



## Use of country systems in fragile states: case studies

Afghanistan  
Sierra Leone and Liberia  
South Sudan  
West Bank and Gaza

---

# Table of contents

<b>Afghanistan</b>	<b>3</b>
Introduction	3
PFM systems and other risks	4
Use of country systems	6
Conclusions and key lessons	11
<b>Sierra Leone and Liberia</b>	<b>13</b>
Introduction	13
PFM systems and other risks	16
Use of country systems	18
Conclusions and key lessons	23
<b>South Sudan</b>	<b>24</b>
Introduction	24
PFM systems and other risks	27
Use of country systems	28
Conclusions and key lessons	35
<b>West Bank and Gaza</b>	<b>36</b>
Introduction	36
PFM systems and other risks	39
Use of country systems	41
Conclusions and key lessons	45
<b>References</b>	<b>47</b>

---

# Afghanistan

## Introduction

State-building in Afghanistan has been a high political priority following western military intervention. This is reflected in the reaffirmation of ambitious targets, mirroring the Paris Declaration, for putting aid on budget in Afghanistan. Pooled funding through the Afghanistan Reconstruction Trust Fund has played an important role in putting aid through government systems, with appropriate safeguards. Afghanistan has made significant progress in improving its PFM systems, although challenges still remain in budget execution. Despite this, progress in meeting the ambitious targets is slow.

**Table 1: OECD 2011 monitoring report and PEFA assessment**

Indicator	Score
CPIA score for budgetary and financial management (2010)	3.5
Aid reported in the 2011 survey	5,342
Indicator 5a: Use of financial management systems	25%
Budget execution	30%
Financial reporting	29%
Auditing	17%
Indicator 5b: Use of procurement systems	11%
Mean PEFA score for country systems (2013)	2.53
D-1 Predictability of Direct Budget Support	B+
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	D+
D-3 Proportion of aid that is managed by use of national procedures	D

Source: OECD 2011; PEFA Secretariat 2014

## Country background

Afghanistan has suffered decades of war and instability since the Soviet intervention in 1979. Following the US intervention in 2001, an interim government was established, led by Hamid Karzai. Presidential elections were held in 2004 and 2009, both won by Karzai. A peaceful handover of power occurred in 2014 following disputed Presidential elections. The winner, Ashraf Ghani became President, with the runner-up Abdullah Abdullah becoming Chief Executive Officer in a deal brokered by the United States.

The international community has maintained a sizeable troop presence in Afghanistan since 2001 under the International Security Assistance Force. Troop levels increased gradually during the 2000s, then and scaled up rapidly in 2009 (Livingston & O'Hanlon, 2015). From 2011 responsibility for security was gradually transitioned to Afghan forces, with international forces declining. The transition process was completed with Afghan forces taking full security responsibility at the end of 2014.<sup>1</sup>

---

<sup>1</sup> [http://www.nato.int/cps/en/natohq/topics\\_69366.htm](http://www.nato.int/cps/en/natohq/topics_69366.htm)

**Table 2: key indicators and statistics**

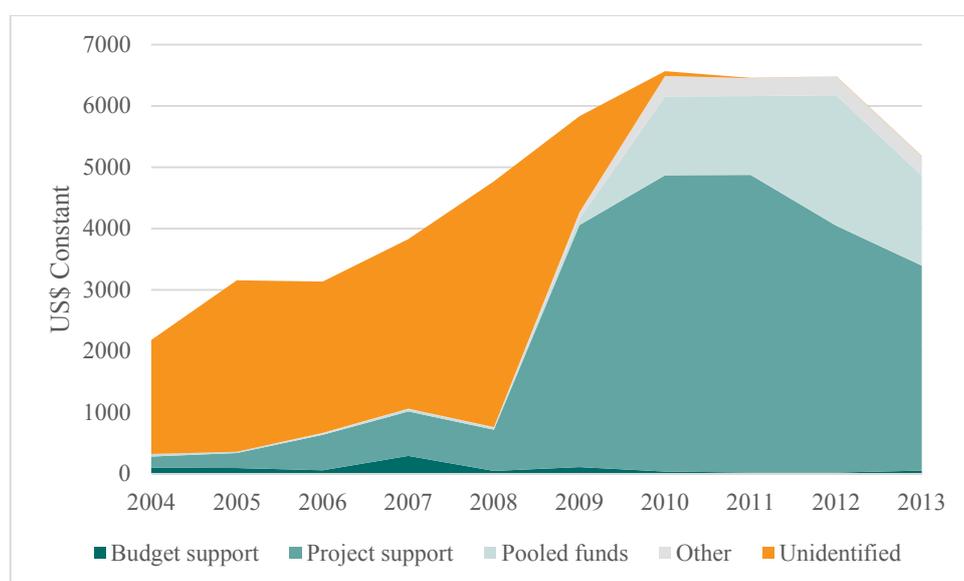
Statistic	Source	Afghanistan
Period of conflict	Various	1979 -
Real GDP growth rate (2007-2012)	IMF WEO 2015	8.0%
GDP per capita (2012, PPP)	IMF WEO 2015	US\$ 1,927
Population (2012 est, millions)	IMF WEO 2015	29.8
HDI rank (2012, out of 187)	UNDP HDR 2010	169

### Overview of donors and aid flows

Aid to Afghanistan has followed a similar pattern to troop levels, as shown in figure 1 below. This increased up to 2010 and has stayed at a high level since. The Afghanistan Ministry of Finance reports that it received \$69.7 billion dollars between 2002 and 2011. The top eight donors, all of whom disbursed more than \$1 billion over that period consisted of five bilaterals (USA, Japan, UK, Canada and the Netherlands) and three multilaterals (EU, the World Bank and the Asian Development Bank). The US was by far the largest donor, disbursing \$47.5 billion and accounting for two-thirds of all aid by itself (Islamic Republic of Afghanistan, 2012).

Support that utilizes country systems, budget support, multilateral funds and pooled funds<sup>2</sup> has also increased since 2009, accounting for a third of ODA disbursements in 2012.

**Figure 1: Official Development Assistance in Afghanistan**



Source: OECD CRS 2015

### PFM systems and other risks

#### PFM systems

Afghanistan's CPIA score and the CPIA score for the quality of budgetary and financial management (indicator 13) is shown in figure 2 below. There has been little change in the overall CPIA score, which remained around 2.6 throughout the period. The budget and financial management score has been consistently higher, and has improved from 3 in 2006-

<sup>2</sup> Multilateral and pooled funds do not necessarily use country systems, but this is the case in Afghanistan, as discussed below.

2008 to 3.5 in 2009-13. This suggests that PFM has had a consistently stronger record than the broader governance in Afghanistan.

**Figure 2: Afghanistan CPIA scores**



Afghanistan has undertaken three PEFA assessments, published in 2005, 2008 and 2013. This has shown significant improvement over that period, as shown in figure 3 below, which shows the average score across each of the six clusters of the PEFA scoring system.<sup>3</sup> The 2008 study concluded that “...the [PFM] system showed significant improvement... leaving Afghanistan better than the average for low-income countries and in some respects on a par with middle-income countries. However, there is still a major gap between planned and actual budget expenditures, due to lack of realism in budget formulation and limited capacity to implement the budget.” (World Bank/DFID, 2008)

Similarly, the 2013 PEFA assessment concluded that it “...portrays a public sector in which financial resources of the general government sector are, by and large, tracked and reported within a budget which is processed with transparency and has contributed to aggregate fiscal discipline.” Afghanistan is on par with, or above the average middle-income country score on predictability and control in execution, accounting and reporting, and external scrutiny and audit (World Bank, 2013a).

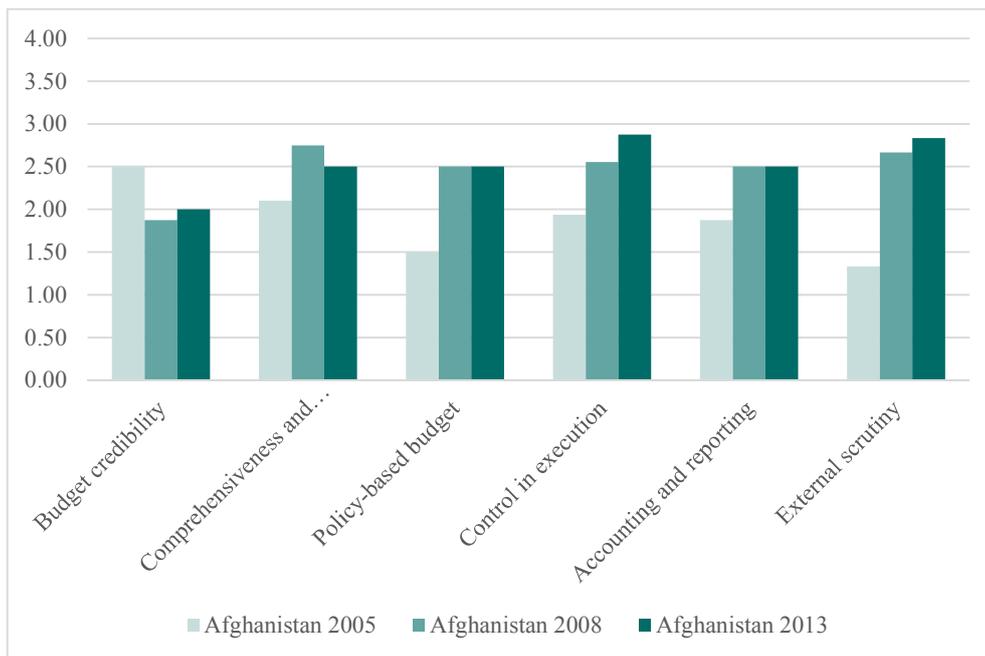
The only area not to see improvement is on budget credibility, “the one area in which Afghanistan scores lower than an average of LICs.” The low score is caused by large deviations in the composition of the budget, large underspends on capital, and inaccuracies in revenue forecasting (World Bank, 2013a). This is likely to have fundamentally political roots, rather than technical ones. The difficulties in collective decision-making in the Afghan Cabinet and the difficulties in getting budgets approved in the fractious parliament may lead to unrealistic budgets that are extremely difficult, or impossible, to implement accurately.<sup>4</sup>

This is likely to be a significant challenge for Afghanistan as aid volumes are expected to decline and the government takes over responsibility for security during the transition period, and will also need to take on the operation and maintenance of off-budget spending on infrastructure.

