Innovative aid instruments and flexible financing: providing better support to fragile states

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Overseas Development Institute
203 Blackfriars Road, London, SE1 8NJ

Tel: +44 (0)20 7922 0300
Fax: +44 (0)20 7922 0399
www.odi.org.uk

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Abbreviations

ADB	Asian Development Bank
AfDB	African Development Bank
AfDF	African Development Fund
AIAF	Afghan Interim Authority Fund
ARTF	Afghanistan Reconstruction Trust Fund
AU	African Union
CABRI	Collaborative Africa Budget Reform Initiative
CAP	Common Approach Paper
CAR	Central African Republic
CBF	Capacity Building Facility
CDD	Community-driven Development
CDF	Capacity Development Facility
DAC	Development Assistance Committee
DFID	Department for International Development
DPAF	Donor Performance Assessment Framework
DRC	Democratic Republic of Congo
EC	European Commission
ECOWAS	Economic Community of West African States
EU	European Union
FSP	Fragile States Principles
GAVI	Global Alliance for Immunisation and Vaccines
GDP	Gross Domestic Product
GEMAP	Governance and Economic Management Assistance Program
IATI	International Aid Transparency Initiative
ICT	Information and Communication Technology
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFI	International Financial Institution
IFMIS	Integrated Financial Information Management System
IMF	International Monetary Fund
INCAF	International Network on Conflict and Fragility
INEE	Inter-agency Network on Education in Emergencies
IDB	Islamic Development Bank
JCMB	Joint Coordinating and Monitoring Board
LDC	Least-developed Country
M&E	Monitoring and Evaluation
MDBS	Multi-donor Budget Support
MDG	Millennium Development Goal
MoU	Memorandum of Understanding
MTDF	Multi-donor Trust Fund
NGO	Non-governmental Organisation
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development

OPM	Oxford Policy Management
PAF	Performance Assessment Framework
PCNA	Post-conflict Needs Assessment
PEFA	Public Expenditure and Financial Accountability
PETS	Public Expenditure Tracking Survey
PFM	Public Finance Management
PIU	Project/Programme Implementation Unit
PoS	Programme of Support
PRS	Poverty Reduction Strategy
SASE	Selectively Applied Salary Enhancement
SFD	Social Fund for Development
SWAp	Sector-wide Approach
UK	United Kingdom
UN	United Nations
UNDP	UN Development Programme
UNESCO	UN Educational, Scientific and Cultural Organization
UNICEF	UN Children's Fund
US	United States
USAID	US Agency for International Development
WFP	World Food Programme

Executive summary

Since the High-level Forum on Aid Effectiveness, there has been growing awareness in the international community that low-income countries with fragile institutions are not just a more difficult case of development, but also require a fundamentally different approach to delivering assistance (UN Secretary-general, 2009). In fragile situations, the normal political and social processes for resolving conflict are weak, and armed violence is a substantial risk. Violent conflict does not have a cost only in terms of life and property – Paul Collier puts the average cost of a civil conflict to a country and its neighbours at $64 billion (2009) – but also sets development into reverse. Per capita incomes fall and institutions that were built slowly before the conflict are destroyed. Conflict in one country tends to spread to others in the region, or even further abroad; refugees flee violence and conflict provides an environment for organised crime that is manifest in the trafficking of people and drugs.

In many fragile states (and in 15 of the 17 g7+ states), the international response has included large-scale investment in UN or regional peacekeeping/peacebuilding forces. Such investment tends to be much larger than the parallel investment made through development assistance. In Sierra Leone and Liberia, the cost of the UN force was five times that of aid flows at the time. In Afghanistan, spending on military support is some 20 times that on civilian support. There is a striking disconnect and lack of policy coherence between the level of investment in peacebuilding/peacekeeping forces and the degree of risk involved and the way aid is provided. In most cases, aid has been provided in the same way as it is in stable countries, with the same procedures applying and the same approaches to risk being followed.

As a consequence, aid – and the results of aid – has been delivered far too slowly. In only a few cases – such as Afghanistan – has there been a clear break from 'business as usual' models in the delivery of aid, with results achieved at anything like at the pace needed. But, as recent poor rates of progress in South Sudan and Haiti reveal, these positive lessons are not being applied consistently elsewhere. The cost of this collective failure to fully adapt the aid system to the needs of fragile states is borne primarily by the populations that suffer from lack of access to infrastructure and basic services. But the irony for donors is that failure to take risks in the delivery of aid has had the cost of much greater and potentially much more expensive risks of renewed conflict. For both fragile states and donors, there is a pressing need to break with the past partial incremental approach to how aid is delivered.

Development objectives such as the Millennium Development Goals (MDGs) are insufficient in situations of fragility. International assistance should support peacebuilding, or preventing violent conflict breaking out or recurring, and statebuilding, or assisting countries to develop institutions capable of resolving conflict, facilitating justice, delivering services and providing an environment for businesses to thrive and that embody national beliefs. It should support the development of legitimate institutions and not undermine them by bypassing them. Governments in fragile situations need support to deliver visible short-term results that demonstrate a break from the past, but also to transform their institutions, develop human capacity at all levels, build infrastructure to secure long-term growth and employment and strengthen the state–society relations that are so critical to building legitimacy.

There is also ongoing debate on the key overarching question of whether fragile states should get special treatment from donors, and, if so, which countries should qualify. This high-level lack of consensus leads to a patchwork of definitions, indices and procedures that are difficult for donors, let alone fragile state governments, to navigate.

In view of these challenges, donors use a multiplicity of aid instruments in fragile states, with varying characteristics and levels of success. There are essentially six categories of aid instruments in common use (OECD INCAF, 2011): general budget support; sector budget support; government-managed pooled funds; jointly managed trust funds; project support; and support to and through non-state actors. These can be examined along a range of dimensions, and the below table contains outline descriptions in relation to their use of country systems and their performance on three of the Paris criteria for aid effectiveness: alignment, harmonisation and ownership, as well as their ability to deliver direct results with their expenditure.

Aid instrument expenditure, use of country systems, Paris principles and direct delivery of results

Expenditure through aid instrument shows…	Use of country systems[1]	Policy alignment	Process (or shadow) alignment	Harmonisation	Ownership	Delivery of direct results
Domestic revenue	All 8	Automatic	Automatic	Automatic	Automatic	Depends on expenditure capacity of government, including contracting/ procurement capacity
General budget support	All 8, can include additional safeguards	Automatic	Automatic	Automatic	Strong	
Sector budget support	Usually all 8, can include additional safeguards	Policy aligned with an agreed sector plan	Automatic	Automatic	Strong, but depends on extent to which sector plan is owned, and extent of earmarking	Depends on expenditure capacity of government, potentially supported by donor programme
Government-managed pooled funds	Ranges from none to all 8, can include additional safeguards	Policy aligned with an agreed sector plan	Could be done, especially if any project/ programme implementation unit (PIU) is embedded in government	Automatic	Moderate, but depends on extent to which sector plan is owned, and extent of earmarking	Depends on effectiveness of expenditure systems used – whether government, donor or mix of two
Jointly managed trust funds	Usually uses parallel systems	Can be policy aligned with an agreed sector plan	Could be done, especially if any PIU is embedded in government	Automatic	Depends on ministerial involvement in decision making	
Project support	Usually uses parallel systems	Only if aligned with the overall development plan or sector plan	Not automatically but could be done	Not automatic: requires coordination	Depends on ministerial involvement in decision making	Depends on effectiveness of implementing agency
Support to and through non-state actors	Uses parallel systems	Only if aligned with the overall development plan or sector plan	Not automatically but could be done	Not automatic: requires coordination	Weak for government – may be ownership at community level	

The evidence suggests that the delivery of results – including aspects of speed, flexibility and risk management – is a key aid effectiveness indicator in fragile states, but is not mentioned in the Paris Declaration. And, while it is possible to identify the factors affecting the direct, project-level results of each type of aid modality (the column on the far right) it is much more complex to rate the types of aid instrument in terms of the indirect results they bring – including in relation to state- and peacebuilding objectives – which will depend to some extent on their performance against the Paris indicators.

A review of the evidence leaves a strong impression of the variability of experiences in different countries, with different donors and even down to the individual level, but it also

1 Which are: planning, budgeting, parliamentary approval, Treasury, procurement, accounting, auditing and reporting, according to "Aid on Budget", CABRI, 2009 – although there are alternative views that include a wider view of country systems such as HR, and decentralisation functions.

brings out some key overarching observations about what usually works and does not work in the use of aid instruments in fragile states. These are summarised below.

Country context and the mix of aid instruments

Each fragile state has its own specific context, and no single approach can fit all contexts. The content of the mix needs to be determined based on this. Similarly, each donor has its own methodology for analysing fragility, and these methodologies are not always shared between donors or with the government itself. At the same time, the structure of international support to peacebuilding and statebuilding is rather complicated, with many different actors, including the military; the international financial institutions (IFIs); humanitarian agencies and organisations; donor agencies; and civil society. Different actors have their own specific legal constraints on how they can operate; different tolerance of risks; and hence different sets of instruments they can use. The mix of instruments in each state should be based on which instruments would most effectively help in the transition from fragility to stability in a particular context with the particular set of actors involved. Some foreign assistance should not pass through the government budget in principle, for example support to build political parties and civil society organisations that amplify the public voice and develop the national conscience.

An example of a useful mix of aid instruments is the dual track approach taken in Afghanistan, with the Afghan Interim Authority Fund set up to get funds moving while the longer-term Afghanistan Reconstruction Trust Fund (ARTF) was established. In the immediate post-conflict moment, both short- and long-term approaches can be taken simultaneously, as long as the short term does not undermine or detract from efforts to put in place long-term processes.

Specialised aid practices for all fragile states

While it is clear that each fragile state is unique and should be treated as such by external actors, there are some common characteristics of fragility. The most visible of these is the difficulty in achieving development progress, such as on the MDGs, within fragile contexts. The plethora of donor methodologies of defining fragility, and the absence of a universally accepted dividing line between fragile and non-fragile states, adds an extra layer of uncertainty and divergence to an already confusing arena. It is also becoming apparent that donors need to put in place specialised aid practices in fragile states to take account of the particular circumstances in these countries, including weak capacity and institutions, the imperative of statebuilding and difficulties in delivery – as exemplified in the Organisation for Economic Co-operation and Development (OECD) Fragile States Principles. For example, the evidence suggests that the Paris Declaration principles might not be sufficient in fragile states, where issues of flexibility in aid allocations and risk management are critical to delivering results.

One of the key lessons from the international campaign to provide debt relief is the need early on to agree on a list of which countries could benefit. It is important that this list was seen to be transparent and fair and not just the arbitrary decision of donors. If a new deal is to be agreed at Busan, there needs to be early agreement among the g7+, multilateral agencies and bilateral donors on the countries eligible for differential treatment. The aim would be to identify a group of fragile states where the risks of the return to conflict are so high and the needs for rapid development are so great that a set of standard changes or exemptions to normal aid regulations/practices – such as those called for in the action plan – should be applied.

Speed and flexibility of aid

The key frustration with current aid systems is the slow pace of delivery. And the most cited desirable attribute for support to post-conflict countries is flexibility. Yet, as progress in some countries shows, a range of practical steps could be taken to speed up assistance and make it more flexible. The experience in Afghanistan in particular demonstrates that, where there is clear urgent need and a keen political interest among donors to act quickly, it is possible to do things differently and break with the 'business as usual' model. Such an approach needs to be applied to a wider – but still ring-fenced and limited – group of fragile states

The benefits of this willingness to act differently was illustrated vividly by the speed of operation of the multi-donor trust fund (MDTF) in Afghanistan and by the flexibility it had to finance a wide range of items – including recurrent budget items (McKechnie, 2010). This was supported by a focus on developing capacity for government procurement and a willingness to use emergency procurement rules for a full 10 years after the end of conflict. One source of inflexibility in fragile states is the demarcation between development and humanitarian funding. As a result of the World Food Programme's (WFP's) successful track record in rehabilitating roads in South Sudan, the government asked it to develop and extend its programme and in effect start the delivery of a nationwide road master plan. However, in the process, WFP was delayed by difficulties in accessing development funding from the World Bank-managed MDTF. WFP was also constrained by its own board requirement that roads be built to a certain quality, which was appropriate for securing humanitarian access in the short term but inappropriate for a longer-term road programme.

One specific approach that has delivered relatively rapid and flexible support is the community-driven development (CDD) programme. Such programmes have demonstrated that services with local ownership and accountability can be delivered at the village or community level with acceptable fiduciary risks. Yet these programmes have the potential to build peace at the local level, contribute to statebuilding by connecting communities to legitimate authority and developing citizenship skills, as well as building government from the ground up. CDD is an underutilised instrument that has proven effective in fragile settings.

One specific concern for many g7+ countries is the lack of funding to manage unexpected emergencies where relatively small sums of money provided rapidly could defuse potentially explosive confrontations.

Good practices for using government systems – with safeguards if required

There is a **range of ways** to provide more aid through government systems and to the recipient country's budget – through direct budget support, pooled funding arrangements or national programme or project financing that flows through the budget and uses national fiduciary and reporting systems (see CABRI, 2009). Providing aid in such a form plays a critical role, in particular during the early post-conflict stages, in supporting the transformation by ensuring continued functioning of key government functions and delivery on critical priorities that can provide legitimacy to emerging governments. A substantial shift in this direction not only is likely to deliver faster development outcomes, better aligned with country priorities, but also strengthens the accountability of government to citizens for delivering services, builds legitimacy and deepens organisational capacity through 'learning by doing' (Knack and Rahman, 2007). Assistance to fragile states is highly fragmented into small projects that are often neither coherent nor coordinated with national priorities (OECD, 2010c).

Aid through national systems may appear more risky than donors delivering projects directly or through non-governmental organisations (NGOs) or humanitarian channels, but these **risks can be managed.**[2] Strengthening national capacity for procurement, accounting and auditing, reporting and programme implementation is clearly part of the solution and may take time.[3] But, in addition, many fragile states, including g7+ states, have demonstrated their willingness to accept additional short-term safeguards to manage the risk involved. Some of the services can be contracted out, dual country–donor decision-making processes can be put in place and donors could collectively establish special accountability or audit checks. The Liberia Governance and Economic Management Assistance Program (GEMAP) dual signatory approach is one positive example (USAID, 2010). In Sierra Leone, initial provision of budget support was accompanied by international accounting firm monitoring of flows within government through to schools etc. (DFID, 2010a). Other examples include use of international accounting firms to undertake additional audits; provision of additional financing to enable national audit offices to

2 The UK Department for International Development (DFID) has developed a new approach that assesses partner governments on both partnership commitments (including domestic accountability) and whether budget support can achieve better results and value for money than other instruments (DFID, 2011).
3 For example, public financial management reforms (PFM) have been gathering pace in the Democratic Republic of Congo (DRC) (Baudienville, 2010).

undertake more frequent audits (e.g. at sub-national levels); support to value for money audits; and introduction of joint government–donor results monitoring approaches in ministries of finance and/or sector ministries.

It is striking than in South Sudan, despite the conflict essentially ending in 2005/06, donors are only now discussing putting money through government systems, and even then many are arguing that it will take five years before the government is ready. It will thus be over 10 years after the conflict before money will flow through the government systems. By contrast, Sierra Leone received general budget support two years after the conflict and Rwanda in around the same timeframe. The Afghanistan trust fund started to provide funding for the recurrent budget after just a few years. It was this early support – that is, within the first five years – that was critical in rebuilding the state in all three countries. Yet, despite all the lessons learning of the past 10 years, it would seem that donors are collectively now less willing to take on risk and deliver through government systems.

Pooled funds*,* including sector pooled funds as well as broader MDTFs, have been shown to provide close alignment with national priorities, consolidate small projects into scalable national programmes, use national systems and harmonise and simplify the transaction costs of foreign assistance. Such pooled funds can also include dual signatory provision. Pooling funds also pools risks among donors and shifts the accountability for risk management to the multilateral organisations that usually administer them. However, while some pooled funds have worked well in difficult environments,[4] others have had weak management and slow disbursements.[5] Key factors behind the more successful funds seem to be degree of government ownership; physical location of secretariats; extent of pools' in-year flexibility; and their ability to finance recurrent expenditures. One of the key constraints to the development of such funds is the unwillingness or inability of some donors to co-finance/mingle their funds with those of other donors.

High levels of foreign assistance do not mean recipient governments should neglect their own revenues, through rationalising taxes and fees and collecting those that are due. It is encouraging that in practice many countries emerging from fragility with high levels of donor support have at the same time sharply increased their domestic revenues. The ultimate shared aim of g7+ countries and donors is to escape aid dependency.

Good practices when not using government systems – aligning aid with the budget

Not all foreign assistance can use national fiduciary systems, and some aid will continue to be provided in parallel. Coordinating this assistance has proven almost impossible for states with weak capacity. In addition, many fragile states highlight the lack of transparency and accountability of this assistance. The costs of military support are often not reported in country and provision is often poorly integrated with domestic funding of military and security. When military support comes to an end – in terms of foreign troops or financial support to the national army – the security budget can suddenly appear to rise sharply.

Roughly half of official development assistance (ODA) is provided through humanitarian channels, and about half of this is for the provision of public services such as education, health and clean water. While humanitarian channels may be faster than using national systems and donors are more ready to run risks with humanitarian aid, it is often characterised by fragmented projects that are difficult to scale up. As humanitarian support comes to an end, government spending on basic services needs to rise rapidly to ensure there is no a sudden drop in the provision of services.

Donors often continue to use parallel systems even after the humanitarian phase has come to an end, which can mean the country ends up with patchy service provision, some areas benefiting from high-cost services that cannot be replicated or sustained and others with no

4 Good examples include the Liberia Health Pooled Fund and the Yemen Social Fund for Development (see DFID, 2010a; Hughes, 2011; ODI, 2011a).
5 One example is the MDTF in South Sudan, which was characterised by cumbersome procedures and slow disbursement rates (Ball, 2007; Bennett et al., 2010).

access. When more normal conditions for statebuilding are established, integrating these differing services into something coherent and affordable is difficult. This touches on issues of both coordination and ownership, but the practical need is for an economic assessment of what services are affordable in the medium to long term, and the institutional arrangements necessary to reach and sustain agreements on service standards, to avoid establishing services for the few that will lead to inequality and integration problems later when a future state is unable to staff and pay for them without starving underserved areas.[6]

Most agencies do publish at least some information about their support. But much of this is still presented and published in donor capitals. The data are often not available in local currency terms or for the government's own financial year. Some donors have signed up to the new international benchmark for aid transparency – the International Aid Transparency Initiative (IATI) – which ensures aid information is given at the right time and in the right format for governments to use. However, the IATI standard spending classifications do not yet automatically map onto the varying domestic expenditure classifications used by each fragile state. When donors publish information at the same time as government budget processes, using the same classification, this is known as 'shadow alignment'.[7]

Schematic comparing the use of government systems with shadow alignment

Government systems	Using government systems (give general budget support or …)	Shadow alignment
Budget formulation • Planning process (PRS and sector plans) • Budget framework paper (or similar) • Compiling the budget • Parliamentary approval	Budget formulation • Donors engage with PRS and sector plans • Donors report plans for project/sector budget support spending in next fiscal year to Ministry of Finance, to be reflected in budget	Budget formulation • Donors publish forward spending ceilings at same time and classification as budget framework paper • Donor publish finalised plans for spending next fiscal year at same time as budget is published
Budget execution • Treasury execution • Procurement systems • Accounting systems	Budget execution • Donors use government systems for their expenditure: Treasury, procurement and accounting	Budget execution • Donors publish in-year reports using same timing and classification as government
Budget reporting and audit • Donors engage with shared reports and audits (e.g. by sector)	Budget reporting and audit • Donor use government reporting systems and auditing systems	Budget reporting and audit • Donors publish end-year reports and audits using same timing and classification as government

As the above figure shows, shadow alignment – where donors publish their own, separate, financial and performance reports with timing, content and classification aligned with the government – is different from donors using country systems – where donors engage in joint planning, execution, monitoring, evaluation and reporting etc. activities along with the government. Shadow alignment is especially powerful because it requires no government capacity – donors can deliver it without any kind of coordination or support, needing only a copy of the budget law or equivalent and the government's chart of accounts. Yet, once the shadow-aligned information has been published, it unleashes capacity in government by giving the most relevant and useful information for officials to use in their coordination mechanisms.

6 One successful example of a transfer from non-state to state provision comes from Timor-Leste's health sector Rosser (2004), in Cox and Hemon (2009).
7 An example of shadow alignment comes from DFID's work with orphans in Zimbabwe (DFID, 2010a).

Using country systems often means donors are more likely to align their aid with government policies and priorities. However, in some cases, policy alignment – that is, aligning aid behind the government's policy objectives (not just its processes, as in the case of shadow alignment) may not be appropriate, for example where there is a clear disconnect between the needs of the poorest and most marginalised groups and the allocation of the national budget and where the potential for such a disconnect needs to be explicitly recognised and managed.

The alignment of most of the support around the budget means it is easier for the government to coordinate aid spending with government spending, and also lays the foundations for the project/programme to move towards sector budget support or general budget support at a later date. It also makes it easier to ensure external support is prioritising peacebuilding and statebuilding objectives – and the International Dialogue's draft objectives in particular. When support is fragmented, there is a greater risk that individual donors' and project managers' objectives take priority and the focus on peacebuilding and statebuilding is diluted.

To reap the benefits of donor alignment, the government must have a strong aid coordination and management function – ideally housed within the fiscal authority[8]. In view of the benefits to the effectiveness of their aid, the need for greater coherence between domestic resources and aid, and the critical issue of building strong institutions to oversee public expenditure both on and off budget as part of an effective state, donors should be ready and willing to support these units, including through funding, staff and complying with requests for data and information.

