile states makes the perception of fiduciary risk especially high. But using country systems is an important component in building state capacity. Bypassing country systems creates additional transaction costs for the government and may even distract attention from the systems that govern the use of domestic resources, undermining accountability of the state. The key trade-off that is faced in using country systems is between this fiduciary risk and the programmatic risk that bypassing country systems can undermine them, making it more difficult to manage a sustainable transition to the management of key functions and services by the state. The decision of how much risk a donor can bear and the balance of programmatic and fiduciary risks is fundamentally political.

Risks can be mitigated through better assessing where country systems can be used, and through improved programme design. First, assessment of the quality of country systems can be improved. The Public Expenditure and Financial Accountability framework (PEFA) is the predominant system, but it is a summary across the whole government and it is backward-looking. It may thus overlook islands of excellence that exist in otherwise unpromising environments and fail to identify opportunities to engage with country systems. Instead, donors can define which part of a country system is essential for their objectives (for example, if increasing the number of teachers is the priority, strong payroll and HR systems are essential but procurement systems will be of less importance). Donors should support the strengthening of these systems not by adopting off-the-shelf international best practices, which often do not travel well, but by using a problem-driven approach that leads to reforms that have both local legitimacy and ownership.

Second, donors can design programmes to mitigate risks, while also aligning them with country systems. There is not just a binary choice between providing budget support or delivering through parallel donor-managed modalities. Project modalities can make extensive use of government systems, even whilst additional safeguards are applied on top of government systems, such as special project accounts or additional payment or procurement processes. Donors can also provide support and monitoring of implementation. Similar safeguards can also be applied even in the case of budget support. For example, it can be provided on a

reimbursement basis after ensuring that only eligible expenditures have been made. Where country systems are not used, donor programmes should "shadow align" with government systems.

Pooled funding can help donors share risk, coordinate support and reduce overhead costs. Pooled funds can allow donors to share risks, and if a pooled fund delivers at scale, then it can also distribute risk across its portfolio by implementing a range of more or less risky projects. Pooled funds can also act as a focal point for coordinating support in a context where the government is unlikely to have the capacity to do this. Pooled funds also allow donors to share, and thus reduce, the costs of setting up the mechanisms needed for risk mitigation such as additional oversight or auditing. However, many pooled funds have not delivered these potential advantages. Expectations must be clear, especially for how the trade-off between delivering quickly and delivering through country systems is to be met, and the design must be tailored to reflect objectives and the specific context.

Examples of how to use country systems, and the role pooled funds can play in this, are drawn from fragile states as diverse as Afghanistan, Liberia, Sierra Leone, South Sudan, and West Bank and Gaza. All are highly aid-dependent, and country systems have been used in all of them except South Sudan. They demonstrate the variety of ways in which aid modalities can be designed to mitigate risk.

This report concludes by setting out some key principles to be considered when making decisions about the use of country systems in fragile states. These revolve around the central conundrum of trading off the fiduciary risks faced in using country systems with the risk of doing harm by undermining the country systems and institutions that are essential for sustainable progress:

- **Understand the country context, including the political economy.** Ensuring accurate understanding may involve undertaking joint analysis with other donors and drawing on fragility assessments prepared as part of the New Deal. In understanding the context for use of country systems, assessment should go beyond broad-brush indicators and identify organisations or sectors where the risk of using country systems are more managements and acceptable.
- **Review your intended programmes through a peacebuilding and statebuilding lens.** How far are programmes and projects contributing to the Peacebuilding and Statebuilding Goals formulated as part of the New Deal? Are programmes strengthening state institutions or undermining them? Are they helping to create conditions to reduce political violence?
- **Understand what you want to achieve** with your overall programme, and whether these are long- or short-term aims (e.g. state-building or rapid delivery of basic services).
- **Identify and agree on key trade-offs, including the risks of not engaging with country systems.** The key trade-off to consider is between fiduciary risk (risk of financial loss) and programme risk (the risk of the programme not achieving developmental results). Using parallel systems and using safeguards may protect against fiduciary or reputational risks, but may undermine programme effectiveness in the short term and government effectiveness in the long run. Similarly, rapid delivery through parallel systems may produce results, but these may be unsustainable. During programme

design, the risks of *not* engaging with country systems should be explicitly considered as well as the risks of engagement with them. Similarly, the trade-offs between fiduciary risk and programme risk, and between achieving more rapid results through parallel systems versus more sustainable results through using and strengthening government systems should be set out and analysed.

- **Match the level of risk you are prepared to bear with the intended modality and the degree of use of country systems.** Careful programme design can create mechanisms that sufficiently mitigate the use of country systems to allow their use. Programmes should also seek to devised strategies that allow progressively greater use of country systems as they are strengthened over time. However, these approaches will need greater supervision, and will thus need a higher level of staffing from donors.
- **Transaction costs can be lowered and risks pooled if country systems are used through pooled funds.** A pooled fund has the potential to provide a mechanism for donors to improve coordination and to share the overhead costs of providing aid through country systems. However, the record of pooled funds shows that they will not achieve these benefits automatically, and must be designed carefully.
- **Support institutional development** through a politically smart, locally owned and problem-driven approach, rather than focusing on international best practice. If the objective is to improve services, technical assistance should focus on those systems most closely associated with budget execution.
- **Choose conditions wisely.** Negative incentives associated with development assistance are now widely acknowledged. The worst of these can be avoided. Commitments on the use of country systems should be linked to measurable implementation of small reform steps which will improve the functioning of country systems.

1 Introduction

The quest for greater aid effectiveness so far feels remarkably unfulfilled. The disappointment with traditional project modalities led to a switch to budget support in the late 1990s and early 2000s, and ultimately to declarations on aid effectiveness in Paris in 2005, Accra in 2008 and Busan in 2011. These included commitments to increase the use of country systems as a part of aligning support with partner countries' national development strategies, institutions and procedures. The argument for using country systems emerged as a central theme for harnessing local ownership, strengthening accountability rather than undermining it and making aid interventions more sustainable. Despite compelling arguments and ambitious international commitments, there was no watershed and progress since 2005 in using country systems has been slow.

In fragile states, one of the hallmarks of which is an ability to provide services to the population, the importance of not undermining government by working outside it has been increasingly recognised. Yet, the political economy of fragile states means that, from a donor perspective, working with governments in these countries carries high risks. The New Deal highlighted the risk that 'International partners can often bypass national interests and actors … and support short-term results at the expense of medium- to long-term sustainable results brought about by building capacity and systems' and called for more effective use of aid to strengthen national capacities and to enhance risk management to allow increased use of country systems (IDPS, 2011).

The importance of the New Deal is underlined by the fact that, while the importance of aid is arguably diminishing in most developing countries as growth in domestic resources and private investments outstrips growth in aid, low-income fragile states remain extremely aid dependent. Extreme poverty has also fallen markedly across the globe. Key exceptions are those countries affected by conflict or facing other forms of insecurity. Though each country is fragile for different reasons, many are characterised by weak state institutions adding to the challenges of fostering security or improving services. Nowhere is the rationale for using country systems clearer – to support the strengthening of state institutions. Yet, rarely are the risks that aid funding will be misspent greater than when using country systems in fragile states. Which concern ought to prevail, and in which countries?

This paper aims to provide practitioners with information that can support decisions to use country systems in fragile states. Section 2 outlines the evolution of thinking on the political economy of fragile states. Understanding the context of operations is essential, and a key part of this is understanding the political economy, and how this can affect the kind of programming selected. Section 3 provides an overview of the use of country systems, including the international commitments made in Paris and Busan, including in the New Deal, and how far these commitments are being met. Section 4 looks at some key issues for the use of country systems in fragile states. It breaks down the country systems that can be used by donors to break the myth that use of country systems is a binary concern – either do it or do not do it. This is complemented by a review of how country systems are measured, how risks

can be better understood and managed, and what this means for the objectives of donor engagement. This section also examines the potential role of pooled funds, and how donors can support institutional development. In Section 5, these debates are contrasted against experiences in a handful of countries – Sierra Leone, Liberia, Afghanistan, South Sudan and West Bank and Gaza. Section 6 concludes with a set of principles that could be used to help guide decisions on when to use country systems in challenging contexts of fragile states.

2 Political economy of fragile states

The first of the OECD principles for engaging in fragile states (OECD, 2007) is for external actors to understand the context in each country. It is thus essential to understand the political economy of the fragile state that is being supported. This section considers how fragility is defined, explores the core conceptualisation of fragility as weak institutions, and sets out the political economy implications of this for working through country systems.

2.1 Defining fragility

There is no universally agreed definition of what constitutes a 'fragile state'. Most development agencies have defined the term as meaning a failure of the state to deliver certain functions that are necessary to meet the most basic of citizens' expectations. The OECD (2008) characterises such states as being 'unable or unwilling to meet [their] populations' expectations or manage changes in expectations and capacity through political processes'. The likelihood that this lack of ability to meet expectations and manage changes will lead to violence is what distinguishes fragile states from other states that similarly struggle to deliver against these objectives (Putzel, 2010).

As a result of different definitions, various institutions maintain different lists of fragile states based on application of different criteria. For example, the World Bank 'harmonised list of fragile situations' is slightly different from the Fund for Peace 'Fragile States Index'. Furthermore, some commentators dislike the 'fragile' term and prefer to talk about 'strong', 'weak' or 'failed' states (e.g. CSRC, 2007); while others are more sceptical about the concept of 'failed' or 'fragile' states in general (e.g. Hagmann and Hoehne, 2009).

The existence of these 'fragile states' is increasingly seen as one of the most important – and intractable – in global development discourse. The emergence of a larger number of weak and often poor states in the post-Cold War era, frequently beset by internal strife and conflict, has led to greater international focus on state fragility and its negative impacts (Fritz and Rocha Menocal, 2007). The challenge of the 'bottom billion' (Collier, 2007) predominantly trapped in poor, conflict-affected (i.e. fragile) states making little or no progress in building institutions that would support economic and social development (Pritchett et al., 2010) is increasingly the concern of the development community. By some projections, mass income-poverty will increasingly be a phenomenon associated with conflict-affected and fragile states (Kharas and Rogerson, 2012). The focus of recent development policy debate on 'leaving no one behind' in eliminating global income poverty will increasingly mean working in conflict-affected and fragile states (UN, 2014).

Specific characteristics of fragility

Fragile states are often seen as each having unique circumstances that make generalisation difficult. Discussion about the nature of fragile states frequently paraphrases Tolstoy to note that 'each unhappy country is unhappy in its own way' (e.g. IMF, 2015; World Bank, 2015). This warns against generalisation or applying the political economy of one fragile state directly to another. In recognition of this, the first principle of donor engagement in fragile states, according to the OECD (2011), is 'to take context as starting point', suggesting that each fragile situation needs to be understood in its own terms rather than approached as a clear universal 'type'.

Despite the varied nature of what can be considered a 'fragile state', the literature does identify some commonalities that are relevant for development actors delivering aid programmes. Review of the fragile states literature sees four types of factors that create and sustain fragility (from McCloughlin, 2012).

1. *Structural and economic factors*: poverty, low income and economic decline, violent conflict, presence of armed insurgents, natural-resource wealth/lack of natural-resource wealth, geography ('bad neighbours'), demographic stress (including urbanisation)
2. *Political and institutional factors*: crises of state legitimacy and authority, bad governance, repression of political competition, weak (formal) institutions, hybrid political orders, institutional multiplicity, political transitions, succession and reform crises in authoritarian states, state predation, neo-patrimonial politics.
3. *Social factors*: horizontal inequalities, severe identify fragmentation, social exclusion, gender inequality, lack of social cohesion (including lack of social capital), weak civil society.
4. *International factors*: colonial legacy, international political economy, climate change, global economic shocks (including food prices).

While not all these factors will be present in each fragile state or environment, they provide an example of the kind of features that international development agencies are likely to experience as they attempt to provide development assistance.

2.2 Fragility as an institutional development problem

International development thinking has increasingly focused on the importance of effective *institutions*[1] in delivering broad-based economic and social development. The idea that the nature, structure and quality of institutions fundamentally determine developmental outcomes is increasingly accepted as a high-level principle in academic theories of comparative economic and political development (e.g. Fukuyama, 2012; North et al., 2009; Acemoglu and Robinson, 2012). The 'good governance' agenda applies this idea to development by suggesting that supporting the 'right' institutions in developing countries can encourage long-term pro-developmental change.

Fragile states can therefore be conceptualised as those that lack effective institutions. The lack of these institutions – to manage conflict between different social actors and/or to deliver basic services to citizens – lies at the root of the

[1] In this context, the term 'institution' is broadly defined to include not only specific organisations and bureaucratic entities but also the *formal* rules, laws and regulations that govern the behaviour of organisations, as well as the wider *informal* 'rules of the game' such as the political, cultural, social and behavioural norms, taboos, customs and codes of conduct that underpin how decisions are made and conflicts resolved (North, 1990).

challenges of fragile states. This situation can persist for a long period, and states that lack effective institutions frequently move through cycles of conflict over long periods with extremely negative effects on development outcomes (World Bank, 2011a).

The nature of the underlying 'political settlement' in fragile states is crucial to understanding the current and future direction of institutional development. Political settlements can be conceptualised as the 'the expression of a common understanding, usually forged between elites, about how power is organised and exercised' (DFID, 2010b). These 'common understandings' may be explicit (for example, written into a formal peace treaty between warring parties) or they may be implicit (for example, an informal understanding that leadership positions in government will be shared among different groups in society). By encouraging an *inclusive* political settlement – one that encourages all powerful social interests to agree to end conflict in return for a certain distribution of economic and political power – donors can support the first steps of developmental change (Putzel and di John, 2012).

The 'peacebuilding' and 'statebuilding' discourse aims to encourage inclusive political settlements and encourage long-term building of pro-developmental institutions. The DAC now outlines a clear 'peacebuilding and statebuilding' approach that should guide donor involvement in fragile states (OECD, 2011). Donor interventions should be structured so that they reinforce, and do not inadvertently undermine, a peaceful political settlement while strengthening 'core' state functions (DFID, 2010b). This guidance emphasises the 'political' nature of aid interventions and the need to ensure that all donor activity – even if it would not traditionally be considered a 'political' intervention – is considered through a peacebuilding and statebuilding lens. Indeed, the wider development discourse puts an increasing emphasis on the need to be 'thinking and working politically' in delivering change in challenging environments (e.g. Leftwich and Wheeler, 2011; Booth and Unsworth, 2014).

2.3 Fragile states and political economy

Discussion of political settlements and the peacebuilding and statebuilding approach provides indications of the nature of the political economy of fragile states. Political economy can be taken to mean 'the interaction of political and economic processes in a society: the distribution of power and wealth between different groups and individuals, and the processes that create, sustain and transform these relationships over time' (DFID, 2009). As noted, the political settlement that underpins a fragile state will contain implicit or sometimes explicit agreements among powerful interests to share economic benefits in a way that satisfies the political interests of most parties. Therefore, the distribution of economic benefits in the political economy of a fragile state is a fundamental reflection of the political settlement.

Alignment between political and economic power is the underlying driver of a stable political economy (Putzel and di John, 2012). For developing countries, this has been most notably conceptualised as a 'limited access order' in development literature. Such an order can be summarised as a situation where: 'political elites divide up control of the economy, each getting some share of the rents. Since outbreaks of violence reduce the rents, the elite factions have incentives to be peaceable most of the time. Adequate stability of the rents and thus of the social order requires limiting access and competition' (North et al., 2007: i). In fragile

states, this limiting of economic and political access results in similar kinds of formal and informal institutions being present, with frequently similar impacts on the resulting political economy.

Political economy and working through government systems

The political economy of a fragile state, derived from its political settlement and the kind of institutions it gives rise to, has a material impact on how the public sector operates and therefore how donors can or might interact with the government. Applying the discussion of the most common features of the political economy of fragile states suggests some conclusions regarding the underlying institutional structures through which government systems will operate.

- *The political logic of fragile states means public resources are often diverted for private benefit.* Using a definition of 'public goods' in the widest sense of the term (to include goods such as security, justice, commercial regulation as well as delivery of public services such as health and education), the nature of fragile states will militate against technical efficiency in delivery. As a result, public resources are frequently used for private gain. This can take many forms, for example:
  - 'grand corruption' of large sums of public funds by powerful individuals and/or networks, for example fraudulent payments for non-existent services made to politically connected individuals or companies
  - 'petty corruption' of small sums of money, for example the practice of lower-level officials demanding bribes that is tolerated by more senior officials who may take a share in return for protection
  - 'soft corruption' where public funds are channelled through official and formal systems to pay for activities that offer very poor value for money to the public and essentially deliver a private benefit to specific individuals, for example use of substantial discretionary allowances for public servants
  - using specific public goods (such as public=sector employment or public housing) to reward politically connected individuals
  - structuring public spending to favour a small group of the relatively wealthy rather than the larger group of the poor, for example education policies that prioritise a small number of students for overseas scholarships rather than mass primary education in rural areas
  - transferring state assets such as land or privatised state enterprises at artificially low prices to favoured clients or family, or by tolerating outright theft
  - diverting natural-resource revenues in a way that benefits (directly or indirectly) powerful political interests
  - diverting the resources of public enterprises, for example state-owned or state-guaranteed banks providing loans that are never repaid to certain individuals or companies, or public utilities tolerating non-payment of electricity bills by certain individuals or institutions.
- *The political logic of fragile states means there are incentives to resist institutionalisation of impersonal rules and laws and instead favour structures that allow for individual discretion.* In order for individuals to access rents and private benefits within the public sector, it is necessary to have relatively weak formal institutions. This means that institutions designed to restrict the discretion of public-sector actors over distribution of private benefits are likely to be resisted. This can be expressed as a lack of transparency over real resource allocation, lack of interest at senior level in internal control systems, and lack of political support for 'watchdog' and oversight institutions such as parliaments and anti-corruption institutions. Indeed, some have characterised this in an African context as the purposeful 'institutionalisation of disorder' (Chabol and Deloz, 1999) that allows for widespread use of discretion and individual decision-making within the public sector.

- *As a result, there are often weak incentives to deliver a high volume of public goods.* Since public resources have a tendency to be diverted for private benefit, and strong rules that might counterbalance this trend are often resisted, public goods tend to be under-delivered compared to an optimal situation. This incentive is in addition to other non-political-economy structural constraints on public goods delivery, such as general lack of resources and poorly trained staff.
- *Where public goods are delivered, there are weaker incentives to deliver them equally*. Political support can be 'purchased' more easily by allocation of selective benefits to networks of supporters through patronage, rather than through broad-based delivery of public goods to everyone. The delivery of public goods on a fully impersonal and equitable basis would undermine a powerful lever of reward and sanction that can be used to strengthen or weaken those networks that suit the interests of members of the ruling coalition.

These features create an inherent tension between typical donor objectives and the political economy of fragile states. Donors typically seek to support programmes that will encourage the broad-based distribution of public goods on the basis of fair, objective criteria so as to deliver equitable development. However, in many fragile states this will go against the logic of how power and resources are distributed.

Some caveats to this broadly negative discussion about the relationship between political economy, fragile states and development outcomes are needed, however. The above list of political economy characteristics typical of a fragile state is not *always* associated with negative development outcomes. States displaying many of these characteristics have historically also been noted as relative development success stories. A wide range of literature reviewing the economic success of East Asia in the post-war era paints a picture of relatively high levels of corruption, clientelistic practices and rent-seeking elite behaviour alongside rapid economic and social development (e.g. Kahn, 2003; 2010). Contemporary Bangladesh has frequently been noted by commentators as an example of a country with dysfunctional politics and poor governance that has nevertheless achieved clear gains in terms of economic and social outcomes in recent decades (e.g. *Economist*, 2012; *The Lancet*, 2013). As a result, while the political-economy features noted above are typically associated with poor development outcomes and state fragility, this need not necessarily always be so. Careful examination of the exact nature of the political settlement, the resulting institutions and the impact of the distribution of economic rents is needed to correctly understand the relationship between political economy considerations and development outcomes.

In addition, it is worth noting that countries with the political economy characteristics listed above do not always display obvious signs of conflict, violence or disorder. Societies can exist in a stable equilibrium – albeit at perhaps a low level – for many years, as long as the economic and political power of important actors remains in some degree of balance. As a result, a fragile state may appear superficially stable and robust for a long period. In some cases it could be that a non-developmental political settlement is nevertheless a 'stable' political settlement (Putzel and di John, 2010). However, sudden shocks (economic or political) that destabilise the current pattern of rent distribution can mean the unravelling of the political settlement and the rapid emergence of conflict. At a global level, for example, geopolitical change in the early 1990s undermined the political economy of the USSR and Yugoslavia, leading to the relatively sudden (and often violent) break-up of these multi-national states. Similarly at an individual country level, the economic shock of an oil-production shutdown in

South Sudan combined with uncontrolled rent-seeking led to the breakdown of the implicit political settlement and rapid (re-)emergence of conflict (de Waal, 2014).

Rigorous challenge by donors to underlying political economy incentives can therefore be potentially destabilising. Given that fragile states are seen as having achieved only an uneasy balance between political and economic power, changes to the political and economic equilibrium forced by donors could have widespread consequences (Putzel, 2010). It is worth noting in this context that the second principle for operating in fragile environments on the OECD (2007) list is 'do no harm'.