<sup>3</sup> Alphabetical score are converted using the following conversion for each Performance Indicator: A = 4, B+ = 3.5, B = 3, C+ = 2.5 C = 2, D+ = 1.5 and D = 1.

<sup>4</sup> See Schick (1998) and Simson and Welham (2014) for further detail on the pervasiveness of unrealistic budgets in developing countries.

**Figure 3: PEFA scores for Afghanistan**



Source: PEFA secretariat

Other assessments carried out include DFID’s Fiduciary Risk Assessment (FRA). This was first carried out in 2008 and is updated annually (Independent Commission on Aid Impact, 2012). However, the results of these assessments are not made public.

**Other concerns/risks**

The capacity of the government to manage funds, and corruption have been the main risks of using donors have been concerned about. These were summed up by the US Special Inspector General for Afghanistan Reconstruction in testimony to the House of Representatives: “The Afghan government does not appear to have the capacity to manage the amount of funding envisioned in the international community’s pledges of direct assistance.” Less donor oversight of on-budget than off-budget aid leaves it “...particularly vulnerable to fraud, waste, and abuse. This is especially risky, given the pervasiveness of corruption in Afghanistan.” (Special Inspector General for Afghanistan Reconstruction, 2013) Similarly, the Paris Declaration Survey reported that “The main constraints in using Afghanistan’s PFM systems are lack of absorptive capacity in line ministries to effectively execute budgets and lack of donor confidence in the government’s systems due to widespread corruption.” (OECD, 2011a).

**Use of country systems**

**Country systems used by donors**

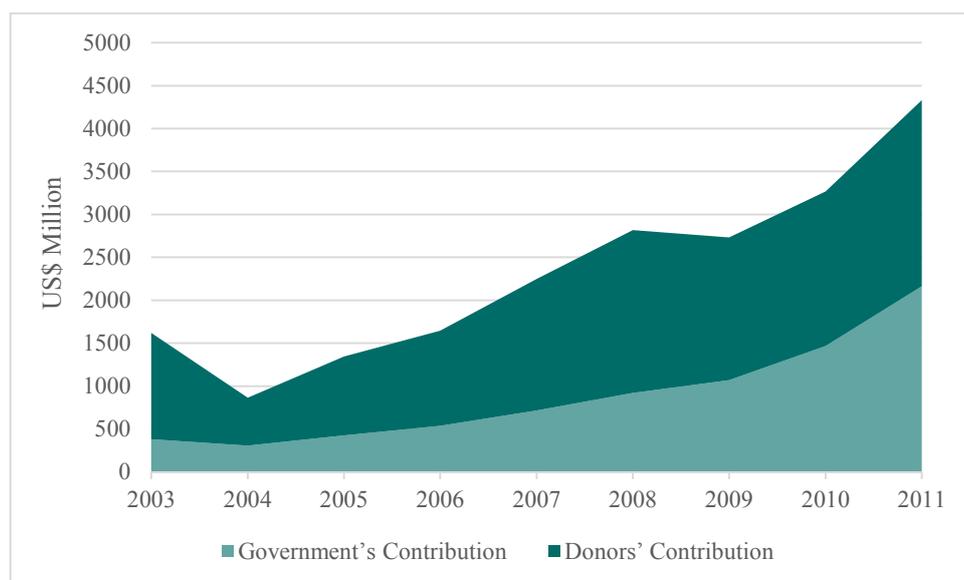
The international community has made ambitious commitments to the use of country systems in Afghanistan.<sup>5</sup> The Tokyo Mutual Accountability Framework (2012) reaffirms the commitment to align 80% of their aid to Afghan-defined priority programs and to channel at least 50% of development assistance through the Afghan Government budget.

However, the current percentage of aid on budget is only 18% (\$2.3 billion). Despite this, the government of Afghanistan is extremely aid dependent, with aid making up 50% of the

<sup>5</sup> At the Kabul Conference in July 2010, donors agreed to channel at least half their development aid through the government’s budget by 2012, as part of the transition to greater Afghan authority (the “Kabul process”), while the Afghan government agreed on necessary reforms to strengthen its public financial management systems, reduce corruption, improve budget execution and increase revenue collection.

government budget, although this has declined from over 70% in 2003. As Figure 4 below shows, the improvement in recent years is largely down to improved revenue collection by the Government of Afghanistan with the government contribution to the budget consistently rising. Whilst the government is now funding a majority of the recurrent budget, until 2011 the development budget was purely donor funded.

**Figure 4: Government and donor funding of the Afghanistan National Budget**



Source: Islamic Republic of Afghanistan, 2012

### Aid Modalities

There are three major pooled funds operating in Afghanistan, shown in table 3 below.

**Table 3: Pooled Funds in Afghanistan**

Trust Fund	Donors
Afghanistan Reconstruction Trust Fund	Australia, Canada, Denmark, EC, Finland, France, Germany, Japan, Sweden, UK, USA (and
Afghanistan Infrastructure Trust Fund	Japan, USA, UK
Law and Order Trust Fund for Afghanistan	EC, Japan, Switzerland

Source: New Deal Monitoring Report 2014 and Islamic Republic of Afghanistan, 2012

Of the aid that is on budget, 51% comes through these pooled funding mechanisms, with the remaining 49% through bilateral contributions (Islamic Republic of Afghanistan, 2012).

The ARTF was established in 2002 and is administered by the World Bank. It has received more than \$5 billion in donor funds, which support certain recurrent costs of government (mostly salaries) on a reimbursement basis, and also supports investments in certain sectors. The LOFTA was also set up in 2002, and is administered by UNDP. It supports the salaries of the police, the rehabilitation of the police facilities, equipment (non-lethal), and training. The Afghanistan Infrastructure Trust Fund was established in 2010 to finance infrastructure, administered by the Asian Development Bank.

---

The New Deal Monitoring Report 2014 describes the ARTF as one of the two (along with the multi-donor budget support programme in Sierra Leone) “most substantive examples of country system usage” (International Dialogue on Peacebuilding and Statebuilding, 2014). A review of thirteen donor evaluations and the governments evaluation of aid, also highlighted the effectiveness of the ARTF: “The programs that all donors recognize as successful are those that are funded through multidonor facilities of some kind, ARTF being the prime example of this approach.” LOFTA received less good reviews, but this may be due to the sensitive nature of the expenditures it is financing (Sud, 2013).

### **Aid coordination**

There have effectively been two levels of aid coordination in Afghanistan. High level donor conferences have been held at least every two years since 2001, at which donor funding has been pledged and government and donors have made mutual commitments. The last of these in Tokyo resulted in the Tokyo Mutual Accountability Framework.

At the country level, the main mechanism for donor coordination has been the Joint Coordination and Monitoring Board, which is jointly chaired by the Government of Afghanistan and the UN Assistance Mission to Afghanistan (UNAMA).

There is a stark difference of opinion on the effectiveness of these donor coordination mechanisms: “Donor assessments generally find good aid coordination overall... In contrast, the government’s assessment expresses concern that donor coordination has not been effective. It suggests that various donor groups are unwieldy, with donors pursuing their own interests and government representatives having little voice.” (Sud, 2013)

A British Parliamentary review of aid to Afghanistan sided with the government’s view: “Coordination among donors, all with differing priorities, has been a significant obstacle as it has led to poorly coordinated or ill-advised aid projects” and noted that while there had been “...some improvements in strengthening donor coordination, they have been too little and too late for a reconstruction effort of this scale.” (House of Commons International Development Select Committee, 2012)

### **Country systems used by donors**

As set out above, significant amounts of aid, averaging \$1.4 billion per year are on budget in Afghanistan, and the ambition is to significantly increase this. Currently, 49% of these funds are from bilateral spending, and 51% through Trust Funds.

The largest Trust Fund, the ARTF operates its support for recurrent costs on a reimbursement basis. Around three-quarters of the recurrent costs supported have been for payroll expenses, with remaining quarter for operations and maintenance expenses.<sup>6</sup>

Each month, the ARTF supervisory agent reviews the eligibility of recurrent expenses incurred by the government of Afghanistan and compliance with internal controls. If an expenditure is not found to be eligible, it is not reimbursed. The lowest approval is for 73% of payroll submissions in 2012, and 14% of operations and maintenance submissions in 2003/04. (Special Inspector General for Afghanistan Reconstruction , 2015).