The need for predictable, sustained financing

This is needed to avoid either 'stop go' patterns of aid or excessive concentration of assistance immediately after the end of a crisis, for example at the conclusion of a conflict. The transition from fragility to resilience requires national institutions to take root, a process that may take 40 years or more (Pritchett and de Weijer, 2010). Statebuilding is not a linear process, and is characterised by setbacks as well as leaps forward (OECD INCAF, 2011). As the 2011 World Development Report 2011 states 'Volatility greatly reduces aid effectiveness, and it is twice as high for fragile and conflict-affected countries as for other developing countries, despite their greater need for persistence in building social and state institutions' (World Bank, 2011). In addition, the peacebuilding and poverty implications of changed funding should be assessed, particularly when a donor is taking actions related to political changes within the country that may be disconnected from the population that would be affected by changed levels of aid. Donors also need to take into account the state of development of domestic bond markets, recognising that in some countries governments are unable to increase domestic borrowing to cover even very short delays in donor disbursements.

The development of long-term capacity

A new approach is needed to **longer-term capacity building.** Despite billions spent on capacity development, the long-term value for money of these investments has been poor. Project or programme implementation units (PIUs), salary top-ups to national government staff and poaching government staff by donors, NGOs and the UN have undermined government capacity, and created a disconnect between ring-fenced donor projects and national programmes. Donors have demanded such approaches in order to solve the particular problems they face and in general have failed to engage adequately in supporting necessary government-wide reforms. However, there have been some examples of good practice, and these should be replicated much more widely. For example, in Rwanda, it has been possible to require that there should be no more than one PIU in any ministry. In Uganda, a successful ministry-wide UN salary top-up scheme proved instrumental in the development of sustainable long-term capacity of the ministry. Governments in fragile states also face particular challenges in recruiting staff. For example, in Liberia, the total number of professional civilian

8 CABRI (2008b) generated an Aid Management Index, which gives countries a higher score if the aid management unit is located within the central budget authority.

staff employed by the UN was 10 times the number the government was trying to recruit for its own Senior Executive Service (SES).

Transparency, results, accountability and value for money

The 2011 World Development Report (World Bank, 2011) highlighted the importance of legitimate institutions for exiting fragility, and defined two types of legitimacy:

- **Political legitimacy,** 'or the use of credible political processes to make decisions that reflect shared values and preferences, provide the voice for all citizens equally and account for these decisions'; and
- **Performance legitimacy,** 'earned by the effective discharge by the state of its agreed duties, particularly the provision of security, economic oversight and services, and justice'.

Transparency and accountability of governments and donors are required in fragile states for several reasons: 1) by governments to understand how budgets are spent, strengthening performance legitimacy through service delivery, and to give confidence to the public and civil society, strengthening political legitimacy by supporting state–society relations; 2) by donors to ensure there is a clear link between externally funded activities and national priorities and that aid impacts positively on governments' ability to deliver on its own priorities; and 3) at the global level to enable sharing of lessons and experiences with different aid instruments, to enable country actors to make informed decisions about what aid instruments will best deliver results in different context. This underpins greater aid effectiveness in fragile states. Good examples of transparency include Timor-Leste's and the Palestinian National Authority's publication of fiscal data, the Haiti Aid Map[9] and Uganda's publication of expenditure data at the local level (Reinikka and Svensson, 2004).

A range of instruments and policies can ensure greater mutual accountability between donors and government, supporting broader transparency and accountability goals. These include the use of mutually accountable compacts, such as in the case of the Afghanistan compacts, or dual accountability frameworks such as GEMAP in Liberia. There is also the potential for innovative instruments that link improved systems and safeguards to the use of country systems.

9 http://www.aidinfo.org/this-is-how-aid-transparency-coulod-look.html

Part I: Problem statement, analysis and evidence

1. Introduction

Fragile and post-conflict environments pose a unique set of challenges to the aid effectiveness agenda. Donor engagement needs to be adapted accordingly, and 'business as usual' donor practices may not apply. As a result, recipient governments and donors need to think innovatively regarding aid good practice in fragile states. In previous (and current) engagement, donors have often behaved in highly fragmented, uncoordinated ways, which have undermined emerging state capacity and, at times, done harm. However, over recent years, donor practice has improved, and it is becoming progressively more effective.

This paper first seeks to document the current use of aid instruments, highlighting common challenges and examples of good donor practice, and second to put forth specific high-level recommendations that recipient governments and donors should address as a priority. It is recommended that aid delivery in fragile states be made more effective through innovative modalities that gradually shift away from implementing aid through external instruments towards incrementally putting aid on budget and using country systems. Alternatively, where it is not feasible to use country systems, the effectiveness of aid instruments can still be improved in order to adhere to international standards as set out, for instance, in the Paris Declaration and the Accra Agenda for Action. This will further enable more effective partnerships between recipient governments and donors, and the skilful application of aid instruments in order to address the causes and consequences of fragility, assisting countries to transition out of fragile and post-conflict environments.

Keeping these challenges in mind, the overarching themes that emerge throughout the paper centre on the importance of the following issues relating to aid in fragile states:

1. Country context and the mix of aid instruments;
2. Specialised aid practices for all fragile states;
3. Speed and flexibility of aid;
4. Good practices for using government systems – with safeguards if required;
5. Good practices when not using government systems – aligning aid with the budget;
6. The need for predictable, sustained financing; and
7. Transparency, results, accountability and value for money.

The report is structured as follows:

- Section 2 sets out the issues at stake and Section 3 a taxonomy of aid instruments.
- Sections 4, 5 and 6 present evidence, analysis and evaluation of the current use of aid instruments in fragile states, based on a literature review and a questionnaire circulated to Organisation for Economic Co-operation and Development (OECD) International Dialogue on Peacebuilding and Statebuilding Working Group on Aid Instruments members.
- Section 7 offers recommendations for improving aid practice.

2. Challenges of aid instruments in fragile states

Since the High-level Forum on Aid Effectiveness, there has been a growing awareness in the international community that low-income countries with fragile institutions are not just a more difficult case of development, but require a fundamentally different approach to delivering assistance (UN Secretary-general, 2009; World Bank, 2011; Zoellick, 2008). In fragile situations, the normal political and social processes for resolving conflict are weak, and armed violence is a substantial risk. Violent conflict not only has a cost in terms of life and property – Collier (2009) puts the average cost of a civil conflict to a country and its neighbours at $64 billion – but also puts development into reverse. Per capita incomes fall and institutions that were built slowly before the conflict are destroyed. Conflict in one country tends to spread to others in the region, or even further abroad; refugees flee violence and conflict provides an environment for organised crime that is manifest in the trafficking of people and drugs.

In many fragile states (and in 15 of the 17 g7+ states), the international response has included large-scale investment in UN or regional peacekeeping/peacebuilding forces. Such investment tends to be much larger than the parallel investment made through development assistance. In Sierra Leone and Liberia, the cost of the UN force was five times that of aid flows at the time. In Afghanistan, spending on military support is some 20 times that on civilian support. There is a striking disconnect and lack of policy coherence between the level of investment in peacebuilding/peacekeeping forces and the degree of risk involved and the way aid is provided. In most cases, aid has been provided in the same way as it is in stable countries, with the same procedures applying and the same approaches to risk being followed.

While donor assistance often benefits recipient countries, fragile states in particular warrant careful attention, given the challenges they face regarding **absorptive capacity.** For instance, in Timor-Leste, the official poverty rate actually increased despite $8 billion of aid being pumped into the country over an eight-year period. An OECD publication on resource flows to fragile states has found that highly fragile states are able to effectively manage only approximately one-third of the aid they receive (OECD, 2010b). Furthermore, the absorption rate for general budget support in Burkina Faso was between 102.1% and 93.1% between 1998 and 2003, whereas that for projects was between 65.1% and 74.3% (Shah et al., 2010). Such a lack of progress on poverty reduction suggests that knowing the limits of absorptive capacity is crucial to effective aid. Money may be being spent, but it needs to be managed carefully to enable the delivery of results in these complex and highly political environments.

2.1. Ownership, risks and effectiveness

As the Rome Declaration, the Paris Declaration and the Accra Agenda for Action have all stressed, the effectiveness of aid is critically dependent on ownership of aid programmes by recipient countries; the alignment of aid with recipient government policies; and the harmonisation of aid between donors. Ownership is of central importance because effective development is fundamentally an internally led process, with externally led processes recognised as having limited success in the long term. The transition from fragile to robust states is dependent on building capable, effective and legitimate institutions that are held accountable and can provide and oversee public services.[10] Moreover, the way donors provide aid can shape the extent to which ownership of aid is possible. Lessons from Afghanistan and elsewhere indicate the risks of damaging public institutions, or slowing their development, if external assistance is provided through parallel channels.[11]

One way to support these principles is for donors to channel funds through country systems. However, fragile states are often characterised by an extremely weak state apparatus, which

10 This is consistent with the messages of the World Bank World Development Report 2011.
11 OECD (2010b) highlights the risks of damaging institutional development by providing aid through instruments that are implemented in parallel with national systems. This is also reflected in the academic literature; see, for example, Brautigam and Knack (2004) and Knack and Rahman (2007).

can magnify the risks for emerging state capacity as well as for donors in using country systems. These risks[12] include:

- Fiduciary risk, where funds are misappropriated or unaccounted for, or do not achieve value for money;
- Developmental risk, where the envisaged developmental objectives are not fulfilled;
- Non-financial risk, such as macroeconomic, governance or partnership risks;
- Procurement risk, where the efficient and effective use of aid is hindered by national procurement standards;
- Reputational risk, where governance issues or the abuse of funds affect the reputation of the donor country (Shah et al., 2010).

Of these, fiduciary risk and corruption are often the primary reasons for donors' reluctance to use country systems. There is also a key risk of being seen to legitimise a state that may not be fully representative of its people.

In view of these risks and of the low capacity of the systems in place, donors employ a range of aid instruments, which engage in different ways with the existing systems, ranging from general and sector budget support to various types of pooled funds, where only some government systems are used. In many circumstances, these instruments are intended to have a dual objective – to build capacity in government while also delivering services – although this is far from straightforward.

Often, and more frequently in fragile states, the risks involved in using country systems are seen as too great, and donors opt for alternative instruments. There is a wide range of such aid instruments, from some types of donor-managed multi-donor trust funds (MDTFs), to projects that maintain even greater direct donor control over funds. In these circumstances, many donors perceive that there is a very limited opportunity for governments to take effective ownership of a development agenda, and provide the voice and coordination that is required to deliver on alignment and harmonisation. This in turn means it is difficult for donors to deliver on the Paris principles. Some governments and donors have sought to address this through a focus on strengthening government budget, procurement and oversight systems so they can eventually use them to a greater extent. This involves improving not only financial accountability mechanisms, but also the broader accountability processes within government – including parliaments, audit bodies, civil society and the media.

Aid instruments cannot be chosen without regard for the specific context in which they are to be deployed. Donors are increasingly recognising that there is significant diversity within the category of 'fragile states', and that what works in one place does not necessarily apply elsewhere. Any framework of aid instruments should note that the opportunities and risks will inevitably vary depending on the context. Analysis of context needs to be dynamic and flexible. Responses to questionnaires revealed that, while donors are aware of the context within which they operate, they often do not reassess their context analysis and adapt this to keep pace with the ever-changing post-conflict environment. Forms of dynamic conflict and context analysis should be an integral part of the design of aid instruments in a given context, for example with regular updating cycles and discussion of more than one potential future scenario. The multiplicity of donor frameworks has led to a patchwork of definitions, indices and procedures, which are difficult for donors, let alone fragile state governments, to navigate.

In choosing aid instruments, it is not only the specific characteristics of the aid instrument that need to be considered. Aid instruments also need to be made complementary and push towards common end goals. This can be accomplished through the strategic design of an aid instrument 'portfolio' that reflects the amount of risk (of all types) each donor is able to bear. Aid instrument portfolios also provide a potential platform for designing aid instruments that facilitate the future transition to those instruments that rely more heavily on country systems, when local capacities have been built up further. This is a complex area when the type of

12 For an in-depth discussion of risks in fragile states, see ODI and OECD INCAF (2010).

transition each country experiences is different and can even be non-linear, depending on contextual and other factors.

Fragile states are 'subject to the same unintended impacts [of development assistance] that make alignment and harmonisation agendas relevant in other countries' (Christiansen, 2004: 7). However, fragile states also constitute unique environments that can pose challenges to the relevance of aid effectiveness principles largely developed for non-fragile contexts. The consequences of not complying with aid effectiveness principles are potentially more disastrous in fragile states, as a result of a number of issues:

- There are more complex sets of international actors present, resulting in more complex collective action problems.
- The challenges faced in fragile states are often more complex, involving both immediate and more enduring, underlying causes of fragility, both of which need to be addressed if sustainable peace is to be achieved. There is little point in helping secure macroeconomic stability if this fails to address the causes of conflict.
- Objectives in fragile states are more complex and involve strengthening institutions and public confidence in them to prevent the outbreak of armed violence, as well as the more traditional poverty reduction development aims as embodied in the Millennium Development Goals (MDGs). Donor governments often have competing objectives in fragile states (security, political, economic and developmental) and these underline donor alignment.
- Unaligned aid diverts much-needed capacity from an already weak state, undermining statebuilding efforts.
- Tensions between government accountability to donors and domestic accountability to citizens are particularly significant in post-conflict settings, potentially undermining peacebuilding efforts. Accountability of the executive to the legislature is also weakened if the government's budget excludes expenditures implemented directly by donors.
- Aid distributed through parallel systems undermines 'learning by doing' processes, through which national institutions gain depth and improve their effectiveness.
- While fragile states often benefit from high influxes of aid in the initial post-conflict period, the institutional transformation that underlies a sustainable transition from fragility can take a generation or more to accomplish. Tensions can exist between humanitarian and development objectives. Furthermore, assistance for longer-term development goals is often not forthcoming, and a lack of attention to Paris principles can exacerbate this lack of long-term financing.

It is therefore vital to ensure that the choice of aid instrument, whether it uses country systems or not, works to support aid effectiveness and deliver the greatest possible sustainable results with the finances available. These are key issues that will be examined in more detail in the case studies that follow.

3. Analytical taxonomy of current aid instruments

As the International Network on Conflict and Fragility (OECD INCAF, 2011) has noted, there are essentially six categories of aid instruments in common use: general budget support; sector budget support; government-managed pooled funds; jointly managed trust funds; project support;[13] and support to and through non-state actors. In this section, we look at aid instruments in general, recognising that these apply in specific ways to fragile state contexts. With this caveat in mind, the general discussion of aid instruments that follows remains relevant to fragile states and will be discussed in greater context in Sections 3 and 4.

In this paper, we examine these groups of aid instruments according to four key aid effectiveness criteria:

- The extent to which they use government systems;
- The extent to which they embody the Paris principles;
- The different opportunities and risks they pose to donors and governments; and
- The level of transparency of each instrument.[14]

3.1. Use of country systems

The first criterion – the extent to which aid instruments use country systems – is the most visible way to distinguish between these six categories. To analyse this, we need to identify which country systems are relevant. Since donor funds are mostly[15] of a public nature, the counterpart government system for managing donor funds is the overall budget system. As such, the Collaborative Africa Budget Reform Initiative (CABRI) Aid on Budget schematic shown in Box 1 illustrates the relevant country systems donors could utilise. According to CABRI, there are eight types of country systems within the government budget (which donors can therefore use to bring their aid more 'on budget'): national plans, budget documentation, parliamentary approval, structures for Treasury (banking), procurement, accounting, audit and reporting (CABRI, 2008c).

An alternative list of government systems comes from the Public Expenditure and Financial Accountability (PEFA) Indicator D-3, which measures 'the proportion of aid that is managed by use of national procedures' and includes banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements. Others see country systems as a much broader concept, including policymaking, human resource management, monitoring and evaluation (M&E) and accountability; downstream spending delivery such as school and health facility management systems; and the mandates of different levels of government levels as specified in the country decentralisation systems.

13 Although project support includes several modalities that may use government systems to a varying extent, ranging from fully aligned and harmonised use of government systems for planning, implementing and accounting for projects to donor domination of project selection and design and direct donor execution with minimal government involvement.
14 Further work could analyse each instrument in relation to its adherence to the Fragile States Principles (FSP).
15 Nearly all donor funding to fragile states has been to the public sector. Donors like the International Finance Corporation (IFC) provide finance to the private sector without government guarantees. The Marshall Plan provided much of its assistance to the private sector. But private investment has been difficult to attract to fragile states apart from in enclaves and around extractive industries.

Box 1: Use of government systems - the CABRI Aid on Budget schematic

CABRI has developed a schematic for defining the eight different ways donor aid can be 'on budget', by looking at which of the government's systems it uses. According to CABRI, 'All forms of aid can and should be brought on budget in one or more of the dimensions' (Meyers, 2009).

Term	Definition
On plan	Programme and project aid spending is integrated into spending agencies' strategic planning and supporting documentation for policy intentions behind the budget submission
On budget	External financing including programme and project financing and its intended use are reported in the budget documentation
On Parliament	External financing is included in the revenue and appropriations approved by Parliament
On Treasury	External financing is disbursed into the main revenue funds of government and managed through government's systems
On procurement	Externally financed procurement follows government procurement procedures
On accounting	External financing is recorded and accounted for in the government's accounting system in line with the government's classification system
On audit	External financing is audited by the government's auditing system
On report	External financing is included in ex-post reports by the government

Recent analysis by CABRI reveals a wide range in the ability among even multilateral donors to deliver aid on budget. Some are able to deliver on nearly all of the above dimensions and others on a few. Donors' ability to deliver aid on budget is also highly influenced by recipient-country policies, systems and context.

Source: CABRI (2008c).

There is much diversity in the extent to which aid instruments use government systems. For example, some MDTFs use government accounting or auditing systems. General and sector budget support use most of these systems, while project aid and support to non-state actors use the least. In a country systems discussion recently with CABRI in Timor, UN representatives considered that they were able to use eight components, the European Union (EU) three and the World Bank six. At a minimum, aid that is aligned with the broad national priorities sets out in the national development plan could be seen as 'on plan'. Very few aid instruments apart from expenditure related to general budget support are approved by Parliament.

3.2. Paris principles of aid effectiveness

Aid instruments can embody the Paris principles to varying extents, as summarised in Table 1 below (which includes domestic revenue as a comparison). In the following discussion, we examine how the instruments embody the Paris principles in terms of the outputs the funds are spent on (summarised in the table) and then look at how the conditionalities for each type of instrument can follow Paris principles (summarised in Table 2).

Paris principles and aid expenditure

General budget support and sector budget support have the potential to be the most Paris-compliant instruments because they have the most ownership and the least earmarking, follow all government processes and harmonise donor support. However, there remain design issues in ensuring these instruments support service delivery, sustainable capacity building and institution building to the greatest extent, and the policy dialogue and conditionalities around budget support are carefully managed.

MDTFs can use many government systems, or be completely separate. Even when donors are unable to use country systems, many of these aid instruments can still have 'Paris-type' characteristics. For instance, many projects or MDTF expenditures using non-government systems will be **policy aligned** if the expenditure through the instrument supports the government's stated priority policies – even if they use non-state providers – for example if these policies are laid out in a national development plan. This highlights the usefulness of a national development plan in giving donors 'something to align with'.

Expenditure through an aid instrument can be **process aligned** if its budgeting and financial management processes are similar to the systems and timing used in the government budget. Process alignment means it is easier for the government to coordinate aid spending with government spending, and also lays the foundations for the project/programme to move towards sector or general budget support at a later date. For example, donors that have committed to the International Aid Transparency Initiative (IATI) standard should begin to publish donor documents and data in line with the timing of the relevant government budget publications (both forward looking and outturns), using the same administrative classifications, clearly showing the particular government agency/ministry that is the counterpart.[16] This is often called 'shadow alignment'.

MDTFs may be well **harmonised** (in that they channel funds from many donors) even if their policy and process alignment with the government budget is weak. This may often be a 'selling point' for these instruments, given that in some circumstances there may not be a national sector plan with which to align, or that donors may not always want to be strongly aligned with recipient government priorities.

Ownership is a critical concept. The OECD defines this as, 'The effective exercise of a government's authority over development policies and activities, including those that rely – entirely or partially – on external resources. For governments, this means articulating the national development agenda and establishing authoritative polici*es* and strategies.'[17] And the 2011 World Development Report (World Bank, 2011) highlights the importance of legitimate institutions for exiting fragility, defining the two types of legitimacy as follows:

- **Political legitimacy,** 'or the use of credible political processes to make decisions that reflect shared values and preferences, provide the voice for all citizens equally and account for these decisions'; and
- **Performance legitimacy,** 'earned by the effective discharge by the state of its agreed duties, particularly the provision of security, economic oversight and services, and justice'.

A full discussion of the concept of ownership is beyond the scope of this paper, but there are clear links between political legitimacy as expressed in the World Development Indicators and the ownership definition from the OECD. A common theme is the need for the government to make credible, authoritative, accountable policy decisions. In terms of the day-to-day operations of government, 'making authoritative decisions' means ministers must be involved in decision-making processes and be accountable for these decisions to the president or prime minister, cabinet, legislature, civil society and general public. An aid instrument could be designed to ensure ownership if government ministers and/or Parliament are publicly involved in decision making regarding the use of funds, even if these funds are not managed or implemented by ministry staff (and even if only through silent assent).