Donors therefore face difficult choices when deciding if and how to work with governments. Working with the grain of this power structure – including using country systems – risks supporting negative behaviour, or appearing to 'approve' of the current system. Indeed, many commentators note that poorly designed international aid risks being simply another form of economic rent (alongside natural-resource revenue) that national elites may ultimately subvert to their benefit (e.g. Collier and Hoeffler, 2004). On the other hand, working entirely outside government systems and funding only non-state actors risks missing out on both the statebuilding benefits of supporting public institutions and being a catalyst in the transition from rent-seeking clientelism to a more open social order.

Donors are also subject to their own political economy constraints in fragile states (e.g. Unsworth, 2009). These internal factors vary between donors, but frequently relate to the need for donors to demonstrate quick and visible results, spend increasingly large sums of money in fragile states, avoid significant fiduciary risk while also complying with international obligations and commitments to use country systems (e.g. Natsios, 2010, for discussion of USAID). These internally generated political economy constraints will affect the decision on whether and how to use country systems. Donors could, therefore, usefully invest more time in examining their own political economy drivers, notably how the multiple objectives of donor aid programmes can affect decisions about risk tolerance when deciding whether and how to use country systems.

These conclusions have significant implications for donors working in contexts of state fragility in comparison to more stable environments. It suggests that there are few 'off-the-shelf' solutions that can be easily transferred from one fragile context to the next. Instead, 'taking context as starting point' (the first OECD-DAC principle of engagement in fragile states) means designing original programmes with a focus on the specific drivers of fragility in the country concerned. It suggests the need for a much greater investment in understanding the interactions between external aid and the underlying political settlement and supporting political economy (see below for a discussion on political economy analysis). It means a greater emphasis on sectors in which many traditional donors are often less experienced.

The 2011 *World Development Report* (World Bank, 2011a) on conflict and fragility puts a clear priority on 'security, justice and jobs' in fragile situations. Of the five 'Peacebuilding and Statebuilding Goals' only one refers to service delivery (the others cover security, justice and jobs and legitimate politics). This emphasis contrasts with the traditional focus of Western donors on basic-service delivery, particularly in health and education, and infrastructure development. The analysis also encourages a long-term view. The emergence of pro-developmental institutions in Western society is typically conceived as being the result of a centuries-long process (e.g. Fukuyama, 2012; North et al., 2009); and many poor fragile states today are on a trajectory of capacity development in their public

institutions that means it may take decades to reach even a middling level of performance (Pritchett et al., 2010). Donors must therefore be ready to invest in institution building for the long term.

Numerous tools of analysis exist to try and help donors better understand the circumstances of where they are working. Political economy analysis (PEA) tools provide a framework and methodology for donors to undertake formal investigations into the countries in which they work. This kind of analysis can then be used by donors to help inform a decision about whether to use country systems in some form. Numerous frameworks (see McCloughlin (2014) for an overview) cover sector, country and individual problem-driven levels of analysis. Several frameworks have been formally adopted by leading donor organisations (e.g. DFID, 2009; World Bank, 2011b; SIDA, 2013). The advantages and disadvantages of different PEA tools have generated extensive commentary of their own (e.g. Fisher and Marquette, 2013). It is beyond the scope of this paper to review PEA models in detail, but others have noted that the most established PEA models all share a focus on the interaction between economic rents and political power, and typically share similar underlying principles relating to: the centrality of politics; a downplaying of normative prescription; a focus on underlying factors that shape the political process; and a focus on donors as political actors themselves (from Mcloughlin, 2014). There are also suggestions that donors have not managed to harness these tools in a way that yields changes in organisational behaviour (Yanguas and Hulme, 2014). While the reasons are not clear, this clearly points to the need for donors to think more carefully about how political considerations can be more closely integrated into their programming process.

3 Overview of use of country systems

This section outlines the rationale for using country systems, highlighting the concern that operating outside country systems can weaken them. How use of country systems is defined in international commitments on aid effectiveness is then discussed, followed by consideration of how the strength of country systems is assessed. International commitments on use of country systems are then examined, together with the evidence on how far these are actually being met.

3.1 Why is use of country systems important?

As Section 2 discussed, development thinking has increasingly emphasised the centrality of effective institutions – a capable state able to carry out its core functions of managing social conflict and delivering basic services. Statebuilding has thus been recognised as a central challenge in fragile states. One of the OECD's Principles for Good International Engagement in Fragile States and Situations is to 'Focus on statebuilding as the central objective' (OECD, 2007), and this has been further elaborated as the 'Peacebuilding and Statebuilding Goals'[2] under the New Deal for engagement in fragile states (IDPS, 2011).

The argument is that using countries' own systems is central to building sustainable and effective institutions. Bypassing country systems and using donors' separate systems imposes transaction costs on government, diverting attention from managing their own funds, and undermines the development of countries' own systems in favour of servicing a donor-constructed system (OECD, 2010). The risk is that a 'dual public sector' is created, 'run parallel to, and often in competition with, national state structures' (OECD, 2010).

Moreover, there are compelling theoretical arguments that using country systems can: reinforce accountability of the state, rather than this being diffused between the state and fragmented donors; strengthen rather than fragment planning policy and planning processes; and reinforce 'learning by doing' so that state structures can develop over time. If resources are spent through parallel systems, there will be no opportunity for institutions and systems to 'learn by doing' prior to the state being able to mobilise increasing domestic resources. If the capacity of country systems to manage funds and deliver services is not built by using them, the risk is that any progress made through aid spending is simply unsustainable. Some have gone further to argue that bypassing the state can actually destroy the institutional capacity that exists (Fukuyama, 2004: 39), for example by poaching government staff for donor projects, undermining the local private sector that cannot fulfil

[2] The five Peacebuilding and Statebuilding Goals are:

- legitimate politics – foster inclusive political settlements and conflict resolution
- security – establish and strengthen people's security
- justice – address injustices and increase people's access to justice
- economic foundations – generate employment and improve livelihoods
- revenues and services – manage revenue and build capacity for accountable and fair service delivery.

complicated donor procedures, and overwhelming government staff with the requirements of fragmented mini-projects (Ghani and Lockhart, 2008: chapter 5).

However, the evidence for these effects is contested. Knack (2012) states that there is little systematic cross-country quantitative evidence for these effects. He notes that 'Although the [Paris Declaration] principles and associated indicators reflect a broad consensus within the donor community...the empirical basis for this new aid effectiveness agenda is thin. Advocacy for reform of donor practices is based on theory, intuition and scattered anecdotal evidence.'

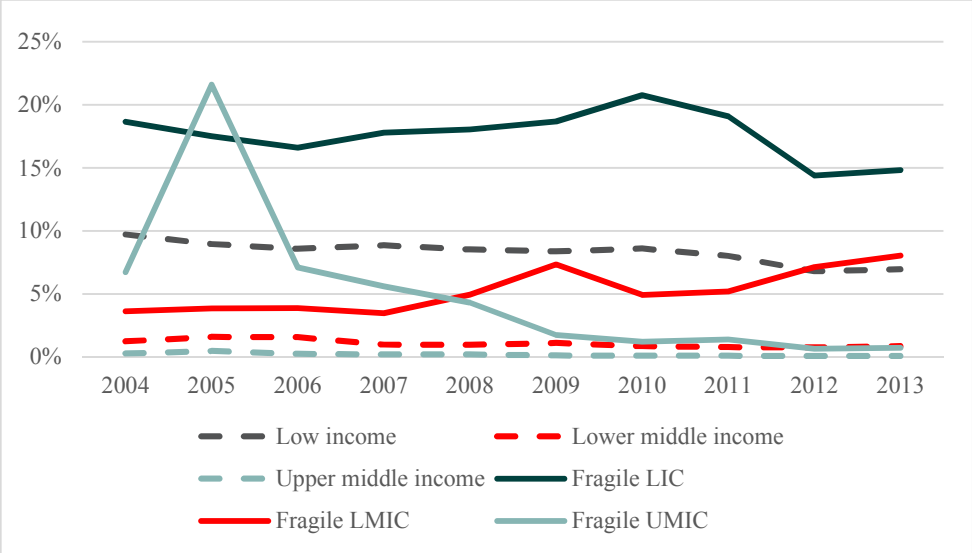
But this may simply be because there is an insufficient record of use of country systems to evaluate systematically. The evaluation of the Paris Declaration found that alignment with country systems started from a mostly low base and made mostly slow progress (Wood et al., 2011: 19) and that 'a large majority of the evaluations find only limited if any overall increase by most donors in the use of country systems and procedures, notably financial and procurement systems.' (Wood et al., 2011: 24).

Budget support is perhaps the purest use of country systems. Tavakoli and Smith (2013) review a decade of evaluations of budget support, finding that it is associated with improvements in country financial management systems. Glennie et al. (2013: 23) analyse the explanations for the findings contained in this evidence base and point to two. First, that use of country systems incentivised increased oversight and engagement from the government and its accountability agencies, donors and civil society, and that this increased donor knowledge led to better capacity-building interventions. Second, using country systems bought donors 'a seat at the table' from which to pressure more effectively for improvements in systems. This pressure was not simply from applying system-strengthening conditions to aid, but also from policy dialogue on system strengthening.

These studies also all agree that the evidence is clear that fragmented, project-based aid weakens country systems. Knack (2012) notes that where systematic empirical evidence exists for the Paris Declaration, this is for the harmonisation elements (the adverse effects of fragmentation of aid among a larger number of donors), rather than for the alignment elements that cover use of country systems. In particular, Knack and Rahman (2007) find that greater donor fragmentation, and smaller shares of aid coming from multilateral agencies, are associated with declines in the quality of a country's bureaucracy. Tavakoli and Smith (2013) note that one of the original rationales for the move to greater budget support was that evaluations in the 1980s and 1990s suggested that parallel, non-government project management arrangements seriously undermined the effectiveness of government systems. Similarly, Glennie et al. (2013: 20) state that 'the evidential basis for the move towards using country systems relied heavily on negative experiences of project aid rather than positive experiences of a programme approach.'

Thus the evidence suggests that there is a real risk that operating outside country systems will weaken them, with the focus instead on parallel systems run by donors. This risk is even higher in low-income fragile states as they are so aid-dependent. Figure 1 shows aid as a percentage of GDP for fragile states by income level, and for the group of countries at that income level. All fragile states are more aid-dependent than other countries at the same income level, with low-income fragile states being notably aid dependent. With average aid as a percentage of GDP of around 15%, and revenue as a percentage of GDP of only around 11-12% in fragile states (World Development Indicators), this means that in low-income fragile states donor resources tend to make up a large share, even a majority, of the resources available to the public sector.

Figure 1: Aid as a percentage of GDP by country category



Sources: World Development Indicators, authors' own calculations

A further rationale for increased use of country systems in fragile states is that improved functioning of country systems will lead to improved service delivery by local and central governments, which will increase their legitimacy. However, the evidence for this is not clear: 'Emerging evidence thus suggests that improvements in services do not appear to shape perceptions of state legitimacy in a simple, linear way. But a relationship does appear to exist: poor experiences of service quality tend to lead to declining perceptions of the state, while inclusive participation and mechanisms to raise grievances appear to have a positive effect' (Denney et al., 2015: 4-5). The way in which a state engages with its citizens may be more important for legitimacy than the level of services provided. Thus, where working through government systems also improves how those systems relate to citizens, this has the potential to increase state legitimacy. This finding is in some ways analogous to the finding that improved accountability to poor people is essential for improving service delivery (World Bank, 2003). Similarly, the kind of participatory processes which aim to foster accountability also seem to create greater legitimacy.

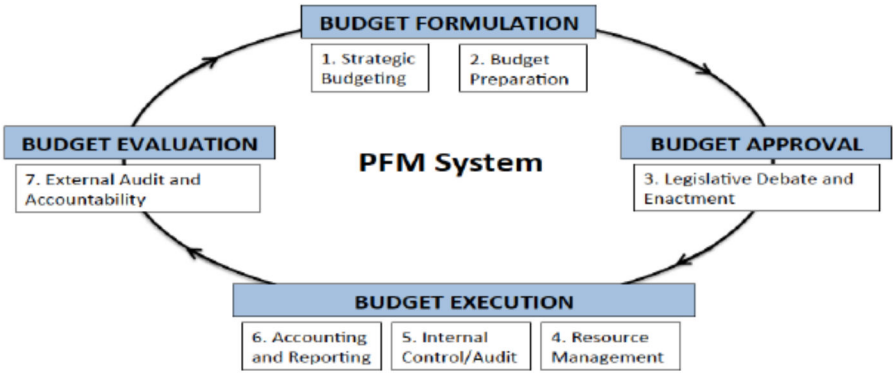
While there is not cross-country quantitative evidence that using country systems strengthens them, there is evidence from a variety of evaluations that budget support – perhaps the purest use of country systems – has this effect. And conversely, there is strong evidence that fragmented, project-based aid that bypasses country systems weakens them. Low-income fragile states are extremely aid-dependent and thus, if a substantial proportion of aid does not use country systems, there is an extremely high risk that this will reduce the effectiveness of country systems and the state will be weakened as a locus for decision-making which will instead take place in parallel donor systems.

3.2 Defining use of country systems

'Country systems' is typically used as a shorthand for 'country public financial management (PFM) systems'. These are the systems used to manage public resources (revenues and expenditures). As set out in Figure 2, a typical PFM system incorporates four main functions, which are further sub-divided into key processes. Figure 2 is of course greatly simplified. In practice, each broad category requires numerous systems and functions. For example, resource management depends on

systems for procurement, project management, cash and payment management, debt management, human resources, and so on. Each category may also span different levels and types of government organisation – such as local government, state-owned enterprises and semi-autonomous bodies.

Figure 2: A simplified view of a PFM system



Source: Andrews et al. (2014)

The Collaborative Africa Budget Reform Initiative (CABRI) set out a typology of the different dimensions of use of country systems in a 2008 report, *Putting aid on budget* (CABRI, 2008). This disaggregated country systems across the main stages of the budget cycle: planning and budgeting; budget executing; reporting and audit). These dimensions are shown in Table 1.

Table 1: Dimensions of use of country systems

Term	Definition
On plan	Aid is integrated into spending agencies' strategic planning and supporting documentation for policy intentions behind the budget submissions.
On budget	Aid is integrated into budgeting processes and is reflected in the documentation submitted with the budget to the legislature.
On parliament	Aid is included in the revenue and appropriations approved by parliament.
On treasury	Aid is disbursed into the government's main revenue funds and is managed through the government's systems.
On procurement	Procurement using aid funds follows the government's standard procurement procedures.
On account	Aid is recorded and accounted for in the government's accounting system, in line with the government's classification system.
On audit	Aid is audited by the government's auditing system.
On report	Aid is included in ex-post reports by the government.

Source: CABRI (2008)

More recent CABRI research (CABRI, 2014) emphasises the need to make a clearer distinction as to what 'use of country systems' means when considering these dimensions. Putting aid on plan, on budget and on report is largely an issue of aid transparency and coordination that enables a government to integrate this information into its own decision-making. It may not involve government having real influence over how the aid funds are to be spent, even if the information on how aid is to be spent is included in government documentation.

The issue of how aid funds are actually managed – whether donors actually rely on country systems to manage their resources – are more about putting aid on treasury, procurement and account. In these cases aid funding is under the control of

government and passes through the government's budget execution systems (see Figure 1). One limitation of the CABRI classification is that putting funds 'on treasury' is a relatively narrow way of think about how government manages resources. Andrews et al. (2014) instead refer to 'resource management', including human resource management and payroll systems for paying salaries, procurement systems for purchasing goods and services and public investment management systems for managing capital expenditures, which includes procurement and project management. These are the functions which will need to work acceptably for donors to use country systems. How the multilateral development banks use country systems is described in Box 1 below.

Depending on the ultimate objective of funding provided to government, the relevant parts of the PFM system that matter may differ. For example, the key PFM functions contributing to effective service delivery will vary substantially between different service sectors that require different mixes of inputs. Education services require substantial salary inputs to pay teachers and funds for day-to-day operational costs to be provided to schools, both dispersed across a wide area, whereas road construction requires large capital expenditures and an effective procurement function to contract these activities with construction firms (Welham et al., 2013).

In line with the theorised link between tax and accountability, one PFM function that could contribute to statebuilding is expansion of the tax base. Given the evidence on the aid dependence of fragile states presented above, and in the case studies such as Afghanistan and Palestine, this is likely to be true as a simple matter of the sustainability of the state. Functions also required are basic expenditure control and execution functions that allow a state control over where it is spending funds, and regular and timely payment of sector salaries as a stabilising and confidence-building mechanism (Welham et al., 2013).

Box 1: Use of country systems by multilateral development banks

Multilateral development banks' (MDBs') original financial modality was loans to governments facing foreign exchange constraints, so the presumption was that a government would use its own systems to manage funds, subject to a banker's loan appraisal. As these appraisals started to indicate significant fiduciary and implementation risks, additional safeguards were introduced, including MDB requirements for use of their own procurement rules, environmental standards, and rules for compulsory land acquisition and involuntary resettlement.

Using the CABRI classification of country systems, MDB financing is almost always on plan, on budget and on parliament. MDBs' selection processes for new financing involve consultations with counterparts, usually the ministers of finance or planning, to agree on activities within national plans. MDB financing is usually on budget, particularly as counterpart funds may be needed and to ensure that recurrent costs will be financed. Depending on the constitutional requirements, MDB loan agreements may require ratification by the legislature, or approval as part of the government's overall budget and the authority to enter into foreign commitments (e.g. loans) to implement it.

The degree to which MDB finance is *on-treasury* depends on the financing instrument and the assessment of fiduciary risk in the country. Budget support is fully on treasury. For example, under World Bank Development Policy Loans/Credits/Grants financing, funds are deposited a country's foreign exchange reserves account (usually at the central bank) and the bank then deposits an equivalent amount in local currency into the government's single

treasury account. The World Bank carries out an assessment of country fiduciary systems before agreeing to a DPL and strengthening areas of weakness may be a requirement for the reforms supported by the loan or grant. Similarly, the African Development Bank's rules for policy-based lending call for a trend of increasing fiduciary capacity as adequate for budget support. For investment projects, the World Bank uses the borrower's own financial management systems 'where appropriate' and to mitigate risk where these are inadequate. Typical practice is to establish a dedicated account at the central bank or another bank and provide funds in advance to the government to draw from to pay contractors and suppliers related to the project. Expenditures from this dedicated account are normally reviewed on the basis of unaudited reports and the account is topped up when its balance falls below a threshold. In other cases, the World Bank will reimburse on actual expenditure, or directly pay third parties such as contractors; these arrangements can be used in a post-conflict situation where financial management systems have not been fully restored.

The use of country *procurement* systems under MDB financing has depended on the choice of financing instrument. Budget support operations such as DPLs use the country's own systems. In the case of the World Bank, investment lending requires application of the Bank's Procurement Guidelines, which are really procurement rules. In 2015 the World Bank's Board approved changes to procurement rules that allow alternative procurement arrangements, including use of national procurement systems, in 'clearly defined circumstances.' [3] However, whist the new policy allows greater use of country systems, responses to the new policy (as set out in the policy paper) from contractors, suppliers and donor governments may force conservative, risk averse assessments of national systems and slow movement towards using them.

The World Bank's new Program for Results (PfR) instrument has use of country systems as the default, but the kind of controls used in investment lending may be imposed in situations which Bank staff consider risky. Borrower feedback from this instrument has been favourable and includes reduced transaction processes, borrowers institutionalising the verification of results, and a shift in the dialogue with Bank staff from verification to results.[4]

As set out above, the CABRI typology does not focus on the broader budget execution systems of government. Significant fraud and corruption can take place during implementation, such as through contract variation negotiations and shoddy construction work, which might not be detected through a conventional audit. MDB staff thus engage in extensive monitoring of *project implementation* to ensure that the project is on-track to achieve its outputs on time, its development objectives, and to check whether funds are going to their intended purpose. This monitoring is more than ensuring compliance with loan agreements and can be a critical source of implementation advice, particularly in fragile states, where project management capacity can be weak. The World Bank's new procurement framework specifically allows Bank staff to provide advice during procurement which was formerly forbidden because of potential liabilities. In addition to this, MDBs have tended to create their own *monitoring and evaluation systems* to meet the banks' needs, although borrowers are required to analyse the results at project completion. There is a trend towards strengthening local capacity for performance auditing and monitoring and evaluation and this is constrained more by a MDB's narrow focus on 'its' projects than by MDB policies and procedures.

Project accounts are *audited* by an auditor acceptable to the World Bank. This is often the government's auditor but when this lacks capacity, the government may engage an external firm. In the case of trust funds in fragile states

[3] World Bank (2015) *Procurement in World Bank investment project financing. Phase II: the new procurement framework.* http://consultations.worldbank.org/Data/hub/files/consultation-template/procurement-policy-review-consultationsopenconsultationtemplate/phases/phase_ii_the_new_procurement_framework_-_board_paper.pdf

[4] World Bank (2015*) Program-for-Results: Two Year Review*

financing recurrent costs such as government salaries and operating costs, the Bank may appoint its own monitoring agent to carry out ex post review of previously incurred expenditures and declare those that fail to pass government audit or monitoring agent review as ineligible for reimbursement from the trust fund.[5]

Other derogations from country systems

MDBs have imposed their own rules for environmental management and involuntary resettlement related to investment projects which can affect the human rights of project affected people. While strengthening and using country systems in these areas is under review in the case of the World Bank, this has proved controversial among international NGOs and the governments of some industrialised countries.