Capital investments financed by the ARTF are as standard World Bank-financed investment projects, with ex ante approval for expenditure, rather than ex post reimbursement, as with recurrent financing. There are several programmes (the National Solidarity Programme, rural roads, education and irrigation) which require construction of a large number of scattered works. To ensure effective supervision of these investments, the ARTF has contracted a Supervisory Agent to provide additional resources.

The largest bilateral provider of budget support is the USA. This support requires additional safeguards in that the funds provided do not pass through the mainstream Treasury accounts.

---

<sup>6</sup> <http://www.artf.af/who-we-are/frequentlyaskedquestions>

---

Instead funds for each of the nine bilateral agreements use special bank accounts set up by the Ministry of Finance (Special Inspector General for Afghanistan Reconstruction , 2015). The World Bank (IDA) and the Asian Development Bank (ADF) have provided policy-based budget support to Afghanistan, and Japan also provided close to \$95 million of commodity aid between 2009 and 2013.<sup>7</sup>

Donors have provided extensive capacity building support to public financial management, including planning, budgeting, financial management and procurement. “The amount committed by donors for capacity building has been substantial. The Ministry of Finance estimates that total donor support for capacity building (not including funding for civil service salaries) between 2002 and 2010 was \$6.45 billion.” (Sud, 2013)

### **Factors affecting the use of country systems**

The broad parameters for use of country systems in Afghanistan mirror international commitments under the Paris Declaration: donors have promised to increase their use of country systems, as long as the government makes progress on strengthening PFM systems.

The Tokyo Declaration target of 50% of aid being on budget is roughly equivalent to the Paris Declaration target of reducing the proportion of aid not using partner country PFM systems by one third for countries with a CPIA score of 3.5 to 4.5. Based on the 2011 figures reported in the Ministry of Finance’s Development Cooperation report, a one third reduction in off-budget aid would be equivalent to 46% of aid being on budget, making the Tokyo Declaration target slightly more ambitious than this.

However, the lack of progress in this target being met – in 2011 only 18% of aid was on budget – reflects the difficulties donors have in putting this commitments into practice. In Afghanistan this may be related to the sheer volume of aid provided.

The constraints that are voiced to this are the same as voiced in other countries: capacity within the government and corruption. This is despite Afghanistan making significant progress on improving financial management, as measured by PEFA. However, Sud (2013) notes that “even the slightest leakage of funds can be a major stumbling block” citing US GAO concerns on the \$2.8 million of NSP funds not having reached the beneficiaries, out of more than one billion dollars disbursed (i.e. 0.028% of fund). He notes that as of 2013 the development of clear metrics to measure progress was still ongoing and that “Without a realistic approach to this issue by the donor community, the debate on off-budget aid is likely to remain unresolved for a long time.” Sud (2013)

### **Impact of use of country systems**

As sets out above, there has been significant progress on improving PFM in Afghanistan. The World Bank IEG concludes that “Afghanistan’s PFM framework is better than would be expected for a country of this per capita income that started virtually from scratch ten years ago” (IEG 2012, 31).

However, despite this, most of the assessments reviewed by Sud conclude the capacity of the government remains weak, and are reliant on donor-funded staff (both international and Afghan) on much higher salaries than the civil service. There is also payment of top-ups to civil servants. Altogether, Sud (2013) concludes that there is “a ‘parallel civil service’ that has been running the government for 10 years after the start of the capacity building efforts.” The perception remains that the state remains dependent on unsustainable outside expertise to function (de Weijer, 2013).

In addition the large amount of off-budget aid has led to donors creating parallel systems to distribute their aid budgets. Sud (2013) reports there are more than 25,000 Afghan contract staff paid for by individual project funds, a situation which leads capable Afghans to opt for

---

<sup>7</sup> The government sold the commodity on the open market and thus obtained budget support. As far as Japan was concerned, its money was spent properly on oil. This is an example of how a country (Japan) that almost never provides budget support can absorb higher risks justified by strategic considerations.

these jobs instead of working as civil servants. The US assessment concludes, “the donor practices of hiring Afghans at inflated salaries have drawn otherwise qualified civil servants away from the Afghan Government and created a culture of aid dependency” (US 2011, 3). However, the way forward to transition from this situation is not clear.

A first step will be the better coordination of capacity building, rather than each donor and project pursuing its own approach. The US Special Inspector General for Afghanistan Reconstruction reports that the US is planning to move capacity-building support from stand-alone programmes to the ARTF’s Capacity Building for Results programme (Special Inspector General for Afghanistan Reconstruction, 2015).

Despite the skepticism on sustainable institution building, there has been significant development progress. There has been large improvements in the coverage of primary healthcare, primary education enrollment, transport, irrigation and community development. “Basic education has been expanded eightfold and is now accessible in a large part of the country, although quality remains a concern. A Package of Basic Health Services now reaches most of the country. NSP has done a remarkable job in reaching a large number of communities in virtually every province” Sud (2013).

A further benefit of the use of country systems is that programmes run through government may be better targeted on poverty than bilateral aid. A comparison of US assistance and the National Solidarity Programme revealed the latter closely targeted poverty rates, whereas bilateral US assistance targeted the most insecure areas, rather than the poorest (Sandefur, 2013). “About 80 percent of USAID’s resources are being spent in Afghanistan’s south and east, particularly on stabilization programs.” (Senate Foreign Relations Committee, 2011)

### New Deal principles

As part of the New Deal for engagement in fragile states (International Dialogue on Peacebuilding and Statebuilding, 2011), members of the International Dialogue signed up to the FOCUS<sup>8</sup> principles on new ways of engaging with fragile states, and the TRUST<sup>9</sup> principles of providing aid more effectively.

The first New Deal Monitoring Report (International Dialogue on Peacebuilding and Statebuilding, 2014) set out a traffic light system for evaluating progress on these goals. Green indicates substantial progress on New Deal Commitments, amber some progress and red insufficient or no progress. The FOCUS principles are measured on a country-by-country basis, and are summarised in the table below.

**Table 4: Progress on FOCUS PRINCIPLES**

Principle	Progress in Afghanistan
Fragility assessments	Afghanistan is undertaking a New Deal study in 2015, which will use the key principles and approach of a fragility assessment to analyse country progress in meeting the PSGs and identify the extent to which the PSGs are reflected in existing national strategic plans and frameworks.
One Vision, one Plan	Afghanistan’s 2008 National Development Strategy was translated in 2010 into twenty-two National Priority Programmes. These act as ‘One Vision, One Plan’. However, their formulation pre-dates the New Deal. A donor self-assessment shows that 13 out of 15 donors are already more than 80% aligned to the NPPs.

<sup>8</sup> Engagement based on a country-led **Fragility assessment** developed by the g7+ with the support of international partners, a country-led **One vision and one plan**, a country **Compact** to implement the plan, **Use** of the PSGs to monitor progress, and **Support** inclusive and participatory political dialogue and leadership.

<sup>9</sup> Enhanced **Transparency**, **Risk-sharing**, **Use** and strengthen country systems, **Strengthen** national capacities, and **Timely** and predictable aid.

Principle	Progress in Afghanistan
Compacts	Afghanistan's Compact (the 2012 Tokyo Mutual Accountability Framework) has nine donor commitments on implementing aid effectiveness, and 16 government commitments in five thematic areas.
Use of PSGs to monitor	Afghanistan has not established PSG indicators. The upcoming New Deal study will be used as an opportunity to consider whether specific country-level indicators for the PSGs are required, in addition to the existing indicators in the Tokyo Mutual Accountability Framework. Donors are reported to have indicated that they are not keen on the suggestion of new indicators.
Support political dialogue and leadership	Afghanistan reports that steps to lay foundations for credible and inclusive processes of political dialogue and leadership have principally taken place through international conferences for Afghanistan. The Tokyo Mutual Accountability Framework provides a mechanism for dialogue between Government and development partners at operational level.

Source: *International Dialogue on Peacebuilding and Statebuilding (2014: Annex A)*

The New Deal Monitoring Report does not provide an equivalent scoring by country for the TRUST principles, which are instead evaluated on overall donor performance. However, it is possible to get a sense of implementation from the discussions presented so far.

**Table 5: Progress on TRUST PRINCIPLES**

Principle	Progress in Afghanistan
<b>Transparency</b>	Afghanistan scored 59/100 in the 2012 Open Budget Index, ranking 60 out of 98. It has seen a large improvement from scores of 8 in 2008 and 21 in 2010. Donors scored a D+ in the 2013 PEFA assessment for financial information provided by donors for budgeting and reporting on project and program aid, and scored a D in 2008 and a D+ in 2005.
<b>Risk Sharing</b>	The Afghanistan Reconstruction Trust Fund ensures a harmonised financing approach while pooling fiduciary risks and supports national programmes to facilitate service delivery by the government.
<b>Use and strengthen country systems</b>	The Afghanistan Reconstruction Trust Fund provided funding for the government's recurrent budget soon after its conflict ended. Policy-based budget funding was deemed critical for rebuilding the state in these countries and enabled the government to re-establish its basic functions. The Tokyo Mutual Accountability Framework includes a target for 50% of aid to be delivered through country systems.
<b>Strengthen capacities</b>	Donor support for capacity building has led to significant progress in improving Afghanistan's PFM systems. However, there are concerns that much of this progress relies on donor-contracted staff. There are also concerns that the large number of contract staff hired for parallel projects undermines attempts to build government capacity.
<b>Timely and predictable Aid</b>	Predictability of direct budget support disbursements were ranked B+ in both the 2013 and 2008 PEFA assessments.