16 This is in line with the PEFA Indicator D-2.
17 http://stats.oecd.org/glossary/

Table 1: Aid instrument expenditure, use of country systems, Paris principles and direct delivery of results

Expenditure through aid instrument shows…	Use of country systems[18]	Policy alignment	Process (or shadow) alignment	Harmonisation	Ownership	Delivery of direct results
Domestic revenue	All 8	Automatic	Automatic	Automatic	Automatic	Depends on expenditure capacity of government, including contracting/ procurement capacity
General budget support	All 8, can include additional safeguards	Automatic	Automatic	Automatic	Strong	
Sector budget support	Usually all 8, can include additional safeguards	Policy aligned with an agreed sector plan	Automatic	Automatic	Strong, but depends on extent to which sector plan is owned, and extent of earmarking	Depends on expenditure capacity of government, potentially supported by donor programme
Government-managed pooled funds	Ranges from none to all 8, can include additional safeguards	Policy aligned with an agreed sector plan	Could be done, especially if any project/ programme implementation unit (PIU) is embedded in government	Automatic	Moderate, but depends on extent to which sector plan is owned, and extent of earmarking	Depends on effectiveness of expenditure systems used – whether government, donor or mix of two
Jointly managed trust funds	Usually uses parallel systems	Can be policy aligned with an agreed sector plan	Could be done, especially if any PIU is embedded in government	Automatic	Depends on ministerial involvement in decision making	
Project support	Usually uses parallel systems	Only if aligned with the overall development plan or sector plan	Not automatically but could be done	Not automatic: requires coordination	Depends on ministerial involvement in decision making	Depends on effectiveness of implementing agency
Support to and through non-state actors	Uses parallel systems	Only if aligned with the overall development plan or sector plan	Not automatically but could be done	Not automatic: requires coordination	Weak for government – may be ownership at community level	

Ownership and use of systems

The observations in the discussion above highlight an important dichotomy. The term 'use of country systems' is often seen to imply that the government has a role in decisions about allocation, timing and prioritisation and the specific policies aid is funding. While ownership and use of systems often reinforce each other in practice, this is not necessarily the case, as 'ownership' – the government's role in decision making – can be achieved independently of the use of country systems, and vice versa. In a familiar example, almost all donor support can be termed 'on plan' as long as the country's poverty reduction strategy (PRS) identifies the standard sectors of donor intervention. Meanwhile, the use of contracting-out for service delivery in many countries means government systems are used to a lesser extent – but the decision-making ability is still in place as long as the contracted expenditure is following the government's agreed framework, prioritisation and policy design (OECD and Partnership for Democratic Governance, 2010). In contrast, if a government is given a 'take it or leave it'

18 Which are: planning, budgeting, parliamentary approval, Treasury, procurement, accounting, auditing and reporting, according to "Aid on Budget", CABRI, 2009 – although there are alternative views that include a wider view of country systems such as HR, and decentralisation functions.

option for a donor project that uses country systems, do they really have ownership of the project, as defined above by the OECD, where an authoritative decision is required? These are two distinct discrete concepts and there are risks to conflating them, such as in the example in Rwanda in Box 2, that countries could be pushed towards becoming accountable for aid that is not, in fact, under their control.

Box 2: Rwanda - aid on budget

Experience with the CABRI network in Rwanda has highlighted the importance of understanding the country setting in determining which elements of the budget process are critical for moving towards greater alignment. In Rwanda, it became clear that the rules for putting aid on budget were lacking, and that the existing means for capturing aid information were inadequate.

One finding of the study was that the government of Rwanda did not want aid that was not under the control of government to be 'on Parliament', since it could not be accountable to Parliament for this aid.

Finally, although the research findings showed a complex reform agenda at stake, participants in the study workshop 'agreed unanimously that data collection and management should be streamlined as a matter of urgency, implying amongst other things that co-ordination of aid information on MINECOFIN should be addressed'.

Source: CABRI (2009).

Paris principles and aid conditionality

It is also important to identify the extent to which the use of **conditionalities** in aid instruments adheres to the Paris principles. According to Foster et al. (2010), 'Conditionality can be classified according to the key agreements underlying any aid transaction:

1. Agreement on what the recipient will do in return for the aid. This can be sub-divided into:
   - *a* Entry conditions: minimum conditions that have to be achieved and maintained. These may relate to ethical standards (respect for human rights or democracy), public financial management, or the content of overall or sectoral strategy. They can also relate to bilateral objectives (supporting donor foreign policy positions).
   - *b* Periodic review: no explicit link between specific conditions and the expenditure of aid, but progress against a performance assessment framework influences the level and timing of disbursements.
   - *c* Conditionality on actions. Under multi-tranche operations, conditions used to be set in advance, with waivers required before funds could be disbursed if conditions were not met. It is now more common for funds to be disbursed based on actions that have already been completed. Indicative conditions or 'triggers' for future aid are still specified in advance, but the significant change from previous practice is that they can be more easily changed or modified in negotiation.
2. Agreement on objectives that must be achieved in order to receive the aid. Outcome or output targets are agreed in advance, and disbursements are linked to the actual performance, either explicitly, or via a more judgemental assessment of overall performance.
3. Agreement on what the aid may and may not be spent on ('earmarking').
4. Agreement on how the aid will be provided (procedural or process conditions).'

Conditionality therefore refers to a number of facets of the agreements between donor and recipient. Whether conditions are harmonised among donors or aligned with government priorities is open to question. Conditionalities are by no means automatically harmonised among donors that provide programmatic aid, and although a joint framework may be in place for some multi-donor aid instruments, this may constitute a 'menu' of conditions that individual donors choose. Moreover, donors do not always have joint conditionality arrangements even for general budget support (often they have individual budget support arrangements which may or may not share conditionalities).

Similarly, alignment of conditionalities depends on the extent to which the benchmarks reflect the government's own stated reform or performance priorities (depending on the type of conditionality). The level of ownership is closely linked to this, and depends on the extent to which there has been a clear and in-depth policy dialogue around the content of the conditionalities.

It should be noted that donor use of conditionalities has important consequences for local ownership and has, in the past, frequently undermined such ownership. Conditionalities need to incorporate 'do no harm' principles in a more effective manner. In addition, ownership of conditions by one part of government does not imply cross-government ownership.

Table 2 shows how the conditionality associated with different aid instruments reflects the Paris principles. It breaks down the conditions for each type of aid into entry conditions, interim conditions (actions, outputs and outcomes) and earmarking. At the top of the table, conditionality related to budget support focuses mostly on objectives, policy actions and standards, but leaves government more discretion over what the aid is spent on and how it is managed. At the bottom of the table, conditionality reflects the narrower objectives of project aid, and focuses on the operational requirements for the success of the project, and on what the funds are to be spent on and how they are to be managed.

Table 2: Aid instrument conditionalities and Paris principles

Conditionalities show…	Alignment	Harmonisation	Ownership
Domestic revenue	No external conditionalities	No external conditionalities	No external conditionalities
General budget support	• Entry conditions: determined by donor • Interim conditions: aligned if drawn from government plan • Earmarking: none • Process conditions: fully aligned if using national budget processes for all aspects of reporting, monitoring and audit. May have additional safeguarding beyond government processes	• Entry conditions: not automatic. Donors may have similar minimum standards for entry (for instance, most require on-track International Monetary Fund (IMF) programme) but action required for harmonisation • Interim conditions: not automatic. Performance assessment frameworks (PAFs) are drawn up in some countries (a labour-intensive exercise), with donors choosing their conditions from the PAF • Earmarking: none • Process conditions: harmonisation not automatic. Different donors may require different additional safeguards	Depends on the quality of the policy dialogue Depends on the extent of cross-government ownership: how much the part of government that negotiated the agreement is representative of the implementing part of government
Sector budget support	• Entry conditions: determined by donor. Most depend on existence of government sector plan • Interim conditions: aligned if drawn from government sector plan • Earmarking: earmarked to sector • Process conditions: fully aligned if using government processes for all aspects of reporting, monitoring and audit. Extent of requirements beyond government systems differs	• Entry conditions: not automatic. Donors may have similar minimum standards for entry but action required for harmonisation • Interim conditions: harmonised if all conditions are drawn from PAF, but not automatic • Earmarking: earmarked to sector • Process conditions: harmonisation not automatic. Different donors may require different additional safeguards	

Government-managed pooled funds	• Entry conditions: determined by donor(s) setting up fund but may depend on existence of government plan • Interim conditions: aligned if drawn from government plan • Earmarking: depends on nature of fund but likely to be earmarked to sector • Process conditions: if fully managed by government then fully aligned. May be some additional safeguarding beyond government systems	• Entry conditions: determined by donor(s) setting up fund so highly likely to be harmonised • Interim conditions: conditions harmonised in the operating guidelines of the fund • Earmarking: depends on nature of fund but likely to be earmarked to sector • Process conditions: determined by donor(s) setting up fund so highly likely to be harmonised	
Jointly managed trust funds	• Entry conditions: donors determine entry conditions but may depend on existence of government plan • Interim conditions: aligned if drawn from government plan • Earmarking: depends on nature of fund • Process conditions: alignment depends on extent to which fund uses national budget processes	• Entry conditions: Determined by donor(s) setting up fund so highly likely to be harmonised • Interim conditions: conditions harmonised in operating guidelines of fund • Earmarking: depends on nature of fund • Process conditions: determined by donor(s) setting up fund so highly likely to be harmonised	Depends on the quality of the policy dialogue
Project support	• Entry conditions: likely to be determined unilaterally by donor • Interim conditions: not all projects link spend to conditions, but for those that do, alignment with government priorities/plans depends on quality of dialogue • Earmarking: earmarked to project priorities • Process conditions: unlikely to be aligned but depends on use of national systems	• Entry conditions: determined by individual donors. Unlikely to be harmonised • Interim conditions: determined by individual donors so unlikely to be harmonised unless multi-donor project • Earmarking: earmarked to project priorities • Process conditions: unlikely to be harmonised unless multi-donor project	Depends on the quality of the dialogue with government
Support to and through non-state actors	• Entry conditions: likely to be determined by donor • Interim conditions: depends on nature of support • Earmarking: depends on nature of support • Process conditions: not aligned as not using national systems	• Entry conditions: determined by individual donors. Unlikely to be harmonise. • Interim conditions: determined by individual donors so unlikely to be harmonised • Earmarking: depends on nature of support • Process conditions: determined by individual donors so unlikely to be harmonised	Ownership of conditions by non-state actors depends on dialogue with donor

Source: Foster et al. (2010).

3.3. Risks and opportunities

Another way of distinguishing the various aid instruments is to recognise the inherent opportunities and risks of each instrument. These relate to key areas such as different levels of transaction costs and administrative burdens on recipient governments. Some aid instruments facilitate policy dialogue, strategic interactions or flexibility of processes; others have a greater focus on service delivery or on building sustainable institutions. Some instruments attempt to address a combination of these goals. These are set out in Table 3.

Table 3: Inherent opportunities and risks of different aid instruments

Instrument	Opportunities	Risks
General budget support	• Major opportunity to link resources to core capacity building and outcome achievement, while providing incentives to further strengthen country systems • Can finance recurrent expenditure that is central to state functioning • Lower transaction costs for partner country • Joined-up resourcing and dialogue with development partners create a more predictable partner country–development partner relationship	• There may not be a centralised budget to work with • Requires high standards of public financial management (PFM) to mitigate fiduciary risks • Demanding in terms of the level/type of dialogue with development partners; political objectives and constraints may undermine predictability • Can seem 'remote' from short-term improvements in service delivery in the early phases
Sector budget support	• Supports state functioning through an owned sector programme or strategy, while providing incentives to strengthen country systems • Focuses resources on a priority sector • Lower transactions costs than pooled or sector-wide approach (SWAp)-type approaches • Joined-up sector dialogue	• Sector institutions may face particular capacity challenges – for example with respect to PFM systems • Focused engagement on a priority sector may distort engagement in other key priorities, undermining government decision making and allocative efficiency
Government-managed pooled funds	• Pooling of development partner resources • Aligned with government strategy, but allows narrower earmarking (often to specific activities) than budget support • Can accommodate safeguard measures where PFM systems are weak	• Earmarking may undermine government's ability to prioritise public investments • Poses management challenges for recipient • Transaction costs may be higher than budget support • Heavy focus on systems and procedures for pooling; decision making can detract from delivering outputs/outcomes • Pooled funds may delay the transition to budget support when conditions allow
Jointly managed trust funds	• Joint governance and management arrangements mitigate fiduciary risk • Opportunity to develop government systems and capacity for management of resources • Can reduce transaction costs for both development partners and partner countries	• Management challenges for both development partners and partner countries • Attention to improving government systems may in early stages slow down delivery of outputs • Use of trust funds may delay the transition to other aid modalities making greater use of country systems when appropriate

Project support	• Can target specific priorities/gaps, through earmarking for specific activities • Project support can use country systems to differing extents • Flexibility in design • Quick wins	• Can privilege short-term impacts over longer-term engagement • Narrow earmarking can undermine government decision making and allocative efficiency • Can result in a 'dual public sector' and undermine incentives to support state capacity where parallel structures and processes are used • Can create sites of patronage and decision making that rival the state or undermine government processes where parallel structures and procedures are used
Support to and through non-state actors	• Can help to meet short-term service delivery needs where state capacities are weak • Can support citizen engagement and effective channels of participation for marginalised groups • Can foster innovation in service delivery • Flexibility in design • Quick wins	• Can undermine strengthening of government systems • Can undermine transparency and domestic accountability • Can raise social expectations beyond state capacity, fuelling frustration • Can happen in an under-regulated environment

Source: Cox and Hemon (2009).

3.4. Transparency

Finally, aid instruments also vary in the extent to which they are transparent – a key consideration for long-term overall effectiveness. This transparency brings the greatest benefits when it is provided in a 'comprehensive, timely, accessible and comparable' manner, according to the Aid Transparency Assessment from Publish What You Fund (2010). Again, general budget support and sector budget support have the potential to be the most transparent to the government since they automatically flow through government systems, although donors are not always transparent about their commitments and disbursement times. Further transparency to the public in country then depends on the government's own systems. Aid instruments that do not use country systems can be transparent depending on their design and management. Table 4 summarises the transparency properties – to government, the public in donor and recipient countries and other donors – of the different types of aid instruments.

Table 4: Aid instruments and transparency

<table>
<tr><th>Transparent from donor …</th><th>… to recipient government</th><th>… to public via government</th><th>… directly to public</th><th>… to other donors</th></tr>
<tr><td>Domestic revenue</td><td>Strong</td><td>Depends on the level of transparency of the overall government budget</td><td>N/A</td><td>N/A</td></tr>
<tr><td>General budget support</td><td>Strong</td><td>Depends on the level of transparency of the overall government budget</td><td rowspan="7">Depends on donor methods for dissemination used, e.g. international websites, local websites, radio, newspaper, public launches, etc.</td><td rowspan="7">Via websites, meetings and formal/ informal coordination mechanisms</td></tr>
<tr><td>Sector budget support</td><td>Strong</td><td>Depends on the level of transparency of the overall government budget</td></tr>
<tr><td>Government-managed pooled funds</td><td>Strong</td><td>Could be included in budget documentation; if so, depends on the level of transparency of the overall government budget</td></tr>
<tr><td>Jointly managed trust funds</td><td>Strong</td><td>Could be included in budget documentation (less likely than 3); if so, depends on the level of transparency of the overall government budget</td></tr>
<tr><td>Project support</td><td>Only if donors report to government</td><td>Only if donors report to government, and government includes it in budget; if so, depends on the level of transparency of the overall government budget</td></tr>
<tr><td>Support to and through non-state actors</td><td>Only if donors report to government</td><td>Only if donors report to government, and government includes it in budget; if so, depends on the level of transparency of the overall government budget</td></tr>
</table>

Source: Authors

The above analysis has highlighted the wide array of aid instruments that are available in development contexts, including fragile states. Each instrument embodies a range of different characteristics, which reflect different donor approaches, different levels of government systems in different sectors and ministries and political as well as chance and individual factors. As this section has shown, there is, in theory, a wide variation in the extent to which these instruments can use country systems; adhere to Paris principles; manage risk; and foster transparency. The next section considers how this array of instruments has been applied in practice at a country level in fragile states, which pose particular challenges for the effectiveness of aid instruments.

4. Evidence and case studies of aid instruments in fragile states

In order to build a picture of what factors determine the success (or otherwise) of development assistance, this section identifies some good practice of aid instruments to date. It starts with a discussion of the speed and flexibility of aid instruments, before moving on to examples of good practice of using country systems through budget support and MDTFs. The next sections cover good practice on transitioning between aid instruments, specifically those regarding short-term service delivery objectives and longer-term capacity-building objectives

4.1. Speed, flexibility and results

A chorus of criticism from fragile states' governments and civil society has shown that, in many situations, aid – and the results of aid – has been delivered far too slowly. Only in a few cases – such as Afghanistan – has there been a clear break from 'business as usual' models in the delivery of aid, where results have been achieved at anything like at the pace needed. But as the recent poor rates of progress in South Sudan and Haiti has revealed, these positive lessons are not being applied consistently elsewhere. The cost of this collective failure to fully adapt the aid system to the needs of fragile states is borne primarily by the populations that suffer from the lack of access to infrastructure and basic services. But the irony for donors is that failure to take risks in the delivery of aid has had the cost of much greater and potentially much more expensive risks of renewed conflict. For both fragile states and donors, there is a pressing need to break with the past partial incremental approach to changing how aid is delivered.

One source of inflexibility in fragile states is the demarcation between development and humanitarian funding. As a result of the World Food Programme's (WFP's) successful track record in rehabilitating roads in South Sudan, the government asked it to develop and extend its programme and in effect start the delivery of a nationwide road master plan. However, in the process, WFP was delayed by difficulties in accessing development funding from the World Bank-managed MDTF. WFP was also constrained by its own Board requirement that roads be built to a certain quality, which was appropriate for securing humanitarian access in the short term but inappropriate for a longer-term road programme.

One specific approach that has delivered relatively rapid and flexible support is the community-driven development (CDD) programme. Such programmes have demonstrated that services with local ownership and accountability can be delivered at the village or community level with acceptable fiduciary risks. Yet these programmes have the potential to build peace at the local level, contribute to statebuilding by connecting communities to legitimate authority and developing citizenship skills, as well as building government from the ground up. CDD is an underutilised instrument that has proven effective in fragile settings. The benefits of this willingness to act differently was vividly illustrated by the speed of operation of the MDTF in Afghanistan and by the flexibility it had to finance a wide range of items – including recurrent budget items (McKechnie, 2010; Symansky, 2010). This was supported by a focus on developing capacity for government procurement and a willingness to use emergency procurement rules for a full 10 years after the end of conflict. Other examples discussed in the following sections include a step-change in procurement procedures or MDTF design and management, and the use of fast-track modalities alongside long-term capacity building. It is interesting to note that, in many cases, rather than being a trade-off, the effective use of government systems is often critical for delivering results.

4.2. Aid using country systems

Donors are rightly concerned about the misuse of aid funds, and are accountable to their legislatures to ensure that resources used to fund governments provide value for money and do not go astray. Yet, without taking some risk, it is not possible to assist countries to transition out of fragility and aid dependence. Risk aversion can lead to slower institutional development, delayed development outcomes, increased risk of return to conflict and long-term aid dependency. Tolerance for risk does not imply tolerance for the outcomes when risks become actual events. Donors can and should expect the country's own accountability systems to come into play (indeed, these institutions complement good PFM system), and may wish to carry out their own investigation and sanctioning process, especially when national accountability institutions fail to work properly. In addition, there is some evidence that PFM systems in fragile states may ensure transparency and accountability even when the country ranks low on international corruption indices. For example Afghanistan's PFM system benchmarked well even against higher-income country comparators, despite Afghanistan's low score on the Transparency International and World Bank Institute corruption indices, probably because most corruption involved abuse of power or was related to the illegal narcotics trade rather than misuse of public funds.[19]

There is a **range of ways** to provide more aid through government systems and to the recipient country's budget – through direct budget support, pooled funding arrangements or national programme or project financing that flows through the budget and uses national fiduciary and reporting systems.[20] Providing aid in such a form plays a critical role, in particular during the early post-conflict stages, in supporting the transformation by ensuring continued functioning of key government function, and delivering on critical priorities that can provide legitimacy to emerging governments A substantial shift in this direction not only is likely to deliver faster development outcomes, better aligned with country priorities, but also strengthens the accountability of government to citizens for delivering services, builds legitimacy and deepens organisational capacity through 'learning by doing' (Knack and Rahman, 2007). Assistance to fragile states is highly fragmented into small projects that are often neither coherent nor coordinated with national priorities (OECD, 2010c).

Aid through national systems may appear more risky than donors delivering projects directly or through non-governmental organisations (NGOs) or humanitarian channels, but these **risks can be managed.**[21] Strengthening national capacity for procurement, accounting and auditing, reporting and programme implementation is clearly part of the solution and may take time.[22] But in addition, many fragile states, including g7+ states, have demonstrated their willingness to accept additional short-term safeguards to manage the risk involved. Some of the services can be contracted out and dual country–donor decision processes put in place, and donors could collectively establish special accountability or audit checks. The Liberia Governance and Economic Management Assistance Program (GEMAP) dual signatory approach is one positive example (USAID, 2010). In Sierra Leone, initial provision of budget support was accompanied by international accounting firm monitoring flows within government through to schools etc (DFID, 2010a). Other examples include the use of international accounting firms to undertake additional audits; the provision of additional financing to enable national audit offices to undertake more frequent audits (e.g. at sub national levels); support to value for money audits; and the introduction joint government–donor results monitoring approaches in ministries of finance and/or in sector ministries.