In summary, MDB use of country systems depends on the choice of financing instrument, with development policy lending (i.e. budget support) tending to use country systems fully, with some additional safeguards in particularly risky environments. Investment lending tends to ring fence procurement, with the partial exception of locally procured items, and requires funds to flow through a dedicated account managed by the finance ministry. In other respects such as national plans, budgets, legislative approval, project implementation, financial accounting, audit and reporting, MDB financing normally uses national systems. MDB procedures have flexibility to require additional capacity or controls in high risk environments, which may include ring fencing, contracting out services, or special oversight arrangements. The extent to which a MDB uses country systems depends on its dominant shareholders and how these constituencies balance fiduciary, programme results and strategic risks with value for money.

Two main conclusions can be drawn from this discussion. First, all donors should at a minimum be able to put aid on plan and on budget, as this does not require ceding any control of funding to recipient governments. Doing this could also help mitigate concerns that substantial off-budget aid flows reduce focus of the state as a centre for allocation of resources. Second, the specifics of the country systems to be utilised will ultimately depend on the overall objectives of the donor funding, and the sectors it is to be focused on.

3.3 How are country systems assessed?

A key challenge surrounding the decision to use country systems, or not, is how to objectively assess those systems. Without a reasonable understanding of the reliability of country systems, donors will not be able to accurately judge which country systems to use and when the risks outweigh the benefits. Also, if the quality of country systems cannot be measured, it makes it more difficult to hold donors accountable for using (or not using) country systems.

This sub-section looks in more detail at how donors currently measure and assess country systems. The most significant point for practitioners is that the current suite of measures and indicators of PFM quality provide a useful benchmark for good practice, but do not always reveal how well systems actually work or give an indication of their future performance. Such macro-level indicators are particularly ill-suited to fragile states where the context changes rapidly and systems are more likely to function in islands of excellence, rather than consistently across public financial management processes and organisational units.

[5] See World Bank (2006) Disbursement handbook for World Bank clients for more on how the flow of funds to borrowers is managed.

How do we assess country PFM systems?

The most widely used indicators for assessing the overall quality of public finance management (PFM) systems are the Country Policy and Institutional Assessment (CPIA) framework and the Public Expenditure and Financial Accountability (PEFA) framework. These are complemented by a range of other frameworks used to measure the quality of country systems as a whole, or specific areas such as procurement. The focus here is mainly on PEFA, which has become the dominant framework for most donors assessing PFM systems in partner countries.

The CPIA is a broad framework that measures a number of dimensions of governance and policy. Historically, CPIA was used as the main basis for monitoring country systems under the Paris Declaration and the Busan Agreement. The specific PFM measure is for the quality of budgetary and financial management, which has three dimensions that carry equal weight (World Bank, 2011c: 39). These are the extent to which there is:

1. a comprehensive and credible budget, linked to policy priorities
2. effective financial management systems to ensure that the budget is implemented as intended in a controlled and predictable way
3. timely and accurate accounting and fiscal reporting, including timely audit of public accounts and effective arrangements for follow up.

There has been a notable shift over the past decade away from using CPIA to measure country systems, including for monitoring donor commitments to use country systems under the Paris Declaration and the Busan Agreement. In its place, there is a preference for using the PEFA framework (Box 2). CPIA is also being replaced by the World Bank as the main tool for guiding International Development Association (IDA) exceptional allocations, which go to 'post-conflict and re-engaging countries' which will instead be guided by the more granular Post-Conflict Performance Indicators Framework (PCPI).[6]

Box 2: Changes to PEFA and the Busan monitoring indicators

There are currently two important changes to how country systems are assessed internationally, both centred on the Public Expenditure and Financial Accountability (PEFA) framework.

First, the PEFA indicators are under review. The objective of the changes is to: respond to clarifications from users; keep up with changes in 'generally accepted good practices'; improve relevance; and maintain comparability with the assessments that have been conducted already. Consultations and testing will be coming to an end in 2015, and the new framework is likely to be launched in 2016. The proposals opened for consultation affected nearly all the indicators and would expand the new framework from 76 to 88 dimensions while controversially dropping indicators of donor performance. Though changes are relatively extensive, the new PEFA framework will look and score reasonably similarly – and so is open to the same mis-uses as previous versions.

Second, the Effective Institutions Platform has held consultations on changes to the monitoring indicators in the Busan Agreement for the use of country systems. The proposal is to replace the CPIA score with a composite index

[6] In practice, this only covers a few fragile states on the World Bank's harmonised list. In 2013 the countries listed as *post-conflict* were Afghanistan, Burundi, DRC, Côte d'Ivoire, Liberia and South Sudan. Only the Central African Republic, Haiti, Myanmar and Togo qualified as *re-engaging* countries. Scoring corresponds broadly to CPIA, with a similar scale, but some measures are more specific while others cover criteria that CPIA does not (e.g. post-conflict risk). For more information on PCPI, see: http://www.worldbank.org/ida/ISIA/PCPI2011-QAAug2012.pdf.

created from the PEFA indicator set, with seven fixed components and seven agreed through the Country Dialogues. This avoids the need to conduct a full PEFA assessment, which is usually done every two years, or even less frequently, and so impractical for monitoring annual performance. This will make the scoring of country systems more transparent and collaborative. However, it will also place greater importance on the PEFA framework, which may open assessments up to gaming.

Sources: Effective Institutions Platform and PEFA Secretariat

The majority of donors' assessments of fiduciary risk now use PEFA as the basis for assessing the quality of public financial management in recipient countries. Though CPIA scores and PEFA scores are correlated, the PEFA framework is broader and more transparent. The PEFA framework was introduced in 2005 and measures performance against 28 separate performance indicators (PIs) that cover the full budget cycle (Table 2). Each performance indicator may have more than one dimension that is assessed. For example, PI-2 measures (i) variance in the composition of expenditures, and (ii) actual expenditure charged to the contingency fund.

The PEFA framework has a number of other advantages. Unlike the CPIA, scores are not combined into one aggregate score, in the recognition that it is difficult to appropriately weight the importance of each aspect of the PFM system in different countries. Also unlike CPIA, PEFA assessments are accompanied by a report explaining the rationale for the rating, which is often contested in CPIA assessments. In good reports this goes beyond a review of the scoring to provide necessary caveats (such as where a score is not reflective of system quality) or a description of where reform is genuinely important. Finally, PEFA assessments can be conducted by country officials and have even been applied to review local government systems.

Table 2: The PEFA framework

A. PFM-OUT-TURNS: Credibility of the budget	
PI-1	Aggregate expenditure out-turn compared to original approved budget
PI-2	Composition of expenditure out-turn compared to original approved budget
PI-3	Aggregate revenue out-turn compared to original approved budget
PI-4	Stock and monitoring of expenditure payment arrears
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and transparency	
PI-5	Classification of the budget
PI-6	Comprehensiveness of information included in budget documentation
PI-7	Extent of unreported government operations
PI-8	Transparency of inter-governmental fiscal relations
PI-9	Oversight of aggregate fiscal risk from other public sector entities
PI-10	Public access to key fiscal information
C. BUDGET CYCLE	
C (i) Policy-based budgeting	
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
C (ii) Predictability and control in budget execution	
PI-13	Transparency of taxpayer obligations and liabilities
PI-14	Effectiveness of measures for taxpayer registration and tax assessment
PI-15	Effectiveness in collection of tax payments
PI-16	Predictability in the availability of funds for commitment of expenditures
PI-17	Recording and management of cash balances, debt and guarantees
PI-18	Effectiveness of payroll controls

PI-19	Competition, value for money and controls in procurement
PI-20	Effectiveness of internal controls for non-salary expenditure
PI-21	Effectiveness of internal audit
C (iii) Accounting, recording and reporting	
PI-22	Timeliness and regularity of accounts reconciliation
PI-23	Availability of information on resources received by service delivery units
PI-24	Quality and timeliness of in-year budget reports
PI-25	Quality and timeliness of annual financial statements
C (iv) External scrutiny and audit	
PI-26	Scope, nature and follow-up of external audit
PI-27	Legislative scrutiny of the annual budget law
PI-28	Legislative scrutiny of external audit reports
D. DONOR PRACTICES	
D-1	Predictability of direct budget support
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid
D-3	Proportion of aid that is managed by use of national procedures

In addition to CPIA and the PEFA framework, there are a number of targeted assessments that can support a more detailed evaluation of some country systems, such as procurement, debt management, accounting, audit and budget transparency. There are also tools that engage more with policy, such as Public Expenditure Reviews (PERs). Some of these frameworks are listed in Table 3. Though completed assessments are not always available to the public, it is standard practice in most countries for the final results to be shared with development partners.

An in-depth assessment of each framework is beyond the scope of this paper, but some may provide a useful complement to more high-level PFM assessments. For instance, the World Bank has used procurement assessments when assessing fiduciary risk (Shand, 2006). The IMF has recently introduced a Public Investment Management Assessment that could help donors understand more about financial management related to investment projects using country systems. Public Expenditure Tracking Surveys may give a micro-level understanding of actual resource flows in a given sector which could be important for the quality of service delivery (Box 3). Critically, the limitations that are discussed next in relation to the PEFA framework also apply to these diagnostic tools.

Table 3: Other diagnostic tools

Organisation	Assessment
IMF	Reports on the Observance of Standards and Codes (ROSCs)[7] Public Investment Management Assessment (PIMA)
World Bank	Reports on the Observance of Standards and Codes (ROSCs) Public Expenditure Review (PER) Public Expenditure Tracking Survey (PETS) Diagnostic Framework for Assessing Public Investment Management Debt Management Performance Assessment (DEMPA) Country Procurement Assessment Report (CPAR) Gap Analysis Framework for Comparing Public Sector Accounting to International Standards Guidance Methodology to Assess Alternative Procurement Arrangements[8]
OECD	Methodology for Assessment of National Procurement Systems (MAPS)
AFROSAI-E	Strategic Capabilities Model

[7] Managed jointly between the IMF and World Bank. ROSCs cover 12 recognised areas, including accounting; auditing; fiscal transparency; monetary and financial policy transparency; and payments systems.

[8] See World Bank (2015b). Although this guidance is draft, the new procurement policy was approved by the World Bank's Board on July 21, 2015. http://consultations.worldbank.org/Data/hub/files/consultation-template/procurement-policy-review-consultationsopenconsultationtemplate/materials/annex_j_-_alternative_procurement_arrangements_0.pdf.

CIIA	Internal Audit Capability Model
CIPFA	Financial Management Model
EIPA	The Common Assessment Framework (CAF)
INTOSAI	Capacity Building Needs Assessment Toolkit for Supreme Audit Institutions
UK NAO	SAI Maturity Model

Source: adapted from OECD (2011)

Box 3: Public Expenditure Tracking Surveys (PETS)

Tools such as PEFA assess the broad landscape of PFM, usually at the national level, but also sometimes of subnational governments. This is best suited to general budget support and a shallow assessment of fiduciary risk.

However, of all the available tools, possibly the most useful for donors wanting to support service delivery in a specific sector are Public Expenditure Tracking Surveys (PETS) and Quantitative Service Delivery Surveys (QSDS). These track the flow of resources (financial, human and other) from central government to service-delivery unit (Koziol and Tolmie, 2010). They map resource flows, analyse public expenditures in relation to those flows and are analysed against survey information from frontline service providers.

The advantage of PETS is that they give a clearer picture of what actually happens to resources appropriated for service delivery. Generally these have been applied to the health and education sectors (Gurkan, et al., 2009) where donors have had a greater involvement. Common problems that such surveys have revealed are provider absenteeism, delays in transfers or in-kind support and leakage of funds, particularly in non-wage expenditures (Reinikka and Smith, 2004; Koziol and Tolmie, 2010). Such issues are unlikely to be revealed through standard PFM diagnostics or public expenditure analysis.

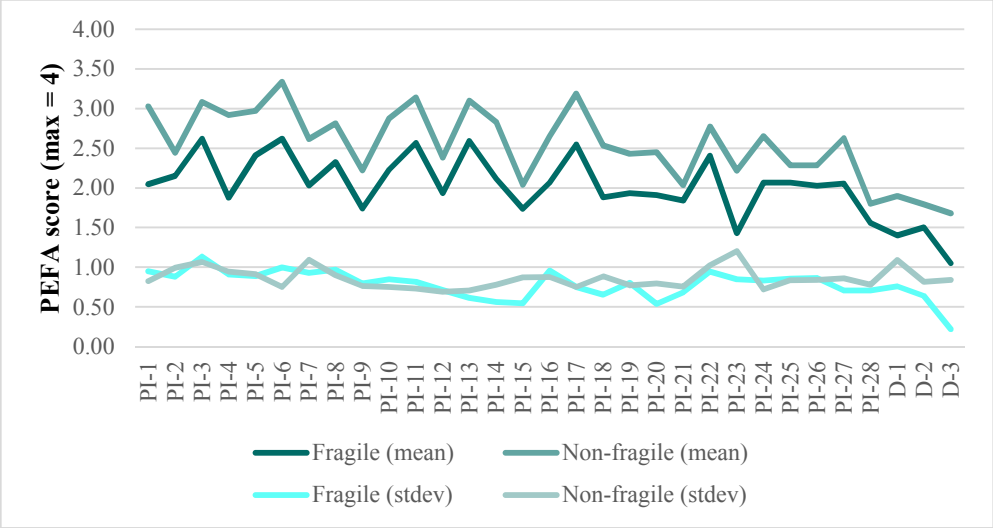
Experience in some countries has also shown that such information can trigger changes in government behaviour. A notable case is Uganda where PETS found massive leakage (a bad thing) but also stimulated reform by the finance ministry to safeguard transfers to service-delivery providers (a good thing). In this way, the conclusions of these surveys might well be beneficial in a wider sense, and not just because they can contribute to assessments for using country systems.

Despite these benefits there are still important limitations to PETS. The use of PETS has been limited by the costs and time involved (OECD, 2011). Costs have ranged from $75,000 to $200,000 in a single sector, and a normal survey can take a year, or more, to complete (Gurkan, et al., 2009). Even with such an investment, findings may not always be robust because of poor data quality and accounting (Gurkan, et al., 2009).

How relevant is PEFA for assessing PFM functionality?

The short answer, is ‘only to a limited extent’. PEFA is arguably the most comprehensive single assessment of PFM systems in developing countries, and is a useful starting point for deciding whether or not to use country systems (OECD, 2011: 12). It may also provide a reasonably good sense of the overall quality of PFM systems in a given country. Certainly, scores confirm the expectation that fragile states have weaker PFM systems than non-fragile states, as suggested by Figure 3.

Figure 3: PEFA scores in fragile and non-fragile states[9]



Source: authors' calculations using PEFA Secretariat public repository of assessments

However, social institutions are generally difficult to measure objectively and so such scoring systems need to be used with caution (North et al., 2009). Indicators are commonly critiqued for being overly normative (Davis et al., 2011), or too subjective (Thomas, 2009; Langbein and Knack, 2010). In general, measures are predicated on a universal model of 'good governance'. They also ignore sectoral differences and revert to the mean. As a result, many are closely correlated, because they measure the same subjective view of the world. Furthermore, once indicators become important, they may generate incentives for 'gaming' which then reduces the usefulness of the indicator (Høyland et al., 2012).

The PEFA indicators are not an exception. Though PFM systems are not quite an institution, measures of these systems suffer similar limitations. Arguably, the most important limitation in the context of using country systems is that the PEFA framework presents a view of what PFM systems should look like, not necessarily how well they functions (Andrews, et al., 2014). Many of the indicators measure compliance with 'good practices' that may not be essential for the PFM to deliver on core functions.[10] Others measure processes, rather than outcomes. Though good process is critical in PFM, it is not sufficient to promote more credible fiscal management or better, more efficient services (Schick, 2013). As a result, the PEFA indicators are a better measure of the 'form' of a system than its 'function'.

Considering the core functionalities put forth by Andrews et al. (2014), particular weaknesses lie in the indicators for budget execution, as summarised in Table 4. For example, PEFA assessments do not reveal either if salaries, contracts and transfers are paid on time or the extent of corruption and non-performance losses (Andrews, et al., 2014).[11] Yet, budget execution functions – such as the reliable

[9] PEFA scores have been converted to numbers and aggregated using the widely used methodology by de Renzio (2009): A=4, B=3, C=2, D=1, with a + adding a further 0.5.

[10] There are significant biases in these good practices, including a preference for anglophone systems. For example, anglophone countries score better on external oversight, while francophone countries get better results for legislative scrutiny of the budget (Andrews, 2010). This bias is also evident at the subnational level (Paulais, 2012). Furthermore, not all OECD countries comply with these 'agreed good practices'. In 2008, Norway performed a PEFA assessment on its systems and scored several 'C's and a couple of 'D's with particular 'weaknesses' in internal audit and procurement (NORAD, 2008).

[11] Different types of service or investment can be analysed in still further detail. For example, there are many areas which could affect the quality of investment projects implemented by a partner government. These include the quality of bid documents (not steering procurement to 'favourite' areas or suppliers), transparency of procurement, contract management, timeliness of project implementation, disbursement lags, and many others.

payment of salaries and completion of investment projects – are of critical importance to donors aiming to promote public services or minimise fiduciary risks. Critically, other frameworks (like CPIA) and attempts to adapt PEFA to specific sectors (as USAID has done for the health sector) suffer from the same weaknesses.

Table 4: Diagnostic frameworks and functions of the PFM system

Functions of the PFM system	Do existing assessment frameworks reflect on functionality?	Do existing frameworks reflect on process compliance (assumed to be) associated with functionality?
Prudent fiscal decisions	Partly	Yes
Credible budgets	Yes	Yes
Reliable and efficient resource flows and transactions	No	Yes
Institutionalised accountability	Partly	Yes

Source: Andrews et al. (2014)

Another, related limitation is that PEFA assessments cannot explain where PFM systems are going wrong or how they can be improved (Woolcock, 2014). This is an important consideration for donors supporting PFM reforms to strengthen country systems. PEFA assessments do not consider issues of capacity or provide guidance on the appropriate sequencing of reforms (Fritz et al., 2012). Therefore, when donors harmonise their reforms using PEFA, there is considerable risk that reforms will address issues of form without changing the way systems actually function (and see the discussion in Section 4).

Also important is that PEFA indicators do not give a view of how systems are performing now, how they will perform in the future, or if there are islands of excellence which may still permit the use of country systems. As with all other PFM indicators and measurement frameworks, PEFA is backward looking. Within the limitations just described, PEFA may still give a broad picture of how systems have functioned in the recent past, and if there have been improvements. However, this may not reflect how systems perform today, or how they will perform tomorrow. It is also unable to tell donors if some systems are working well enough in certain areas to use country systems (e.g. in the ministry of health versus the ministry of education). This limitation is especially important in fragile states where the context may change rapidly and capabilities are unevenly distributed. This is also critical where the use of country systems implies fiduciary risks in the future, not in the past.

How does this relate to the CABRI framework for use of country systems?

Tying this together with earlier discussions on the use of country systems provides a useful overview (Figure 4). The strongest measures in the PEFA framework and for CPIA are on budget credibility, measuring differences between the original and final budget at a relatively macro level. Subject to the usual concerns about data quality, these give a reasonable view of the aggregate performance of the PFM system as a whole. This also speaks to one of the functional purposes of the budget – being a credible plan for fiscal management. Breaking this down using the levels of the CABRI framework shows a more mixed picture. The weakest indicators are associated with the systems for procurement, which is measured mostly against international good practices – e.g. the law requires competitive bidding. There is no indication of whether the systems are followed or if they result in value for money

from purchases. However, most areas are more mixed, with some indicators that are more closely tied with the actual performance of the system and some that reflect only good practices or processes with only tenuous links to performance. More details are provided in the Appendix.

Figure 4: Linking the PEFA and CABRI frameworks

CABRI framework	What does PEFA measure?				Does PEFA capture functionality?
	Policy/legal	Processes	Outputs	Outcomes	
On plan		X	X		No
On budget	X	X	X	X	Yes
On parliament	X	X	X		Partly
On treasury	X	X	X	X	Partly
On procurement	X	X			No
On account	X	X	X		Partly
On audit	X	X	X		Partly
On report	X	X	X		Partly
Overall	X		X	X	Partly

Sources: adapted from Andrews (2010) and Andrews et al. (2014)

To conclude, PEFA is better than other available frameworks for assessing the PFM system as a whole, but is insufficient as a basis for judging whether or not to use country systems. The framework captures a large amount of information that when interpreted carefully can give a reasonable sense of how a PFM system operates. However, such frameworks are indicators rather than full diagnostic tools and focus on intermediate processes that can be measured within reasonable time and cost. For this reason, practitioners should consider the rationale for scoring as much as the score itself. The temptation to use PEFA as a trigger or threshold for financial support should be avoided. Practitioners should also be wary of interpreting scores for processes as synonymous with scores for the PFM outcomes they care about – having a medium-term expenditure framework (MTEF) in place does not necessarily lead to better medium-term planning, for example. Importantly, donors working in fragile states may need to place less emphasis on these indicators, which are backward looking and can quickly become outdated in a rapidly changing environment where informal rules of the game are likely to prevail over formal laws and practices. They should also look out for any 'islands of excellence' – ministries or agencies which are capable of managing donor funding well, particularly where international partners supplement poorly performing national accountability systems, as multilateral development banks often do.