## Conclusions and key lessons

The political importance of leaving a functioning state in Afghanistan following western military intervention meant that ambitious targets for using country systems were set. Despite

---

Afghanistan making significant progress on strengthening PFM systems, progress towards these targets by donors has been slow. Most progress has been made by multilaterals and pooled funds which are able to put a much greater proportion of aid on budget. There are also concerns about the sustainability of the improvements in systems given the extent of foreign technical assistance Afghanistan is receiving.

As well as the importance of putting aid through country systems for establishing a viable state, there is also a strong case to be made that it matters for development effectiveness. Two of the most successful programmes in Afghanistan – the expansion of basic healthcare, and the National Solidarity Programme – operate through government ministries.

# Sierra Leone and Liberia

## Introduction

This case study compares the use of country systems in Sierra Leone and Liberia. These two countries have many similarities in context, the level of aid, the degree that aid uses country systems and the strength of public budgetary and financial management. Rather than providing a full overview of the use of country systems in both countries, the case study focuses specifically on the relatively successful experience with budget support in Sierra Leone and in the use of pooled funding and results-based aid in Liberia. This provides a useful illustration of how donors used different vehicles in two similar countries.

**Table 6: OECD 2011 monitoring report and PEFA assessment**

Indicator	Liberia	Sierra Leone
CPIA score for budgetary and financial management (2010)	2.5	3.5
Aid reported in the 2011 survey	US\$ 402m	US\$ 451m
Indicator 5a: Use of financial management systems	42%	37%
Budget execution	49%	22%
Financial reporting	34%	38%
Auditing	44%	49%
Indicator 5b: Use of procurement systems	32%	21%
Mean PEFA score for country systems (2012 and 2010, respectively)	1.95 (approx. C)	2.42 (approx. C+)
D-1 Predictability of Direct Budget Support	D	D
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	D+	D+
D-3 Proportion of aid that is managed by use of national procedures	D	D

Source: OECD 2011; PEFA Secretariat 2014

## Country background

The neighbouring states of Liberia and Sierra Leone share a common history of conflict and instability. Both countries, initially established for emancipated slaves from the United States and UK respectively, saw public institutions deteriorate through decades of corrupt, oppressive regimes, coups, attempted coups and civil war. Conflict lasted, on and off, from 1989 to 2003 in Liberia and from 1991 to 2002 in Sierra Leone, linked by the support Liberia's Charles Taylor's National Patriotic Front lent to Sierra Leone's Revolutionary United Front. By the time conflict ended, both countries ranked firmly among the least developed countries in the world.<sup>10</sup> In 2005, GDP per capita was just US\$470 in Liberia and US\$1,156 in Sierra Leone (adjusted for purchasing power parity at 2010 prices). In the same year, only DR Congo, Niger, Burundi, Chad and Central African Republic scored lower on the Human Development Index.

Both countries have made clear progress in rebuilding their economic and political foundations over the past decade, albeit from a low base. Economic growth has rebounded, poverty rates have fallen and life expectancy improved. Sierra Leone has held three broadly credible and peaceful elections, including a transition between the two main political parties in 2007. Military security has been restored with external support. Liberia has held two post-

<sup>10</sup> Unlike in Liberia, fighting in Sierra Leone rarely reached the capital, Freetown, though almost 2.6 million people are thought to have been displaced across the country (Kaldor & Vincent, n.d.). [Liberia no elec/water]

conflict elections in 2005 and 2011, won by President Ellen Johnson Sirleaf, but security in Liberia remains more fragile than in Sierra Leone, and the UN continues to maintain a military presence. Despite this, Liberia has been performing well (indeed better than Sierra Leone) on a number of indicators, particularly related to the economy and business environment, but also on components of the CPIA and the Human Development Index.

**Table 7: key indicators and statistics**

Statistic	Source	Liberia	Sierra Leone
Period of conflict	Various	1989-2003	1991-2002
Real GDP growth rate (2006-2010)	IMF WEO 2015	7.6%	5.2%
GDP per capita (2010, PPP)	IMF WEO 2015	719.2	1,320.0
Population (2010 est, millions)	IMF WEO 2015	3.8	5.8
HDI rank (2010, out of 169)	UNDP HDR 2010	162	158
Ease of doing business ranking (2013)	World Bank 2015	67	142
Africa Infrastructure Development Index score (2010, out of 100)	AfDB 2013	11.1	7.6

Since early 2014, both countries have been affected by an outbreak of Ebola that claimed over 11,000 lives in West Africa. This case study does not consider the international response to this humanitarian crisis. However, weaknesses in national health and PFM systems have been badly exposed by the epidemic. This created a number of fiduciary, reputational and operational risks for donors engaging in the region. Box [X] provides some of the key lessons learnt from the response so far, though no doubt more will be revealed in the coming years.

### Overview of donors and aid flows

Aid is an important resource for both Liberia and Sierra Leone. Figures for both GDP and aid flows are not always reliable, but estimates suggest that official aid has ranged between 41% and 147% of GDP in Liberia and 15% and 31% in Sierra Leone in the post-conflict years up to 2010. Both countries receive mostly project aid, according to OECD DAC statistics, but there has been relatively strong commitment to budget support from donors in post-conflict Sierra Leone that was not a feature of the aid landscape in Liberia.

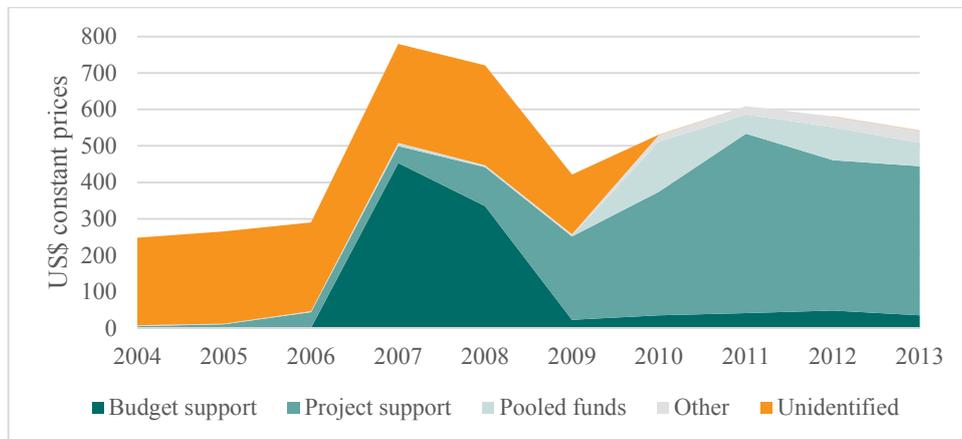
Aid has been channelled mostly through debt relief and project aid. Budget support (general and sector) disbursements have usually been less than US\$30 million per annum in Liberia, compared to over US\$60 million in Sierra Leone between 2009 and 2013. This makes it a small proportion of development assistance to both countries – around 6% in Liberia and 12% in Sierra Leone in 2013, excluding debt relief. In contrast project aid makes up around 76% of ODA to Liberia and 63% in Sierra Leone, excluding debt relief. However, relative to other countries, budget support has been a large proportion of public expenditure in Sierra Leone and an important focal point for policy dialogue between the government and its development partners (Lawson, 2007). It is also important to note that the budget support recorded for Liberia in 2007 and 2008 was from the World Bank and the IMF to repay arrears to the two institutions – it is effectively debt relief rather than true budget support, which was only provided later and in much smaller amounts.

The number of donors providing country programmable assistance nearly doubled in both countries between 2000 and 2013 but new donors are generally small.<sup>11</sup> As a result donor fragmentation remains relatively low. Before the conflict ended, the five largest donors

<sup>11</sup> In recent years, the largest donors for Sierra Leone have been the EU, UK and IDA. In Liberia, the USA is the largest donor, together with IDA, Japan, the EU and Norway.

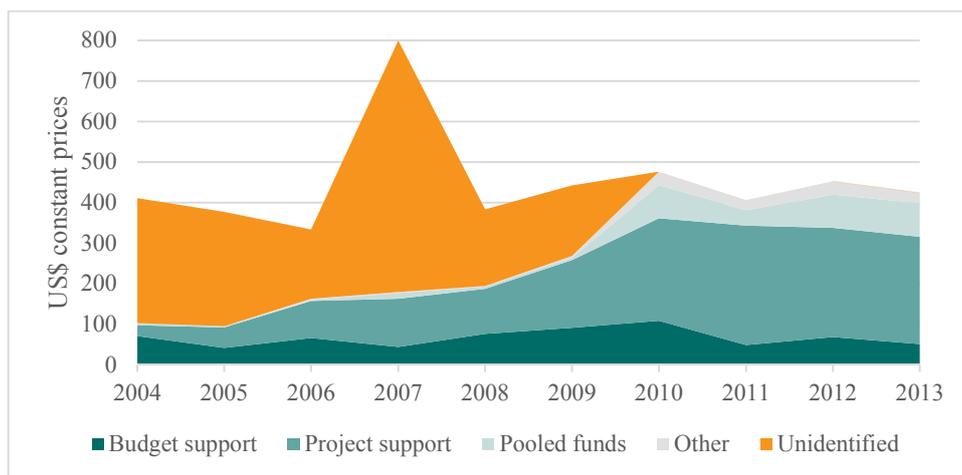
provided over 80% of country programmable aid in Liberia and nearly 90% in Sierra Leone.<sup>12</sup> This has since fallen to around 60% and 70%, respectively, in recent years as other donors entered the frame.