It is striking that in South Sudan, despite the conflict essentially ending in 2005/06, donors are only now discussing putting money through government systems and even then many are arguing that it will take five years before the government is ready. It will thus be over 10 years after the conflict before money will flow through government systems. By contrast, in some fragile states, general budget support is a live option as soon as donor engagement begins. Sierra Leone received general budget support two years after the conflict and Rwanda in around the same timeframe. The Afghanistan trust fund started to provide funding for the

19 See OECD (2011) for more on risks and rewards in fragile states and McKechnie (2010) for information on procurement risks in Afghanistan.
20 See, for example, CABRI (2009).
21 The UK Department for International Development (DFID) has developed a new approach which assesses partner governments on both partnership commitments (including domestic accountability) and whether budget support can achieve better results and value for money than other instruments (DFID, 2011).
22 For example, PFM reforms have been gathering pace in the Democratic Republic of Congo (DRC) (Baudienville, 2010) .

recurrent budget after just a few years. It was this early support – that is, within the first five years – that was critical in rebuilding the state in all three countries. Yet, despite all the lesson learning of the past 10 years, it would seem that donors are collectively now less willing to take on risk and deliver through government systems.

Using country systems often that donors are more likely to align their aid with government policies and priorities. However, in some cases, policy alignment, that is, aligning aid behind the government's policy objectives (not just its processes as in the case of shadow alignment), may not be appropriate, for example where is a clear disconnect between the needs of the poorest and most marginalised groups and the allocation of the national budget, and the potential for such a disconnect needs to be explicitly recognised and managed.

Recipient governments have important perspectives on the use of country systems. Use of country systems entails greater scrutiny and could be controversial in cases where weaknesses are exposed: not all elements of the recipient government may welcome this attention. But as the 2010 CABRI Annual Seminar notes (in Manuel et al., 2010),

> *At the ODI/IMF Conference in November 2010, finance ministers from fragile states voiced their opinion that they 'would prefer that development assistance be provided through government systems as much as possible, and preferably in the form of budget support [...] The effective use of aid resources, including putting aid on budget, remains an important priority for CABRI participating countries ... The use of country systems is not an end in itself; rather it is an important means to achieving better transparency, accountability and ownership over public resources in general, not only those provided by donors.*

In addition, the CABRI 2010 report notes that partner countries want aid to flow through their systems to ensure comprehensive information on the total resource envelope, which can inform better inter-sectoral allocations. A related issue is horizontal equity and concerns about equitable resource flows across geographic areas. Aid that is aligned with government systems or flows through them can make any disparities and revealed allocation decisions more visible, and therefore possible to regulate and manage through a national political lens. Use of country systems allows for greater control of funds, with concomitant accountability. The observation that development policy is described by the overall allocation of public funds in a country, not just one set of projects or sectors, makes the need to see the overall public spending – government and donor – as a cohesive, strategically managed whole, critical to development success.

4.3. Using country systems: good practice for budget support

General budget support is used as a modality of support to the implementation of overall PRSs at the national level. Budget support is the aid instrument most closely aligned with supporting the development of national systems, and it solves a problem for donors of managing aid where it has become too large to be managed off budget without causing distortions. However, it is also the modality that raises the greatest political challenges for both donors and recipient governments. General budget support was provided to very weak environments as structural adjustment or balance of payments support in the late 1980s and early 1990s (Ghana, Mozambique and Uganda). As Foster (2007) notes, 'the DFID commitment of general budget support to Rwanda in 2000 was widely perceived as a bold move, yet the Government had by then already built budget and financial management systems that were immeasurably stronger than those that were in place in Ghana, Uganda or Mozambique in the early years of structural adjustment'.

General budget support was introduced very early in some donor engagements, as in the Central African Republic (CAR) and Haiti, with post-conflict Sierra Leone receiving multi-donor budget support since 2001. This was recognised at the time and afterwards to be a 'high risk, high reward strategy' (DFID, 2010a) (see Box 3). It was accompanied by a series of additional fiduciary safeguards, such as the use of international audit firms to supervise transfers from the Ministry of Finance to line ministries and then to final beneficiaries (such as schools). More recently, it has been accompanied by the widespread use of public expenditure tracking surveys (PETSs), which have confirmed the funds are continuing to reach local institutions.

However, budget support is more than a transfer of resources, and donors can use it to influence national systems and processes in a number of ways, as described in the recent Common Approach Paper (CAP) by the World Bank and the African Development Bank (AfDB) (World Bank and AfDB, 2011):

> *Rather than viewing budget aid as simply a transfer of financial resources to the country's budget, and with a narrow focus on public financial management, it should be considered as a key element of an aid package that consists of evidence-based policy dialogue, analytical work, technical assistance, capacity building activities, as well as financial transfers. This package should be more explicitly geared at addressing the underlying causes of fragility and supporting the transition toward resilience. This can be done by highlighting the role that budget aid can play in: stabilizing the macro-budgetary framework and allowing the state to carry out basic functions, to cement its legitimacy and contribute to maintaining political stability; supporting the longer-term endeavours of peacebuilding and statebuilding; and contributing to strengthening the capacity of recipient countries by channelling aid through national systems.*

As Scanteam (2007) argues, 'policy dialogue has had the greatest impact when linked with budget support, weakest when funding is for off-budget projects'. The recent CAP by the World Bank and AfDB notes that the case for budget support in fragile states needs to be made more strongly, more insistently and more explicitly in programme documentation. 'In the documentation associated with [budget support operations], not enough attention has been given to showing that budget support in fragile situations can potentially generate even greater benefits than in non-fragile contexts'. Nevertheless, budget support is still a transfer of financial resources, and political support for it is more likely if emphasis can also be placed on what additional services or investments can and will be supported as a result.

There is considerable debate over the best design for good budget support operations in fragile states (as outlined in the recent CAP). For instance, there are differences in opinion between the World Bank, the European Commission (EC) and the AfDB as to whether improved PFM should be a precondition of budget support or is better thought of as an outcome of budget support. Differences in approach to memoranda of understanding (MoUs) and PAFs are also significant. However, there are some areas of consensus, including the need for strong country leadership; an analysis of the absorptive capacity of the recipient; drawing conditions from national strategies or common PFM matrices or PAFs where they exist (although it is possible that in fragile states it would require considerable time to develop these in the first instance, perhaps too much time to delay budget support); planning budget support for longer periods than one-year cycles (see, for instance, Box 3 on budget support in Sierra Leone); building in M&E with more care; and that, if budget support ceases as a result of a failure to meet conditions, the disbursements should cease or be reduced[23] in the year following the decision in order to increase predictability.

Box 3: Multi-donor budget support in Sierra Leone - high risk, high benefit?

DFID, the EC and the World Bank have provided Multi-donor Budget Support (MDBS) to Sierra Leone since 2001. Under a 10-year MoU between Sierra Leone and the UK, DFID provides £10 million annually, plus an additional £5 million performance tranche, to recognise progress towards the MDBS benchmarks. The benefits of MDBS to Sierra Leone have included:

- A non-inflationary boost to public spending, stimulating demand and improving business confidence, contributing to more rapid economic growth in the immediate post-conflict period;
- Higher spending in MDG-related areas, with some evidence of direct impact on service delivery

23 For example, the EC and DFID have distinguished core funding from the part that is at risk, which allows for reduction rather than cessation if triggers are not met.

in the education sector; and

- Significant improvements in PFM, against a low base, leveraged by MDBS dialogue and disbursement conditions.

In addition, in a fragmented aid landscape, MDBS dialogue arrangements have become the most robust donor coordination mechanism.

Reviews have highlighted that the MDBS is a high-risk, high-benefit strategy. Predictability of funding has been a key challenge. In order to manage fiduciary risk, DFID makes commitments only for the current financial year, making it difficult for the government to plan its expenditure in the medium term. Lack of predictability has led to heavy reliance on unplanned domestic borrowing, threatening the positive impact of the MDBS. An ODI review stated that DFID should either make its contributions more predictable or move to other forms of funding. The implication is that, without accepting higher risk by increasing predictability, the reward cannot be maximised.

Source: DFID (2010a).

Strikingly, the CAP emphasises the importance of a thorough risk assessment, including the risk of NOT providing budget support.

> *The current emphasis on risk to the donor institutions (notably fiduciary risk) should be more balanced against the risk to state stability and the pursuit of nationally-led reform of not providing budget aid […] In all case studies benefits have been realized in terms of stronger country ownership, greater emphasis on medium-term results and national development objectives, improved PFM, greater promotion of fiduciary accountability, and lower transactions costs for government and donors alike.*

Box 4 describes DFID's approach to this problem. This individual donor assessment then relates to the assessment of other donors, and most donors have slightly different criteria and conditions that need to be met before budget support can be awarded. A key question for the international aid architecture and in-country coordination is whether donors should join together to assess the criteria and/or conditions that would be applied in this case, which could improve coordination and collective decisions. There are risks that the most cautious will hold back other donors, and often there is a small core of donors who pioneer budget support, while others join later, which is often especially true in sector budget support. Standard criteria may include budget execution capacity; multiyear plan/strategy; and PFM capacity.

Box 4: Determining budget support instruments - the DFID approach

Step 1: Assessing partnership commitments

Assess governments against commitments regarding: 1) poverty reduction and the MDGs; 2) respecting human rights and other international obligations; 3) improving PFM, promoting good governance and transparency and fighting corruption; and 4) strengthening domestic accountability.

With regard to the latter commitment, domestic accountability is evaluated according to the capacity of citizens in developing countries holding governments and public authorities to account for delivering on their commitments. This requires **transparency** – government making available and accessible to citizens relevant information; **citizen engagement** – government providing opportunities for citizens and those representing them to engage on policy development and resource allocation; and **answerability and enforceability** – effective scrutiny and enforcement mechanisms allow citizens can hold government officials to account. This may require external entities, such as Parliament, the judiciary or civil society.

Step 2: Assessment of whether budget support can achieve better results and value for money than other instruments

All budget support submissions will explain how the choice of budget support instrument was made taking into account 1) the results country offices are committed to delivering; 2) a diagnosis of opportunities and constraints to their achievement; and 3) the relative merits of the different types of instrument in tackling these constraints and exploiting opportunities.

Instruments will be chosen among general budget support, sector budget support and sector programme support (non-budget support financial aid). Choices will depend on the country context and appetite for leverage, control and risks (for details of such risks see Section 1) The choice of financial aid instrument need not be an 'either/or' decision, but that financial aid instruments (both budget support and non-budget support) can complement one another to achieve more results and better value for money.

Source: DFID (2011).

A discussion of budget support would not be complete without mentioning dilemmas over its applicability in countries that have significant domestic revenue from natural resources, such as Timor-Leste. In these cases, budget support might not always be necessary and may not be worth the heavy transaction costs for donors. For example, in Azerbaijan, donors give about \$20 million in general budget support to a national budget that is approximately \$12 billion. Presumably, this kind of programme is less about financial transfer and more about other objectives such as building capacity and transferring knowledge, because for a small amount of money relative to the budget, projects are a flexible and manageable alternative with potentially lower transaction costs. In this case, governments may want external support and know-how in building specific capacities, or designing and implementing specific technically demanding projects. Some key questions need to be answered in these contexts:

- What are the limitations to budget support in some of the more resource-rich countries?
- How can country systems be strengthened without necessarily leading to budget support? (For example, donors could agree to use local fiduciary or other systems, which could significantly decrease transaction and coordination costs.)
- To what extent could very limited budget support still be useful in terms of signalling effect, for example giving budget support that supports state–society strengthening – such as DFID's focus on domestic accountability?

The key for many of these countries may be to ensure that their systems are actually functioning by the time they arrive at -middle income' status and no longer have access to the same levels of external funding and technical assistance, regardless of whether they need aid to fill a fiscal deficit or not.

From these examples, there appears to be a common theme of early restoration of good basic systems, staffed by nationals and augmented with technical assistance and consultants. On this basis, there seem to be two possible approaches or categories of budget support that are relevant in fragile states: early adoption and gradual adoption. Sierra Leone and Afghanistan may be examples of the former where it is possible to establish that some areas of the budget are sufficiently robust or can be made so with some additional controls to ensure some fiduciary standards are met, and where there is a recognised high risk/return ratio. The second is where there is a planned progression over time against PFM benchmarks to a threshold where most donors gradually come on board to support the entire budget and the system as a whole. This would happen when a threshold of defined fiduciary standards with an acceptable (i.e. lower) level of risk is reached. This suggests that donors could encourage an approach based on defining these categories more clearly along a continuum, by determining the fiduciary standards and performance indicators and additional safeguards required for budget support at various stages of capacity development in post-conflict situations. Donors could then provide budget support when risk/returns are acceptable to them, while the government makes progress in improving political stability and restoring public institutions. A results framework for budget support should include measures for emergency service delivery and improvements to budgets and controls that are realistic in the post-conflict/fragile state context, which could be monitored using technical assistance, NGOs and feedback from communities.

This type of approach would need to leave open the space for country-specific and country-led PFM reform programmes (discussed in the next section), perhaps targeting a certain level of risk/return or safeguard provision as specified by donors, but in a context-specific and country-relevant way.

Sector budget support

Sector budget support is distinguished from general budget support by its focus on a sector. It can be in the form of general budget support with sector dialogue (the Development Assistance Committee (DAC) definition) or as earmarking to the sector ministry budget as a whole (which would exclude much of what is currently being reported as sector budget support, which usually does not include all categories of ministry spending). Sector budget support channels funds via the recipient government's Treasury, and uses government budget execution systems. In this respect, it is like general budget support. However, in the case of sector budget support, the other inputs that accompany the transfer of funds relate to the sector being supported. These other inputs include policy dialogue, conditionality, technical assistance and capacity building (ODI, 2010a).

The decision to move between general or sector budget support is difficult for many donors, since it requires a technical assessment of the country's systems (in the sector, if relevant) with a political assessment of the overall regime (or particular individuals within that regime), all mediated through the prism of each donor's risk profile. Another key difference between sector and general budget support is that the former is comparatively more dependent on a planning framework, as much of the function of general budget support is to ensure macro-stability and support recurrent expenditure.

Other sector approaches

New developments in results-based approaches, including the MDG contract and the use of 'cash-on-delivery' aid methods, could also be seen as forms of general/sector budget support. While potentially promising, these are relatively new approaches that have yet to be evaluated in more stable environments, let alone in fragile states.

Another recent variant of budget support is the multi-donor Protecting Basic Services Grant in Ethiopia, which is given to sub-national government units and has led to an extraordinary expansion of primary services (such as family planning) and a rapid improvement in health outcomes. This has been accompanied by a set of explicit fiduciary strengthening measures ('SAFE') such as additional auditing requirements. This approach has proved to be a very effective way of managing the political challenges that have arisen with general budget support to the Ethiopian central government. It is less clear, however, how well such an approach would work in fragile state environments. The success of this project in Ethiopia is recognised in part to be a function of the highly effective civil service right down to the local level.

Furthermore, it is no coincidence that one of the first large-scale cash-on-delivery grants is also being attempted in Ethiopia.

SWAps also provide a means to facilitate the effective planning and implementation of sector reforms. Under a SWAp, all relevant funding to the sector generally supports a single policy. Expenditure is directed by recipient governments, with all funding parties adopting a common approach to the sector. While SWAPs often include sector budget support, they can act as a central platform where instruments that do not use country systems can be aligned under government leadership and policy priorities.

In Bangladesh, non-profit and private organisations play a significant contribution to the implementation of health services – alongside a large role for the public sector. Prior to the establishment of a SWAp in 1998, donor engagement with Bangladesh was fragmented, and the monitoring and coordination of a multitude of projects represented a heavy administrative load for the government. Implementation of the SWAp brought together governments, donors and other stakeholders under the country's strategic health plan, representing a shift in donor support from project to programme level, integrating external assistance into government programmes in order to improve coordination and avoid duplication of resources (ODI, 2011).

4.4. Using country systems: good practice for MDTFs

Pooled funds, including sector pooled funds as well as broader MDTFs, have been shown to provide close alignment with national priorities, to consolidate small projects into scalable national programmes, to use national systems and to harmonise and simplify the transaction costs of foreign assistance. Such pooled funds can also include dual signatory provision. Pooling funds also pools risks among donors and shifts the accountability for risk management to the multilateral organisations that usually administer them. However, while some pooled funds have worked well in difficult environments,[24] others have seen weak management and slow disbursements.[25] Key factors behind the more successful funds seem to be degree of government ownership; physical location of the secretariat; extent of the pool's in-year flexibility; and ability to finance recurrent expenditures. One of the key constraints to the development of such funds is the unwillingness or inabilities of some donors to co-finance/mingle their funds with those of other donors.

Examples of good MDTF and pooled fund practice that allow for strong alignment and national voice, and that balance swift disbursement with quality implementation can be found, for example, in Afghanistan (shown in Box 5).

24 Good examples include the Liberia Health Pooled Fund and the Yemen Social Fund for Development; see DFID (2010a), Hughes (2011) and ODI (2011a).
25 One example is the MDTF in South Sudan, which was characterised by cumbersome procedures and slow disbursement rates (Ball, 2007; Bennett et al., 2010).

Box 5: The Afghanistan Reconstruction Trust Fund (ARTF)

The ARTF is a key example of the way that a MDTF can successfully avoid undermining state systems and indeed strengthen them. Key factors that contributed to the ARTF's success included:

- **Selective engagement with ministry leadership:** The World Bank found that the single most important ingredient of success was the quality of ministry leadership. Well-led ministries made substantial progress while poorly led ministries achieved little and did not respond to additional finance and technical assistance.
- **Allowing the government to use the trust fund as a bank account:** Once expenditures and payments have gone through the government system, they are audited by the monitoring agents of the trust fund, after which the money is then transferred into the government's own bank account. This provides an appropriate level of integrity and assurance for donors using the government budget preparation and execution systems.
- **Limited earmarking:** Donors were not allowed to express preferences for more than 50% of their annual contribution, and preferences must reflect government priorities, be included in the development budget and have a financing gap.

Source: McKechnie (2010).

Although external co-financing instruments may contribute to certain harmonisation and coordination goals, they do not automatically support alignment with country processes and systems. Most pooled funds amount to little more than large donor-led projects co-financed through the pool. The more successful MDTFs and common funds have been more akin to budget support for investment programmes and projects than co-financed donor projects, as demonstrated in Box 6 below on Liberia's experience with pooled funds and Yemen's Social Fund for Development.

As these experiences illustrate, quality leadership in national institutions is critical for effective MDTF performance. Fund structures that allow national partners to take the lead in a limited number of key areas at the outset and subsequently expand these responsibilities as their capacity increases have proved most successful. A phased approach to ownership may therefore be most realistic in fragile situations (Ball and van Beijnum, 2010). With sufficient coordination, the use of MDTFs can help facilitate a move towards the use of country systems. As states transition to greater stability, country systems should increasingly be used. A particular challenge for donors is building capacity rather than substituting for it. As states graduate to budget support, donors should ensure that issues of conditionality and policy dialogue with the recipient government are properly addressed. This phased approach to ownership of planning and prioritisation may start with a post-conflict needs assessment (PCNA), and donors may initially brief ministers and high-level civil servants only on broad-brush policy choices, but MDTFs should develop an explicit plan for how to move to more detailed and substantive policy discussions, including the development of national strategies and sectoral plans.

Involvement of civil society in common fund steering committees can be beneficial. This is not common practice, but has proved to be positive in the case of the MDTF for Aceh and Nias, for instance, where civil society involvement was effective in addressing the needs of the rural poor (McKechnie, 2010).

Box 6: Government ownership of donors' aid instruments in Liberia and Yemen

The **Liberia Health Sector Pooled Fund** is widely acclaimed as the most successful of Liberia's three pooled funds (the others being the Education Pooled Fund and the Reconstruction Trust Fund). It is in effect a recipient-managed MDTF but with an international auditing firm acting as co-signatory. It is recognised as providing efficient disbursement and sound and transparent financial management. Financing decisions are embedded in a strong sector strategy that has allowed the health ministry to effectively prioritise and drive the fund's interventions. The Ministry of Health and Social Welfare has responsibility for monitoring implementation and one-third of government hospitals and clinics are now financed through it.

One reason for the fund's success is that the Project Coordination Unit is based in the Ministry of Health and Social Welfare. Indeed, the unit and the ministry's own Finance Department are co-located and co-managed. All the planning, procurement and M&E functions are operated using the same common approach. From the start, the Project Coordination Unit has prioritised using country systems for procurement. Donor-provided international technical assistance has supported both the unit and the Finance Department. The donor top-up salaries provided to the unit's local staff – which puts their salaries on a par with those in the private sector – are also provided to the ministry's own Finance Department staff. This set-up is in sharp contrast with the other pooled funds, where the project units are located in the Ministry of Finance and use World Bank procurement rules.[26]

Another reason for the fund's success is the degree of trust that has developed between the ministry, the donors and the NGOs. This has been founded on the minister's own leadership, personal integrity and track record in successfully running a hospital through the conflict period that served the wounded from all the warring parties. However, an early decision to use fund resources to support NGO delivery of services (recognising that the government systems would take at least five years to be rebuilt) was a powerful demonstration of the government's commitment to delivering results. In addition, the ministry produces regular reports on the finances of the pooled fund and the ministry's own budget.

Despite the success of the Liberia Health Fund, it is striking how long it took to be established and how little used it still is. The DFID project to support financial management in the ministry was agreed in 2006 and started in 2007. But the fund was only established in 2009 with just one or two donors and to date none of the largest donors in Liberia participates. The US Agency for International Development (USAID) was unable to comingle its funds (although USAID is now considering piloting an approach). The EU has surprisingly just ruled that the fund does not meet its minimum fiduciary standards (although at the technical level it was judged to be satisfactory on four out of the five required areas and changes have now been made to the fifth).