3.4 International commitments on use of country systems

The Paris Declaration agenda of improving aid effectiveness emerged in response to concerns that states had been marginalised during the period of structural adjustment in the 1980s. It was driven by concerns that aid was undermined by poor results, poor value for money and lack of sustainability. The agenda that

emerged from this critique emphasised country ownership instead of conditionality, strengthening of country systems to ensure sustainability, and reducing the administrative and transactions costs of aid (Glennie et al., 2012).

While the Paris Declaration crystallised this aid-effectiveness agenda, there was rising international concern with fragile states. It was felt that in 'the world's most challenging development situations, poorly conceived involvement can do more harm than good. Fragile and conflict-affected situations require different responses than those applied in better performing countries.'[12] In 2007, the OECD Development Assistance Committee developed the Principles for Good International Engagement in Fragile States (OECD, 2007).

In 2010 the group of fragile states that had offered to pioneer implementation of these principles formed the g7+ group of fragile states. This group aimed to advocate for reform of how the international community engages in conflict-affected states. The result of this was The New Deal for Fragile States, endorsed at the 4th High Level Forum on Aid Effectiveness in Busan, which also produced the Global Partnership for Effective Development Cooperation (GPEDC), the successor agreement to the Paris Declaration and Accra Agenda for Action.

The New Deal built on, and went beyond, the Principles for Good International Engagement in Fragile States by establishing the Peacebuilding and Statebuilding Goals to measure progress in fragile states, and by setting out mutual commitments between fragile states and development partners to support country-owned and -led pathways out of fragility, and to provide aid and manage resources more effectively.

The Paris Declaration and its successors, and the New Deal for Fragile States, contained substantial commitments on the use of country systems. Donors committed in the Paris Declaration to 'use country systems and procedures to the maximum extent possible', and this was reaffirmed in the Busan Declaration 'to use country systems as the default approach for development co-operation in support of activities managed by the public sector'. In the New Deal, one of the TRUST[13] commitments on effective use of aid was that 'International partners will increase the percentage of aid delivered through country systems'.

The distinction between aid transparency (putting aid on plan, budget and report) and aid management (using country budget execution systems and putting aid on treasury, procurement and account) discussed above is reflected in the indicators for the GPEDC monitoring framework. Indicator 6, 'Aid is on budgets which are subject to parliamentary scrutiny', emphasises transparency and the oversight role of national parliaments.

Indicator 9b on the use of developing country PFM and procurement systems focuses on the management arrangements. This indicator is the 'Proportion of development co-operation disbursements for the government sector using the developing country's PFM and procurement systems'. In terms of CABRI's original typology of use of country systems, the focus is on aid being on treasury, procurement, account and audit.

The definitions of use of country systems in the GPEDC monitoring framework to measure progress on these indicators are strict (Table 5). They do not count aid that is managed through country systems with additional safeguards in place, such as

[12] http://www.oecd.org/countries/afghanistan/aboutthefragilestatesprinciples.htm.

[13] TRUST: Transparency, Risk-sharing, Use and strengthen county systems, Strengthen capacities, Timely and Predictable aid (and see Box 8 in Section 5.4).

opening special accounts or introducing special audit arrangements. It is worth noting that investment lending (i.e. project lending) by the multilateral development banks would not count as using country systems under these definitions, as such projects usually require special accounts, ex-post or ex-ante procurement reviews, and sometimes special audits and monitoring of implementation (see Box 1 for more detail on the MDBs).

Table 5: GPEDC framework for monitoring the use of country systems

Indicator	Definition	CABRI equivalent
Use of national **budget execution** procedures	Meet three out of four criteria: • funds included in budget • funds follow normal budget execution (authorisation, approval, payment) procedures • funds processed through treasury system • do not require opening of a separate bank account	• Being on budget and on parliament is implied but not the central focus of this indicator • On treasury
Use of national **financial reporting** procedures	• Do not require maintenance of a separate accounting system • Do not require financial reports using a separate chart of accounts	• On account
Use of national **auditing** procedures	• Fund subject to audit under the responsibility of the Supreme Audit Institution • Do not request additional audits under normal circumstances And at least one of: • do not require different audit standards from those adopted by the supreme audit institution • do not require the supreme audit institution to change its audit cycle	• On audit
Use of national **procurement** systems	• do not make additional, or special, requirements on governments for procurement of works, goods or services	• On procurement

Source: adapted from OECD/UNDP (2013)

The other side of the coin of this strict definition of what can count as aid using country systems is that the targets for increasing the proportion of aid using country systems are conditional on a relatively high score for the CPIA measure of the Quality of Budgetary and Financial Management.[14]

- For countries with a CPIA Quality of Budgetary and Financial Management score of 5.0 and above, the target is to reduce the proportion of aid not using country systems by two-thirds.

- For countries with a score of 3.5-4.5, the target is to reduce the proportion of aid not using country systems by one-third.

These scores are sufficiently high that few fragile states pass the threshold of having a CPIA score above 3.5 and none has a CPIA score above 5.[15] As Table 6 shows, this is true whichever definition of fragile state is used.[16]

[14] See Box 2 on proposals to replace the CPIA measure with a measure based on elements of PEFA.

[15] This is also true for non-fragile states. In the 2014 GPEDC monitoring survey, of the 33 (fragile and non-fragile) responding countries, no country had a score above 5, meaning the first target did not apply to any country, and 13 (39%) had a score below 3.5 meaning neither of these targets applied to them.

Table 6: Comparison of CPIA scores in fragile states

Fragile states definition	Budget and PFM CPIA average score	No. of countries on list	No. with score >3.5	Percentage with score >3.5
World Bank harmonised list	2.99	33	6	18
OECD list	3.21	50	14	28
G7+ members	3.14	20	2	10

Source: authors' calculations

In recognition that these targets do not apply to most fragile states, the New Deal has more flexible language than the GPEDC indicators, stating that donors and recipients will 'jointly identify oversight and accountability measures required to enhance confidence in and to enable the expanded use and strengthening of country systems'. These explicitly include safeguards ruled out above such as use of independent monitoring agents (effectively special auditing arrangements, meaning aid would not be counted as using national audit procedures) and co-managing programme implementation (meaning aid would not count as using national budget execution and procurement procedures). As a result, the New Deal states that 'international partners will increase the percentage of aid delivered through country systems on the basis of measures and targets *jointly agreed at the country level*' (IDPS, 2011). This has the potential to allow more realistic targets to be set for fragile states that take into account the need for safeguards or derogations on country systems, and the need for more realistic targets on the quality of country systems.

The run-up to the formulation of the post-2015 Sustainable Development Goals has lessened international focus on the aid-effectiveness agenda, as attention has moved to setting targets for what development should achieve, rather than how aid can support achievement of progress against development targets. Two recent studies highlight that recipient countries still place a high priority on the principles set out in the Paris and Busan declarations. DAC's Survey of Partner Countries finds that 'Respondents placed very high value on alignment with government policy priorities, predictability and responsiveness … they expected general and sector budget support to be the most important modalities for future assistance'. Countries preferred support that used country systems as they expected it to be better aligned with country priorities, strengthen country systems and reduce transactions costs and fragmentation (Davies and Pickering, 2015). Similarly, ODI's *Age of Choice* project found that the 'three most common priorities with respect to the terms and conditions of development assistance are ownership, alignment to national priorities, especially sectoral alignment, and speed of delivery' (Schmaljohann and Prizzon, 2015).

There is high demand for aid that uses country systems from both fragile and non-fragile states. The commitments made under the GPEDC for increasing the use of country systems are conditional on systems stronger than those currently existing in most fragile states. This is recognised in the New Deal which calls for targets set at country level and recognises the need for safeguards. The differential arrangements that will be reached in different countries highlight the need for close attention to how this is implemented across different fragile states.

[16] One criterion for appearing on the World Bank harmonised list is an overall CPIA score of 3.2 or below. Such states are thus unlikely to have a budget and PFM CPIA score above 3.5.

3.5 Evidence on donor use of country systems

Despite the continued demand from recipient countries for greater use of country systems, donors are making limited progress towards meeting these aspirations. The evaluation of the Paris Declaration found in 2011 that:

> a large majority of the [country] evaluations find only limited if any overall increase by most donors in the use of country systems and procedures, notably financial and procurement systems … Half of the evaluations find that the limited use of country systems is mainly explained by a continuing lack of confidence by donors in those systems and/or concerns about prevailing levels of corruption, as well as concerns that country systems can still be slower and more cumbersome than those of donors. In several instances, the general donor reluctance was reported to be unchanged in spite of considerable effort by governments and/or positive, objective assessments of progress. (Wood, et al., 2011)

This prompted renewed commitments as part of the Busan Agreement and the New Deal for fragile states.[17] However, the first Global Partnership progress report once again suggested that there had been no increase in the use of country systems between 2010 and 2013 for the countries for which there is data (OECD/UNDP, 2014). Similarly, the 2014 New Deal Monitoring Report found 'insufficient or no progress in line with [New Deal] commitments' on the use of country systems (IDPS, 2014).

Not all evidence is quite so pessimistic. Recent cross-country analysis has suggested that donors have actually increased the use of country systems overall between 2005 and 2010 (Knack, 2014). Equally important, there is evidence that donors are changing the way they engage in fragile states. For example, there appear to have been improvements in the coordination of donor financing:

> many donors co-financing interventions and working with governments to develop new financing approaches – notably in the form of trust funds – in cases where direct budget support is not yet possible. This more integrated financing approach is providing a platform for donors to do more joint work on risk assessment and management, which is otherwise proving difficult to achieve on a standalone basis. (IDPS, 2014)

That is positive, even if many of these innovative approaches do not meet the strict definition of use of country systems in the Busan monitoring framework. On balance, however, progress has been slow without any obvious evidence for why that might be.

To what extent does the quality of PFM systems influence donors' decisions to use them for delivering aid? On the surface fiduciary risks appear to play an important part in donor decisions on whether or not to use country systems. Certainly, the strength of PFM is a central feature of many donor guidelines for choosing aid modalities or assessing fiduciary risk. Some of these tools are listed in Table 7. For example, the UK's Department for International Development conducts a Fiduciary Risk Assessment every three years where grants are provided, considering both the national PFM system and specific risks associated with the programme (DFID, 2011). This is generally used in conjunction with a Country Governance Assessment, which reflects the need to consider broader factors when analysing fiduciary and other risks. For budget support, the partner government also has to abide by a set of partnership principles.

[17] The Busan Declaration states that 'much more needs to be done to transform co-operation practices and ensure country ownership of all development efforts' (OECD/UNDP, 2014).

Table 7: Donor tools and guidelines for the use of country systems

Institution	Risk assessment tool	Links/related papers
UK DFID	Fiduciary Risk Assessment	'How to' note
Asia Development Bank	Guidelines for Implementing Second Governance and Anti-Corruption Plan	Staff guidance
World Bank	Use of Country Financial Management Systems in Bank Financed Investment Projects	Interim guidance note
Inter-American Development Bank	Guidelines to Determine the Use of the Public Finance Management System	Not available
KfW	Structured Analysis of the Fiduciary Risks on Budget Support	Not available Related framework
DANIDA	Guidelines for Risk Management	Guidelines
French Ministry of Foreign Affairs	Foreign Affairs Directives for Managing Fiduciary Risk Associated with Budget Support in Foreign States	Not available
European Commission	Budget Support Guidelines	Guidelines

Sources: authors and OECD (2011)

Yet, it is not clear how strongly these assessments of PFM and fiduciary risk influence the use of country systems by donors in practice, or what other factors are consistently important. One study suggests that Country Financial Accountability Assessments and Country Procurement Assessment Reports conducted between 1999 and 2004 had relatively little influence on the choice of aid modality used by the World Bank (Shand, 2006). Quantitative research appears to confirm this view. For example, Knack (2014) finds that the quality of country systems (proxied by the CPIA) is only a small factor behind the use of country systems, though this varies considerably by donor.[18] The same study also suggests that donors that use country systems are not necessarily the same as those that increase their use of country systems as PFM systems improve. For example, the UK and Denmark use country systems for a similar proportion of their aid, on average, but Denmark is more willing than the UK to tolerate the risks associated with weaker PFM systems (Table 8).

Table 8: Use of country systems and sensitivity to changes in PFM quality[19]

Mean use of country systems		Sensitivity to change in PFM quality	
Top 5	**Bottom 5**	**Top 5**	**Bottom 5**
Asian Dev. Bank	GAVI	Norway	Italy
IFAD	USA	Asian Dev. Bank	Korea
Norway	Korea	Finland	France
Netherlands	UN	UK	UN
World Bank	Japan	Canada	Denmark

Source: Knack (2014)

Clearly, use of country systems depends on political factors. This is not surprising. Some donors, such as DFID, explicitly recognise this in their policy documents.

[18] The study finds mixed evidence for 2005 and 2010 that donors did increase their use of country systems, with relatively little of the variation in use of country systems explained by their quality. His analysis shows 'a positive, significant, and robust relationship between quality of systems and their use by donors … However, quality of systems explains a relatively small share of the variation in their use, and there is considerable heterogeneity among donors in their use of country systems, and in their sensitivity to quality of systems.'

[19] Note that not all correlation coefficients were statistically significant.

More broadly, Knack (2014) has suggested that donors have been more likely to use country systems if: (a) they provide a large share of total aid to a country, (b) there is a high degree of public support for aid in the donor country, and (c) the country performs well on measures of civil liberty. As a result, a principled approach to use of country systems may be as relevant as an analytical one based on measurement of fiduciary risks.

Overall, there is widespread disappointment in the progress made in increasing the use of country systems since the Paris Declaration in 2005. Most studies are extremely downbeat, though there is also some evidence of improvements in donor coordination. What is clear is that the quality of PFM systems themselves, and possibly even the donor tools used to assess them and other fiduciary risks, have limited influence on the use of country systems. Instead, this is governed by preferences of the donor organisations and differs markedly between them.

3.6 Key messages and conclusions

Using countries' own systems is central to building sustainable and effective institutions. By working outside government systems, donors impose additional transaction costs on weak bureaucracies and divert attention away from management of domestic resources. Critically, the decision to use country systems is not binary. CABRI provides a useful framework to conceptualise the different aspects of the use of country systems. Each aspect involves a different level of fiduciary risk. On the one hand aid can be aligned to the policy cycle – on plan and on budget – with limited fiduciary risks. Alternatively it can be managed through country systems – on treasury and on procurement. It is the latter that is most likely to reduce the transaction costs of aid for the recipient country.

Indicator frameworks such as PEFA and CPIA provide donors with a broad overview of the PFM system in a given country, as well as where potential weaknesses lie. This may help donors decide which country systems to use. Diagnostics using the PEFA framework have become a standard feature of fiduciary risk assessments used by donors to decide (or at least justify) whether or not to use country systems. However, in being a macro summary of government performance, and being backward-looking, the PEFA framework has important limitations that are also found in other diagnostic tools. It may overlook islands of excellence that exist in otherwise unpromising environments and fail to identify opportunities to engage with country systems.

Therefore, donors using PEFA to assess country systems should: (a) carefully consider the rationale for scoring the indicators that are important to them; and (b) note where indicators reflect on processes rather than PFM outcomes. Particular attention needs to be directed at the budget-execution phase, where PEFA is arguably furthest removed from the outcomes that donors care about – whether staff will be paid, procurement is efficient and transfers will be made and received by service-delivery units.

The shortcomings of PEFA and the fact that donors support can be greater for islands of excellence than it may be for other areas of government, mean that donors will need to carry out their own assessment of risk in the areas where its funding will go. Donors could consider using a Public Expenditure Tracking Survey or conducting a specific assessment for the relevant sector(s). However, such micro-analysis is expensive and time consuming, and so may not be practical in all situations. A further option is to focus discussions with country governments as part of the new Country Dialogues on finding the appropriate indicators to measuring PFM systems related to budget execution in critical services. The

OECD's Effective Institution Platform has put forward a proposal to introduce more structured country dialogues, led by recipient governments, to encourage discussions over the use of country systems by donors using the CABRI typology (EIP, 2013). This is an opportunity for the government and its development partners to discuss appropriate measures of the quality of the PFM system, and systems related to budget execution in particular.

Regardless of these processes, there is also the need to recognise the political dimension of the decision to use country systems. The decision of how much risk to bear is ultimately a political preference that can vary widely between donors, and across countries for a single donor, as donors seek to balance multiple objectives of their aid programme and country engagement with programmatic and fiduciary risks. In some cases country systems are used and in others fiduciary risks are a barrier to this use. However, these risks can still be reduced. The next section explores how this risk of using country systems can be managed more effectively by putting in place additional controls that allow the maximum possible use of country systems, thus attempting to reconcile the goal of using country systems with the political economy of a fragile state.

4 Use of country systems in fragile states

The OECD has adopted a typology of risk[20] (the potential for an adverse event or result to occur).

- **Contextual**: risks relating to the political, economic and social landscape of the country such as state failure, violent conflict, economic crisis, natural disaster or humanitarian crisis.
- **Programmatic**: the risk that programmes do not meet their objectives or inadvertently do harm, for example by exacerbating social tensions or undermining state capacity.
- **Institutional**: the risks to the donor including fiduciary risk, security risk, reputational and political risk.

According to the OECD (2014: 20), 'Current risk management practices are predominantly focused on institutional risk reduction'. In the short term, development agencies will have little influence on contextual risk, although donor programmes may well be designed to reduce these risks over the longer term. Thus the key trade-off will be between the programmatic risks and institutional risks.

The programmatic risk is that not using country systems will lead to fragmented project aid that can undermine the effectiveness of country systems, and that any improvements created by aid spent off-budget will not be sustained once responsibility reverts to the recipient government. The key institutional risk is the fiduciary risk of funds being improperly used, and the political and reputational risks to the donor if this is the case. This trade-off is sharpened in fragile states as their country systems are in need of strengthening, and because the political economy of fragile states is unlikely to be conducive to use of country systems, and standard measures of fragile states' PFM systems means donors have not made commitments to using them without safeguards.

The challenge for donors is therefore to select modalities through which to disburse aid which balance concern for fiduciary risks with the concern that country systems will be harmed by not being used. This section first explores ways in which this might be done, looking at the implications of different aid modalities for use of country systems, and for the level of fiduciary risk. It then looks at how pooled funds can help manage risk, and concludes by examining how recipient-country systems can be strengthened.

[20] This discussion is based on OECD (2014).

4.1 Risk management and transitioning to use of country systems

The New Deal highlighted that donors and recipients need to identify specific measures that can allow donors to use country systems. However, there appears to be a limited stock of practice in how to adapt use of country systems to the circumstances of fragile states. The New Deal monitoring report finds that moves towards the use of country systems are limited by 'a lack of attention to and knowledge about mixed modalities and a gradual approach'. There is no evidence of planning for gradual progress on strengthening and increasing the use of country systems: 'mixed approaches are rarely registered and tracked, and this makes it difficult to set joint targets. It also suggests that greater clarity and nuance is needed about what use of country systems actually involves and how to monitor early steps towards their greater use' (IDPS, 2014). This section thus aims to set out with a framework for thinking through how steps could be taken to use country systems, and risks involved.

'Use of country systems' can cover a wide range of activities, not all of which pose the same level of fiduciary risk. For example, 'use of country systems' meaning non-earmarked budget support provided direct to a fragile-state government may well open up donor funds to the risks of political-economy dysfunctions noted above. However, 'use of country systems' meaning donors aligning their programmes with government policy ambitions or using the same monitoring and evaluation framework as government does not involve the same level of risk.

The different ways of 'using' country systems will carry different political-economy risks and opportunities. The New Deal commitment on the use of country systems includes the commitment from both donor and recipient to 'jointly identify oversight and accountability measures required to enhance confidence in and to enable the expanded use and strengthening of country systems'. One way of thinking through this is to examine how different aid modalities can potentially use country systems. Table 9 classifies aid modalities into donor execution, national government execution on a projectised basis, and budget support. The implications of each of these for the use of country systems are discussed in turn.

Where aid is being directly executed by a donor (donor execution), for example through direct contracting of an NGO to implement the project, then the use of country systems will be restricted to the aid-transparency issues of ensuring that aid is reflected in the country's plans, budgets and reports. Projects should be on budget, on parliament and on report. This requires providing regular and accurate information to the government at the right time in its budget cycle so it can be incorporated in plans, budgets and reports. Ideally reporting should be done in accordance with at least the broad categories of the government's own budget classification system (e.g. salaries, operations, capital). This modality eliminates the risk of working with country systems, but carries the risk that working outside country systems will weaken them. In such a case, projects should be shadow-aligned[21] with government systems as far as possible. The case studies provide two particularly clear examples of this: the design of secondary-school capitation grants under the DFID Girls' Education Project in South Sudan mirroring the government-provider primary-school capitation grants; and implementation modalities for the health sector in Afghanistan that were sufficiently similar to allow the off-budget parts of service delivery to be brought into the common government system once this proved to be running effectively.

[21] Shadow alignment is the practice of providing aid so that it mirrors national systems to enable rapid conversion to use of country systems as soon as conditions permit (DFID, 2010a).