**Figure 5: Official Development Assistance in Liberia**



Source: OECD CRS 2015

**Figure 6: Official Development Assistance in Sierra Leone**



Source: OECD CRS 2015

The donor community in Sierra Leone was found to have exceptionally strong informal networks that lessened the impact of fragmentation in practice (OECD, 2010a). Though there have been efforts in Liberia to harmonise practices, these do not appear to have had the same unity as in Sierra Leone (Fölscher & Allan, 2014).

<sup>12</sup> Calculations are based on the OECD DAC statistics. These sometimes differ from the OECD country reports for the Paris or Busan agendas. For example, the country report for Sierra Leone records only 21 donors providing country programmable assistance between 2005 and 2006 (OECD 2010), while the DAC statistics show 24 donors in 2005 and 31 in 2006.

**Figure 7: Aid fragmentation in Liberia and Sierra Leone**



Source: Authors' calculations from OECD DAC statistics, May 2015

## PFM systems and other risks

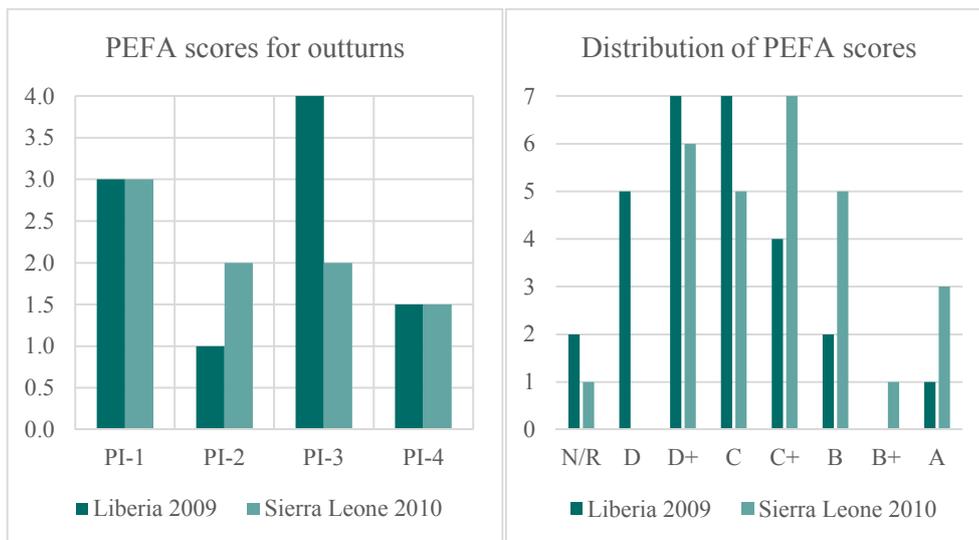
### PFM systems

Overall, available indicators suggest that PFM systems are stronger in Sierra Leone than in Liberia, though the gap may have closed in recent years.<sup>13</sup> CPIA scores for budgetary and financial management were stable at 3.5 in Sierra Leone (on a scale of 0-6) in all available years (2005 and 2013) but rose in Liberia from 2.5 in 2009 to 3.0 in 2013. Similarly, PEFA scores in Sierra Leone (in 2010) are bunched around a C+, compared to around C in Liberia. At the very least, it suggests that Sierra Leone complies more closely with international good practices for PFM, including for a number of indicators that are important for donor use of country systems, such as procurement and fiscal reporting.

Despite this, the two countries have similar scores for budget credibility on the expenditure side. Both operate cash-budgeting systems, with limited scope to borrow domestically to smooth expenditures as revenues fluctuate. The two countries are also highly dependent on resource revenues from mining that make macro-fiscal management highly uncertain (reflected in the poor PEFA scores for credibility of revenue forecasts). Combined with delayed aid disbursements, weaknesses in budget preparation, and the need to pacify IMF and political demands, officials must effectively reprioritise spending on a near continuous basis during budget execution. However, these challenges are not unique and are features of countries that have been receiving budget support for long periods, including Uganda.

<sup>13</sup> CPIA scores for Liberia are not available before 2009 and PEFA assessments are not publicly available for exactly the same years (2007, 2010 and 2014 for Sierra Leone; 2009 and 2012 for Liberia). The analysis draws mainly on the PEFA assessment for 2009 in Liberia and 2010 in Sierra Leone because these were conducted close together and are less likely to have been influenced by gaming than later assessments.

**Figure 8: PEFA scores for Liberia and Sierra Leone**



Source: PEFA secretariat

Public expenditure tracking surveys have been a regular feature of the PFM system in Sierra Leone over the past decade. Some suggest that there have been improvements in the PFM system since the end of the conflict. For example, 75% of essential drugs were accounted for in Primary Health Units in 2006 compared to just 5% in the early 2000s (Thomson, 2007). However, a more recent tracking survey prepared by Save the Children (2012) showed a number of PFM weaknesses remain at the subnational level.

Most notable was significant discrepancies between the records of money transferred by councils and the funds received by District Health Management Teams and hospitals. No similar surveys were found to compare the state of PFM in Liberia’s service delivery units, though the Government has reportedly conducted surveys in the health, education and security sectors.

The improvements noted in the public expenditure tracking surveys in Sierra Leone are consistent with the broader claims that PFM systems have improved in both countries since conflict ended over a decade ago (Tavakoli, et al., 2014; Fritz, et al., 2012). Progress has arguably been more dramatic in Sierra Leone than in Liberia, though that perception may now be changing (Welham and Hadley, 2015). Improvements were supported by large volumes of technical and financial assistance from donors, but have been underpinned by strong country ownership.

**Other concerns/risks**

Corruption is identified by DFID as a specific fiduciary risk in Sierra Leone and Liberia (DFID, 2013). Despite reported progress in tackling corruption in the public sector, Sierra Leone scores particularly poorly on international (perception-based) indices of corruption. These do not necessarily mean that corruption will affect the use of donor (or government resources).

There are also concerns in Sierra Leone that PFM reform has slowed in recent years after rapid improvements in the first half of the 2000s (Welham and Hadley, 2015). This is set against a backdrop of changing revenue dynamics since large-scale iron ore mining resumed in 2012, freeing domestic resources for capital spending for the first time and raising concerns about the capacity of government systems to execute investment projects, which have historically been financed by donors.

### **Box 1: Use of country systems during the Ebola response**

The 2014 Ebola virus epidemic was unprecedented, affecting numerous countries in West Africa, but particularly Guinea, Liberia and Sierra Leone. By June 2015, there had been nearly 15,000 confirmed cases in these countries, with many more suspected, claiming thousands of lives. Lessons are still being learnt about how to prevent and manage future outbreaks. Some of these experiences are relevant to the discussion of the use of country systems.

Weak health and financial management systems meant that the response was predominantly conducted through parallel systems. In Sierra Leone, the World Bank reportedly chose not to use government payroll systems to make hazard payments to health workers in Sierra Leone after early signs of corruption (Maxmen, 2015). UNDP managed the hazard pay database and co-ordinate the payment system, with additional safeguards provided by an external accounting firm, BDO. However, there have been reports that numerous frontline workers did not receive their hazard pay (Maxmen, 2015). The Government in Liberia also opted to deliver US\$ 20 million in additional funding through an Ebola Trust Fund with a number of special safeguards, which it hoped would attract contributions from donors (GoL, 2014). Major donors such as the United States and World Bank opted not to use this arrangement, though the World Health Organisation did. An audit for the first three months of operations was conducted by the General Auditing Commission of Liberia and raised concerns over how some of the funds were used.

However, that does not mean that country systems were not used at all. A number of donors were able to front-load budget support and thereby increased the use of country systems. In addition, the IMF disbursed an additional US\$130 million to the affected countries through the Extended Credit Facility (Sierra Leone and Liberia) and the Rapid Credit Facility (Guinea) to compensate for revenue losses and emergency spending needs.

## **Use of country systems**

### **Country systems used by donors**

According to OECD (2011) Report on Aid Effectiveness, donors use country systems for between a third and half of aid disbursed in Sierra Leone and Liberia. However, PEFA indicators for donor practices in both countries are poor. Notably, budget support has been subject to delays and information on donor-finance projects is not available in either the budget or quarterly reports. In practice aid that used country systems was mostly provided as budget support or delivered through a pooled fund. Two specific examples are discussed in more detail next, in addition to results-based aid in Liberia. However, there are also donor projects that are on plan, on budget, on parliament and on treasury under the CABRI framework, but then use the donor accounting, procurement and audit systems. In Liberia, the experience has generally been positive, though delays in transfers from the finance ministry to the accounts of the implementing ministries have sometimes been delayed leading donors to pay directly to the implementing ministry (Fölscher & Allan, 2014).