The **Yemen Social Fund for Development** (SFD) is a special institutional vehicle for delivering social infrastructure, micro-business support and capacity development directly to poor communities. It was created in 1997 and is now regarded as a highly effective and transparent mechanism for delivering development programmes to local communities. It employs a bottom-up, demand-driven approach, involving beneficiaries in the identification, design, implementation and maintenance of community projects.

The SFD is administratively and financially autonomous, with its own legislative framework, and operates outside the regular ministerial structure. However, it is also strongly country owned, with a board of directors that includes six cabinet ministers, under the chair of the prime minister, and representatives of civil society and the private sector. It is not subject to regular public service employment rules, allowing it to pay attractive salaries and recruit competitively.

With a large share of development finance passing through the SFD, it is less likely that the regular budget will evolve into a tool of development policy. To address this problem, DFID and other donors are encouraging the SFD to develop stronger relationships with central government, and to fit its activities into the government's national and sectoral development strategies. The SFD has provided a medium-term vision that is aligned more closely with the objectives of the national development plan. It has also supported national legislative and policy processes in the microfinance, education, environment and local government sectors.

Sources: DFID (2010a); Hughes (2011); ODI (2011a).

26 The role that the Ministry of Finance plays in the management of the fund has not been fully investigated. Further research on how the fund is coordinated with the overall government budget may be of interest.

The political demands for a visible peace dividend soar after conflict and there is, at times, a palpable need to focus on short-term, visible gains. Donors assess this need for speedy delivery of services and reconstruction in order to secure the peace and begin stabilisation, and usually trade off in favour of speed against capacity building and alignment objectives. However, the evidence for early 'peace dividends' from aid is not always compelling. For instance, in South Sudan, as set out in Box 7, hasty efforts to 'win the peace' were not successful in creating an effective MDTF. Experience (e.g. in Burundi) indicates that working through national institutions yields greater benefits over time and produces more sustainable outcomes (Ball, 2007; OECD, 2010). 'More needs to be done to manage trade-offs between quick delivery and longer-term sustainability' (OECD, 2010a).

Box 7: A less successful MDTF experience - South Sudan

Administered by the World Bank, the MDTF Southern Sudan focuses on rebuilding the southern states of Sudan and providing capacity-building support to the newly formed government of South Sudan. All parties recognise that the fund has been slow to disburse funds and achieve the desired impacts. Reasons for this include:

- **Overly cumbersome rules on disbursing funds:** This has left large sums lying unused. Initially, the Bank applied the same procedures as those used in general development programmes, without tailoring them to the post-conflict environment.
- **Stipulation of counterpart funding:** In the initial phases, project funding rules required cofounding by the government of South Sudan. Following a fiscal crisis, many projects could not be implemented simply because the government was unable to raise funding.
- **Unrealistic expectations, ineffective administrative leadership and lack of specialist knowledge on South Sudan:** Despite good intentions, the Bank attempted to implement overly ambitious reforms without sufficiently considering the limited capacity and complex political reality of South Sudan. Lack of effective administrative leadership in the fund – in particular delays in establishing procedures for the Bank to transfer resources to UN agencies already operating in South Sudan and in locating sufficiently senior Bank staff in adequate numbers – compounded the limitations of low central government capacity.

Sources: Ball (2007); Bennett et al. (2010).

As the case of South Sudan also demonstrates, a pooled fund should use procedures that are appropriate for a fragile state environment, recognising that knowledge of the local context is critical. Effective leadership is crucial and staff administering pooled funds should design procedures to maximise speed and flexibility, instead of adding complex procedures at every level.

While there is a need for speedy delivery of services and reconstruction in immediate post-conflict situations, support to common funds can permanently block the way to supporting government systems (OECD, 2010a). Specific attention to capacity building has been lacking in many external financing instruments to date. As of 2007, 'no MDTFs have a clear capacity development policy' (Scanteam, 2007). This may be acceptable in the initial stages of an MDTF but should be addressed as soon as is feasible.

Transaction costs

External financing instruments can reduce transaction costs for the recipient only if they replace other disparate sources of funding rather than being additional. Most MDTFs to date have not met this goal, as donors continue to provide large proportions of bilateral funds outside of these funds. There are also instances of proliferating pooled funds, with their consequences of increased transaction costs and inefficient allocations of aid to sectors.

Project implementation units

Donors frequently opt to use PIUs within MDTFs in order to manage their assistance within government ministries. There is wide variation in the extent to which PIUs have capacity building as a key objective, and thus whether they are consistent with a move to country systems or not. For example, some PIUs are located within the donor office and these seem less likely to process align well with government systems and develop capacity than PIUs that are located in sector ministries and manage several donor and government projects. However, even the use of better-aligned PIUs has been questioned, and the perception remains that such units tend to substitute for capacity by creating parallel delivery structures (UNDP, 2007b;). Rwanda provides an example of good practice, whereby the government has limited donor use of PIUs to one per ministry, which has led to improved integration of PIUs with country systems and greater effect on capacity and effectiveness.

Reimbursement modality

The reimbursement modality that has been used large scale in the ARTF is an interesting approach to aligning government and donor incentives while reducing bureaucratic delays to expenditure. The 'flow-of-fund' effect means that the MDTF can act like a bank account for the government and indeed shows the similarities between certain kinds of MDTFs and general budget support. In the ARTF, this has led to significant capacity-building effects as expenditures had to be eligible to be refunded. This has also been used in smaller-scale MDTFs, for example the World Bank, the AfDB and the EC reimbursing teachers' salaries and other 'critical budgetary expenditures' in DRC, thus in effect injecting fresh cash into government accounts based on a sample audit of past spending. This has also been the case for USAID directly paying teachers' and nurses' salaries through the government payroll in Liberia. This kind of support blurs the line between general and sector budget support and project support (since the spending is completely ring-fenced) – it can be known as 'ring-fenced budget support'. In countries with an integrated financial information management system (IFMIS), the tracking of these ring-fenced expenditures could in principle be operationalised.

Service delivery

Service delivery through MDTFs can frequently be contracted out to non-government suppliers and NGOs, which may in fact be likely in the first instance. These can be 'branded' as governmental so as to signal change and increase the legitimacy of the state, and gradually be taken over by government when possible (as in Afghanistan's ARTF, discussed above, and Timor-Leste's health sector reform, discussed in Section 4). OECD and the Partnership for Democratic Governance (2010) recognise the important role that contracting out service delivery can play in fragile state situations, noting that,

> Governments in fragile states need to maintain legitimacy, ensure security and deliver services to their people, often in situations where significant portions of the population are displaces, physical infrastructure is significantly impaired, the rule of law is minimal or absent, the private sector is highly informal, and basic services – if they exist – are delivered mainly by non-governmental and civil society organisations. Moreover, the government itself is likely to be facing significant operating constraints: legal revenue collections may well be minimal, and government institutions may lack appropriately qualified staff. In such circumstances, contracting out may be the only feasible option for addressing the government's immediate delivery challenge.

Such unconventional service delivery functions might need to be considered in greater detail, as long as efforts are made to ensure that short-term delivery by non-state actors does not jeopardise state legitimacy and capacity in the long term. There is, however, a risk that such an approach might even fail to address needs in the short term. Even in significantly destroyed countries, it is often the case that some institutionalised form of service delivery has survived (this may be more in education than in health), even if these institutions are not always formal or the formal part hides a large informal part. Not taking this into account and superimposing a new institutional arrangement 'over' these may be very complicated, and not necessarily the most effective solution. For example, in DRC, 80% of 'public schools' are actually already under a contract between the state and churches, that is, run by churches in principle in line with a formal 'convention'. In this situation, the choice between supporting the government and churches to gradually rebuild the existing structure, and introducing an independent agency to the sector, would require a full understanding of the context.

4.5. Transitioning between aid instruments

Effectively addressing both the short-term priorities and the longer-term development objectives of fragile and post-conflict states requires either **a mix of aid instruments** or **dual objective aid instruments.** Addressing immediate priorities requires a degree of 'capacity substitution', but previous experience shows that careful design in programmes to build ownership and re-establish local institutions results in more rapid, sustainable progress overall (DFID, 2010a; Foster, 2007; OECD, 2010c). Dual objective aid instruments are those that combine the objectives of delivering services (which may require capacity substitution in the short term) with the objective of capacity development and improving country systems. Examples of such instruments can be found in the use of MDTFs with a pooled technical assistance element, or capacity development facilities (CDFs).[27] The latter approach involves utilising various instruments and approaches in order to balance immediate service delivery, facilitate a gradual move from external implementation of aid towards use of country systems and bring aid on budget. Since such an approach will involve a variety of different donors and programme implementers, it is important that this takes place within a framework that facilitates coordination within and between governments and donors. Otherwise, overlapping responsibilities of national counterparts risk slowing down service delivery.

Afghanistan and Timor-Leste demonstrate interesting examples of these issues (see Boxes 8 and 9 for more detail). The close similarities between these two types illustrate the multiplicity of aid instruments that are used. Further examples of initiatives that address short-term priorities and help build longer-term capacity are those in the Yemen SDF and procurement programmes in Afghanistan.

27 CDFs offer a common government–donor platform to support capacity development efforts, from short-term injection of salary support to institutional change management and skills training. They allow different forms of fund management and programmatic engagement, through pooled funds, to be administered either by the government or by a lead donor (UNDP, 2007b)

Box 8: Transitioning between short- and long-term budget support - the Afghan Interim Authority Fund (AIAF) and the ARTF

Established in the immediate post-conflict period of 2002, the AIAF was prepared and managed by the UN Development Programme (UNDP). It was set up for six months in order to establish a flexible mechanism for quick resource mobilisation and initial institution building, supporting the recurrent expenditure of the Afghan Interim Authority. During this time, the ARTF was established in the context of a temporary National Development Strategy (OECD, 2010c).

Over the six-month period from January to July 2002, salary payrolls were re-established for all 32 provinces of Afghanistan, salary payment control systems were installed, finance staff were trained, including in information and communication technology (ICT)-related skill, and emergency repairs were completed for 30 ministerial offices of the Afghan Interim Authority. The AIAF further supported the commissions created under the Bonn Agreement, including the Emergency Loya Jirga that endorsed the Transitional Administration led by the president. The Emergency Loya Jirga was fully funded by the AIAF. Support included conference planning and management, the rehabilitation of Kabul Polytechnic, where the Loya Jirga took place, and transportation of regional delegates to Kabul. In accordance with the exit strategy devised for the AIAF prior to its establishment, the fund ceased operations after the successful conclusion of the Emergency Loya Jirga and the installation of the Transitional Administration.

Budgetary support for the Transitional Administration was taken over by the ARTF, jointly prepared and managed by the World Bank, the Asian Development Bank (ADB), the Islamic Development Bank (IDB), the UN Assistance Mission in Afghanistan and UNDP, and administered by the World Bank. In addition to financing infrastructure projects and the country's recurrent budget deficit, one aspect of the ARTF is to establish financial management and fiduciary standards and help the Ministry of Finance and the National Audit Office to meet standards set. Through demonstration effect, the ARTF's standards are influencing how the government conducts the control and audit function for regular public expenditure beyond functions directly funded. Thus the ARTF is an important platform for capacity development within Afghanistan.

Source: UNDP 2007, Brinkerhoff 2007

The Timor-Leste health sector case study demonstrates the usefulness of a clearly specified national framework for a sector – which is probably more detailed and implementable than many PRSs or sector plans – in terms of supporting alignment, ownership and harmonisation. Although national plans around which donors can align may not be immediately available in fragile states, donors can support the development of such plans and ensure they are as clear about the activities required to implement them as possible.[28]

[28] This raises the interesting point that success factors of MDTFs may also be dependent on the relative size of the fund in relation to the size of the country, and its requirements in terms of per capita spending; the state of the initial institutions and, for example, communications infrastructure needed for systems; and the initial capacity level of the public administration. In many cases, resources are not necessarily commensurate to (difficult to measure) needs, and further research into quantifying these needs may be of interest.

Box 9: Service delivery transitions in Timor-Leste

The health sector in Timor-Leste is a positive example of a transition from non-state to state service delivery. Following the almost complete departure of health professionals and destruction of health facilities, donors initially relied entirely on NGOs to provide emergency health services, but at the same time moved rapidly in developing new health institutions. A Joint Health Working Group, bringing together UN experts, NGOs and East Timorese health professionals, took on both the coordination of the relief effort and the creation of the Interim Health Authority. A joint assessment mission concluded that the priority was to address immediate basic health needs without constraining future policy choices. Donors therefore continued to fund NGOs for service delivery, but required them to submit to the coordination and policy direction of government, as set out in a MoU. Service provision was later shifted to the government through a transition strategy that began with high-priority areas (such as immunisation and health promotion) and later expanded.

As a result of these interventions, Timor-Leste was estimated to have 6 functioning hospitals, 65 community health centres and 170 health posts, giving 87% of the population access to a health facility within two hours' walk. One of the success factors in this transition was the availability of flexible and coordinated donor support, which enabled NGO service delivery to be funded up to the point when local authorities were able to take over. Most importantly, the case demonstrates the importance of placing emergency relief, reconstruction and long-term policy and systems development within a common strategic framework, so that they do not work at cross purposes.

Source: Rosser (2004), in Cox and Hemon (2009).

There is currently no standard approach among donors with regard to transitioning between different aid instruments and concurrently addressing short- and long-term objectives. Most commonly, a number of instruments are in use at any one time. Instruments are often formulated on a programme-by-programme basis, with new instruments developed as the outgoing programme or project nears the end of its lifecycle. Graduation between different instruments may also be concentrated in a particular sector where there is strong domestic leadership and capacity, and extended to others when appropriate. If tailored to context, such approaches can be expedient as long as there is a strategic framework in place to facilitate a gradual shift towards increasingly placing direction and management of resources in the hands of national actors as country systems.

INCAF highlights the multiplicity of funding instruments for transition, pointing out that there are significant difficulties for donors in determining where flexibility and/or potential synergies between aid instruments exist (OECD, 2010a). There remains work to be done on clarifying the role of these various instruments (including humanitarian instruments) and the international aid architecture surrounding financing for transition and fragile states. However, there is considerable scope for better coordination of funding streams at the country level.

Both short- and long-term outcomes are determined by actions we take in the present, and instruments that address both should be reflected in donor engagement at any one point in time. Collier has argued that donors mistakenly focus on the medium term whereas the most significant priorities relate to short- and long-term objectives(Collier, 2009). However, defining the short, medium and long term is not straightforward when transitions can be non-linear and complex. In general, transitions are unlikely to be 5- or even 10-year long and can take a generation to achieve, with the length of time varying significantly in different contexts.

Capacity development

Moving towards a greater use of country systems invariably entails capacity building within recipient governments. Formalising agreements on how to transition out of parallel funding and implementation structures towards national implementation and country systems can facilitate this. An example of good practice for capacity building comes from the Capacity Building Facility (CBF) in Kosovo (see Box 10).

The development of an overall framework for capacity development that places individual programmes and projects under a common umbrella provides a means of addressing these challenges. A country-specific framework for capacity development that defines objectives, priorities and the role of external assistance can be agreed between recipient governments and donors. While covering immediate and long-term needs, such a framework could ideally be accompanied by a well-sequenced and realistically budgeted implementation plan (Massing, 2005). However, such careful planning may be infeasible in a capacity-scarce environment. It is important to recognise the swiftly changing conditions in fragile states and the need to seize all possible opportunities, so it is advantageous to have an incremental approach that contains a short-term (e.g. one-year) costed plan, with the outer years as a more flexible framework that can be reviewed and developed as the implementation date draws nearer.

Box 10: Kosovo - avoiding capacity substitution

In May 2004, UNDP and its partners established the CBF to achieve standards for Kosovo defined by the UN Interim Administration in Kosovo mission. The programme utilised a multi-pronged approach to avoid the hazards of capacity substitution while still achieving necessary quick results.

- Coaching services were offered to select middle- and senior-level civil servants where a skilled counterpart acted as an 'on-the-job' coach or mentor.
- The CBF sought not only to transfer relevant technical skills but also, perhaps more importantly, to enhance leadership skills and promote an active approach to reform through results-based change management, initiative, accountability and risk taking.
- Advisory services offered greater technical support through the employment of full-time advisors for one year, to strengthen capacities to formulate and guide the implementation of institutional reforms.
- Short-term technical advisory services allowed the CBF to show quick results by providing consultants for short-term (two to six weeks) technical assistance.
- The combination of these components allowed the CBF to respond quickly to the needs of ministries and donors without sacrificing long-term capacity development objectives.

Source: UNDP (2007).

While this kind of support can be effective, there is some evidence that the advisor coaching model may be less effective than recruiting people with the right skills to fill substantive posts where there are skill or experience gaps. These individuals hence build effective institutions and train their subordinates on the job. This is what private sector companies in fragile states also do. Placing additional capacity in line positions rather than as 'advisors' implicitly supports the institutional functions, rather than acting as a 'bolt-on' to an unreformed institution.

In the domain of capacity building, a pitfall that donors need to guard against is **salary policy.** Donors can easily undermine government capacity through drastically unaligned salary structures, compounding an existing capacity problem. As donors have the funds to pay markedly more than recipient governments, donors can attract skills and capacity away from government. This has severe repercussions for recipient governments, which are therefore unable to compete with donors for the best-skilled local staff. One example of the scale of this can be seen in Liberia, where the UN system currently employs around 1,500 professional Liberian staff, many of whom would be strong candidates for the government's own overstretched Senior Executive Service (SES), which numbers only 100.

In order to address this, some efforts have been made to better align pay structure for local staff through salary top-ups. For examples of such initiatives in Uganda and Tanzania,[29] see Box 11. However, these initiatives are typically uncoordinated among donors and the government, and can create resentment among public employees. A more desirable alternative would be to address civil service remuneration, appointments, evaluation and career development, while recognising that such tasks are inevitably complex to design and take time to implement.

[29] In a different context, Botswana also made good use of Overseas Service Aid Scheme salary supplementation.

Box 11: Uganda and Tanzania salary enhancement schemes

In Uganda, a salary enhancement scheme operated for the entire local staffing of the Ministry of Finance/Planning from 1989 to 1996. In 1989, public servants salaries were on just $20 a month. The UN scheme was revolutionary at the time as it paid everyone a supplement – initially $130 for professionals and $70 for support staff. The total cost was less than that of a single expatriate technical assistant. The scheme was phased out in 1996 at the time of the introduction of a new living wage salary scheme for the whole civil service. The scheme was consistently rated one of the most effective capacity-building projects and by the end of it the ministry was reckoned to be one of the strongest finance ministries in Sub-Saharan Africa.

In Tanzania, the Selectively Applied Salary Enhancement (SASE) scheme was predicated on a pay reform that saw salaries rise for civil servants in general, increasing gradually over a five-year period, and paid for by savings and economic growth. The salaries for individuals selected for their importance to the reform process were set at their post-reform levels at the outset of the scheme, funded through donor budget support. The supplement was dependent on annual performance, and was effectively phased out as salaries of other civil servants caught up under the pay reform. However, the government was slow to implement the pay reform on which the SASE was predicated, and donors tended to 'projectise' their support, that is, link funds to specific salary supplements. This experience demonstrated that salary supplementation schemes that were politically viable and supported (enjoying sustained political will) could benefit from being realistic in their time horizons. This could in turn encourage donors to make good on their commitments (in the Tanzania case, a separate fund was administered by the government, which made it less prone to earmarking than direct budget support).

Sources: ODI unpublished research; UNDP (2007).

5. Expediting the shift to country systems in fragile states

There are many reasons why donors may be unable to use country systems, as set out in Section 2. In these circumstances, donors can focus on building country systems in order to transition to them into the future and, in the meantime, deliver outside the state.

For example, using MDTFs and pooled funds that do not use country systems can enhance aid effectiveness by reducing transaction costs, mitigating the high risk levels inherent to post-crisis situations and providing more flexible and predictable funding. They can also provide a means of collecting and sharing information, serving as a forum for donor discussion and, not least, providing a platform on which to support the alignment of donor policy with national priorities of the recipient country.

Building capacity is a critical element in ensuring donors can eventually use national systems with confidence. There are examples where the development of country system capacity over time has encouraged donors to use the systems, even if in the first instance donors provided capacity (for instance in Afghanistan through the ARTF and Timor-Leste's health sector transition).

In addition to the choice and design of aid instruments, donors can take a range of actions to expedite the shift to using country systems. There are three general areas of donor actions that seem to have supported this shift:

1 PFM and procurement;
2 Mutual and domestic accountability; and
3 Transparency and aligning aid with the budget.

5.1. PFM and procurement

There are ongoing debates as to how best to sequence PFM reform in a post-conflict environment (see, e.g., ODI, 2009). As the CAP argues, 'On PFM reform, agencies have differed on priorities in part as a result of preferring one diagnostic tool over another. When poorly managed, these disagreements can lead to delay in organizing support around key policy reforms' (World Bank and AfDB, 2011). Given the need for the process to be well managed, it is surprising that few fragile states have a donor PFM coordination group (Manuel et al., 2010). In Sierra Leone, donor harmonisation and coordination around PFM were factors in the success of reforms (ODI, 2009), whereas in Kosovo lack of coordination was an obstacle to reform success. It should be noted that the World Bank and the AfDB have moved towards using a common PFM matrix (and in some cases common PAFs) (World Bank and AfDB, 2011).

While precise best sequencing is debatable, it is agreed that PFM reform in fragile states should be kept simple at first (although this does not mean delaying reforms such as computerisation). The key area where capacity needs to be built in order to foster greater donor confidence is the national budget process, in particular developing a budget process that can coordinate various actors and ensuring sound budget execution (as was important for donor confidence in Afghanistan, Kosovo and Timor-Leste). An example of good donor practice in improving budget processes is demonstrated through the case of DRC, detailed in Box 12. The quicker these processes can be institutionalised to a functional level, the quicker funds can start flowing. This is essential if development impacts are to be realised within an acceptable timeframe.