Table 9: Typology of aid modalities

Aid modality	Description of management arrangements
1. Donor execution	**Aid projects are managed directly by donor.** This means that donors are establishing parallel systems for the delivery of services or investment. For capital projects, this approach effectively leads to an in-kind transfer to government, which can lead to problems in allocation of adequate staffing, operations and maintenance budget once the project is handed over.
2. National government execution on projectised basis	**Aid is managed by a government agency, but on a projectised basis.** Funds would be under the control of the national government, and can be managed by civil servants, or by contracted staff in a project implementation unit (PIU).In either case, projectised implementation would mean that additional safeguards would be applied on top of government systems. Funds may not be fully: • 'on treasury', e.g. use of a project bank account to avoid mingling of project funds with other Treasury funds or payment requires additional authorisations by the donor or PIU staff rather than the normal government payment process; • 'on account', e.g. use of a separate accounting system; or • 'on procurement' e.g. use of separate procurement procedures and procurement reviews such as ex post sampling for smaller amounts and ex ante checks for payments above a certain threshold. The donor may also require regular monitoring of implementation, where donor staff provide advice and help government staff overcome bottlenecks as well as ensuring that the project implementation is timely and likely to achieve its development objectives. Funds might also not be fully 'on audit' if special audits of project funds are required, either by the national Supreme Audit Institution in line with donor requirements, or contracted out to separate external agency. If a project is managed through a PIU, arrangements for this can range from every donor project having its own PIU to a programme management unit integrated into the ministry/agency for all its investment projects, often supported by external contract employees, which all donors share. In either case, funds would be on budget, and the location of the PIU within, and under control of, the government agency should improve coordination with national development plans and budgets.
3. Sector and general budget support	**Budget support is typically fully fully 'on treasury', 'on account' and 'on procurement'. However, specific safeguards can still be applied.** Sector conditionality or ear-marking could be applied to funds that are fully 'on treasury', 'on account', 'on procurement' and 'on audit'. Alternatively other safeguards could be applied that are similar to those used in (2) above: • Require some co-signatory authority, as with Liberia's Governance & Economic Management Assistance Program (GEMAP), which would imply the funds are not fully 'on treasury'. • Operate on a reimbursement basis where expenditures are monitored and only eligible expenditures are reimbursed, for example the Afghanistan Reconstruction Trust Fund or USAID Fixed Amount Reimbursement Agreements (FARA), so these funds are effectively not 'on audit'. This is typically used for smaller items where the government could absorb the cost of any ineligible expenditures. For larger expenditures, often capital, an ex ante 'no objection' is required as once the lender has disbursed against the contract, it is almost impossible to get the money back if there was misprocurement. • Additional or separate auditing or fiduciary oversight arrangements, often combined with a reimbursement basis, again meaning the funds are not fully 'on Treasury'.

Source: authors' own formulation, adapted from Foster and Leavy (2001)

Where a project will be implemented by government in low-capacity environments, or where civil services are being reconstructed, the risk of working directly through

normal government structures may be seen as too high, thus requiring the establishment of a Project Implementation Unit (PIU). However, this should be done in a way that minimises the establishment of implementation arrangements that work in parallel to government systems. This will support, rather than undermine, the long-term institutional development of government. Aid implemented on a projectised basis by the national government can also end up in a similar position to direct donor execution; alternatively, a project can make extensive use of government systems, depending on how it is established.

First, PIUs should be aligned with government structures. They should be co-located in the appropriate part of the responsible government ministry and managed under the leadership of that institution. In this way, they can contribute to the strengthening of that institution, rather than undermining it.

Second, the creation of a large number of PIUs for each project within a single Ministry carries the risk of detracting attention from the Ministry's own management systems to managing a large number of PIUs. The risk of damaging country systems through fragmented projects was discussed in Section 3.1 above. PIUs should thus be coordinated so that in each ministry there is a single project management unit[22], which oversees all projects within the ministry. The rationale for this is to provide common programme implementation and coordination management for all donor-funded projects and programmes (Manuel et al., 2012), which should lead to improved sector information and better sector policies, introduce economies of scale for shared functions (such as procurement or M&E) and increase institutional memory and expertise through reducing staff turnover (Versailles, 2012). This unit should be fully embedded into the government agency and designed to transition into the agency's investment management department. Similarly, over time, the staffing should transition from externally contracted staff to civil servants.

In Rwanda, the proposal for a Single Project Management Unit (SPIU) was developed through the Government of Rwanda's aid reforms from 1998, which responded to the 'early experience of aid in post-genocide Rwanda [being] one of chaos with many uncoordinated activities funded by a myriad of aid agencies' (Versailles, 2012). Rwanda's experience shows that establishing such arrangements requires commitment from development partners to use the SPIU structure, and that, once a large number of PIUs is established, there is a lengthy period of transition to phase out separate PIUs for individual projects and agencies (Versailles, 2012). In Afghanistan, grant coordination and management units were established in sector ministries. This is discussed further in the case studies in Section 5.

Third, there should be consideration of how far the PIU can use country systems, and plans for transitioning to greater use of country systems over time. There is a large degree of scope depending on the exact project arrangements. The lowest risk is likely to be ensuring that the funds are 'on account' so that they use the government accounting system and chart of accounts. This will ensure project expenditure is directly comparable to government expenditure and outturns can be more easily shown alongside government expenditure in financial reports. Putting funds 'on treasury' or 'on procurement' is where the risks are likely to be considered higher. Derogations to these procedures may be considered necessary to manage risk.

[22] This can also be referred to as programme management unit or department.

Similarly, even sector and general budget support – that is funds which are largely provided for an unrestricted purpose – may not necessarily fully use all government systems. General budget support could utilise co-signatory arrangements, as in Liberia's Governance and Economic Management Assistance Program (GEMAP), or reimbursement arrangements, such as budget support to Afghanistan from the Afghanistan Reconstruction Trust Fund, or to Palestine through the PEGASE (Palestino-Européen de Gestion de l'Aide Socio-économique) programme, or through USAID Fixed Amount Reimbursement Agreements.

These types of arrangements, both for budget support, and for project support, often also require separate monitoring or fiduciary oversight from the main government monitoring and audit arrangements. Reporting during implementation is necessary to ensure that corrective action can be taken when projects are off-track in terms of implementation and likely results.

Table 10 sets out how country systems can be utilised, based on this discussion, using the CABRI definitions, for each of the aid modalities. Where a box is green, there is full use of country systems; where a box is yellow, there is partial use of country systems, or derogations made to reduce fiduciary risk. This demonstrates that even where country systems are utilised, there are ways of mitigating the fiduciary risks that are faced.

Table 10: Aid modalities and use of country systems

Modality	On plan	On budget	On parliament	On treasury	On account	On audit	On report	Fiduciary risk issues
1. Donor execution	√	√	(√)				√	Low risk as national systems play no role in managing funds
2. National execution on project basis	√	√	√	(√)	(√)	(√)	√	Risk depends on extent of use of government systems for the management of funds. Management could be entirely delegated to a PIU, or have a PIU using elements of country systems.
3. Sector and general budget support	√	√	√	√	(√)	(√)	√	Significant risk as funds managed by national systems. However, this can be mitigated by: tighter earmarking, reimbursement modalities and independent oversight.

Source: authors' representation

Trade-offs in use of country systems

The objective of greater use of country systems is to support sustainable institutional change in the form of stronger country systems. Where there is no engagement with country systems, there is a real risk of causing harm as parallel donor execution is likely to lead to high transaction costs for government in tracking a multiplicity of fragmented projects (Davies and McKechnie, 2013), and reducing learning-by-doing, especially where an aid-dependent government has only limited domestic revenues available. The US Senate Foreign Relations Committee put this bluntly: 'Most U.S. aid bypasses the Afghan Government in

favour of international firms. This practice can weaken the ability of the Afghan state to execute its budget, lead to redundant and unsustainable donor projects, and fuel corruption' (U.S. Senate, 2011). Similarly, Andrew Natsios has argued that a risk-averse 'counter-bureaucracy' focused on eliminating fiduciary risks reduces the ability of programmes to build sustainable institutions (Natsios, 2010).

These risks must be weighed up against the fiduciary risks of using country systems. But as Tables 9 and 10 show, fiduciary risk can be mitigated even when country systems are used. Projectised modalities can be used to mitigate risk, providing assurance funds are used for the intended purpose and providing additional support to capacity-constrained institutions. Even budget support can be provided with additional safeguards, through co-signatory authority, using a reimbursement basis, and putting in place additional auditing or fiduciary oversight arrangements.

However, ultimately the use of country systems is a political decision: how much fiduciary and reputational risk is a donor willing to bear in return for the expected benefits? While the discussion on political economy paints a somewhat pessimistic view as to how public funds (including potentially donor funds) are likely to be handled by the government of a fragile state, the literature identifies a number of instances where use of country systems in fragile states can positively reinforce developmental change. Fragile states may experience a clear moment of transition that allows for use of country systems to encourage a decisive pro-developmental shift.[23] For example, following a rebel attack on the capital city in 2000, the already-weakened central institutions of the Sierra Leonean state risked financial collapse just as final negotiations of a peace agreement were underway in 2001. In this context, the decision by the UK government and others to provide relatively unrestricted budget support can be seen as having helped facilitate the transition of the country from a particularly negative political economy situation of open conflict towards a better (although certainly not ideal) situation of a fragile national unity government.

As the case studies will explore in more detail, many donors can and do use country systems even in countries that are generally seen to have challenging political economy environments. For example, Liberia now receives budget support even though most assessments of its political economy would suggest that its domestic institutions are not structurally 'pro-developmental'. Afghanistan is a similar case. In these cases the overall risk to donor funds being handled by government systems is presumably considered lower than the risks (both fiduciary and political) of operating entirely outside government (although in practice many donors will operate their programmes using both channels). The level of risk accepted by donors is clearly correlated with the degree of their countries' political involvement. In the case studies discussed in the next section, Afghanistan and the West Bank and Gaza hold far more geostrategic importance for most donors than does South Sudan.

4.2 Use of pooled funds

Pooled funds – or multi-donor trust funds (MDTFs) – are often presented as a separate aid modality. However, a pooled fund will have to make the same choices in how to disburse funds as a bilateral donor. This ultimately comes down to the choices of aid modality set out above. A pooled fund could, for example, operate

[23] Financial aid to fragile states can aim to support three broad functions (Bernardi et al., 2015: 32): macro-fiscal stabilisation, restoring basic functions, and incentivising policy reform. While the longer-term focus of use of country systems may be on supporting the delivery of basic functions or policy reforms, the potential for aid to support macroeconomic stabilisation should also be considered.

entirely outside government systems, deliver through project implementation units, or provide budget support.

However, there are several features of a pooled fund that potentially allow it to work more easily through country systems. First, it provides a focal point for policy dialogue with government. The political economy of fragile states set out above may mean that creating a stable forum for government–donor discussions is difficult, and a pooled fund can provide one arena for this. A single forum reduces the transaction costs and demands on government.

Second, pooling funds should allow pooled funds to operate at a larger scale than most bilateral donors.[24] Where use of country systems requires additional safeguards such as establishment of project units or monitoring agents, the overhead costs of these are reduced compared to the size of funds under management. Similarly, the size of projects can significantly reduce the coordination burden on government of engaging with a few large projects or programmes rather than a large number of small, fragmented projects. Avoiding placing too many demands on a weak bureaucracy is of even more importance in fragile states.

Third, the pooling of funds by donors means that risks are shared across donors. This may enable the pooled fund to take on the risk of working through country systems that an individual donor would not be able to. Risks can also be assessed across the portfolio of the pooled fund. However, the ability to do this will clearly depend on the size, scope and objectives of the fund. For example, a pooled fund operating across a large number of programmes (such as the Afghanistan Reconstruction Trust Fund) will be better able to have a mix of more or less risky programmes than a pooled fund focused on one sector (such as the Liberia Health Pooled Fund).

How successful are pooled funds in providing these advantages of coordination and government engagement, reduced costs and sharing risk? The key lessons emerging from existing studies seem to point to the importance of getting the design of the pooled fund right at the start of the process, and that this is crucially dependent on the context.

A systematic review of the impact of pooled funds on aid effectiveness (Barakat et al., 2011) points to limited evidence that pooled funds can improve alignment and mixed evidence on whether they improve harmonisation. However, this review notes that the positive experiences found could be potentially replicated if MDTFs were better designed, and the importance of context in the design and implementation of the MDTF.

The importance of context in the design of MDTFs is also highlighted by Commins et al. (2013) in examining the use of pooled funds to support service delivery in fragile states.[25] As well as the potential advantages in the use of pooled funds highlighted above, the potential disadvantages are also set out, such as complexity, cost of the fund manager, slow disbursement and low commitment from donors. Design of a pooled fund will inevitably involve trade-offs, and the key one is between capacity-building and the speed of delivery of services. It is important to ensure that there are realistic expectations of the speed at which services can be

[24] In the case studies examined, an average of 20% of aid in 2013 was provided through either specific-purpose programmes and funds managed by international organisations or through basket funds/ pooled funding.

[25] Note that this study consists of two parts. Part I sets out policy findings, and Part II sets out operational guidance for designing and managing a pooled fund, covering issues such as objectives of a pooled fund, the governance structure, choice of the fund manager and implementation.

delivered through working with government. The review concludes: 'A pooled fund is not a panacea, and it will not automatically engage better with the government, pool risk, reduce transaction costs and align funding within an overarching strategy. But such objectives can be achieved with good design linked to realistic expectations, hard work and judicious and sustained support and engagement from the donors' (Commins et al., 2013: iv).

4.3 Supporting institutional development

Strengthening of public financial management is arguably central to building a legitimate state (Krause, 2012). It is one of the main reasons why donors have committed to use country systems. These commitments are almost always accompanied by technical and financial aid for PFM reforms. Yet despite significant investments in capacity building, it is not clear that these efforts have consistently yielded sustainable results. A growing literature has tried to understand the reasons for this. Three broad themes that can help practitioners engage more constructively with the challenges are: (a) viewing capacity as a system; (b) taking a problem-driven approach; and (c) supporting functions for managing service delivery.

The challenge of PFM reform

Reforming the budget system, and other areas of PFM, is complex and highly political. A number of commentators have noted that PFM systems serve many functions (Schick, 2011; Allen, 2009). The national budget is at once an appeal to voters, a coordination tool within government and a means of financing programmes and maintaining stability. It is also an important tool for the distribution of economic rents, which makes reforms difficult except in those unusual circumstances where reforms enhance rent-seeking behaviours among powerful actors (Allen, 2009). In advanced economies, systems have been established gradually over tens, hundreds and, in some cases, thousands of years (Schick, 2004; Krause, 2013).[26]

The challenges of PFM reforms are almost certainly greater in fragile states than in most other contexts (Fritz et al., 2012). Though each country is different, the pace of reforms is likely to be constrained by institutional and political economy factors associated with North et al's (2007) 'limited access orders' (described in Section 2.3 above and in Allen, 2009). Strong patronage systems, lack of rule of law, weak coordination mechanisms in central government and limited oversight may all be barriers. Furthermore, governments in fragile states often have more limited human and financial resources, and may also be more aid-dependent (Symansky, 2010). On top of this, reforms are implemented in the context of high levels of uncertainty, or even violence, which add further dilemmas to fiscal management and service delivery. Establishing basic, credible systems in this environment is not straightforward.

Critiques of orthodox approaches

Over the past three decades various approaches have been used to support developing countries in reforming their public financial management systems. These have been supported by significant financial aid.[27] Yet, results have been

[26] Modern budgeting practices in OECD countries emerged gradually and usually in step with other institutional changes (Allen, 2009; Schick, 2004; Krause, 2013). This was a feature in liberal democracies like the UK and USA, but also in emerging economies such as Korea (Koh, 2007). Therefore, a number of commentators have urged greater patience with the pace of reforms, especially in post-conflict countries where strong progress appears to have been made in a relatively short period of time, such as Sierra Leone (Lawson, 2007).

[27] To illustrate the scale of investment, PFM reforms were supported by over $930 million in 2007 (de Renzio et al., 2011).

underwhelming, provoking widespread criticism. Allen (2009: 8) concludes that 'in general … the reform process has been frustratingly slow, even in narrow technical areas of the budget system' (Allen, 2009: 8).

The orthodox approach to PFM reform is easily caricatured. Donors drive large-scale reforms across the breadth of the PFM system. Reforms change the formal rules of the game to comply with international best practices. For example, the use of medium-term expenditure frameworks (MTEFs) has exploded from 11 countries in 1990 to 132 countries in 2008 (Brumby et al., 2013). Large-scale investments in training and IT systems accompany changes to the legal framework, with the intention of controlling political behaviours. Reforms are guided and monitored by regular PEFA assessments and compliance with log-frame targets enforced from donor headquarters far removed from the realities of implementation. Though clearly stereotyped here, this type of reform is commonplace. This has prompted widespread criticism.

One common critique of this model of reform relates to sequencing. Some have noted that advanced economies industrialised and increased living standards despite having incremental, line-item budgets with a one-year horizon. Indeed, instruments such as accrual accounting for the public sector are still uncommon in OECD countries. Therefore, low-income countries and fragile states may not require such complex practices in order to improve fiscal management and service delivery. At best this is a distraction; at worst it diverts attention and resources away from the real problems.

Another critique asks whether reforms change the way systems work, or just the way they look. Andrews (2009) believes it is mainly the latter and has argued that countries in Africa are implementing reforms that reflect international best practices in order to 'gain legitimacy and support in their external environment, not primarily to improve effectiveness'. This manifests in a number of ways. For example, Porter et al. (2010) demonstrate how fragile states perform relatively well on *de jure* measures of the PFM system, and less so on the *de facto* measures. In other words, the laws and policies in place are stronger than their execution. Such incentives may perpetuate existing capability traps (Andrews et al., 2012) and may be accentuated when resources are tied directly to improvements in the PEFA scores, as in some donor programmes (OECD, 2011). Others have argued that reforms have been neither politically smart nor locally led (Booth and Unsworth, 2014), and that broad reforms have not helped target limited resources on issues that really matter for improving fiscal management and service delivery.

Alternative approaches to PFM reform sequencing and delivery

In response to these perceived failings, a number of alternative approaches have been put forth to challenge the standard PFM reform model. These aim to find the 'best fit' for reforms rather than simply pursuing the 'best practice' in all contexts.

There is no obvious consensus on the appropriate way to sequence reforms (Diamond, 2013). One influential line of thinking in the early 2000s followed from Schick's (1998) argument that it was important to 'get the basics right' before introducing sophisticated new systems (Box 4).[28] Taking this a step further, others developed a 'platform approach' where reforms are carefully sequenced so that more complicated advances are initiated in carefully planned stages, but only once all the more basic reforms have been introduced (Tommasi, 2009).[29] Though there

[28] Schick (1998) was responding to what he felt were misguided attempts to replicate New Zealand's apparent success in applying New Public Management thinking to the public sector.

[29] The use of the platform approach to guide reforms in Cambodia has been widely documented, and forms the basis for most of the lessons learnt (see for example DFID (2005)). However, application of the platform approach – though not strictly – appears to have fostered successful reforms in Ethiopia (Peterson, 2011).

is still wide support for addressing the 'basics first', most recent literature considers the platform approach to be unnecessarily constraining. In some cases, it may be possible to implement more complicated reforms before having all the basics in place (Allen, 2009; Andrews, 2013). Instead, the issue may be more about selection of the appropriate reforms than sequencing (Allen, 2009).

Today, there is growing attention on the reform process itself, with recommendations that ridged plans and log frames are replaced by more flexible implementation approaches that focus on specific problems and then find solutions as issues materialise during implementation (Andrews, 2013). Recent World Bank work in the Pacific has suggested what this might mean for countries with small populations and narrow economic bases that may have relevance to fragile states as well (Haque et al., 2015). ODI's experience in implementing 'problem-driven, iterative and adaptive' reforms in a small group of fragile states suggests that this approach may be appropriate in fragile states where conventional projects are particularly ill suited.

Box 4: Schick's 'basics first' approach to PFM reform

- The government should foster an environment that supports and demands performance before introducing performance or outcome budgeting
- Control inputs before seeking to control outputs
- Account for cash before accounting for accruals
- Establish external controls before introducing internal control
- Establish internal control before introducing managerial accountability
- Operate a reliable accounting system before installing an integrated financial management system
- Budget for work to be done before budgeting for results to be achieved
- Enforce formal contracts in the market sector before introducing performance contracts in the public sector
- Have effective financial auditing before moving to performance auditing
- Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them

Source: Schick in World Bank (1998)

Lessons for fragile states

A number of themes have emerged in recent literature that can be used as a basis for future interventions. These cover the framing of capacity building, taking a problem-centred approach, focusing reforms on budget execution, and the importance of supporting intermediate players. Although this is not an extensive review, each of these is discussed briefly below. An overarching conclusion is the need to refocus donor–government discussions on the actual problems being faced.

Capacity should be analysed at the system level. A criticism of PEFA is that it pays no specific attention to capacity. The capacity of the PFM system depends on the way people and organisations interact in the system and with others outside it. This provides three ways to understand capacity: at the levels of the individual, the organisation and the system as a whole. Andrews et al. (2012: 5) explain that the excessive focus on the level of individuals has undermined efforts to build capacity in developing countries. Focusing on the actions (or lack of action) from political

leaders or officials usually leads to reforms that aim to correct those behaviours using best-practice models. For example, procurement is designed to be more competitive or laws become more stringent. Such reforms may be accepted by the country in order to access resources – budget support, debt relief or lending from the IMF – or maintain legitimacy with the international community. However, they are unlikely to be implemented as intended, opening up a gap between laws and policies and the practices they are supposed to govern.