The International Dialogue (2014) report on the New Deal identifies Sierra Leone for the progressive use of country systems by donors. Earlier evaluations of DFID support are equally complementary, with one commending the “bold political decision” by DFID to use budget support, comprising 35% of total financial commitments (Poate, et al., 2008). The Multi-Donor Budget Support partners, who provide around 70% of all financial support, generally use joint assessments of risk and have committed to increase the percentage of aid delivered through country systems (International Dialogue, 2014). Budget support has been coupled with significant financial support for governance reforms, including strengthening public finance management through successive World Bank administered trust funds. These too have been highlighted for the strong early progress that resulted, in part, from strong

---

government ownership and the reform incentives created by budget support (Tavakoli, et al., 2014).

In contrast, Liberia stands out for the use of pooled funding and results-based aid modalities. In the health sector, donor assistance transitioned from humanitarian interventions to the use of country systems through the use of a pooled fund (Hughes, et al., 2012). Established by the Government in 2008, with an initial contribution from DFID of US\$8 million, the Health and Welfare Pooled Fund is managed by a Steering Committee chaired jointly by the Minister of Health and a lead donor, and is administered by PwC as an external Pool Fund Manager (Liberia Poverty Reduction Forum, 2008). The fund uses government procurement regulations and financial management systems, and is audited by both the General Auditing Commission (GAC) and an independent auditor appointed by the Steering Committee. More than two-thirds of the Fund is used for delivering a basic package of health services, with 9% reserved for systems strengthening (Hughes, et al., 2012). Between 2007 and 2009 around 10% of donor aid to the health sector was implemented through the Fund (Hughes, et al., 2012).

USAID does not use the pooled fund, but instead provides results-based aid through a Fixed Amount Reimbursement Agreement (FARA). This scheme reimburses the government for agreed outputs based on predetermined amounts, transferring the risk of corruption and inefficiency largely onto the Liberian government. The programme approved support of up to US\$42 million between 2011 and June 2015, including for the government to contract NGOs for health service delivery. As yet there is no public evaluation of the scheme to judge the improvement from previous arrangements, though the scheme itself has early received acclaim.

Trends in the use of country systems are clearly fluid, though data is not always available to track these changes with certainty. A notable shift in Liberia has been the decision of the EU, African Development Bank and World Bank to provide budget support since 2009/10. The 2012 PEFA assessment for Liberia also noted a significant shift in project aid executed by the government rather than donors between 2009/10 and 2011/12. Sierra Leone has also seen a large increase in project-type modalities since 2009.

### **Factors affecting the use of country systems**

The decision whether or not to use country systems in these three examples remains largely political. In the case of Sierra Leone, the decision to use budget support was made early on. For DFID, a key objective was to provide sufficient financing to make a difference to macroeconomic management and restore an operational budget that could support an expanded wage bill for the police and defence forces (Lawson, 2007). This was backed by a ten year memorandum of understanding about budget support in 2002, indicating real long-term engagement. When the agreement expired in 2012, budget support continued. DFID has also played a role as an anchor in the donor group which has supported informal coordination.

In Liberia, donors were providing largely humanitarian assistance after the conflict ended and could not agree to use sector budget support as recently as 2008 (Hughes, et al., 2012). Concerns were cited over the quality of public finance systems, but also of the capacity of health systems to absorb funding (Hughes, et al., 2012). These needed to be mitigated in order for donors to agree to use the Fund. Interestingly, disagreements between donors over the use of USAID's new Fixed Amount Reimbursement Agreement led USAID to pay directly into the Central Bank rather than the Pool Fund, effectively providing earmarked budget support before other donors (Hughes, et al., 2012).<sup>14</sup> This move demonstrates that the modality itself may not be a barrier to using country systems more broadly.

---

<sup>14</sup> Other donors using the Pooled Fund reportedly had concerns over the implications of results-based payments – principally that by funding inputs rather than outputs, the other donors may be underwriting the risk of non-performance (Hughes, et al., 2012).

---

## Risk

The approach to risk management has been very different in the examples provided so far. Fiduciary risks in Sierra Leone were, and remain, high for donors providing budget support (Lawson, 2007). Macroeconomic risks have been managed through the requirement for the Government of Sierra Leone to adhere to an IMF programme. Indeed, the relationship between the IMF and Minister of Finance James Jonah was good enough for the government to establish a reputation for sound fiscal management even before the conflict ended (Thomson, 2007). This ‘trust’ may even have been a factor behind the provision of budget support in the first place. However, patronage continues to dominate the political landscape in Sierra Leone and rules-based PFM systems are still being institutionalised (Lawson, 2007; Welham & Hadley, 2015). PFM reforms are being supported by significant investments from a number of donors (Tavakoli, et al., 2014). Despite this, risks in the short-run are likely to remain, and so will be subject to political attention (Lawson, 2007).

In Liberia, fiduciary risks in the Health Pooled Fund were mitigated initially through the appointment of a Fund Manager, initially PwC, and commissioning independent audits (Hughes, et al., 2012).<sup>15</sup> As issues were raised, the Office of Financial Management in the Ministry of Health was strengthened, for example to improve monitoring and evaluation of spending. These processes were overseen by the Steering Committee, which also produced and annual Fiduciary Risk Assessment Review (Hughes, et al., 2012). The Fixed Amount Reimbursement Agreement also had a number of controls, despite there being limited risk to USAID. The usual procurement constraints on USAID funding were waived, but pre-approval was still needed for the Government to purchase drugs and for requests for proposals that exceeded US\$1.5 million. Otherwise, funding was executed through government procurement and financial management systems.

## Impact of use of country systems

As noted already, the overall approach to budget support in Sierra Leone has been widely acclaimed. There appears to be some evidence from evaluations of DFID’s contributions, that budget support has increased the fiscal space for delivering public services (Lawson, 2007). Budget support may also have strengthened the government’s commitment to sound macro-fiscal management under an IMF programme (Tavakoli, et al., 2014). Certainly the government has been able to foster relatively strong economic growth while maintaining control over inflation (Welham & Hadley, 2015). PFM and other public sector reforms have also had varying degrees of success in building country systems. Capacity building has been relatively successful for the State Audit Institution (Thomson, 2007), and pockets of effectiveness can be easily identified in the Ministry of Finance management staff, who have been absorbed by the government payroll. This has permeated country systems below the national level as well, as evidenced by reduced leakage at health centres and schools compared to the early 2000s (Thomson, 2007). However, reforms to reduce corruption and improve the civil service overall have generally been less effective (Thomson, 2007).

The use of country systems in the health sector in Liberia successfully transitioned donor funding from humanitarian to developmental assistance, and increased the share of health spending under the control of the Government of Liberia (Hughes, et al., 2012). This has reportedly translated in lower administrative burdens for service delivery units and subnational governments. The number of health facilities where the principal source of funding is from the Ministry of Health has risen from 95 in 2008 to 309 (of 378) in 2011, while the number of counties with only one source of donor financing has increased from 8 in 2008 to 14 (of 15) in 2011 (Hughes, et al., 2012). However, not all donors have used the

---

<sup>15</sup> A similar approach was used for the Liberia Governance and Economic Management Assistance Programme (GEMAP) from 2009 onwards, when co-signatory authority was passed to Liberian counterparts. A formal evaluation by Cohen, et al. (2010) noted that this arrangement helped to gain greater control over salary payments and other procurement, as well as authority to establish new rules and procedures. However, it did not prevent all fraud.

fund – including USAID, the EU and the Global Fund – meaning overall benefits are still below potential (Hughes, et al., 2012).

### New Deal principles

As part of the New Deal for engagement in fragile states (International Dialogue on Peacebuilding and Statebuilding, 2011), members of the International Dialogue signed up to the FOCUS<sup>16</sup> principles on new ways of engaging with fragile states, and the TRUST<sup>17</sup> principles of providing aid more effectively.

Overall, Sierra Leone stands out as the most extensive and integrated implementer of the New Deal, though Liberia is also making progress on this front. The first New Deal Monitoring Report (International Dialogue on Peacebuilding and Statebuilding, 2014) set out a traffic light system for evaluating progress on these goals. Green indicates substantial progress on New Deal Commitments, amber some progress and red insufficient or no progress. The FOCUS principles are measured on a country-by-country basis, and are summarised in the table below.

**Table 8: Progress on FOCUS PRINCIPLES**

Principle	Progress in Sierra Leone and Liberia
Fragility assessments	<b>Sierra Leone:</b> conducted a fragility assessment in 2012, which was due to be updated in 2014. The PSG indicators were mainstreamed into the national Agenda for Prosperity.
	<b>Liberia:</b> A fragility assessment was conducted in Liberia.
One Vision, one Plan	<b>Sierra Leone:</b> Agenda for Prosperity drew on the lessons learned from the previous development plan, inputs from the Fragility Assessment and outcomes from a national Transformation and Development Conference. Development partners are aligned to the Agenda for Prosperity, and budget support donors (UK, World Bank, ADB, EU) held consultations with Government on the development of their country strategies.
	<b>Liberia:</b> New Deal principles are incorporated into Liberia’s Agenda for Transformation, which demonstrates how the PSGs map to its objectives.
Compacts	<b>Sierra Leone:</b> Sierra Leone’s Compact (the 2014 Mutual Accountability Framework) is explicitly based on New Deal principles, and is focused on delivery of the Agenda for Prosperity. Extensive discussions were held between Government, Development Partners and civil society before it was finalised. It has a results dashboard that tracks progress in implementing commitments.
	<b>Liberia:</b> reportedly considering Compact development
Use of PSGs to monitor	<b>Sierra Leone:</b> has established country level indicators for measuring progress against each of the five PSGs. The PSG indicators have been included as one of the building blocks in the Mutual Accountability Framework dashboard.
	<b>Liberia:</b> has developed draft PSG indicators, and established a New Deal dashboard to track aid disbursements across the five PSG.