Box 12: Budget reform in DRC

In 2001, DRC was still in the midst of a devastating civil war and the country faced immense challenges of insecurity, macroeconomic instability and poverty. Reform efforts were therefore focused on a limited, but successful, number of measures to establish a stable macroeconomic environment. Efforts to reform the public expenditure management system achieved substantial progress, including adoption of a new budget nomenclature, design and implementation of the expenditure chain, implementation of cash-based management and increased budget monitoring. These early reforms enabled the country to gain control of key macroeconomic indicators and were facilitated by the momentum created by the signing of a peace agreement in 2001 and the constructive engagement of the IMF and World Bank.

Source: Baudienville (2010).

It is possible and indeed probable in all but the most fragile states that there is some existing PFM system and capacity. In Sierra Leone and Afghanistan, for instance, 'there was at least some residual legacy of PFM systems in each case, albeit severely weakened by the conflict' (ODI, 2009). An in-depth analysis of existing capacity and systems is critical for donors (Shah et al., 2010). Indeed, getting the existing PFM system to work was a key reason why the ARTF was able to disburse quickly.

The literature also points out that the PFM reform agenda requires explicit attention to change management and the political nature of reform. PFM reforms need some political buy-in, although early successes can bring later converts, as in Afghanistan. The fact that some actors may positively benefit from a poor PFM system and will therefore block change is an important consideration. A sophisticated political understanding of the PFM reform context will therefore be required to navigate the challenges of potential 'spoilers' and understand the perverse incentives of some actors in conflict-affected countries.

Procurement

Procurement systems play a critical role in expediting the move to country systems. Development of capacity in procurement can take a back seat to donors' concerns about corruption and misuse of funds. There are repeated exhortations in the literature for donors to address the matter of their procurement standards: 'There is a need to balance the fiduciary and development aspects of procurement and the majority feeling at the conference seemed to be that the fiduciary concerns had become too dominant, to the detriment of development. The conference considered this an issue that the development community needs to address as a matter of urgency' (Manuel et al., 2010). And 'The current balance of [procurement] practice in transitional contexts appears to be unduly cautious and to put too little weight on the benefits of local engagement' (OECD, 2011).

It is not clear that there is presently sufficient will in the donor community to address this issue. For instance, McKechnie (2010) points out that,

> *The World Bank's attempt to pilot greater use of country systems in procurement in non-fragile states appears to have failed as no project using country procurement systems will likely be approved under the pilot by the time it ends on June 30, 2011. Reasons for this include Bank insistence on equivalence between country and highly prescriptive Bank processes, lack of incentives by both countries and Bank staff to participate in the program, and lack of integration of new fiduciary systems into wider public sector reforms.*

While rigorous procurement system needs to be built over the long term, in a post-conflict environment the focus could usefully be on establishing 'good enough' systems rather than attempting to stipulate best practice regulations to which recipient governments are unable to adhere. Doing so is an important step in improving both capacity and legitimacy of post-conflict and fragile state governments.

However, donor practice in Afghanistan demonstrates a pragmatic approach to accommodating donor procurement standards (see Box 13). McKechnie (2010) recommends that donors 'quickly establish government procurement capacity capable of meeting the requirements of donors. This was probably the single most important factor in rapid implementation in Afghanistan.'

Box 13: Flexible procurement in Afghanistan

Establishing government procurement capacity was probably the single most important factor in rapid implementation in Afghanistan. The first World Bank financing operation funded international consulting firms that provided fiduciary support, including procurement services. Afghanistan also established a reconstruction agency to expedite all project-related procurement, similar to in other countries, e.g. Lebanon and Palestine. While the procurement consultants enabled the government to manage procurement to international standards, they were largely unsuccessful in building procurement capacity. A second firm was engaged to provide capacity-building assistance, and the first firm's role was limited to processing transactions. As capacity grew in sector ministries, more procurement responsibility was devolved to them, with the procurement consulting firm's staff in the Ministry of Planning concentrating more on large or complex items or on ministries facing a short-term investment demands.

The World Bank financed new grants and credits under its Operational Policy 8.00, which cuts back substantially on processing time and allows other flexibility in procurement, retroactive financing and streamlined financial management and disbursement procedures. This policy framework was initially designed for Bank financing after natural disasters and has been used in Afghanistan now for nine years. USAID used the flexibility allowed within its rules in cases where overriding foreign policy considerations are invoked.

While the risk of misprocurement is high in Afghanistan, the consequences of programme failure are also high, particularly armed violence that would reverse development achievements and also create security problems for the surrounding region and beyond. Because of its geopolitical significance, Afghanistan's partners have been willing to run risks greater than in other fragile situations, for example financing the recurrent costs of government and a heavy reliance on sole source procurement.

Source: McKechnie (2010).

Building permanent procurement capacity can and should be prioritised but, as the Afghanistan case demonstrates, this can happen as a dedicated separate exercise in parallel with short-term, interim procurement procedures. This is similar to the two-staged approach detailed in Box 8, where a 'fast-track' is established first, with a follow-on stage that focuses explicitly on capacity building. Donors can also expedite this by ensuring that procurement staff deployed to fragile states are experienced and understand the capacity issue thoroughly (as in Afghanistan and the Occupied Palestinian Territories).

5.2. Mutual and domestic accountability

Donors and governments have responsibilities to each other and to their publics. Accountability mechanisms allow the actors in question to be held to account on these responsibilities and commitments, whether they are made at international, national or local level.

Mutual accountability

Dual key accountability provides a co-signatory process by means of which both donors and recipient governments are accountable for some parts of government spending, developing enhanced 'dual accountability' local institutions and systems with embedded external inputs that are more likely to meet donor fiduciary requirements. This dual approach ensures donors are able to provide oversight and reduce concerns regarding corruption, while also allowing the recipient government a sense of local ownership over the sign-off process. It allows governments to use local institutions for delivery but with oversight and controls bolstered with external input. Criticisms have been raised, however, about the extent to which dual key accountability intrudes on the sovereignty of recipient governments. Nonetheless, the concept is potentially powerful and opens up interesting possibilities, which seek to balance local leadership and capacity with donor scrutiny. One well-known example of a dual accountability initiative is GEMAP in Liberia, detailed in Box 14 below.

Box 14: Dual accountability (dual key) - GEMAP in Liberia[30]

GEMAP is a multi-donor agreement signed by the National Transitional Government of Liberia in early 2006, along with USAID, the EU, the UN, the IMF, the World Bank, the African Union (AU) and the Economic Community of West African States (ECOWAS). GEMAP is based on the premise that, in order to restore public trust in government and attract investment, Liberia has to stem diversion of state resources, manage public finances transparently, deliver government services and demonstrate the political will to prosecute corruption.

The unique feature of GEMAP (and also the most controversial) has been the placement of financial controllers in key state-owned enterprises, and the placement of experts in the Ministry of Finance Bureau of Budget and Treasury. These experts have had co-signing authority on spending and are therefore managerial rather than advisory in capacity, as distinct from other public sector support programmes. It is widely claimed that having co-signatory authority on all financial transactions at key revenue-generating government institutions was central to building a culture of accountability in the Liberia civil service.

Sources: http://gemap-liberia.org/about_gemap/index.html; USAID (2010).

This example illustrates that coordination of such programmes can be more effective when it is government led, as in the case of Liberian President Ellen Johnson-Sirleaf chairing the Economic Governance Steering Committee of GEMAP. After all, changing culture and behaviour in country often has less to do with external inputs and everything to do with the institutional incentives faced by officials as a result of political and civil service leadership. Where there is strong political imperative and commitment to the development and restoration of services based on developing rules-based institutions and transparent, well-managed budgets, external safeguards could be devised that support these efforts. Donors can inform their use of such dual accountability mechanisms with political economy analysis to understand what scope and pace of institutional strengthening may be possible over time. Indeed, most donors already recommend governance analysis in post-conflict and fragile states (see, e.g., DFID, 2011) that focuses on understanding the nature of the political settlement and drivers and incentives that underpin new or restored state institutions.

It is worth noting that the dual accountability mechanism in Liberia reduced fiduciary risk mainly for the Liberian taxpayer rather than for donors. USAID, the main funder of GEMAP, does not provide budget support, and during the co-signatory period the amount of budget support the Liberian government received was relatively small (and further research into the role GEMAP played in securing budget support would be of interest). Linking external support explicitly to this kind of co-signatory safeguard, or other safeguards, may be a potential innovation of the dual accountability concept. And if donors could be more explicit about their collective appetite for risk and desire for supplementary controls, as described in the section on budget support, it might be possible for government and donors to agree a baseline and framework for the increasing delivery of aid through local institutions in central or local government, linked to safeguards and/or reform targets.

GEMAP was based on dual (or shared) accountability for operational management of public funds – an 'input' focus. Other types of mutual accountability focus more on output or outcome targets, or on milestones or benchmarking. One option is to have paired milestones that act as reciprocal goals for government and donors. One platform on which governments can facilitate coordination among donors and help ensure that donors align themselves with government priorities and systems is through the formulation of an international compact. Box 15 details the lessons learned from the Afghanistan Compact, formulated in 2006, to establish a framework for international cooperation.

[30] For a fuller discussion of GEMAP in Liberia, see USAID (2010).

Box 15: The Afghanistan Compact

The Afghanistan Compact was launched on 31 January 2006, providing the framework for partnership between the government and the international community. It set out goals in three interdependent areas: security; governance, rule of law and human rights; and economic and social development.

The Compact was significant in that it integrated security, governance and development and set out mutual commitments that, while not legally binding, provided the basis for a more coherent and strategic approach to providing assistance to Afghanistan. It set up a Joint Coordinating and Monitoring Board (JCMB) co-chaired by the Afghan government and UN to ensure greater coherence and provide public reports on its execution. However, implementation was set back as a result of a number of issues:

- The large number of commitments lacked prioritisation, were difficult to monitor and exhibited a lack of clarity; donors prepared their own strategies, which often changed year by year, with a disconnect between political–security and development activities.
- The lack of focus of the Compact meant donors could essentially continue to finance and implement what they pleased. It Compact included almost everything, as a result of lobbying by ministries and donors. Around two-thirds of the development assistance was outside the government budget and reporting on this 'external budget' was very inadequate.
- There was a lack of intermediate targets to provide unambiguous evidence as to whether commitments were on track to be met.
- The JCMB coordination process was cumbersome and process driven, and its plenary meetings were large and rarely took decisions. The political pressure on JCMB meetings was to declare progress, rather than to face up to problems and solve them.

What are the lessons from the Afghanistan Compact experience?

- There should be a government-owned strategic framework underlying the compact. International partners can assist the government in preparing this, but it needs to be broadly owned by the partner country.
- Focus the compact on a small number of key, high-level goals necessary to achieve fundamental objectives critical to peacebuilding, statebuilding and development. These goals should encompass actions by all relevant policy communities – diplomatic, security and development. Other subsidiary goals should be delegated elsewhere, e.g. to the PRS process, international financial institution (IFI) policy-based financing or sector aid coordination groups. The high-level forum overseeing the compact can intervene when subsidiary processes do not work.
- Ensure that the high-level forum is well led on both government and international sides and that the secretariat has the technical capacity to present well-formulated options to the forum.
- Commitments in the compact need to be costed and integrated into the government's budget framework, including those actions not financed from the budget, with sufficient clarity to monitor outcomes, final and interim outputs, inputs and organisational responsibilities for delivery.
- Actionable commitments to full transparency of donor and government financing, interim progress and results need to be built into the compact, with 'naming and shaming' at the high-level forum when parties do not live up to their agreements.

Source: ODI unpublished research

Monitoring, reporting and accountability

Expediting moves towards donor use of country systems requires that recipient governments can demonstrate that they have accountable budget processes and the capacity to report and monitor effectively. General monitoring, reporting and accountability requirements can suffer from the fact that donors' own reporting requirements often take precedence over building government's own capacity to monitor its activities (Scanteam, 2007). There are examples where governments are taking over the monitoring of activities funded through pooled funds, as in the case of the Liberia Health Sector Pooled Fund.

However, in an effort to expedite moves to country systems, there is a need to focus greater attention on government capacity with regard to monitoring, reporting and accountability. Repeated requests of donors (e.g. Ball, 2007; Foster, 2007; ODI, 2005) to reconsider their procedures have not led to major changes in this area to date.

Improved monitoring, reporting and accountability are not, however, limited to financial processes. There is also a need to grow links between financial accountability and the wider accountability context (which includes Parliaments, auditors, civil society and the media). Donors can play a role here in terms of supporting both the capacity of domestic accountability actors and their scope for ensuring accountability (see, e.g., Hudson and GovNet Secretariat, 2009).

One way to enhance accountability is to make the intended results from aid more explicit and known, especially to local government and service recipients. Even at an early stage, it may be possible for government and donors to set rudimentary targets that can be monitored, and this is also the case for donor resources channelled through NGOs, local governments and smaller institutional bodies in local communities.

Aid policies and donor assessment frameworks

Recipient governments also have a role to play in improving aid effectiveness. Mutual accountability has been challenging to realise as genuine two-way accountability between donors and recipient governments in fragile environments. In part, this is because donors have greater sanctions that they can use (such as the potential or actual withdrawal of aid), whereas recipient governments may feel less able to refuse aid where donor accountability conditions are not met. Recipient governments do have, however, a significant amount of, often overlooked, ‘political capital’ at their disposal. Many donors have signed up to international principles on aid effectiveness and, in theory, this provides mechanisms through which they can be held to account. The Paris Declaration Monitoring Survey, for example, provides one way of holding donors to account on these commitments in countries that take part (including Afghanistan, CAR, Congo, DRC, DRC, Haiti, Iraq, Liberia, Sierra Leone, South Sudan, Sudan and many others).

While there is general agreement that donor coordination is much more effective and appropriate when carried out by the state, many countries do not have the resources or capacity to provide effective coordination mechanisms, which are crucial for aid effectiveness by holding donors to account on their commitments and allowing them to meet their harmonisation and alignment commitments.

One example of successful government activities for holding donors to account comes from Rwanda, where there are strong instruments of mutual accountability: the Donor Performance Assessment Framework (DPAF), which matches the Common Assessment Framework that monitors government performance. The DPAF uses quantitative targets for donors, against which they are publicly ranked. A DFID staff member blogged that:

> At the Development Partners meeting a few months back, all donors were held to account by the Ministry of Finance for the promises they had made, using a list of 18 commitments we had all signed up to – such as delivering the money we had pledged, recording our aid in the Government budget, and giving clear indications of our future financial plans. Every donor’s score was put up on the screen for everyone to see, and there were some red faces round the room - the lowest score was 2/18 *(Leach, 2009)*.

In addition, some countries may have aid policies that set out their preferred aid modalities (usually budget support, but not always) and aid effectiveness priorities. The Afghanistan Aid Policy, for instance, shows that there is considerable appetite in the country for changes in donor behaviour and greater use of country systems.

Where donor aid policies are not yet in place, donors must still provide recipient governments with the **political space** to make decisions (which, at times, donors might not agree with). For instance, in Timor-Leste, the government made the decision (against IMF advice) to pay relatively large sums to members of the population to relocate, in order to ease pressure building on the capital of Dili. While donors may not agree with such decisions, it is important that governments have the space to make political decisions, regardless of the manner in which aid instruments are being deployed. Another case of this is in Liberia, where the president committed to delivering key outcomes in her first 100 days, including restoring electricity to the capital. Donors had to work hard to get their procurement systems to deliver against this tight government-imposed timetable, regardless of whether they thought this the most important priority.

5.3. Transparency and aligning aid to the budget

Transparency, coordination and use of parallel systems

One of the critical problems in fragile states is that donors often continue to use parallel systems to deliver services even after the humanitarian phase is coming to an end. This means the country ends up with patchy service provision, some areas benefiting from high-cost services that cannot be replicated or sustained, while other areas have no access. When more normal conditions for statebuilding are established, integrating these differing services into something coherent and affordable is difficult. This is partly a coordination issue and partly an ownership issue, but the practical need is for an economic assessment of what services are affordable in the medium to long term, and institutional arrangements to reach and sustain agreements on service standards, to avoid establishing services for the few that will lead to inequality and integration problems later when a future state is unable to staff and pay for them without starving underserved areas.

The costs of military support are often not reported in country and the provision is often poorly integrated with domestic funding of military and security. When military support comes to an end – in terms of foreign troops or financial support to the national army – the security budget can suddenly appear to rise sharply. In fragile states, half of official development assistance (ODA) can be provided through humanitarian channels, and about half of this would typically be for the provision of public services such as education, health and clean water. While humanitarian channels may be faster than using national systems, and donors are more ready to run risks with humanitarian aid, it is often characterised by fragmented projects that are difficult to scale up. As humanitarian support comes to an end, government spending on basic services needs to rise rapidly to ensure there is no a sudden drop in the provision of services.

While donors clearly recognise the importance of transparency of aid in fragile states (meaning the provision of timely, accessible and comparable information), evidence on donors implementing transparent aid in practice is patchy (in part because of a lack of information because of non-transparent donor practices). Some information is available through MDTF websites, which 'provide the most transparent tracking of decisions and resources, ensuring unparalleled accountability' (Scanteam, 2007). This does not mean the information is necessarily timely or useful for recipient governments or civil society, but publication is undoubtedly an important first step. In Afghanistan, the ARTF put all its information on the web and developed a system for standardised reporting (a challenging exercise initially).

One project that aims to improve donor transparency is the IATI, a recently agreed international standard for data publication by donors. Data published to a standard format in a timely fashion can improve donor decision making in concrete ways. Donors will have details of the activities of other donors, which should help avoid clustering of support in certain provinces or sectors with a corresponding lack of support in other areas (Brookings, 2010). Challenges are apparent, for instance in establishing agreed definitions (such as what is counted as a disbursement or commitment). IATI is the current arena where these definitional problems are being addressed and where a common standard is being developed that should improve transparency on the part of both recipient governments and donors. Transparent aid practice is also, at times, limited by a lack of standardised classifications. For instance, the fiscal deficit of fragile states is calculated by some donors as excluding grant assistance, which skews the perceived performance of such states to appear significantly worse than when calculations take grants into account. Such variation in classifications can inhibit transparency by promoting a lack of clarity around fragile state performance.

Coordination of aid instruments and national processes

Where donors are not yet prepared to use country systems and instead provide assistance through mechanisms such as MDTFs or project support, there is a need for greater coordination with national decision-making processes. Aid transparency serves recipient governments' planning purposes, enabling governments to plan their own resource allocation with more certainty, and is increasingly recognised as a critical part of aid effectiveness (Birdsall and Kharas, 2010; Development Initiatives, 2009; Moon and Williamson, 2010; Publish What You Fund, 2010). In information-poor environments, such as fragile states, the benefits of standardised information publication are even greater than in an information-rich environment. In fragile states specifically, 'Donors should take more seriously their responsibilities for reporting to recipient governments on the expenditure of aid funds, using the governments' own charts of accounts. Providing enough good quality information at the right time on donor expenditure allows recipient governments to incorporate this information into their own budget processes and documents' (Manuel, 2010).

This is recognised in the work of the International Budget Partnership, which is an international initiative that rates governments in relation to the amount of information they publish on their country's budget process. While there is some good donor practice in reporting allocations and expenditure to partner governments, as demonstrated in Box 16, challenges remain.

Box 16: Transparency in fragile states

In Afghanistan, Paris Declaration monitoring data for 2008 show that 99.0% of the World Bank's actual disbursed aid and 95.1% of aid disbursed by the UK was recorded as disbursed by the government of Afghanistan. This is a very high level of 'match' between donor information and recipient government information. However, the degree of match between levels of aid recorded by the Afghan government and those actually disbursed by donors varied considerably across donors, with some donors having none of their disbursements recorded by the government. The World Bank also had 98% of its disbursements recorded in Burundi, and the International Fund for Agricultural Development (IFAD) had 95%. In the CAR, China and the EC had 100% of their disbursements recorded (although in this case the World Bank had only 13.8%). The EC had 92.7% of its disbursements recorded in Yemen (although, again, the World Bank had only 8.4%).

Paris Declaration monitoring data also allow us to compare donors' scheduled disbursements with government expectations as reflected in the national budget.[31] Again, there is considerable variation across donors in fragile states. In Afghanistan, nearly all donors had scheduled considerably less aid for disbursement than the government had estimated in the national budget, with the exception of the UN, which had only 18.7% of its scheduled disbursements reflected in the national budget. The major vertical funds (the Global Alliance for Immunisation and Vaccines (the GAVI Alliance), the Global Fund) had none of their scheduled aid reflected in the budget estimates in Afghanistan, Burundi or DRC.

Source: ODI research using Paris Declaration monitoring data using methodology from Publish What You Fund (2010).

Most agencies do publish at least some information about their support, but much of this is still presented and published in donor capitals. The data are often not available in local currency terms or for the government's own financial year, and the IATI standard spending classifications do not yet automatically map onto the varying domestic expenditure classifications used by each fragile state. At present, there are debates about whether a standardised reporting system for donors (such as that adopted by IATI) can be made consistent with recipient systems, in particular in relation to budget classifications. Although this would undoubtedly be more complex given the wide variety of recipient countries globally, recent work has developed a generic functional classification that would enable greater read-across (Moon and Mills, 2010). For IATI to deliver real benefits in transparency for recipient

31 Using 2006 data, the most recent available for this question.

countries, including and especially fragile states, this critical element of the standard must be developed.