Reforms should begin by asking 'what is the problem?' Instead of focusing on best-practice reforms regardless of the starting point, reform should start by identifying the problems that prevent a system from operating effectively. A common critique of public sector reforms is that they promote solutions that are not relevant to the problem. Andrews' (2010: 43) review of PFM reforms in Africa reveals that these are extremely similar. For example, in the 31 countries reviewed, 28 were implementing medium-term expenditure frameworks, 25 were introducing performance- or activity-based budgeting and all 31 were aiming to comply with the IMF's Government Financial Statistics standards. This has probably been perpetuated by using PEFA as the basis of numerous reform plans (Fritz et al., 2012). Yet it is important to recognise that some systems may need to lag behind or even be outsourced completely (Haque et al., 2013). The first step to avoid this trap is to refocus donor–government discussions on the actual problems being faced. Donor–government dialogues could help identify these key problems alongside PFM diagnostics and focus reform efforts on addressing them.

Dialogue should focus on the functions needed for service delivery – especially budget execution. Evidence from ODI's Sector Budget Support in Practice research suggests that donors have not addressed the 'missing middle' of service delivery, by failing to support the capacities and systems needed to manage, support and supervise frontline service providers. Therefore, although some central-level functions have improved, the reach of budget support beyond public financial management functions and into service delivery capacities still needs strengthening (Williamson and Dom, 2010). Fritz et al. (2012) also found in a number of fragile states that reforms centred on budget execution were generally more successful than those in other areas of the PFM system.

Donors should find ways to bridge critical communication or coordination gaps. Many fragile states lack strong central coordination from the government – this can create gaps in communication between departments, between the donors and the government, and even between donors. Assessments of PFM reforms in a number of fragile states conclude that coordination between donors has generally emerged slowly, and that the fragmentation of donor interventions in the early years reduced the impact of overall efforts (Fritz et al., 2012). The use of pooled funding from the start of engagement may be one way to address these challenges. However, the experience of informal networks of donors in Sierra Leone suggests that donors can also take greater responsibility for coordination among themselves and with partner governments even if formal structures are not in place (see the case study below on Sierra Leone).[30] Coordination gaps may also emerge within the government, which can undermine reforms. ODI's Budget Strengthening Initiative operates at a technical level within finance ministries in a handful of fragile states. Lessons learned from the past five years suggest that technical assistance working with middle managers can play an important role in bridging those coordination gaps and building internal support for reforms (Gill, 2015).

[30] This may be necessary even if formal coordination mechanisms are in place. Research on how recipient governments (and particularly non-DAC donors) have responded to changes in the aid landscape suggests that many prefer to engage bilaterally (Schmaljohann and Prizzon, 2015). In these circumstances, informal coordination between partners may be essential to ensure formal donor coordination rounds are effective.

While these lessons may improve the chance of successful reform, there may still be failures. Little is known about the proportion of reforms that should be expected to succeed, especially in the challenging contexts associated with fragility. The sense of optimism that follows the end of conflict may quickly be replaced by a collective view that reforms are not delivering on expectations. Therefore, progress should not be judged solely on the (possibly overambitious) targets set at the start of the reform period when optimism is high. Once again, a constructive government–donor dialogue may be one way to manage these expectations.

4.4 Key messages and conclusions

The New Deal called for expanded use of country systems, and identification of the measures required to enhance confidence in them. At present there is no agreed approach and framework for how to do this in fragile states. First, the nature of the decision needs to be clarified. How much fiduciary risk a donor is willing to take on in dealing with a fragile state where the political economy often militates against the effective use of funds is a fundamentally political decision. The fiduciary risk of using country systems needs to be balanced against the longer-term programmatic risk that country systems may be undermined, meaning that there is no growth in the capacity of a state to sustainably deliver services to its citizens.

A framework has been set out for how different aid modalities can utilise – or not utilise – country systems and, where they do, what mechanisms could be used to reduce the risks of using country systems. A key lesson is that projects and programmes can be designed to be better coordinated with government so that any transition to fuller use of country systems is more straightforward to manage.

In principle pooled funds are an effective way to support this sort of approach as they can coordinate aid, reduce transactions costs and deliver at scale, and share risk between donors. However, the record of pooled funds in achieving these goals is mixed. To fulfil their potential, pooled funds need to be designed to match the goals of donors and the country context.

The New Deal also called for more effective strengthening of country systems, and the building of fiduciary and administrative capacity. However, PFM reforms are challenging to implement, even in non-fragile states, and have generally disappointed. Increasingly, there is a realisation that best-practices may not always be the right fit for fragile states with limited capacity and wide-ranging development challenges. Focusing donor–government dialogue and reforms on priority problems and capacity gaps may help avoid the numerous problems that wholesale PFM reforms have encountered over the past two decades. In many cases, this will mean focusing discussions on service delivery, especially budget execution systems. Finding ways to bridge key coordination gaps can reinforce interventions, whether that is between donors, between the government and donors, or between stakeholders within the government. Importantly, not all reforms will succeed and progress may not always meet the expectations of the public, the government or development partners.

5 Overview of case studies

This section reviews evidence gathered from case studies of the use of country systems in five countries:

- Afghanistan
- South Sudan
- Liberia
- Sierra Leone
- West Bank and Gaza.

Each case presents a unique context and demonstrates the wide range of approaches to the use of country systems. The focus for each has been on the past decade, with particular emphasis on approaches used in the past five years. Data for comparisons have been drawn mostly from OECD DAC statistics and the World Bank's World Development Indicators. This has been supplemented with other indices and country-specific data. The full case studies are in a second volume. Each case study considered: (a) the nature of fragility, (b) the degree to which country systems were used, (c) what risks existed and which were managed, (d) the impact on country systems and donor objectives, and (e) the extent of the application of New Deal Principles. Here, these issues are covered in less detail.

The discussion begins with a brief comparison of the context in which country systems are being used – performance on widely used socioeconomic indicators, fiduciary risks associated with the PFM system and other risks that could affect the use of country systems. This is followed by a more detailed look at how donors have responded to these varied circumstances to use country systems – the degree to which aid uses country systems, how this was done, how risks were mitigated and what role capacity building has played in the process. The analysis is broad-brush and will not comprehensively tackle all the relevant political economy considerations. Instead it serves to provide an illustration of the issues raised in earlier sections, concluding with examples from specific sectors.

5.1 Overview of country systems and other risks

Though all classified as fragile states by the OECD and the World Bank, the countries and territories reviewed are at very different stages of economic and

human development (Table 11). In 2012, GDP per capita ranged from under $800 in Liberia to nearly $5,000 in West Bank and Gaza, adjusted for purchasing power.[31] This places Liberia among the least developed countries in the World, while GDP per capita in West Bank and Gaza is nearer to the levels of upper-middle-income countries. South Sudan was classified as lower-middle-income before it was downgraded to low-income status in 2013 under the World Bank country lending groups. However, social indicators are generally poor in all countries. Afghanistan, Liberia and Sierra Leone are among the lowest-ranked countries in the Human Development Index. The West Bank and Gaza performs better on these metrics, but the territories suffer from high rates of unemployment and are significantly poorer than Israel.

Table 11: Socioeconomic statistics for case study countries

	Afghani-stan	Liberia	Sierra Leone	South Sudan	West Bank and Gaza
Period of conflict	1978-2001 2006-	1989-2003	1991-2002	2005-2010 and 2013-	1948-
Total population estimate, millions (2012)	29.8	4.2	6.0	10.8	4.0
GDP per capita, PPP (2012)	$1,927.14	$796.47	$1,469.30	$1,842.66	$4,921.39
Status in World Bank country lending groups	Low income	Low income	Low income	Low income	Middle income
Average real GDP growth per capita (2008-2012)	8.0%	7.1%	2.9%	N/A	4.3%
Inflation (2007-2012)	8.1%	9.5%	14.0%	17.8%	6.3%
Unemployment rate (2012, ILO estimate)	8.7%	3.7%	3.4%	N/A	23.0%
Human Development Index rank (2012)	169	175	184	N/A	107
Poverty headcount ratio at $1.25 per day (various years)	N/A	83.8	56.6	N/A	0.08
Infant mortality rate per 1,000 live births (2012)	72.0	55.6	109.6	66.1	19.1
Adult literacy rate (various years)	32%	43%	45%	N/A	96%

Sources: World Development Indicators 2015 June; Human Development Report 2014

Each country has its own particular risks and challenges associated with the use of country systems. For example, South Sudan and Afghanistan are ranked in the top five most corrupt countries in the world. Corruption has also been a serious concern in Sierra Leone over the past decade. However, the type of corruption varies between countries and may not always be a risk to the way government funding is managed. For example, much corruption in Afghanistan involves extortion, power with impunity and diversion of customs revenues before they reach the treasury, rather than theft of money from treasury systems.

Macroeconomic concerns are also present. South Sudan depends on oil for up to 90% of its revenues, which are the country's main source of foreign exchange. This exposes the government to significant volatility. The West Bank and Gaza are not sovereign states and rely on clearance revenues from Israel for around 40% of government revenues. Furthermore, labour and trade restrictions imposed by Israel place additional importance on public sector employment. For many of these

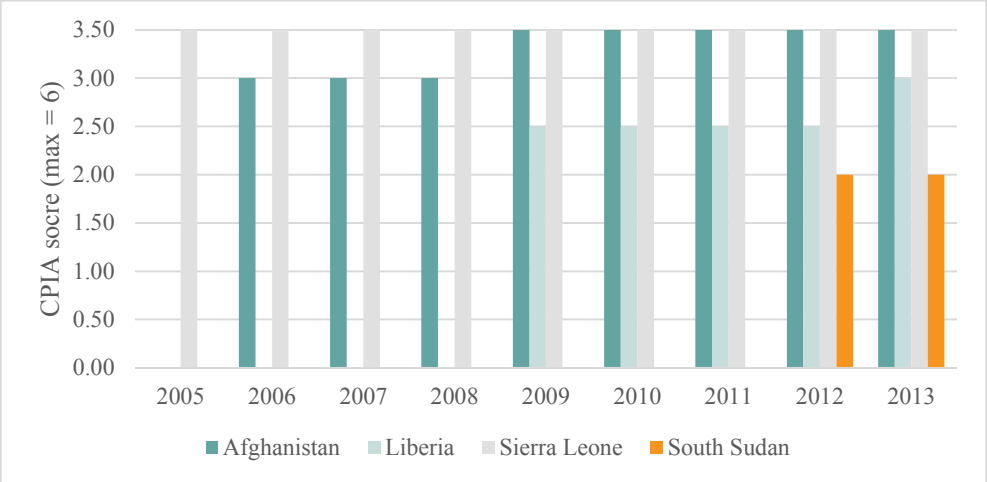
[31] GDP estimates need to be treated with a measure of caution due to inaccuracies in estimates for individual countries. In particular, commentators have noted that Liberia's GDP is likely to be under-estimated (see IMF 2009: 12). This will overstate the role of aid in the economy and the strength of domestic resource mobilisation, as well as other ratios.

countries, the threat of a resumption in conflict remains a constant source of uncertainty – notably in Afghanistan, South Sudan and West Bank and Gaza.

Politics also plays an important role for donor engagements. Recent consultations in South Sudan, for example, suggest that some donors were unaware of the political economy factors that underpinned differences between the official and black-market exchange rates that create rents for the elite. This was significant as budget support rested on compliance with IMF conditionality, which included harmonisation of the official and black market exchange rates. Ultimately, this condition was not met and budget support not disbursed. On the other hand, successful PFM reforms in Gaza have been driven by the desire of the Palestinian Authority to establish the basis for a potential future state of Palestine.

Country systems themselves are also at different stages of development. Data to compare the countries over time are restricted to recent years, and come with the caveats described in Section 3.3. Figure 5 plots CPIA scores since 2005, and Figure 6 compares averages of PEFA scores for available assessments.[32] Sierra Leone scores well on both indicators, relative to the other countries, and has been building its systems with donor support since the early 2000s. South Sudan scores lowest on both measures, but has only been an independent country since 2011. Afghanistan scores more moderately on CPIA, but top under PEFA, because budget credibility is poor in Afghanistan (Table 12) and CPIA gives this a higher weighting. In contrast, Liberia scores as highly on the CPIA as Sierra Leone, but only marginally above South Sudan in PEFA. West Bank and Gaza have undertaken two PEFA assessments, which score relatively poorly, but qualitative assessments generally conclude that PFM systems perform well compared to other countries in the region, especially for budget execution.

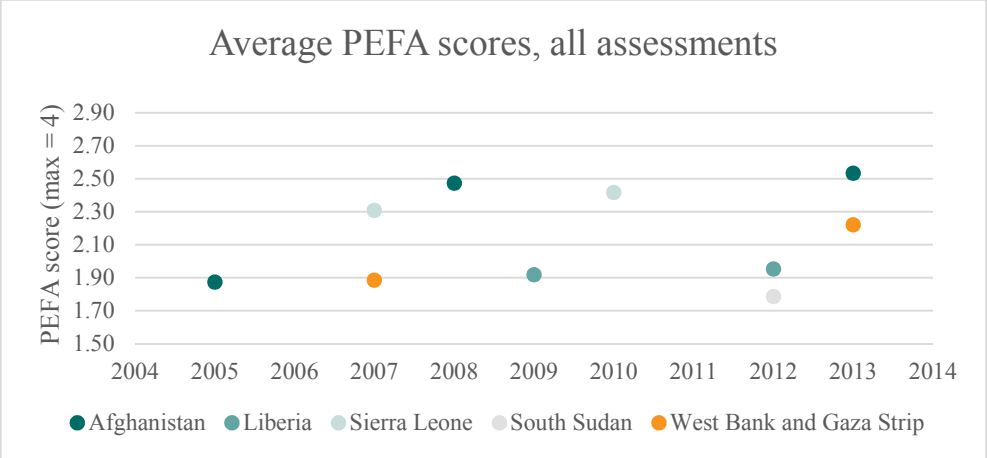
Figure 5: CPIA scores for budget and financial management



Source: Worldwide Governance Indicators

[32] The scores have been converted to numbers and averaged using the methodology proposed by de Renzio (2009). Simplistically: D=1; C=2; B=3; A=4. Any + is replaced with 0.5.

Figure 6: PEFA scores for publicly available assessments



Source: PEFA Secretariat

Table 12: PEFA scores for budget credibility

PEFA indicator	AFG	LBR	SLE	SSD	WBG
Year published	2013	2012	2010	2012	2013
PI-1 Expenditure budget credibility (aggregate)	D	D	D	D	D
PI-2 Expenditure budget credibility (disaggregated)	C	D	B	D	A
PI-3 Revenue budget credibility (aggregate)	D+	D+	C	D+	C+
PI-4 Level of domestic payment arrears	C	D	C	D	B

Note: Minimum score D, Maximum score A. Source: PEFA Secretariat

Overall, contexts vary considerably. Despite being classified as fragile by both the OECD and the World Bank, these nations demonstrate a range of vulnerabilities. Though still significantly underdeveloped, Sierra Leone and Liberia have become increasingly stable and secure since conflict ended. There, donors are increasingly aiming to build stronger state institutions, foster economic growth and improve public services. At the other extreme, the West Bank and Gaza is not a state with control over its borders, despite having some characteristics of middle-income countries. Establishing military security also remains a development priority in both South Sudan and Afghanistan. On the metrics available, Sierra Leone and Afghanistan have established what look like PFM systems with at least basic functionality. Liberia and West Bank and Gaza have shown progress in this regard. South Sudan is still a relatively young country, and systems are clearly still weak. The next section considers how donors have used country systems in these varied contexts to: (a) promote peace and statebuilding and (b) improve coordination and harmonisation.

5.2 Comparing the use of country systems

Aid has been an important resource for all these countries (Table 13). Country programmable aid makes up at least half of government resources in Afghanistan, Liberia and Sierra Leone. Only the West Bank and Gaza (clearance revenues) and South Sudan (oil revenues) receive a larger share from domestic revenues than they do from aid. Nevertheless, the revenues available are characterised by high levels

of uncertainty with serious implications for macroeconomic and fiscal management.

In per capita terms, the West Bank and Gaza received by far the highest per capita allocations of aid at over $500 in some years. After 2009, Afghanistan received around US$200 per capita each year, with Liberia receiving half that amount, and South Sudan and Sierra Leone receiving slightly less (Table 14). The EU and the United States are prominent donors in Liberia, West Bank and Gaza, South Sudan and Afghanistan. In Sierra Leone, DFID played a bigger part, though the EU is a larger provider of aid. The distribution of donors naturally plays a part in the use of country systems – using the strict OECD definition, the United States uses country systems for around 10% of aid to a recipient country, on average, while the EU uses country systems for around 40% (Knack, 2014). Therefore, it is reasonable to expect countries where the United States is an exceptionally large donor to exhibit lower use of country systems.

Table 13: Country programmable aid, percentage of GDP

Country	2006	2007	2008	2009	2010	2011	2012	2013
Afghanistan	36	44	38	44	34	33	30	23
Liberia	20	81	74	29	34	30	26	24
Sierra Leone	14	13	13	16	16	13	11	9
South Sudan	-	-	-	-	-	3	7	7
West Bank and Gaza	19	23	30	27	23	17	14	-

Sources: OECD Stat, WDI

Table 14: Country programmable aid per capita (US$)

Country	2006	2007	2008	2009	2010	2011	2012	2013
Afghanistan	100	165	142	197	193	204	204	154
Liberia	36	169	171	87	111	114	108	107
Sierra Leone	50	53	60	71	70	64	67	62
South Sudan	-	-	-	-	-	56	65	68
West Bank and Gaza	275	357	565	529	532	456	384	479

Sources: OECD Stat, WDI

The level of use of country systems has varied between the cases, but donors have used country systems in all of them. According to OECD statistics, donors have generally been more willing to use country systems for budget execution, reporting and audit than for procurement (Table 15). However, in Afghanistan and West Bank and Gaza, the use of audit systems is also low, possibly reflecting the additional safeguards imposed on multi-donor trust funds which are mainly audited by external auditors, but also by the United States which is the largest donor, as well as the government audit capacity in relation to high aid flows. In Palestine, it may also be because of the lack of domestic oversight since the legislature closed in 2007. Though there are clear variations, the commitment to use country systems in such a wide variety of contexts is significant. Notably, use of country systems was higher in Liberia than in Sierra Leone and Afghanistan, which scored higher on the CPIA and PEFA metrics of PFM systems. This may support the view presented in Section 3 that strength of PFM in recipient countries is not always the predominant concern in donor decisions to use country systems.

Table 15: OECD 2011 survey of aid using country systems

Indicator	Afghanistan	Liberia	Sierra Leone	South Sudan	West Bank and Gaza
Recent PEFA score averaged (various years)	2.53	1.95	2.42	1.79	2.22
CPIA score for budgetary and financial management (2012)	3.50	2.50	3.50	2.00	N/A
Aid reported in the 2011 survey (US$ millions)	5,807	402	451	N/A	1,589
Financial management	25	42	37	N/A	37
Budget execution	30	49	22	N/A	43
Financial reporting	29	34	38	N/A	42
Auditing	17	44	49	N/A	25
Procurement	11	32	21	N/A	51

Sources: OECD (2011); PEFA Secretariat (2014)

Budget support has been used in all these countries, except South Sudan. Provision of budget support was a greater share of aid in Sierra Leone, Afghanistan and West Bank and Gaza than in Liberia. This is despite Liberia demonstrating strong progress on PFM reforms since 2006 and recording similar scores to Sierra Leone on CPIA indicators for budgetary and financial management in recent years. Reports suggest that donors were more concerned about the quality of country systems in Liberia than in Sierra Leone, though it is not possible to state this conclusively. South Sudan was also considered for budget support when oil production was shut off, but this was never finalised as progress on conditions to liberalise the exchange rate stalled and conflict resumed.

Pooled funding has been an important mechanism for the use of country systems. Table 16 shows the percentage of ODA disbursed through pooled modalities[33] in each country in 2013. This shows that pooled modalities are significant for delivering aid and have the potential to be as large as all but the largest bilateral donors. Indeed the 2014 review of the New Deal claimed that direct use of country systems by bilateral donors appears more difficult than when money is disbursed through pooled funds.

Pooled funds existed for a variety of purposes: health sector funding (Afghanistan, Liberia), infrastructure development (Afghanistan, West Bank and Gaza) and budget support (Afghanistan, West Bank and Gaza, Sierra Leone). Some pooled funds provide joint budget support, others joint project support. DFID operational plans for West Bank and Gaza explicitly state that the choice of pooled funds was to improve harmonisation and reduce administration costs, which would be higher if each donor worked independently. The external review of the Afghanistan Reconstruction Trust Fund (ARTF) comes to a similar conclusion, but also suggests that pooled resources can increase impact because of the economies of scale. Donors can also benefit from pooling risks in fragile states where there are high fiduciary, operational and reputational risks.