<sup>16</sup> Engagement based on a country-led **Fragility assessment** developed by the g7+ with the support of international partners, a country-led **One vision and one plan**, a country **Compact** to implement the plan, **Use** of the PSGs to monitor progress, and **Support** inclusive and participatory political dialogue and leadership.

<sup>17</sup> Enhanced **Transparency**, **Risk-sharing**, **Use** and strengthen country systems, **Strengthen** national capacities, and **Timely** and predictable aid.

Principle	Progress in Sierra Leone and Liberia
	However, it has not yet established a mechanism for monitoring PSG progress within the context of the national planning framework.
Support political dialogue and leadership	<b>Sierra Leone:</b> All stakeholders including the Government, CSOs and Donors meet to discuss issues relating to elections and governance. Civil society also participates in the quarterly co-ordination and dialogue meetings between Government and development partners.
	<b>Liberia:</b> not reviewed.

Source: *International Dialogue on Peacebuilding and Statebuilding (2014: Annex A)*

The New Deal Monitoring Report does not provide an equivalent scoring by country for the TRUST principles, which are instead evaluated on overall donor performance. However, it is possible to get a sense of implementation from the discussions presented so far.

**Table 9: Progress on TRUST PRINCIPLES**

Principle	Progress in Sierra Leone and Liberia
<b>Transparency</b>	<b>Sierra Leone:</b> was included in 2012 for the first time in the Open Budget Index, scoring 39/100 and ranking 60 out of 98. Donors score a D in the 2014 PEFA assessment for financial information provided by donors for budgeting and reporting on project and program aid.
	<b>Liberia:</b> has improved its score in the Open Budget Index from 3/100 in 2008 to 43/100 in 2012, and a rank of 55 out of 98. Donors score a D+ in the 2012 PEFA assessment for financial information provided by donors for budgeting and reporting on project and program aid.
<b>Risk Sharing</b>	<b>Sierra Leone:</b> The country survey reports that Multi Donor Budget Support partners, who provide about 70% of all support to Sierra Leone, usually undertake joint assessments. EU member states have also adopted a joint programming approach. The Mutual Accountability Framework Dashboard makes provision for a joint risk assessment between Government and Development Partners.
	<b>Liberia:</b> the Health Pooled Fund used a joint assessment, though budget support arrangements appear to have been made independently by EU, African Development Bank and World Bank.
<b>Use and strengthen country systems</b>	<b>Sierra Leone:</b> It was reported in 2010 that 37% of country programmable aid used country financial systems and 21% procurement systems. A 2013 report by the World Bank's Independent Evaluation Group found that Sierra Leone currently has 295 ongoing donor-funded projects using PIUs for implementation. The Mutual Accountability Framework dashboard sets targets for development partners to increase the percentage of aid delivered through country systems, although the country survey reports that achieving these targets remains a challenge.
	<b>Liberia:</b> It was reported in 2010 that 42% of country programmable aid used country financial systems and 32% procurement systems. The USA has provided direct government financing in the health sector.
<b>Strengthen capacities</b>	<b>Sierra Leone:</b> all four multi-donor budget support partners (EU, UK, World Bank, ADB) have funded a PFM reform programme that has been supporting capacity development in the government and civil society.

Principle	Progress in Sierra Leone and Liberia
	<b>Liberia:</b> GEMAP provided substantial support to governance and capacity building. There is also support to PFM (Sweden) and PFM risk assessments of Government institutions (US).
<b>Timely and predictable Aid</b>	<b>Sierra Leone:</b> donor disbursements were ranked D in the 2014 PEFA assessment, and other reports (e.g. Lawson, 2007) have identified the timing of budget support payments as a complicating factor for budgetary and fiscal management.
	<b>Liberia:</b> donor disbursements were ranked D in the 2012 PEFA assessment.

## Conclusions and key lessons

Both Sierra Leone and Liberia have demonstrated that donors can be encouraged to use country systems in very different ways, even where fiduciary risks are high. In Sierra Leone, the government had established credibility with the donor community for fiscal management, and demonstrated ownership of the development agenda. Though not mentioned explicitly, it seems that this is likely to have influenced donors (notably DFID) to provide budget support soon after conflict ended, who also took a bold political decision knowing that PFM systems were weak. There are signs that donor-government relations have frayed in recent years, though Sierra Leone continues to press for implementation of the New Deal. More obvious is the general shift away from budget support by bi-lateral donors as political tolerance of fiduciary risks waned in recent years.

In contrast, the Government of Liberia was unable to convince donors to provide sector budget support for the health sector. It seems that the administrative difficulties of transitioning from humanitarian assistance to development aid played some part in that reluctance, though it is not clear how much. Certainly, concerns were raised about the ability of the systems – which were probably weaker, but less corrupt, than in Sierra Leone – to absorb additional resources effectively. Instead, the Government focused on mitigating fiduciary risks with additional safeguards on donor resources, while creating a vehicle for coordination – a pooled fund. This had some success in increasing the control the Ministry of Health had over resources, as well as improving donor harmonisation. Systems, such as the Office for Financial Management, may also have been strengthened.

These two examples may be unusual. This case study has not reviewed the full spectrum of use of country systems in these two countries, but focused on those that have been highlighted as successes. Not all approaches to the use of country systems have been as well received. For example, the International Dialogue (International Dialogue, 2014) write:

In several g7+ countries, including Liberia, Sierra Leone and South Sudan, increasing amount of aid has been brought on budget in recent years, based on aid tracking systems, without necessarily being channelled through treasury systems. These mixed approaches are rarely registered and tracked, and this makes it difficult to set joint targets. It also suggests that greater clarity and nuance is needed about what use of country systems actually involves and how to monitor early steps towards their greater use.

The differences in approach cannot be explained by the quality of country systems alone. Instead, successful cooperation has emerged where donors aligned with the government and supported its efforts to reform. In Sierra Leone this was clearly evident at the national level. The Health Sector Pooled Fund in Liberia shows that similar initiatives can develop at the sector level. However, commitment to use country systems through budget support and pooled funds appears to be shifting in favour of project-type modalities in both countries.

---

# South Sudan

## Introduction

This case study reviews the use of country systems in South Sudan. It finds that there has hardly been any use of country systems. South Sudan has unique circumstances with a regional government being set up almost from scratch after two decades of civil war, followed by independence. Between 2005 and 2011, the Government of Southern Sudan was a semi-autonomous regional government within Sudan. After July 2011, the Republic of South Sudan was an independent state. During this time South Sudan also had significant oil revenues, although price shocks from the financial crisis in 2009, and policy shocks from disputes with Sudan made these extremely volatile. This combination of weak systems and significant revenues affected use of country systems. Despite this, as a post-conflict country, South Sudan received significant amounts of aid, and much of the analysis focuses on the pooled funding mechanisms which attempted to coordinate this support. Ultimately the slow start made by what had been anticipated to be the main vehicle – the Multi-Donor Trust Fund – led to other funds being established, and the potential for improved coordination was missed.

## Country Background

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

The semi-autonomous government of Southern Sudan was formed from July 2005, following the peace agreement and took on responsibility for most internal affairs, and received 50% of oil revenues from fields in South Sudan (which accounted for 85% of Sudan's oil output). Following independence, it received all revenues, but oil exports were dependent on ports, pipelines and other infrastructure located in North Sudan.

South Sudan was thus in the relatively unusual situation of being a fragile post-conflict state that also had access to large amounts of its own resources. Public spending per capita were at least three times as high as in East African neighbours such as Uganda and Kenya (World Bank, 2013b).

Experience of war left South Sudan severely undeveloped.<sup>18</sup> The poverty rate stood at 51%. 83% of the population lived in rural areas, and nearly three-quarters depended on crop farming or animal husbandry as their primary source of livelihood. Literacy rates were only 27% and only half of school-age children were in primary school.<sup>19</sup> The under-five mortality and maternal mortality rates were some of the highest in the world.<sup>20</sup>

At independence, key bilateral issues, such as border demarcation, security arrangements, and oil pipeline fees, remained unresolved between Sudan and the new Republic of South Sudan.

---

<sup>18</sup> All the following figures are taken from SSCSE (2011)

<sup>19</sup> The Net Enrolment Rate for primary school in 2009 was 48%.

<sup>20</sup> In 2006, the U5 mortality rate was at 135 per 1000 births, and maternal mortality rate was 2054 per 100,000 live births.

---

When South Sudan seceded it took with it around three quarters of Sudan's oil production. However, the oil pipelines and other infrastructure required to export the oil, are in the north, with the pipeline terminus at Port Sudan. There was no agreement on the fees that South Sudan would pay to Sudan for use of this infrastructure, and negotiations to resolve these issues dragged on. In January 2012, South Sudan accused Sudan of 'stealing' oil for its own use and for export, and shut down oil production in response.