Even donors that support PFM reforms, which encourage greater transparency, still tend to 'ignore' requests to report their activities to the government in a manner that is timely and consistent with the government's own accounting system, as in Afghanistan and elsewhere (Symansky, 2010). As Symansky argues, arguments about incompatible timeframes or inconsistent accounting systems are therefore weak: 'This has been true in every post-conflict country […] The Peace Dividend Trust Report of donor spending in Afghanistan, for example, indicated that even those donors who were leading supporters of PFM reform were unable to produce a reasonable set of data for the Government.' Symansky notes that, given that 'many recent post-conflict government systems tend to be compatible with some of the latest accounting frameworks', the difficulties that donors face in reporting to government then lie elsewhere. In Afghanistan, an aid information system for bilateral as well as multilateral donors supported by UNDP proved difficult to implement. While the government and others argued that the large amounts of off-budget aid should also follow such a standardised reporting system, not all donors agreed.

As donors have become increasingly focused on the results agenda, this has not been paralleled by an open sharing of results with recipient governments. Recipient governments would benefit from understanding what donors have (and have not) achieved and how they have gone about assessing their results. Such transparency of results would allow for a more interactive and relevant conversation between governments and donors about results, what donor assistance has achieved and what can be improved in future.

Aligning aid with the budget

The alignment of most support around the budget means it is easier for the government to coordinate aid spending with government spending, and also lays the foundations for the project/programme to move towards sector or general budget support at a later date. Essentially, if aid funds are considered public resources, then the framework for managing them should be as similar as possible to the government budget, in order to show the cohesive overall structure of public spending (including government and donor funds), even if donor funds cannot pass through the budget. It also makes it easier to ensure that external support is prioritising peacebuilding and statebuilding objectives – and the International Dialogue's draft objectives in particular. When support is fragmented, there is a greater risk that individual donors' and project managers' objectives take priority and the focus on peacebuilding and statebuilding is diluted.

To reap the benefits of donor alignment, the government must have a strong aid coordination and management function – ideally housed in within the fiscal authority.[32] In view of the benefits to the effectiveness of their aid, the need for greater coherence between domestic resources and aid, and the critical issue of building strong institutions to oversee public expenditure both on and off budget as part of an effective state, donors should be ready and willing to support these units, including through funding, staff and complying with their requests for data and information.

As well as policy alignment, where donors implement policies that align with the government's development priorities and objectives, process alignment and shadow alignment are two other key types of alignment that can support coordination, ownership and transparency. Every aid instrument (including projects) has the potential to be shadow or process aligned, enabling conversion to using country systems when conditions permit (Cox and Hemon, 2009; INEE, 2010; Leader and Colenso, 2005; ODI, 2005). Meanwhile, donors continue to use their own systems and protect against fiduciary risk.

32 CABRI (2008) generated an Aid Management Index, which gives countries a higher score if their aid management unit is located within their central budget authority.

Shadow alignment

Shadow alignment is a type of process alignment that focuses on information only. Shadow alignment means that donors publish their own separate financial and performance reports with an aligned timing, content and classification to the government. The information should include projections and outturns and follow national structures, including the timing of the national budget cycle, national administrative classifications, the national currency and the national financial year. The implementation of the IATI standard will mean a large amount of aid information will be made available online, and if current efforts to make this information more accessible and relevant to government deliver, many donors will be delivering shadow alignment. As shown in Figure 1, shadow alignment is different from donors using country systems – where donors engage in joint planning, execution, monitoring, evaluation and reporting activities alongside the government, among others.

Figure 1: Schematic comparing the use of government systems to shadow alignment

Government systems	Using government systems (give general budget support or …)	Shadow alignment
Budget formulation • Planning process (PRS and sector plans) • Budget framework paper (or similar) • Compiling the budget • Parliamentary approval	**Budget formulation** • Donors engage with PRS and sector plans • Donors report plans for project/sector budget support spending in next fiscal year to Ministry of Finance, to be reflected in budget	**Budget formulation** • Donors publish forward spending ceilings at same time and classification as budget framework paper • Donor publish finalised plans for spending next fiscal year at same time as budget is published
Budget execution • Treasury execution • Procurement systems • Accounting systems	**Budget execution** • Donors use government systems for their expenditure: Treasury, procurement and accounting	**Budget execution** • Donors publish in-year reports using same timing and classification as government
Budget reporting and audit • Donors engage with shared reports and audits (e.g. by sector)	**Budget reporting and audit** • Donor use government reporting systems and auditing systems	**Budget reporting and audit** • Donors publish end-year reports and audits using same timing and classification as government

Source: Authors

For example, when the government publishes its budget framework paper, donors could publish their funding envelopes for the following year and outline plans; when it publishes its budget, donors could simultaneously publish their finalised plans for proposed disbursements for the following fiscal year. Even if a donor project were to cross an existing local government administrative boundary, it should be possible for donors to structure the project in such a way as to take into account the boundary: provide any reporting information differentiated by administrative area, ensure links with both local administrative bodies and so on.

Shadow alignment is especially powerful because it requires no government capacity – donors can deliver it without any kind of coordination or support, needing only a copy of the budget law or equivalent and the government's chart of accounts. Yet, once the shadow-aligned information has been published, it unleashes capacity in government by giving the most relevant and useful information for officials to use in their coordination mechanisms – capacity that may otherwise have been tied up in trying to get information from donors and translate it into government classifications and processes. And if government coordination takes a while to develop, the benefits of publishing all donor information in country in a single comparable classification and timing will be significant in both harmonisation terms and also for use by the media, universities and civil society, helping develop domestic accountability for aid.

Experience to date with shadow alignment is limited, but an example that follows such an approach can be found in DFID's support to Zimbabwe (see Box 17).

Box 17: Shadow alignment - protecting orphans and vulnerable children in Zimbabwe

One in four Zimbabwean children has lost at least one parent. Launched in 2005, the National Action Plan for Orphans and Other Vulnerable Children is a government-led programme to improve the health, education, protection and nutrition of the country's orphans and vulnerable children. While DFID wished to support this, it was unable to provide assistance directly through the Zimbabwe government. DFID therefore funded the UN Children's Fund (UNICEF) to implement a one-year, fast-track programme to develop and test a model of shadow alignment, based on three core principles: one action programme, one national authority and one M&E system.

This 'Three Ones' pilot proved successful, and a multi-donor Programme of Support (PoS) was established in 2006. UNICEF chairs a group that meets monthly to coordinate efforts and includes donors unable to channel funds through the PoS fund. The PoS has increased external funding from an estimated $4 million a year to over $84 million in commitments up to 2010.

Source: DFID (2010a).

Process alignment

Shadow alignment can also develop into process alignment, where donors continue to use their own separate delivery systems, but these systems now 'mirror' the processes currently used in government systems. For example, design standards for donor activities could be based on unit costs that are consistent with what would be feasible to replicate and sustain on plausible assumptions about future available resources at the national level. Donors could carry out evidence-based assessments of cost effectiveness across aid instruments within a particular sector using the government's assessment method. These process-aligned methodologies could be designed to be as close as possible to those of the government to facilitate eventual integration, but remain as a separate process while government capacity is still constrained.

In contrast with shadow alignment, process alignment would require some government capacity to design these government processes and procedures that donors could replicate for their projects/programmes, even if at the early stages government officials were unable to implement them for the government budget process. Such shared methodologies would support coordination and eventual integration of plans and priorities, in macro, sector and possibly sub-national processes. Using the consistently costed plans, government and donors could more readily engage in a process of jointly identifying gaps in overall public service provision, and agree responsibility for filling them. Institutional arrangements to reach and sustain agreements on service standards and agree how to plug financing gaps could also support enhanced coordination. This may be a way to work towards the practical need for an economic assessment of what services are affordable in the medium to long term, to avoid establishing services for the few that will lead to inequality and integration problems later when a future state is unable to staff and pay for them without starving underserved areas.[33]

Domestic transparency

It is critical to remember that aid transparency is not only for the benefit of planning officials in governments and donor organisations. Aid transparency can also serve to empower citizens in their relationships with both donors and the state where it is provided in ways that are accessible and where there is capacity to interpret and analyse that information. Aid transparency can support wider improvements in transparency over government's use of resources, facilitating a move towards donors using country systems, as donor concerns about government corruption and due process are mitigated. This can include improvements to

33 One successful example of a transfer from non-state to state provision comes from Timor-Leste's health sector (Rosser, 2004, in Cox and Hemon, 2009).

transparency through making budget and government financial data (including on aid flows) publically available. For example, it would be relatively cost-free (in financial terms) for governments with an IMF programme to put the monthly fiscal data they send to the IMF on their Ministry of Finance website. The Palestinian National Authority, for example, publishes data on its website on a monthly basis regarding fiscal operations, revenues, expenditures and financing sources, and the Timor-Leste Ministry of Finance has recently put 10 years-worth of historical fiscal data on its public website. Another step with potentially large payoffs is for governments to actively promote transparency at the local level through providing information on allocations to front-line service providers. Box 18 documents Uganda's successful experience in this regard.[34] However, information needs to be provided in ways that are accessible (including in local languages where appropriate) and with support to enable information to be interpreted and acted on.

Box 18: Local transparency in Uganda

In an ideal setting, the public accounting system would provide timely information about actual spending on various budget items and programmes, and budget reports would accurately reflect what the intended users receive. This is not often the case in low-income countries, where accounting systems may function poorly, institutions of accountability are weak and there may be few incentives to maintain adequate records at different levels of government. Consequently, little is known about the efficiency of transforming budget allocations into services.

To compensate for these gaps, a new survey tool – a PETS – was designed to gauge how well public resources were reaching the intended facilities. In the mid-1990s, a PETS revealed that schools in Uganda received only $0.20 on average of every dollar allocated to them by the central government, suggesting nearly 80% of funds was being diverted by local officials. As the extent of district government diversion of funds became known in 1996, the central government reacted swiftly. Rather than taking the standard approach of yet another reform project to improve the financial management system, the government decided to engage the citizenry. Led by the ministries of local government and finance, the central government began to publish data in the national newspapers on the monthly transfers of capitation grants to districts.

Primary schools (and district administration headquarters) were required to post notices on actual receipts of funds for all to see. In this two-part campaign, information on entitlements transferred by the central government was made available through newspapers, while information on what each school actually received was posted in schools to inform parents. By giving users access to information on the grant programme, head teachers and parents could monitor the local administration and voice complaints if funds did not reach schools. In addition, by publicly informing beneficiaries of their entitlements, the central government signalled strengthened oversight (to voters and local officials) and the priority it accorded to education. A follow-up tracking survey in 2001 strikingly revealed that the diversion of funds to schools had reduced from 80% to less than 20%. Analysis shows that this decline can be largely attributed to the greater availability of information on spending decisions among citizens, indicating that increased transparency can significantly enhance service delivery.

Source: Reinikka and Svensson (2004).

Transparency alone does not support greater accountability, however. Making information on aid flows and other sources of government revenue more widely available is one component of supporting more responsible and accountable forms of government. There is also a need to act on information provided. Parliaments also have a role to play in ensuring aid transparency, and assistance in building the capacity of parliamentarians and parliamentary committees to play this vital role should be encouraged.

One interesting example of good practice is the Haiti Aid Map (see Box 19), which focuses on the work of NGOs but provides a useful demonstration of how official aid information can be used and can interact with other financial information. Keeping such maps current (including with financial information to inform allocations) is critical to their ongoing usefulness and can be a challenge in fragile environments with low capacity.

34 Another example is the tools that are being developed for facilities and districts to post relevant budget and performance information in accessible formats in Ethiopia, under the Social Accountability component of the Promoting Basic Services programme.

Box 19: The Haiti Aid Map

An excellent example of how aid transparency at an international level could look has recently been provided by InterAction, the largest alliance of US-based NGOs working in development cooperation. In an effort to improve development cooperation in Haiti, InterAction set up a website called Haiti Aid Map that provides information about all current projects by InterAction members in Haiti. According to the InterAction, one objective of this website is to facilitate partnerships and improve coordination among NGOs and other stakeholders such as the private sector, governments and other donors. By visualising information about who is doing what, where and in which sector, all organisations working in Haiti will be able to make more informed decisions on how to spend limited aid resources.

The strong point of the Haiti Aid Map is that relatively detailed information is provided about geographic location (department and commune), activities, project duration, budget and contact information. The stated objective of the Haiti Aid Map is to enhance coordination and cooperation among aid agencies.

Source: http://www.aidinfo.org/this-is-how-aid-transparency-could-look.html

6. Evaluation of aid instruments in fragile states

The above examples of aid instruments yield some interesting insights regarding the factors that determine the success or otherwise of aid practice. It is not surprising, perhaps, that many of the factors identified here as playing a determining role in more effective aid practice reflect initiatives such as the Paris Declaration and the Fragile States and Do No Harm principles. These are set out below, highlighting areas that require greater consideration and commitment from recipient governments and donors alike.

6.1. Country context and the mix of aid instruments

Each fragile state has its own specific context and no single approach can fit all of them. The content of the mix needs to be determined based on country context. Similarly, each donor has its own methodology for analysing fragility and these are not always shared between donors or with the government itself. At the same time, the structure of international support to peacebuilding and statebuilding is rather complicated, with many different actors, including the military; the IFIs; humanitarian agencies and organisations; donor agencies and civil society. Different actors have their own specific legal constraints on how they can operate; different tolerance of risks and hence different sets of instruments they can use. The mix of instruments in each state should be based on which instruments would most effectively help the transition from fragility to stability in that particular context with that particular set of actors involved. Some foreign assistance should not pass through the government budget in principle, for example support to build political parties and civil society organisations that amplify the public voice and develop the national conscience. In the immediate post-conflict moment, both short- and long-term approaches can be taken simultaneously, as long as the short term does not undermine or detract from efforts to put in place long-term processes.

6.2. Specialised aid practices for all fragile states

While it is clear that each fragile state is unique and should be treated as such by external actors, there are some common characteristics of fragility. The most visible of these are the difficulty in achieving development progress such as the MDGs within fragile contexts. The plethora of donor methodologies of defining fragility, and the absence of a universally accepted dividing line between fragile and non-fragile states, adds an extra layer of uncertainty and divergence to an already confusing arena. It is also becoming apparent that donors need to put in place specialised aid practices in fragile states to take account of the particular circumstances in these countries, including weak capacity and institutions, the imperative of statebuilding and the difficulties in delivery – as exemplified in the OECD Fragile States Principles. For example, the evidence suggests that the Paris Declaration principles might not be sufficient in fragile states, where issues of flexibility in aid allocations and risk management are critical to delivering results.

One of the key lessons from the international campaign to provide debt relief is the need early on to agree on a list of which countries could benefit. It was important that this list was seen to be transparent and fair and not just the arbitrary decision of donors. [If a new deal is to be agreed at Busan,] there needs to be early agreement among the g7+, multilateral agencies and bilateral donors on the countries that would be eligible for differential treatment. The aim would be to identify a group of fragile states where the risks of the return to conflict are so high and the needs for rapid development are so great that a set of standard changes or exemptions to normal aid regulations/practices – such as those called for in the action plan – should be applied.

6.3. Speed and flexibility of aid

The key frustration with current aid systems is the slow pace of delivery. And the most-cited desirable attribute for support to post-conflict countries is flexibility. Yet, as progress in some countries shows, there is a range of practical steps that could be taken to speed up assistance and make it more flexible. The experience in Afghanistan in particular has demonstrated that, where there is clear urgent need and a keen political interest among donors to act quickly, it has been possible to do things differently and break with the 'business as usual' model. Such an approach needs to be applied to a wider – but still ring-fenced and limited – group of fragile states. One specific concern for many g7+ countries is the lack of funding to manage unexpected emergencies where relatively small sums of money provided rapidly could defuse potentially explosive confrontations.

6.4. Good practices for using government systems - with safeguards if required

Development objectives such as achieving the MDGs are insufficient in situations of fragility. International assistance should support **peacebuilding,** or preventing violent conflict breaking out or recurring, and **statebuilding,** or assisting countries to develop institutions capable of resolving conflict, facilitating justice, delivering services and providing an environment for businesses to thrive and which embody national beliefs. International assistance should support the development of legitimate institutions and not undermine them by bypassing them. Governments in fragile situations need support in delivering some visible short-term results that demonstrate a break from the past, but also need assistance to transform their institutions, develop human capacity at all levels, build infrastructure to secure long-term growth and employment and strengthen the state–society relations that are so critical to building legitimacy.

High levels of foreign assistance do not mean recipient governments should neglect their own revenues, through rationalising taxes and fees and collecting those that are due. It is encouraging that in practice many countries emerging from fragility with high levels of donor support have at the same time sharply increased their domestic revenues. The ultimate shared aim of g7+ countries and donors is to escape aid dependency.

6.5. Good practices when not using government systems - aligning aid with the budget

Not all foreign assistance can use national fiduciary systems, and some aid will continue to be provided in parallel. Coordinating this assistance has proven almost impossible for states with weak capacity. In addition, many fragile states highlight the lack of transparency and accountability of this assistance. Aid instruments should be designed in a way that does not undermine ownership or country systems. While it is generally accepted that country ownership improves as donors move towards use of country systems, there is also a need to understand ownership as a broader process that applies to all aid instruments, including those that do not use country systems. Finding ways to foster national ownership of aid that does not use country systems will be an important challenge ahead. Donors need to provide space for governments to be able to set and manage their priorities and, alongside this, governments need to become more responsive to public needs, including by building domestic accountability.

6.6. The need for predictable, sustained financing

This is needed to avoid either 'stop go' patterns of aid or excessive concentration of assistance immediately after the end of a crisis, for example at the conclusion of a conflict. The transition from fragility to resilience requires national institutions to take root, a process that may take 40 years or more (Pritchett and de Weijer, 2010). Statebuilding is not a linear process and is characterised by setbacks as well as leaps forward (OECD INCAF, 2011). As the 2011 World Development Report states, 'volatility greatly reduces aid effectiveness, and it is twice as high for fragile and conflict-affected countries as for other developing countries, despite their greater need for persistence in building social and state institutions' (World Bank, 2011). In addition, the peacebuilding and poverty implications of changed funding should be assessed, particularly when a donor is taking actions related to political changes within the country that may be disconnected from the population that would be affected by changed levels of aid. Donors also need to take into account the state of development of domestic bond markets, recognising that in some countries governments are unable to increase domestic borrowing to cover even very short delays in donor disbursements.

6.7. The development of long-term capacity

A new approach is needed to **longer-term capacity building.** Despite billions spent on capacity development, the long-term value for money of these investments has been poor. PIUs, salary top-ups to national government staff and poaching government staff by donors, NGOs and the UN have undermined government capacity and created a disconnect between ring-fenced donor projects and national programmes. Donors have demanded such approaches in order to solve the particular problems they face, and in general have failed to engage adequately in supporting necessary government-wide reforms. However, there have been some examples of good practice and these should be replicated much more widely. For example, in Rwanda, it has been possible to require that there should be no more than one PIU in any ministry. In Uganda, a successful ministry-wide UN salary top-up scheme proved instrumental in the development of sustainable long-term capacity of the [ministry of Finance?]. Governments in fragile states also face particular challenges in recruiting staff. For example, in Liberia, the total number of professional civilian staff employed by the UN was 10 times the number the government was trying to recruit for its own Senior Executive Service (SES).

6.8. Transparency, results, accountability and value for money

Transparency and accountability of governments and donors are required in fragile states for several reasons: 1) by governments to understand how budgets are spent, strengthening performance legitimacy through service delivery, and to give confidence to the public and civil society, strengthening political legitimacy by supporting state–society relations; 2) by donors to ensure there is a clear link between externally funded activities and national priorities and that aid has a positive impact on governments' ability to deliver its own priorities; and 3) at the global level to enable sharing of lessons and experiences with different aid instruments, to enable country actors to make informed decisions about what aid instruments will best deliver results in different context. This underpins greater aid effectiveness in fragile states.

A range of instruments and policies can ensure greater mutual accountability between donors and government, supporting broader transparency and accountability goals. These include the use of mutually accountable compacts, such as in the case of the Afghanistan Compact, or dual accountability frameworks such as GEMAP in Liberia. On the recipient government side, strong domestic accountability using transparency and good PFM are key areas where recipient governments can support the move to greater use of country systems. In addition, recipient countries have a key role to play in holding donors to account for their commitments to international principles of aid effectiveness. Shadow and process alignment are two innovative ways donors can support coordination, build capacity and prepare for the move to country systems, while fully protecting themselves from fiduciary risks.

7. Conclusion and recommendations

Over the past two decades, donors have begun to recognise where their own actions have fallen short and have sought to improve their engagement with fragile and post-conflict states. However, while examples of good practice are increasingly present, the challenge is to ensure these practices are shared more widely and implemented more effectively among donors. Donors need to make good on their commitments to do no harm, work in ways that are sensitive to local contexts and be more accountable for their actions in fragile states.

In response to the challenges described in the preceding sections, the recommendations in Part II have been developed. These cover a range of issues, including the tailoring of aid instruments to specific contexts, communicating results and sustaining assistance beyond the post-conflict moment. These recommendations aim to make aid more effective and transparent for both donors and recipient governments, in order to ultimately build sustainable capacity in weak states. They focus in particular on the factors drawn out here as having a determining impact on the success of aid instruments. These factors build on international aid dialogues that have gone before and seek to provide a menu of options for innovative ways in which aid practice can be improved.

7.1. Recognise that a mix of instruments is required to deliver better results in fragile states

7.1.1. **The g7+ should develop a framework for a country-led, country-specific fragility index.** This would allow fragile states to undertake joint assessments, in consultation with their own citizens and international partners, of their own state of fragility. The index would act as a starting point to identify peacebuilding and statebuilding priorities, inform political dialogue and provide the basis for the design of strategies and plans to support the transition from fragility to stability. Such an index could draw on both internationally comparable indicators (including measures of lack of resources, infrastructure and skilled personnel and measures of risk of renewed conflict, such as presence of UN/regional peacekeeping forces and proportion of youth in a population) and country-specific indicators, including perception survey indicators. Such an index could also be used to assess annual rate of progress out of fragility towards greater stability.