The case studies suggest that how funding is disbursed can have important implications for fiscal management and even donor coordination. In Sierra Leone, for example, budget support was rarely disbursed in the first quarter of the

[33] To capture any differences in definitions used between countries, both the disbursements for 'Contributions to specific-purpose programmes and funds managed by international organisations' and disbursements for 'Basket funds/ pooled funding' are shown. For example, the amounts for the former indicator in Afghanistan suggest the World-Bank-managed ARTF has been classified here.

government's financial year, forcing it to resort to domestic borrowing – so accumulating additional domestic debt. The case study on Sierra Leone (Box 5) also revealed that slow disbursements from one World Bank-managed trust fund, intended to be the main vehicle for aid coordination, led to the creation of others, so fragmenting the donor landscape. A similar process occurred in South Sudan. This supports some of the key messages for the use of pooled funds highlighted in the previous section: the need to establish realistic expectations for pooled funds, and the fundamental trade-off between speed of delivery and strengthening country systems (Commins et al., 2013). Uncertainties in disbursements have also added to the difficulties of managing finances in Gaza and the West Bank.

Table 16: ODA disbursements to pooled modalities, 2013

Country	Contributions to specific-purpose programmes and funds managed by international organisations	Basket funds/ pooled funding	ODA	ODA through pooled modalities (%)
Afghanistan	1,430	22	5,187	28
Liberia	27	33	539	11
Sierra Leone	72	3	523	14
South Sudan	418	19	1,450	30
West Bank and Gaza	446	32	2,512	19

Note: Constant 2013 US$ millions. Source: OECD CRS

Even when country systems are not used, it may still be possible to 'shadow align' donor processes to country systems to minimise the burden on service delivery units of managing multiple processes. A useful example comes from the South Sudan case study, where DFID-funded capitation grants for secondary schools alongside the Ministry of Education's capitation grants for primary schools. Funds did not flow through government systems; however, there was no difference from the schools' perspective: they received funds from government and from the donor project in the same account and had to report on these funds in the same way.

Box 5: Budget support in Sierra Leone

In Sierra Leone, the decision to use budget support was made early on. For DFID, a key objective was to provide sufficient financing to make a difference to macroeconomic management and restore an operational budget that could support an expanded wage bill for the police and defence forces. This was backed by a ten-year memorandum of understanding about budget support in 2002, indicating real long-term engagement. When the agreement expired in 2012, budget support continued. DFID has also played a role as an anchor in the donor group which has supported informal coordination.

Fiduciary risks in Sierra Leone were, and remain, high for donors providing budget support. Macroeconomic risks have been managed through the requirement for the Government of Sierra Leone to adhere to an IMF programme. Indeed, the relationship between the IMF and Minister of Finance James Jonah was good enough for the government to establish a reputation for sound fiscal management even before the conflict ended. This trust may even have been a factor behind the provision of budget support in the first place.

PFM reforms are being supported by significant investments from a number of donors. These made strong progress in the first ten years after conflict officially ended in 2002, but may have slowed recently. Some of the strongest evidence

that reforms have delivered changes at the front line of service delivery come from Public Expenditure Tracking Surveys. For example, 75% of essential drugs were accounted for in Primary Health Units in 2006 compared to just 5% in the early 2000s. Despite this, patronage continues to dominate the political landscape in Sierra Leone and rules-based PFM systems are still being institutionalised. These fiduciary risks remain, and so will be subject to political attention.

Sources: Lawson (2007); Welham and Hadley (2015); Tavakoli et al. (2014); Thomson (2007); Save the Children (2012)

A number of different approaches have been used by donors to manage risks. One consistent theme is that donors in all the cases rely on the IMF for advice on the economic risks of providing aid, particularly when using budget support. This is commonly provided through a Staff-Monitored Programme (or under an IMF lending facility) requiring the government to meet benchmarks for fiscal management and priority reforms agreed with the IMF.[34]

Other approaches to risk involve changes in the way aid is delivered or the introduction of additional safeguards. For example, budget support may be delivered through a reimbursive approach. The US has provided such support in both Liberia and Afghanistan, paying for services after they have been delivered at a predetermined fee. This limits the risk to the US that funds will be diverted for different purposes, but means that most country systems are used to deliver services. Though undocumented, there are suggestions that reimbursable payments may make governments more risk-averse, lowering execution rates. No studies were found to confirm or dismiss these concerns, which highlights how little is known about the effectiveness of new delivery mechanisms like the Fixed Amount Reimbursement Agreements (FARAs). Similarly, the Afghanistan Reconstruction Trust Fund recurrent window operates on a reimbursement basis. Funds are disbursed based on an ex-post review of expenditures, so that only eligible expenditures are reimbursed.

In some cases donor requirements for additional safeguards preclude them using some country systems or violate the strict GPEDC definition for the use of country systems described in Section 3.2. One approach that appears to have worked for sector-specific support is the use of trust funds managed jointly between the government and the donor. Liberia's Health Pooled Fund is a good example of this and was used primarily to scale up funding for a basic package of health services. Another may be the use of performance-based financing for local government infrastructure. These are discussed in relation to specific sectors below.

Maintaining political dialogues was identified as important for balancing risks appropriately in a number of instances. Programming in fragile situations requires good knowledge of the political environment to allow donors to identify the balance of risks when situations change. A key part of dialogue with the country is the implicit threat that donors will revert to parallel systems when faced with a risk event that is not adequately addressed. This will be complicated where government–donor relations are not well established and where the government does not behave as a unitary actor – as was the case in South Sudan. Furthermore, cases such as West Bank suggest that donors will constantly need to trade off fiduciary, programmatic and reputational risks in a highly political environment.

[34] For more information about IMF lending facilities and surveillance see the relevant fact sheets at: http://www.imf.org/external/np/exr/key/lic.htm and http://www.imf.org/external/np/exr/facts/eng/list.aspx.

Box 6: Failures of political dialogue in South Sudan

A number of useful lessons have been learnt from the negotiation of the State Building Contract in South Sudan after independence in 2011. Discussions between the EU and the Government of South Sudan were centred mostly on a small group in the Ministry of Finance, rather than integrating with the wider dialogue aimed at developing the New Deal Compact. However, some suspected that the real decisions were taking place out of sight of donors, between South Sudanese officials.

The political dialogue in South Sudan has also been criticised for the disconnect between diplomatic and development actors while the New Deal Contract was being developed. At this time the political environment was deteriorating seriously, culminating in the resumption of armed conflict in 2013. The rapid escalation in violence ultimately posed the greatest threat to donor interventions of all kinds.

This raised questions. Are donors looking at the right political-economy risks and in particular is a better understanding of the elite political settlement needed when operating in fragile states? Do high levels of uncertainty and risk in fragile states mean that risk registers need to be updated more regularly during programme design in order to track risks as they evolve? What role should diplomatic agents play in providing judgements on political risks for the use of country systems?

Source: Bernardi et al. (2015)

Ultimately, the decision to use country systems, and provide budget support in particular, has been political. Decisions may be partly affected by concerns over fiduciary risks, as was the case in South Sudan (Box 6) with the EU Statebuilding Contract and in Liberia with the decision to use a pooled fund rather than sector budget support. This contrasts markedly with the decision by DFID to provide general budget support to Sierra Leone (Box 5). Similarly, budget support is provided to the West Bank under close scrutiny from bodies such as the United States Senate over concerns that the money will be used to finance terrorist activities. Indeed, a number of donors have stopped financial support to Gaza which has been ruled by Hamas since around 2006. Decisions about the provision of aid (and the modality used) must constantly trade off fiduciary, development and reputational risks when engaging in fragile contexts. However, it may be possible to narrow the political decision-making by providing better information on decision-making through strengthened analysis of fragility and risks.

5.3 Specific sector examples

The case studies provide some useful examples of use of country systems in specific sectors – notably in the health sector and for local government investment projects. These show in greater detail some of the approaches that use country systems to support the provision of public services. However, in each case financial support was accompanied by specific safeguards to protect against fiduciary risks, and so they may not be classified as using country systems under the strict OECD definition.

Liberian Health Pooled Fund: One of Liberia's aid coordination successes has arguably been to transition from humanitarian interventions to the use of country systems in the health sector through the use of a pooled fund (Hughes, et al., 2012). Established by the government in 2008, the Health and Welfare Pooled Fund is managed by a Steering Committee chaired by the Minister of Health and Social

Welfare and a lead donor. It is administered by PwC as an external Pool Fund Manager (LPRF, 2008). The fund uses government procurement regulations and financial management systems, and is audited by both the Supreme Audit Institution and an independent auditor appointed by the Steering Committee. More than two-thirds of the Fund is used for delivering a basic package of health services through international NGOs, with just 9% reserved for systems strengthening (Hughes, et al., 2012). Between 2007 and 2009 around 10% of donor aid to the health sector was implemented through the Fund (Hughes, et al., 2012).

Afghanistan health sector: Donor support to the health sector in Afghanistan is a good example of how working through country systems has helped achieved much faster progress than working outside them. There have been large improvements in the coverage of primary healthcare, 'A Package of Basic Health Services now reaches most of the country' (Sud, 2013) and in health outcomes.[35] Service delivery is mainly by local and foreign NGOs under competitively awarded contracts for franchises for each province, with monitoring of inputs, outputs, health outcomes and patient satisfaction, originally by a third party, but now through the ministry's health information system. This monitoring is important as it engages more closely with the objectives of donor financing and narrows fiduciary risks more than just relying on audits and parliamentary scrutiny which come with significant time lags.

This programme for expansion of health services was originally supported by the World Bank and the EU and USAID, and shifted from traditional parallel approaches once the success of the model became apparent. USAID supports the package by providing funds directly through the finance ministry, then onward to the public health ministry via a special account. For the EU, transitioning towards greater local ownership entails not a major realignment of funds but rather a change in practices to ensure that money is tracked and ultimately used for the intended purposes. The EU directly funds NGOs implementing the basic health package. Although the public health ministry is involved in decisions, including monitoring and evaluation, EU assistance in effect bypasses the government. It now intends to channel funding through the ministry, which in turn will allocate it to implementing NGOs. EU funding was expected to go through the ARTF by 2013.

Local government infrastructure: The combination of technical assistance and performance-based grants for infrastructure development has been used widely in developing countries to strengthen and support local government services. This modality is also used in the case study countries – notably in West Bank and Gaza, South Sudan and Afghanistan. In Afghanistan and West Bank and Gaza, these have also supported reconstruction efforts. The standard model for such projects was influenced by the experiences of the Local Government Development Programme in Uganda in the 1990s. Grants are provided to local governments for the provision of infrastructure, with a high degree of discretion over what capital projects are funded. Instead of being earmarked, the grants are conditional on meeting a set of predetermined 'minimum conditions' and topped up based on progress against 'performance indicators'. Performance indicators are commonly assessed annually and generally target improvements in compliance with financial management legislation, such as timely reporting or delivering a clean audit. These have the dual

[35] Significant progress was made on several key indicators.

- Under-five child mortality was brought down from 126 deaths per 1,000 live births in 2003 to 97 in 2013 (http://www.childmortality.org/index.php?r=site/graph&ID=AFG_Afghanistan).
- DPT3 coverage increased from 41% in 2003 to 90% in 2013 (http://apps.who.int/immunization_monitoring/globalsummary/coverages?c=AFG).
- Skilled birth attendance rose from 12% in 2000 to 39% in 2011 (http://www.countdown2015mnch.org/documents/2014Report/Afghanistan_Country_Profile_2014.pdf) and maternal mortality rates fell from 1,100 per 100,000 live births in 2000 to 400 in 2013 (http://www.who.int/gho/maternal_health/countries/afg.pdf?ua=1).

benefit of improving infrastructure and creating the incentives to strengthen institutions as well.

Box 7: Approaches to capacity building

Financial and technical support for capacity building is provided alongside budget support. One of the principal arguments for using country systems is to build state capacity. For this reason, decisions to use country systems are often matched by financial commitments for public sector or PFM reforms – often through the provision of technical assistance. In some of the case studies (such as Sierra Leone and West Bank and Gaza) aid was conditional on progress against agreed reforms. IMF programmes also usually include some benchmarks for PFM reform. Learning from countries like Sierra Leone is that donors need to be pragmatic about meeting targets, which may be over-optimistic, provided progress is being made. Also, even successful reforms of the PFM system or accountability institutions such as anti-corruption commissions will only mitigate fiduciary risks in the long run.

The approach to capacity building has varied, though many have used long-term embedded advisers recruited locally or from the diaspora. In Sierra Leone large numbers of qualified Local Technical Assistants were used, and have subsequently been absorbed onto the payroll. In Afghanistan, local and external consultants still provide capacity supplementation/substitution, by performing responsibilities on a full-time basis. One study suggests there may be as many as 7,000 Afghan consultants in the government ministries, outside the security sector, mainly due to the slow implementation of civil service reforms. In contrast, some ministries (notably the ministry of finance) in West Bank have rejected embedded technical assistance and taken a lead role in directing resources to the areas they deem are a priority – though those priorities have not always corresponded to what external experts think is necessary.

Approaches have varying impacts on quality of country systems. In Sierra Leone, Local Technical Assistants have played a major part in developing a basic level of capability in the Ministry of Finance, but effectively created a two-tier civil service structure, which raises questions of sustainability. In Afghanistan, donor support has created a parallel civil service that has been running the government for ten years, with the most capable officials opting out of government jobs and into contracted positions, which pay better. This has been accelerated by the practice of many donors of hiring scarce personnel at high salaries for their own programmes, including from government, which has seriously distorted the market for skilled labour (Ghani and Lockhart, 2008). In contrast, West Bank and Gaza already possessed significant capacity, and have been able to direct external assistance to rapidly improve systems for cash management and budget execution (the government's first priority).

Setbacks are inevitable in fragile contexts. This is clearly evident in West Bank and Gaza. The political drive to demonstrate the viability of a future independent state of Palestine has provided significant impetus for reforms, particularly after the Second Intifada in 2000. Rapid progress from 2002 to 2006 in establishing PFM systems was widely acclaimed, but stalled in 2006 with the election of Hamas in Gaza and the West Bank. Capacity in the Ministry of Finance remained dormant until Fatah regained control of the West Bank in 2007 and progress resumed.

Sources: case studies

5.4 Application of New Deal principles

As set out in Section 3.4, the prominence of fragile states in the aid agenda, together with the formation of the g7+ group of fragile states, resulted in the New

Deal for engagement in fragile states. The New Deal consists of three elements (IDPS, 2011):

1. use of the Peacebuilding and Statebuilding Goals (PSGs) to guide work, and track progress, in fragile and conflict-affected states
2. application of the FOCUS principles for new ways of engaging in fragile states to support inclusive country-led and country-owned transitions out of fragility
3. application of the TRUST principles to provide aid and manage resources more effectively and to align these resources for results

The FOCUS and TRUST principles are set out in Box 8. All of the case study countries are members of the g7+, with the exception of the West Bank and Gaza, which is thus not explicitly signed up to implementation of the New Deal.

The first New Deal Monitoring Report (IDPS, 2014) set out a traffic-light system for evaluating progress on these goals: green indicating substantial progress on New Deal commitments; amber some, but not substantial, progress; and red insufficient or no progress. The record of implementation is further discussed below, drawing predominantly on the New Deal Monitoring Report, as this provides the most up-to-date reference, supplemented by additional evidence from the case studies. As the West Bank and Gaza is not part of the g7+, and so not covered in the New Deal Monitoring report, the information used is from the case study and from the Global Partnership progress report (OECD/UNDP, 2014).

Implementation of FOCUS principles

The FOCUS principles are measured on a country-by-country basis, and are summarised in Figure 7. This record of implementation is further discussed below, drawing predominantly on the New Deal Monitoring Report, as this provides the most up-to-date reference, supplemented by additional evidence from the case studies.

Figure 7: Progress on implementation of the FOCUS Principles

Principle	Afghanistan	Liberia	Sierra Leone	South Sudan	Overall Progress
Fragility assessments					
One vision, one plan				-	
Compacts					
Use of PSGs to monitor progress					
Support political dialogue and leadership		-			

Source: IDPS (2014)

Box 8: New Deal for engagement in fragile states principles

Engagement with fragile states will be based on:

F: a country-led **Fragility assessment** on the causes and features of fragility and sources of resilience, developed based on a methodology developed by the g7+ with the support of international partners.

O: develop and support a country-led **One vision and one plan** to transition out of fragility, based on inputs from the fragility assessment.

C: a country **Compact** to implement the plan, to ensure donor harmonisation and coordination and reduce duplication, fragmentation and programme proliferation.

U: Use of the PSGs to monitor country progress.

S: Support of inclusive and participatory political dialogue and leadership, and initiatives to build the capacity of government and civil society leaders and institutions to lead peacebuilding and statebuilding efforts, with specific support to promote youth and women's participation.

To provide and manage resources more effectively and align these resources for results:

T: enhance **Transparency** of the use of aid, including monitoring of overall resource flows to fragile states and tracking of international assistance against individual goals. Support the strengthening and greater transparency of national fiscal systems and provide support to domestic oversight mechanisms.

R: Risk sharing, by recognising that the risk of non-engagement can outweigh most risk of engagement, and develop joint donor risk-mitigation strategies, including conducting joint assessments of risks and identifying and using joint mechanisms to reduce and better manage risks.

U: Use and strengthen country systems, by jointly identifying the oversight and accountability measures required to enable the expanded use and strengthening of country systems, and recipient governments, with support from international partners, taking all reasonable measures to strengthen their public financial management systems. International partners will increase the percentage of aid delivered through country systems on the basis of measures and targets jointly agreed at the country level, and recipient governments will seek to increase the proportion of public expenditure funded by domestic revenues.

S: Strengthen national capacities, by increasing the proportion of funds for capacity development through jointly administered and funded pooled facilities, substantially reducing the number of programme implementation units per institution, ensuring technical assistance reports to the relevant national authority, working towards an understanding on remuneration codes of conduct for national experts, and facilitating South–South and fragile–fragile exchanges of experience on transitions out of fragility.

T: Timely and predictable aid by using simplified, accountable fast-track financial management and procurement procedures to improve the speed and flexibility of aid delivery in fragile situations, increasing predictability by publishing three-to-five year indicative forward estimates, and to make more effective use of global and country level funds for peacebuilding and statebuilding.

Source: IDPS (2011)

Sierra Leone ranks highest on implementation as it has a fragility assessment that provided inputs for the national plan, the *Agenda for Prosperity*, to which donors

are aligned. The 2014 Mutual Accountability Framework is a compact explicitly based on New Deal principles, and focused on delivery of the *Agenda for Prosperity*, including country-level indicators for each of the five PSGs. The Mutual Accountability Framework has a dashboard to track progress, including on these PSG indicators. The development of the fragility assessment, plan and compact all involved participatory consultations, conferences and discussions involving representatives from central and local government, parliament and civil society, and development partners. Civil society participates in the quarterly coordination and dialogue meetings between government and development partners, and all stakeholders meet to discuss issues relating to elections and governance.

The other case-study countries have not made as much progress on one on other element of the FOCUS principles. Fragility assessments have been conducted in all the cases except Afghanistan[36] and enabled countries to identify country-level goals and indicators. However, these have not been fully incorporated into the national plan and mutual accountability framework with donors. As a result the plans have not been informed by a participatory analysis of the country's drivers of conflict and fragility, and adopt a more traditional MDG-based approach. Although progress has been made, more attention is still needed to the PSGs, without which opportunities for addressing fragility through national policy-making and the delivery of services and programmes will be limited.

In Liberia, the New Deal principles are incorporated into its *Agenda for Transformation*, which shows show the PSGs map to its objectives. A compact has not yet been developed, but is reportedly under consideration. South Sudan has a development plan that was originally intended to run over 2011-13 and has been extended to 2016 by the government, but it was formulated before the New Deal was established. Considerable progress was made in 2013 in developing a compact built around New Deal principles and the PSGs. However, launch of the compact was postponed as a result of the parliament's rejection of an exchange-rate condition associated with the establishment of the IMF programme which was part of the government's reform commitments under the compact. Under the compact donors would have moved ahead with several more aligned aid modalities including an EU Statebuilding contract (budget support) and a multi-donor pooled South Sudan Partnership Fund. Violence then broke out before the compact approach could be re-assessed, and political buy-in strengthened.

Afghanistan's National Development Strategy was translated into 22 National Priority Programmes which act as the 'One vision, one plan', but both of these pre-date the New Deal (dating from 2008 and 2010 respectively). The Tokyo Mutual Accountability Framework was not developed as a New Deal Compact, and so does not include PSG indicators to monitor progress,[37] but it aligns with New Deal principles as it has mutual commitments from government and donors to match funding with priorities and deliver on the government strategy.

In the West Bank and Gaza, which is not a member of the New Deal, no fragility assessment has been conducted, and the PSGs are not used to monitor progress. However, the Palestinian National Development Plan clearly acts as the single plan for donors to align behind, and the Palestinian Reform and Development Plan

[36] Although Afghanistan plans to undertake a New Deal study in 2014, which will use the key principles and approach of a fragility assessment to analyse country progress in meeting the PSGs and identify the extent to which the PSGs are reflected in existing national strategic plans and frameworks.

[37] The New Deal Monitoring Report states that 'The upcoming New Deal study will be used as an opportunity to consider whether specific country-level indicators for the PSGs are required, in addition to the existing indicators in the Tokyo Mutual Accountability Framework. Donors are reported to have indicated that they are not keen on the suggestion of new indicators.'