7.1.2. **Donors should ensure that, within the overall mix of instruments, civil society organisations receive appropriate levels of direct assistance** and humanitarian channels when appropriate.

7.2. Make a 'new deal' with fragile states

7.2.1. **Donor countries should identify a group of fragile states where the risks of the return to conflict are so high and the needs for rapid development are so great that a set of standard changes or exemptions to normal aid regulations/practices – such as those recommended in this paper – should be applied.** A simple but practical approach would be to use two UN-led processes and agree that any least-developed countries (LDCs) where there has been a UN/regional peacekeeping mission in the past five years should be eligible. The LDC criterion would keep the focus on the poorest countries. The presence of a UN/regional mission would serve as an indicator of the seriousness of the conflict and the requirement that the mission had to be present in the past five years would serve as an indicator of the risk of renewed conflict. Such a simple definition would cover nearly all the g7+ countries and would include only two others[35]. While there are more sophisticated measures of fragility, this approach has the merits of being based on two long-established UN agreed processes while also covering the key countries of interest. The advantage of linking this to UN/regional missions is that OECD ministries of finance would have some assurance that the list of fragile states would not be extended arbitrarily. Another advantage is that it would force policy coherence between the approach a country adopts to peacekeeping and its approach to providing aid. Such a linkage is also a reminder that it makes little financial sense to invest 10 to 20 times the amount in a peacekeeping mission and then risk having to repeat this level of finance just because the aid is not being delivered fast enough and is not being used where it is most needed. Post-Busan, it may be possible to win agreement on a different basis – for example the OECD list or the proposed new g7+ fragility index. But, given the proximity to Busan, there is not enough time to win agreement on both a new list and the changes to aid regulations/practices that should be made for fragile states. The advantage of a UN-based list is that, as soon as a new UN/regional peacekeeping mission is agreed, the new rules would apply automatically – there would be no need for a separate assessment process. This could have helped in Haiti and could well make a difference in Côte d'Ivoire.

7.2.2. The types of policies that would come under the "New Deal"' could cover the whole gamut of aid policies, such as those covered in these recommendations, and ranging from improved procurement procedures (Recommendation 3) through to improved mutual accountability processes (Recommendation 7)

7.3. Increase speed and flexibility of aid in fragile states

7.3.1. **Donors should allow their emergency procurement procedures to be used in fragile states during the first 10 years**. Most donors have special procedures for emergency assistance and these could be used for at least the first decade after the arrival of a UN/regional peacekeeping mission. This was done by the World Bank in Afghanistan and is estimated to have halved the time taken for procurement accelerating, cutting months and sometimes years off the normal process.

7.3.2. **Donors should develop simplified procurement arrangements for use in fragile states.** This might involve using national procurement rules, with appropriate international oversight, for all procurement other than very large contracts procured through international competitive bidding. It would shift donor oversight from *ex-ante* to *ex-post* reviews, with contracts that failed to meet the agreed standard being financed from the government's own resources, not donor funds. When an insufficient number of bids are received, the government would be permitted to negotiate with the lowest evaluated bidder, rather than rebidding the contract. The role of donor fiduciary staff would shift from external regulators of their own rules, to facilitators of good procurement outcomes from national rules, even if this involved donor staff participating in host government procurement decision making. Multilateral organisations could develop a common set of rules and contract documentation for international bidding.

7.3.3. **All major donors should be required to deploy senior procurement staff with appropriate levels of delegated authority in all g7+ countries.**

[35] This definition would cover 14 of the 17 g7+ states. The only g7+ states that would not be included would be Ethiopia (where there already exist mechanisms for donors to give through government systems - such as the multi-donor protection of basic services grant), Papua New Guinea and Côte d'Ivoire (which is currently not classified as an LDC although its current state would suggest it now should be). The only other states that would also be covered by this definition and that are not currently members of the g7+ would be Guinea and Comoros.

7.3.4. **Donors should deposit 5% of their annual aid programme in a conflict prevention fund.**[36] The government could borrow from this to fund urgent disbursements for conflict prevention activities, within 48 hours and without requiring donor approval from capitals. Such a fund could also be used for disaster response and other emergency measures.

7.3.5. **The g7+ should review experience with CDD programmes and, if favourable, should request additional funding for such programmes.**

7.3.6. **Humanitarian agencies should ensure they have sufficient flexibility in their operating procedures to respond to time limited requests by g7+ countries to go beyond their traditional mandates.**

7.4. Recognise the g7+ has both a clear preference for more aid through government systems and a clear willingness to accept more safeguards to manage the risks involved

7.4.1. **The g7+ should identify what instruments would count as providing aid through government systems and what constitutes an effective pooled fund.** In order to increase the proportion of aid provided through government systems, there needs first to be greater clarity on which aid instruments would be included. The CABRI 10-point measure of whether an instrument provides funding 'on budget' is one potential approach. But it would be useful to have clear statement from the g7+. In addition, a g7+ review of good and poor performing pooled funds would be invaluable in guiding the design and redesign) of future funds.

7.4.2. **The g7+ should identify a set of potential additional safeguards that could be introduced.** The willingness of the g7+ countries to adopt additional safeguards in order to ensure more aid is provided through government systems is not widely recognised. An explicit set of recommended potential safeguards would send a clear political message to all donors ahead of Busan. An alternative would be just to produce a list of safeguards that have been adopted by g7+ members. Even the alternative would still be powerful demonstration of the willingness in practice of g7+ states to introduce such safeguards. It would also help accelerate conversations in country between governments and donors around possible safeguards.

7.4.3. **Major donors – the G7 in particular – should amend their aid regulations/practices to ensure that, where there are appropriate additional safeguards in place, they can provide 50% of their aid through government systems as soon as the conflict ends.** Aid regulations are currently a major constraint on the extent to which donors can provide support through government systems. Given the recognition of the benefits of doing this – and the clear preference of g7+ countries – any significant change in aid practices will require a change in the aid regulations. The G7 (as indeed the G20) has a particular interest in this as it provides a significant proportion of the costs of UN peacekeeping missions. The US has started to experiment with allowing co-mingling – in Afghanistan and Liberia – so change is possible.

7.4.4. **The g7+ countries should commit to increasing the proportion of the budget funded by domestic revenue and the international dialogue should review progress to date and monitor future progress.** Such a commitment and review would answer the argument sometimes made that support to government systems undermines government's own efforts. The review could compare progress made by g7+ countries with rates of progress in other countries.

[36] Managed according to effective MDTF principles.

7.4.5. **Donors that are not among those providing 80% of the assistance to a country, or where the country is not one of the top 10% of their aid recipients, should provide their assistance through pooled funds.** Whatever the size of a donor's programme, there are unavoidable fixed transaction costs of dealing with any donor (accommodating ministerial and official visits; learning donor-specific reporting requirements; preparing data according to donors' specific reporting requirements). These costs are borne by the fragile state and tie up scarce capacity. The costs can seem overwhelming for a country that suddenly emerges from conflict as there is tendency for all donors wanting to be present in the 'new' country just at the time when the capacity of the government is at its weakest and its ability to give a strong lead is at its lowest.

7.4.6. **There should be regular reports from those administering pooled funds at country and global levels.** Poor practices can easily persist where there is limited accountability or transparency. Options to improve accountability include reporting at the global level on the performance of these funds, joint donor–country in-depth reviews of pooled funds at least every three years and administrative agreements for pooled funds to have provision for termination and transfer of the administrator.

7.5. Align all support in fragile states - including project aid, humanitarian aid and security support - to the country's budget and ensure all support prioritises peacebuilding and statebuilding objectives

7.5.1. **All flows – including non-aid flows such as military support – should be reported on and published locally in time for the budget and in the same format as the budget.** All assistance, development, humanitarian and security related, that does not go through the budget should be **shadow aligned** with the national budget and the multi-year frameworks that underlie it. This requires that donors contribute timely information to the budget preparation process in the appropriate format, and provide reports that link to the national review of budget implementation. The donor-funded portion of the budget would pass through the national budget approval and review process, including legislative reviews of the government's plans required under the constitution.

7.5.2. **Humanitarian agencies in particular should ensure all their aid is reported on and governments are including appropriate provision in the medium-term budget frameworks to compensate for any expected changes in the level of humanitarian support.**

7.5.3. **Before Busan, the g7+ should pilot in at least three fragile states the conversion of IATI data into local budget compatible data.** Local donors already report aid flows through processes such as aid management programmes and aid tracking programmes. The benefit of such a pilot would be an important cross check on the reliability of donor data and how difficult (or not) it is to translate the IATI data – available from each donor – into local budget classifications in each country.

7.5.4. **Donors and government should recognise the role civil society can play in ensuring the voices of the poorest and most marginalised are listened to the budget preparation process.**

7.5.5. **Each g7+ country should review all the support provided in light of the emerging International Dialogue's peacebuilding and statebuilding objectives.**

7.6. Provide more predictable, sustained financing in fragile states

7.6.1. **Aid flows through the budget should not change during the course of a budget and donors should give two-year notice of changing funding levels.** The only exceptions should be in the case of a human rights violation bringing a UN resolution or International Criminal Court proceedings against a country.

7.6.2. **Budget support should be disbursed on a monthly basis.** This will reduce the fiscal risks that result from possible delays to lump sum annual payments, and support good budgeting and expenditure planning practice.

7.6.3. **If there is a disagreement, donors should offer to transform a grant into a loan.**

7.6.4. **Donors should plan to achieve at least an average B grade in the donor elements of the PEFA assessment** no longer than five years after development aid programmes have started. PEFA categories D-1, D-2 and D-3 provide a clear internationally comparable measure of the extent to which donor aid is predictable. Given the importance of this issue, the g7+ should monitor and report progress against this indicator every two years (as PEFA scores are updated only every two to three years).

7.7. Ensure aid delivery also supports development of long-term capacity

7.7.1. **There should be at most just one PIU in any ministry,** other than one in the ministries that receive substantial donor assistance that would provide common programme implementation and coordination management for all donor- and government-funded projects and programmes.

7.7.2. **Salary top-ups should be paid to all staff at the same level in the ministry, or not at all.**

7.7.3. **Donors should not pay their national staff any more than government salary scales** and refrain from recruiting staff from government ministries. This would not solve the problem but would ensure that donors have the same incentives as the government to ensure key pay and civil service reforms are quickly introduced in at least the key departments and ministries.

7.7.4. **When UN missions are scaled down, g7+ governments should agree with the UN long-term arrangements for transferring the human and organisational capacity to national purposes.**

7.8. Strengthen transparency, results, accountability and value for money in fragile states

7.8.1. **The g7+ group of fragile states should improve transparency and accountability of the national budget by committing to as many actions as possible from the following list:**

- **Publish summary budget outturn data on a monthly basis,** for example the fiscal data reported to the IMF (excluding any market-sensitive data), following the example of the Palestinian National Authority;
- **Publish key financial and operational information on an annual basis:** for example full payroll for each ministry; prices paid on all procurement items; and annual asset registers (in particular cars) owned by each ministry. Downstream, each ministry and public service body (including schools, hospitals and local authorities) could publish funds received from central

government. The information should be published accessibly, for example using newspapers, radio and community notice boards (as was the case in Uganda in the 1990s) in local languages;

- **Publish budget outturn data for the previous five to ten years** (as Timor-Leste has done);
- **Publish citizens' guides to the budget and the budget process;**
- **Open up as many of the key steps of the budget process to public engagement,** drawing on emerging international best practice standards, such as the Open Budget Index;
- **Become a formal member of the Extractive Industries Transparency Initiative;**
- **Become a formal member of the Construction Transparency Initiative;**
- **Subscribe to the Natural Resource Charter.**

7.8.2. **A joint government–donor financing strategy should be developed in each country.** This would ensure there is a common understanding of the level of fragility at play and the range of instruments available and hence would enable an explicit identification of the right mix of instruments that would help the country move from fragility to stability. The strategy could also commit donors to certain behaviours, and could also set the rules of the game for the level of external controls that would be acceptable to receive more aid on budget, as well as the transition away from such additional controls towards using country systems. Such strategy could be published to facilitate mutual accountability and enable non-governmental actors to engage, comment and monitor progress.

7.8.3. **Donors should contribute up to 5% of their overall aid[37] to a joint government–donor accountability fund.[38]** In some countries, one constraint to introducing greater transparency is simple lack of resources. Where this is the case, donors should be willing to jointly finance a fund that could cover the costs of a range of activities that support domestic and mutual accountability, including government-led donor coordination (which good practice suggests should be housed within the fiscal authority); international sector-wide value-for-money assessments; and publication of government transparency information in newspapers and radio.

7.8.4. **All aid agreements involving aid conditionality should be made public.**

7.8.5. **Recipient governments and donors should publish a joint assessment every three years on the implementation of aid agreements, the results that have been achieved and their cost.**

7.8.6. **The g7+ and donors should develop appropriate indicators to determine aid effectiveness in fragile states, which could include speed, flexibility and risk management as well as the Paris Declaration indicators.**

7.8.7. **The g7+ and donors should develop appropriate country-level mutual accountability frameworks and compacts that deliver stricter prioritisation and better use of different resources without being overburdened by cumbersome bureaucratic procedures.**

[37] Excluding diplomatic activities that are covered by international conventions.
[38] Managed according to effective MDTF principles.

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Appendix 1: g7+ membership, UN/regional peacekeeping missions and LDCs

	Country	UN/regional peacekeeping/ peacebuilding mission		LDC		World Bank fragile FY11	OECD fragile
	g7+ members						
1	Afghanistan	Yes		Yes		Yes	Yes
2	Burundi	Yes		Yes		Yes	Yes
3	CAR	Yes		Yes		Yes	Yes
4	Chad	Yes		Yes		Yes	Yes
5	Côte d'Ivoire	Yes			No	Yes	Yes
6	DRC	Yes		Yes		Yes	Yes
7	Ethiopia		No	Yes		No	Yes
8	Guinea-Bissau	Yes		Yes		Yes	Yes
9	Haiti	Yes		Yes		Yes	Yes
10	Liberia	Yes		Yes		Yes	Yes
11	Nepal	Yes		Yes		Yes	Yes
12	Papua New Guinea		No		No	No	Yes
13	Sierra Leone	Yes		Yes		Yes	Yes
14	Solomon Islands	Yes* (PB)		Yes		Yes	Yes
15	Somalia	Yes		Yes		Yes	Yes
16	Southern Sudan	Yes		Yes		Yes	Yes
17	Timor-Leste	Yes * (PK)		Yes		Yes	Yes
	Other countries with UN/regional missions						
	Bosnia & Herzegovina	Yes* (PK)			No	Yes	
	Comoros	Yes* (PB)		Yes		Yes	
	Cyprus	Yes			No	No	
	Georgia	Yes* (PBK)			No	Yes	
	Guinea	Yes* (PB)		Yes		Yes	
	Iraq	Yes			No	Yes	
	India/Pakistan	Yes			No	No	
	Kosovo	Yes			No	Yes	
	Lebanon	Yes			No	No	
	Tajikistan	Yes *			No	Yes	

Note: List excludes territories (West Bank and Gaza and Western Sahara) and regional missions (West Africa and Central Asia).

Source for UN missions: annual report of the Security Council 2009-10: http://daccess-ddsy.un.org/doc/UNDOC/GEN/N10/607/46/PDF/N1060746.pdf?OpenElement plus World Bank fragile state list FY11. Data for UN and/or regional peacebuilding/peacekeeping mission in the last three years include AU, EU; Organization of American States; North Atlantic Treaty Organization; Pacific Forum.

Appendix 2: Terms of reference

For Policy Paper on Innovative Aid Instruments and Flexibility of Financing

The following sets out the Terms of Reference for a consultancy to support the International Dialogue Working Group on Aid Instruments to develop more detailed recommendations for how aid delivery can be improved through the use of innovative mechanisms and modalities that can help to gradual move from the majority of aid being implemented through external instruments and modalities towards incrementally putting aid on budget and using country systems for implementation.

Introduction

A working Group on Aid Instruments has been set up as part of the International Dialogue on Peacebuilding and Statebuilding. The focus of the working group on is 'to improve the way aid is delivered to ensure rapid and flexible delivery and transition towards government-led delivery through country systems'.

The working group will produce a set of high-level recommendations on how to improve the way external assistance is delivered in situations of very weak implementation capacity to encourage better alignment of external aid with national priorities and delivery in a way that recognizes and reinforces national leadership and management. These recommendations will be submit for consideration to the International Dialogue ministerial meeting in July 2010 in Monrovia, supported by clear analysis of and evidence on current, positive and negative practices of capacity development interventions. These recommendations will consist of four parts: a problem statement, a brief analysis of the issues at stake, the recommendations themselves and an action plan to implement them.

To support the Co-chairs, the members of the working group and the Secretariat of the International Dialogue to prepare the more detailed contributions, the Secretariat is now looking for consultant(s).

Outputs and deliverables

The consultant(s) will be requested to develop a 15- 20 page policy paper with the following elements:

A. Evidence, analysis and problem statement:

- A review of country specific experiences with instruments and partnership approaches which propose transitional solutions to support direct delivery of critical peacebuilding and statebuilding efforts while at the same time developing capacity in situations of weak implementation capacity. This will involved looking at the different instruments and approaches that have been used to gradual move from external implementation of aid towards using country systems and bringing aid on budget, and to understand how different financing instruments and modalities can be used strategically to support a gradual shift towards increasingly placing direction and management of resources in the hands of national actors as country systems and capacities are strengthened and trust established between local and international partners. Finally, it would involve looking at lessons for how different partnership arrangements (e.g. compacts) have been used to help the transition, including through formalising agreements for how to transition out of parallel funding and implementation structures towards national implementation and country systems.
- Highlight evidence of: 1) good donor practice in reporting allocations and expenditure to partner governments, 2) good MDTF practice that allows for strong alignment, national voice and a balances swift disbursement with quality implementation, 3) development of country system capacity including various interim dual accountability mechanisms to encourage donors to use the systems, and 4) examples of effective BS that fosters constructive trust relationships between donors and partner states.
- An outline of the spectrum of available instruments and modalities for linking aid to national budgets (dual key, joint accountability, MDTFs etc), based on how close they link to the budget, whether they use national and/or external mechanisms for oversight etc. Some analysis of the dilemmas and policy considerations (philosophical debates) involved when making decisions about what instrument to chose (from government and donor perspectives) and how to sequence or progress from instruments that give greater control to donors to ones that give greater control to national partners.
- Lessons learned related to what has made the instruments/modalities successful or not, including anecdotal evidence of sectoral engagement, capacity transfer, setting of good fiduciary standards and practices etc. Similarly, what are the lessons in the use of interim mechanisms for speeding up or slowing down decisions on actual budget support?

B. Recommendations:

- An outline of policy recommendations and actions that can guide funding decisions and choice of instruments at the country level, to enable more rapid and flexible funding to be made available for key peacebuilding and statebuilding activities, and improve the government-donor dialogue around specific funding instruments and greater alignment with national development planning and budgets. The recommendations should focus on the following:

1. How to improve transparency on different resource flows, budgets and funding decisions, and to guarantee integrity of spending in contexts where capacities and trust are still being developed to enable alignment of donor and national planning and budgeting. How could donors commitment to standard transparency arrangement related to external financing in contexts where the majority of aid is off-budget help decision making? What would such a commitment look like?

2. How to improve coordination between external financing instruments (MDTFs) and national decision making processes in contexts where donors are not ready to use country systems?

3. How to expedite delivery through country systems, based on good practices on use of dual accountability mechanisms and common standards between national and international partners and building on country experiences?

4. How to design budget support operations that maximise partner leadership to direct resources for national development priorities while assuring donors that donor and national budgets are effectively applied to the benefit of all citizens.

C. Suggested actions for change:

- An outline for specific changes needed in government and donor and collective behaviour to deliver on the above recommendations (and possible sequencing of reforms needed).

Methodology

The above paper will be developed through a desk review of existing literature and experiences. A short questionnaire will be circulated to Working Group members to provide additional information on key dimensions and experiences. The initial review should also be combined with interviews with selected government and donor officials in the working group to better understand the policy considerations at play.

A first draft will be discussed by the Working Group during its next meeting in April. Following this meeting, more detailed consultations might be deemed necessary, including possibly through country visits.

Timeline

A first draft outline of the above should be submitted to the Secretariat by mid March, while a more detailed outline should be submitted by end March for circulation to the Working Group. More detailed revisions will be expected following the Working Group meeting mid-April.

4 February	Submission of draft proposal, including short set of questions for circulation to working group members
25 February	Deadline to submit feedback on questionnaires
15 March	First draft of paper submitted for initial feedback from Co-chairs and Secretariat
Late March	Additional consultations on draft paper with individual working group members
31 March	Second draft paper with recommendations and actions submitted for circulation to working group members
13-14 April (tbc)	Second meeting of the working group on aid instruments discusses policy recommendations and proposed actions
End April	Continued in-depth consultations to refine the Working Group output
6 May	Final draft submitted to Secretariat
16-17 May (tbc)	International Dialogue Advisory & Steering Group Meeting discusses draft action plan (including actions on Aid Instruments)
9-10 June (tbc)	Second Global Meeting of the International Dialogue in Monrovia

Reporting requirements

The consultant(s) will report to the Co-chairs and the secretariat for the working group. The main contact point will be Asbjorn Wee (asbjorn.wee@oecd.org).

Overseas Development Institute
111 Westminster Bridge Road
London SE1 7JD
UK

Tel: +44 (0)20 7922 0300
Fax: +44 (0)20 7922 0399
Email: publications@odi.org.uk
Website: www.odi.org.uk

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