Multi-donor Trust Fund managed by the World Bank has been a vehicle for this. There is no single compact-like document between the Palestinian Authority and the donor community. In terms of supporting political dialogue and leadership, the GPEDC progress report states that the West Bank and Gaza undertakes an inclusive, mutual accountability, assessment of progress with donors, that includes non-executive stakeholders, and the results of which are made public (OECD/UNDP, 2014:Annex A, Table A.7).

Implementation of TRUST principles

The New Deal Monitoring Report does not explicitly score progress on implementation of the TRUST principles by country, as it does for the FOCUS principles. In terms of overall progress, the report finds there has been less progress on the TRUST principles than on the FOCUS principles, as shown in Figure 8. Of the four 'key New Deal implementation gaps' noted by the report (IDPS, 2014: 15), three were of TRUST principles: formal commitments to increase the use of country systems and reduce parallel implementation approaches are rare; capacity-building efforts fall short of a coordinated, systematic approach to institutional transformation; and governments are still struggling to obtain timely and predictable aid information in a format that can be integrated into the national budget. Only one gap concerned a FOCUS principle: progress in PSG implementation is not being systematically monitored either within or across countries.

Donors continue to struggle to adjust their approach to risk at the country level, but pooled funds and, more rarely, other more innovative approaches have been utilised to use country systems.

Figure 8: Overall progress on New Deal principles

FOCUS principles	TRUST principles
Fragility assessments	Transparency
One Vision, one Plan	Risk Sharing
Compacts	Use and strengthen country systems
Use of PSGs to monitor	Strengthen capacities
Support political dialogue and leadership	Timely and predictable Aid

Source: IDPS (2014)

In terms of aid transparency at the country level, all of the case study countries have an aid database of some form but there are capacity or systems challenges in operating these on the side of the recipient government. Together with delays in donor reporting, this limits the ability to provide timely and appropriate aid information to the annual government planning and budget process. Similarly, the GPEDC 2014 progress report stated that 0% of aid to West Bank and Gaza was on budget (OECD/UNDP, 2014: Annex A).

There has been some progress on risk sharing. Whilst there has been limited progress in joint assessments of risks between donors, there are successful examples of pooled funding arrangements and use of country systems as discussed above. However, only in Afghanistan and Sierra Leone have government and donors agreed targets for the percentage of aid that will be delivered through country systems. The New Deal Monitoring Report stated that 'No country or donor reported on the existence of a plan for making gradual, step-by-step progress on strengthening and increasing the use of country systems' (IDPS, 2014: 17).

Similarly, the report finds that capacity strengthening initiatives 'appear to be fragmented, and are not generally set within the context of a country-level

consensus on what capacity development is, how it should take place, the role of international assistance, and the measurement of results' (IDPS, 2014: 20). This provides further backing for an approach to capacity building which is based on a problem-driven approach to seek locally led reforms, as set out in Section 4.3 above. Inconsistent progress on capacity development is demonstrated by an example from Sierra Leone, where single PIUs have been established in the Ministries of Finance, Health and Agriculture. Meanwhile, there are still reported to be 295 projects using PIUs for implementation in Sierra Leone (IDPS, 2014: Annex A).

On timely and predictable aid, a key challenge is that while some donors have made progress in their ability to make long-term commitments through adopting longer programming cycles, g7+ countries continue to report that they cannot access reliable forecasts of future assistance. This is demonstrated for West Bank and Gaza, which the GPEDC progress report states receives a high level of annual predictability (a score of 99% of forecast aid disbursed (indicator 5a)) but a much lower score for medium-term predictability with only 33% of estimated funding covered by forward spending plans (OECD/UNDP, 2014: Annex A).

5.5 Key messages and conclusions

A high-level review of these fragile states shows that donors have made efforts to use country systems in a wide range of contexts. On one level Liberia and Sierra Leone appear to be on the road to increased stability and vulnerabilities stem largely from weak institutions and low levels of development. At the other extreme, West Bank and Gaza is not a state with control over its borders. These territories, as well as Afghanistan and South Sudan, are yet to maintain peace. Insecurity poses significant risks to their development prospects and regional stability. Yet, in each case donors have made efforts to use country systems, and even provide budget support.

The strength of country systems has played a role in the decisions of donors to use country systems, but in many cases the choice is a political one. This is especially true of budget support. Country systems are weak across the board – as is expected in fragile states. West Bank and Gaza arguably has the strongest PFM systems, though Sierra Leone and Afghanistan perform relatively well in PEFA and CPIA metrics. Motivation for use of country systems in West Bank is closely linked to wider political ambitions of peacebuilding and the creating of a viable independent state of Palestine. Similar motives underpinned the early decision of DFID to provide long-term budget support in Sierra Leone, which was generally successful, and the introduction of Statebuilding Contracts for providing EU budget support in fragile states.

Budget support and pooled funds have been the principal vehicles for using country systems, though other modalities are emerging. Budget support (general and sector-specific) is provided in all the countries studied here except South Sudan. Pooled funds have been used in Afghanistan, Sierra Leone and West Bank and Gaza to harmonise aid flows and conditions for budget support. This has also helped to pool donor risks. In practice, pooled funds for sector support may have many of the benefits of sector budget support – as was arguably the case in Liberia's Health Sector Pooled Fund. The same case could be made for payment for results or reimbursive modalities, which use country systems but transfer more of the fiduciary risk from donors to recipient countries, requiring additional safeguards on audit in particular. Liberia's experience with USAID's Fixed Amount Reimbursive Agreement (FARA) suggests that the donor may need to provide significant support

to the implementing ministry and there can be difficulties for budget management if delivery of agreed outputs spans fiscal years (and so budgets).

In most cases, additional safeguards are imposed by donors. Some safeguards are consistent with the strict OECD definition of the use of country systems, like the use of IMF surveillance and conditionality as a check on macro-fiscal management. Others are not consistent with the OECD definition, but nonetheless have advantages over using parallel systems. These include intermediate *ex ante* controls by donors or a designated agency – as in Liberia where USAID must approve drug purchases and requests for proposals in excess of US$1.5 million under the FARA. Alternatively, safeguards may be applied *ex post,* as with the many programmes that use external auditors to verify whether funding has been used appropriately. For example, the Health Sector Pooled Fund uses a government special account and so may be audited by the General Audit Commission (GAC), though independent audits are required each year. Relatively little information is available to assess the impact of these safeguards on development, reputational and fiduciary risk. However, a recent review of Statebuilding Contracts in South Sudan suggests that donors working in highly unstable contexts should monitor risks holistically and regularly, and adopt a wider definition of political risk (Bernardi et al., 2015). When combined with a strong political dialogue, this may help donors to find the right balance of risks.

In implementing the New Deal, more progress has been made on the way donors engage with the case study countries than on how they are utilising their resources. Whilst there have been successful cases of the use of country systems, there are only formal commitments to increase the use of country systems from across all this is Afghanistan and Sierra Leone. Capacity-building support remains uncoordinated, and aid forecasts remain unpredictable.

6 Conclusions

Fragile states arguably hold the key to ending extreme poverty. On current projections, extreme income poverty will increasingly be a phenomenon associated with conflict-affected and fragile states (Kharas and Rogerson, 2012). To 'leave no one behind' will increasingly mean working in these countries – in extremely varied contexts – to help foster sustainable, politically viable states capable of meeting the demands of their citizens.

Using country systems is an important component in building state capacity – to maintain security, foster economic stability and growth and deliver services. Bypassing country systems creates additional transaction costs for the government and may even distract attention from the systems that govern the use of domestic resources, undermining accountability of the state. In contrast, it is argued that using country systems encourages the development of state institutions, encourages the accountability of spending agencies and improves coordination.

Despite the potential benefits and ambitious commitments in Paris and Busan to increase the use of country systems, progress has so far failed to meet expectations. Though the picture varies from donor to donor, in aggregate the proportion of aid using country systems in recipient countries has increased little, if at all. The quality of country systems does not explain much of the variation in their use between countries, despite widespread efforts to measure the strength of PFM systems through frameworks like CPIA and PEFA. This suggests that it is the political decision of how much fiduciary risk a donor will take on that drives use of country systems – and this varies between donors and between countries, even for the same donor.

Against this backdrop, there are a number of principles that may be used to guide decisions on the use of country systems in fragile states.

Understand the context in which you work. A number of countries are classified as fragile, but no two countries are likely to be fragile for the same reasons. Key areas to consider include: the drivers of fragility; capability of the state; future trajectory of security; political economy factors; and the behaviour of other donors. The example of the failure of the exchange rate reform in South Sudan makes it clear that donors need to understand how rents are managed in a country if they are to understand how future reform processes are likely to play out.

To build better understanding of the context into country strategies, the following questions should be considered:

- What is the source of the analysis for understanding the context? Who is on the ground? Has political economy analysis been undertaken? Can joint assessments be undertaken with other donors? For example, a joint risk-management workshop between development partners took place in Afghanistan in 2013, led by the US, and the World Bank and the UK

undertook joint political economy analysis in Sierra Leone (IDPS, 2014: 36).

- Does formulation of the country strategy draw on a fragility assessment, if available?
- Does formulation of the country strategy include consultations with government and with other stakeholders who can help ensure that it is appropriate to the context?

To understand the country context with a view towards using country systems, it needs to be borne in mind that standard indicators, such as PEFA are backwards looking and summarise cross-government performance in a single score. This needs to be supplemented with more granular analysis that can identify organisations or sectors where the risk of using country systems are more managements and acceptable. Even where many systems are weak, or the broad political economy is unpromising there may be islands of excellence or areas more shielded from an adverse political economy.

Review your programmes through two key lenses.

- **A 'statebuilding' and 'peacebuilding' lens** – is your intervention going to strengthen the state and state institutions and create conditions that reduce political violence?
- **A 'do no harm' lens** – is your intervention at least not going to harm, retard, or undermine efforts towards statebuilding and peacebuilding?

The New Deal's Peace and Statebuilding Goals have been formulated to guide the international community's work in fragile states. How far are programmes contributing to progress on legitimate politics, security, justice, employment and livelihoods, and revenues and services? Reviewing these goals is also closely connected to understanding context: "To do no harm, donors need to invest in the difficult and time-consuming task of understanding what underpins the legitimacy of leaders…or how power among elites is configured at the national and local levels." (OECD, 2010: 120). Where there is political violence, are the causes of this understood, and will interventions weaken or strengthen it? An example of this sort of analysis that seeks to understand these questions and translate them into practiocal recommendations for donors is the report *Aiding the Peace* (Bennett et al., 2010), which examined the international community's efforts to support conflict mitigation and peacebuilding in South Sudan between 2005 and 2010. It found that donors analysed marginalisation incorrectly (seeing this as about lack of services rather than as about political isolation), there was insufficient support to establishing the conditions that support the delivery of basic services (building roads, supporting the police), the decentralisation process the government undertook was insufficiently supported, and community peace-building initiatives were uncoordinated and not followed-up. It argued that donors should have worked more closely with decentralised local authorities and local civil society to assess security issues and work out priorities for addressing them, linked community peace-building to such development planning and done more to build the authority of decentralised government.

Understand what you want to achieve with your overall programme. The choice of which country systems to use (or not) is closely linked to the objective of engagement and financial aid. If quick results are necessary, parallel systems may be needed to establish basic services rapidly. If statebuilding and the sustainability of services and systems is a priority, then longer-term engagement and broad use of

country systems may be better able to promote this. In some cases goals may be mutually reinforcing, but in others objectives may work at cross-purposes. Similarly, the focus of the programme will determine how country systems are used. If the focus is basic services, then ultimately government systems to manage education and health, for example, are needed to ensure any progress is sustainable. A focus on other areas, such as job creation, may mean that use of country systems is a lesser priority and activities such as support to small and medium-sized businesses may be more appropriate. Objectives of the programme must be clear and trade-offs identified so that different options can be weighed against each other.

Identify and agree on key trade-offs, including the risks of not engaging with country systems. As with the objectives of intervention, the decisions to use country systems will require important and sometimes controversial trade-offs. For example, rapid delivery through parallel systems produces results that may become unsustainable. Equally, using parallel systems and using safeguards may protect against fiduciary or reputational risks, but undermine government effectiveness in the long run. Even in the short run, parallel systems can hollow out government through hiring away scarce talent and reduce opportunities for learning by doing. The experiences of the 1980s and 1990s that engaging purely on a project basis did not yield the desired results should be borne in mind.

The EU Statebuilding Contract provides an example of how to explicitly consider risks and trade-offs in the design of programmes and projects:

- *The risks of not engaging with country systems*. The concept note for each EU Statebuilding Contract must set out the risks of non-intervention, i.e. not going ahead with the Statebuilding Contract (Bernardi et al., 2015). Equivalently, for each project or each country programme, the risks of not engaging with country systems should be set out as well as the risks of engaging with country systems.

- *Trade-offs should be explicitly considered in the design of programmes and projects.* The final business case (Action Fiche) sets out a consideration of the balance between the risks, and the expected benefits/results. The two key trade-offs that need to be considered are fiduciary risk (risk of financial loss) versus programmatic risk (the risk of the programme not achieving developmental results) and the trade-off between achieving more rapid results through parallel systems versus more sustainable results through using and strengthening government systems.

Match the level of risk you are prepared to bear with the intended modality and the degree of use of country systems: the framework described in Section 4 (and shown in Table 17 below) provides one useful tool for doing this. Use of country systems is not simply a binary choice between using parallel systems on the one hand or providing budget support on the other. There are a range of intermediary positions that can use government systems while applying additional safeguards to mitigate fiduciary risk.

Programme design could be reviewed against this classification and the following questions considered:

- Can appropriate mechanisms be designed to allow the fiduciary risk of use of country systems to be sufficiently mitigated to allow their use?

- Can a strategy be devised to identify clear steps that can be taken towards use of country systems, and the conditions that would allow this? For example a PIU that starts off working in parallel to government systems could gradually be integrated into them. If it is decided that the level of

risk does not allow the use of country systems, programmes should be designed so as to "shadow align" with government systems, so that there can be a smooth transition to the use of country systems once conditions permit.

The overall aim should be for a "virtual" rather than a "dual" public sector (OECD, 2010:126), where programmes are on budget and involve state officials, systems and agencies in their management and decision-making, but also meet the fiduciary standard donors require in the spending of their resources.

Table 17: Aid modalities and use of country systems

Modality	On plan	On budget	On parliament	On treasury	On account	On audit	On report	Measures to mitigate fiduciary risk
1. Donor execution	√	√	(√)				√	Low risk as national systems play no role in managing funds.
2. National execution on project basis	√	√	√	(√)	(√)	(√)	√	Project arrangements can incorporate safeguards such as such project bank accounts and payment processes, application of special procurement rules and processes, such as ex post sampling for smaller amounts and ex ante checks for payments above a certain thresholds, and additional monitoring of information and separate audits.
3. Sector and general budget support	√	√	√	√	(√)	(√)	√	Risks can be mitigated by tighter earmarking, co-signatory arrangements, reimbursement modalities and independent oversight such as a donor-contracted monitoring agent.

It is important to acknowledge the intensiveness of the supervision use of country systems requires. Monitoring of performance is needed during implementation, and not just through ex post audits and evaluation, to ensure that programmes are on track and to determine when corrective action is needed. Support is needed for the capacities and systems needed to manage and supervise frontline service providers (Williamson and Dom, 2010). Multilateral development banks typically have specialised sector, financial management and procurement staff who will work closely with government to ensure projects are being executed according to agreed modalities and are staying on-track to achieve their results. Providing such support is thus likely to mean that donor agencies will need a greater "personnel-to-aid spending" ratio (OECD, 2010:129) when working in fragile states.

Transaction costs can be lowered and risks pooled if country systems are used through pooled funds. The record of pooled funds in fragile states is not unambiguously positive, as described in Section 4.2 above. Pooled funds have the potential to act as a focus for policy dialogue, lower the transactions costs of using country systems, and pool risks if designed and managed correctly. Donor

coordination is most likely to happen when a strong state can provide this coordination function. However, this is exactly what is missing in fragile states. A pooled fund thus has the potential to provide a mechanism for donors to improve coordination themselves. The overhead costs of providing aid through country systems have been outlined above. Where donors resources are pooled, the costs of establishing the necessary expertise and systems to support the use of country systems can also be shared. However, pooled funds will not achieve these benefits automatically, and can fall prey to complexity, a costly fund manager, slow disbursement and declining commitment from donors. Key considerations for getting the design right include[38]:

- be clear on the trade-off in the role of the fund between rapid service delivery and capacity-building and use of country systems;
- understand how design choices such as the size of the funds, the number of donors, how many sectors to cover, and how the fund manager is (e.g. the World Bank, the UN, government, a private firm or an NGO) will impact upon the objectives for the fund and the potential disadvantages of a pooled fund;
- what the governance arrangements for the fund will be, especially how government will be engaged so the funds can act as a policy dialogue, how the fund's priorities are set, and what the procedures for trouble-shooting will be; what can be done if the fund is failing to deliver?

There are also some additional factors to consider in fragile states. These relate primarily to creating the right environment and incentives for building state capacity, which may undermine the benefits of using country systems.

- **Support institutional development** through technical assistance and systems strengthening alongside any financial assistance. The approach should be politically smart, locally owned and problem-driven rather than focusing on international best practice. If the objective is to improve services, technical assistance should focus on those systems most closely associated with budget execution.
- **Choose conditions wisely:** negative incentives associated with development assistance are now widely acknowledged. The worst of these can be avoided. Link commitments on the use of country systems to measurable implementation of small reform steps which have an impact on functioning of country systems. For example increased flows of support could reimburse increased expenditure on priority sectors.

Many of these approaches require strong country dialogue. The first step is to refocus donor–government discussions on the actual problems being faced. This will help to identify where donors are undermining government systems. It will also help establish the main gaps in capacity and systems for fiscal management and service delivery. Together, this provides a common starting point for commitments to increase the use of country systems.

Donors wanting to foster constructive country dialogues must invest in their relationships with partners in-country. Donors will need to appoint staff members with the soft diplomatic skills needed to build informal ties with a diverse range of stakeholders – government, donors, civil society. These personnel should be

[38] Commins et al., 2013 provides detailed operational guidance on the key issues to be considered when establishing a pooled fund.

encouraged to spend time discussing issues with partners in the government, and use these links (and information) to encourage, or steer, constructive dialogues in government–donor forums. In certain cases, it may also be possible to elevate certain issues by hosting events outside the country, inviting relevant stakeholders from the recipient country and from other donors. However, such events can also be disruptive to the day-to-day operations of government, so need to be planned carefully. From the case studies, Sierra Leone represents a good example of how such informal networks can improve relations between donors and with the recipient government.

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Appendix

Table A1: Diagnostics by CABRI framework

CABRI framework	Which PEFA indicators are relevant?	Which other assessments are relevant?	Do assessments capture functionality?
On Plan	PI-12	Fiscal Transparency Code, Debt Sustainability Analysis, Public Investment Management Assessment	**No.** Assessments can help establish if a plan is in place and broadly sustainable, but not if it is used for budgeting.
On Budget	PI-1, PI-2, PI-3, PI-5, PI-6, PI-7, PI-8, PI-10, PI-11, PI-16, PI-27, D-1, D-2	Article IV reports, Open Budget Index	**Yes.** Assesses high-level budget credibility. Most measures still focused on processes and 'good practices'.
On Parliament	PI-26, PI-27, D-2	Open Budget Index, Debt Management Performance Assessment	**Partly.** Mostly process related and a weak indicator of the capacity for oversight. Does not assess politics or accountability.
On Treasury	PI-4, PI-5, PI-7, PI-8, PI-9, PI-15, PI-16, PI-17, PI-18, PI-20, PI-22, PI-23, PI-24, PI-27, D-1, D-2	Article IV reports, arrears audits, Debt Management Performance Assessment	**Partly.** Indicators for arrears and domestic debt can show if a treasury system is under strain. Otherwise, provide limited insights into the reliability of treasury functions.
On Procurement	PI-19, PI-23	Methodology for Assessment of National Procurement Systems, Country Procurement Assessment Report	**No.** Focuses almost exclusively on process measures that may or may not affect performance.
On Account	PI-4, PI-7, PI-8, PI-9, PI-22, PI-23, PI-24, PI-25	Accounting and Auditing ROSC, Gap Analysis for Public Sector Accounting and Auditing	**Partly.** Focuses mainly on processes and international standards, but can reveal issues around the accuracy of

CABRI framework	Which PEFA indicators are relevant?	Which other assessments are relevant?	Do assessments capture functionality?
			financial data and usefulness of reporting.
On Audit	PI-21, PI-26, PI-28	Accounting and Auditing ROSC, Gap Analysis for Public Sector Accounting and Auditing	**Partly.** Reveals the extent to which recommendations by parliament are considered, but provides limited information on the quality of audit reports.
On Report	PI-8, PI-9, PI-24, PI-25, D-2	Public Expenditure Tracking Surveys, Open Budget Index	**Partly.** Considers issues such as comprehensiveness of reports that may affect the usefulness of reports. However, limited information is available on quality and how reports are used.
All	PI-1, PI-2, PI-3, PI-4, D-1, D-2, D-3	Country Fiduciary and Accountability Assessment, Tracking Surveys, Fiscal ROSC, Public Expenditure Review	**Partly.** These are among the stronger measures in PEFA that give a clear sense of the credibility of the budget, but do not necessarily highlight where lack of credibility might stem from.

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