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

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

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

Progress was made on developing the Compact through the remainder of 2013, including consultations in all 10 of South Sudan's states. However, there was a major setback to the support envisaged in November 2013. One of the key commitments in the compact was IMF support, which required unification of the official and parallel exchange rate. Once announced by the Bank of South Sudan on 11 November, Parliament summoned the Governor of the Central Bank the following day and directed that the official rate change should be reversed. He complied with this directive. Furthermore, this period was marked by an escalation of internal political tensions in South Sudan. In July 2013, President Salva Kiir sacked his entire cabinet, including the Vice-President Riek Machar, who had already indicated his desire to challenge Kiir for the leadership of the ruling party, the Sudan Peoples' Liberation Movement (SPLM). Kiir also suspended the party's influential Secretary General, Pagan Amum, who had previously been South Sudan's chief negotiator with Sudan.

Violence broke out in December 2013, when tensions within the Presidential Guard led to fighting during an SPLM National Liberation Council meeting, which saw confrontation between the President and figures who stood in opposition to him.<sup>21</sup> The violence spread rapidly across South Sudan as several army units defected, and civilian militias that had been active during the war, were remobilised.

---

<sup>21</sup> Most notably former Vice-President Riek Machar, suspended SPLM Secretary General Pagan Amum, and the wife of the deceased founder of the SPLM/A, Rebecca Nyandeng.

**Table 10: OECD 2011 monitoring report and PEFA assessment**

Indicator	Score
CPIA score for budgetary and financial management (2012)	2.0
Aid reported in the 2011 survey	N/A
Indicator 5a: Use of financial management systems	N/A
Budget execution	N/A
Financial reporting	N/A
Auditing	N/A
Indicator 5b: Use of procurement systems	N/A
Mean PEFA score for country systems (2012)	1.79
D-1 Predictability of Direct Budget Support	N/A
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	C
D-3 Proportion of aid that is managed by use of national procedures	D

Source: OECD 2011; PEFA Secretariat 2014

**Table 11: key indicators and statistics**

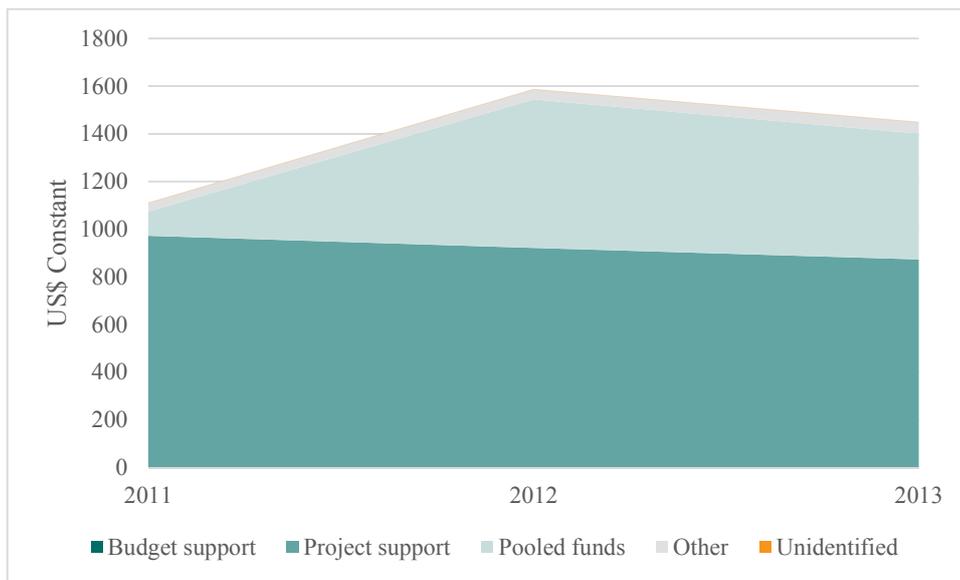
Statistic	Source	South Sudan
Period of conflict	Various	1983-2005; 2013-
Real GDP growth rate (2007-2012)	IMF WEO 2015	N/A
GDP per capita (2012, PPP)	IMF WEO 2015	US\$ 1,843
Population (2012 est, millions)	IMF WEO 2015	10.8
HDI rank (2012, out of 187)	UNDP HDR 2010	N/A

### Overview of donors and aid flows

South Sudan receives a large amount of aid. On OECD CRS figures, US\$1.4 billion was disbursed in 2013, as shown in figure 8 below. The Ministry of Finance reports that South Sudan receives the fifth-highest per capita allocations of aid in in Sub-Saharan Africa (Government of the Republic of South Sudan, 2014).

The largest eight donors, all disbursing above \$50 million in 2013, and accounting for 80% of aid were the United States, the United Kingdom, the EU, Norway, Japan, Sweden and Canada (on OECD CRS data).

**Figure 9: Official Development Assistance in South Sudan**



Source: OECD CRS 2015

## PFM systems and other risks

### PFM systems

CPIA scores for South Sudan are only available for two years (2012 and 2013) following independence. The overall score is low, at 2.1 being below the average of 2.8 for fragile states in sub-Saharan Africa.<sup>22</sup> The score for the quality of budgetary and financial management remains below the overall CPIA score, at 2 in both years.

The reasons for the low score on budgetary and financial management are explained in the PEFA assessment carried out based on fieldwork in April 2011, shortly before South Sudan's independence (World Bank, 2012). As shown in figure 10 below across three clusters South Sudan scores similarly to the average of fragile states (comprehensiveness and transparency, policy-based budgeting, and external scrutiny). However it performs worse than average on budget credibility, control in execution and accounting and reporting.

The average score performance indicators on budget credibility was very low "mainly to major weaknesses in the budget execution process". Particular issues highlighted causing this low budget credibility are a low predictability in the availability of funds due to unpredictable cash rationing, and a related build-up in payments arrears as a result of this, which leads to one year's commitments being paid in a following year, undermining the credibility of budgets further.

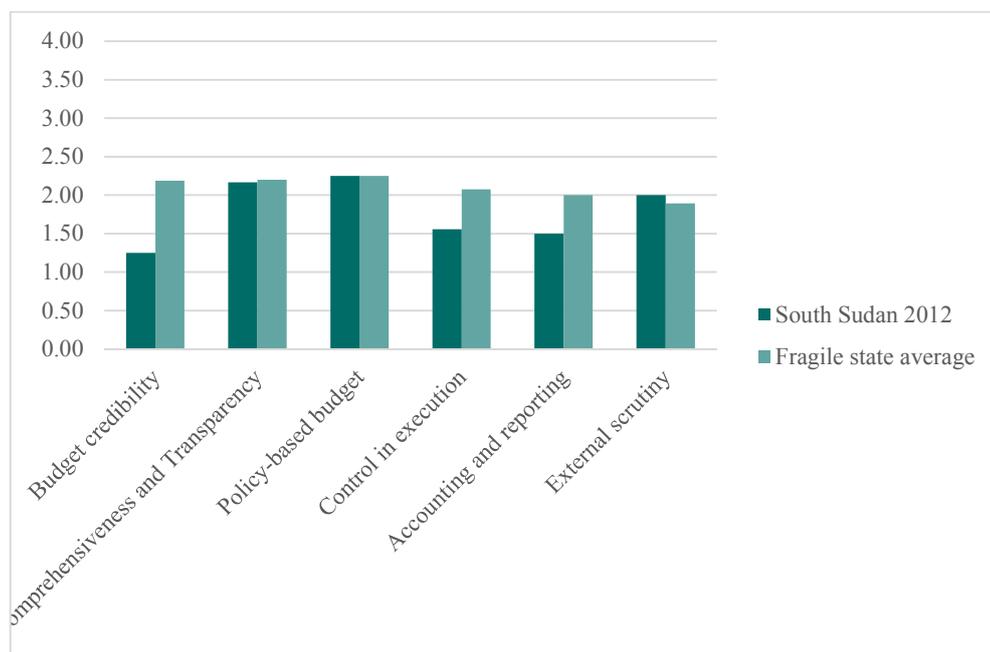
Against these weaknesses, progress was made since the establishment of the Government of Southern Sudan in 2004 on planning and budgeting functions, improved payroll controls with the introduction of the South Sudan Electronic Payroll System (SSEPS) and a human resource information system (HRIS).

However, it is worth noting that one element of the budget – transfers to states – was executed far more reliably than other parts of the budget. Between 2007 and 2012/13 these have been executed at least 94% of the budgeted level in all budget one year.<sup>23</sup>

<sup>22</sup> <http://datatopics.worldbank.org/cpia/country/south-sudan>

<sup>23</sup> Government of South Sudan and Republic of South Sudan budgets, various years.

**Figure 10: PEFA scores for South Sudan, 2012 and Average of Fragile State Scores**



Source: PEFA secretariat; Fragile state average is based on World Bank/ADB/AfDB Harmonised List

### Other concerns/risks

The lack of budget controls has been noted above as a major risk. Studies of the underlying political economy of South Sudan trace this to the political dynamics unfolding in South Sudan in the run-up to the independence referendum. The strategy was to spend massively on the military payroll in order to make it too expensive for Sudan to “rent” a southern militia and disrupt the referendum. The army payroll and salaries both rose between 2005 and 2011, and this strategy worked in deterring Sudan from stopping the independence referendum. Similarly, the strategy for maintaining loyalty among the SPLM leadership was to allow corruption with impunity (de Waal, 2014).

### Use of country systems

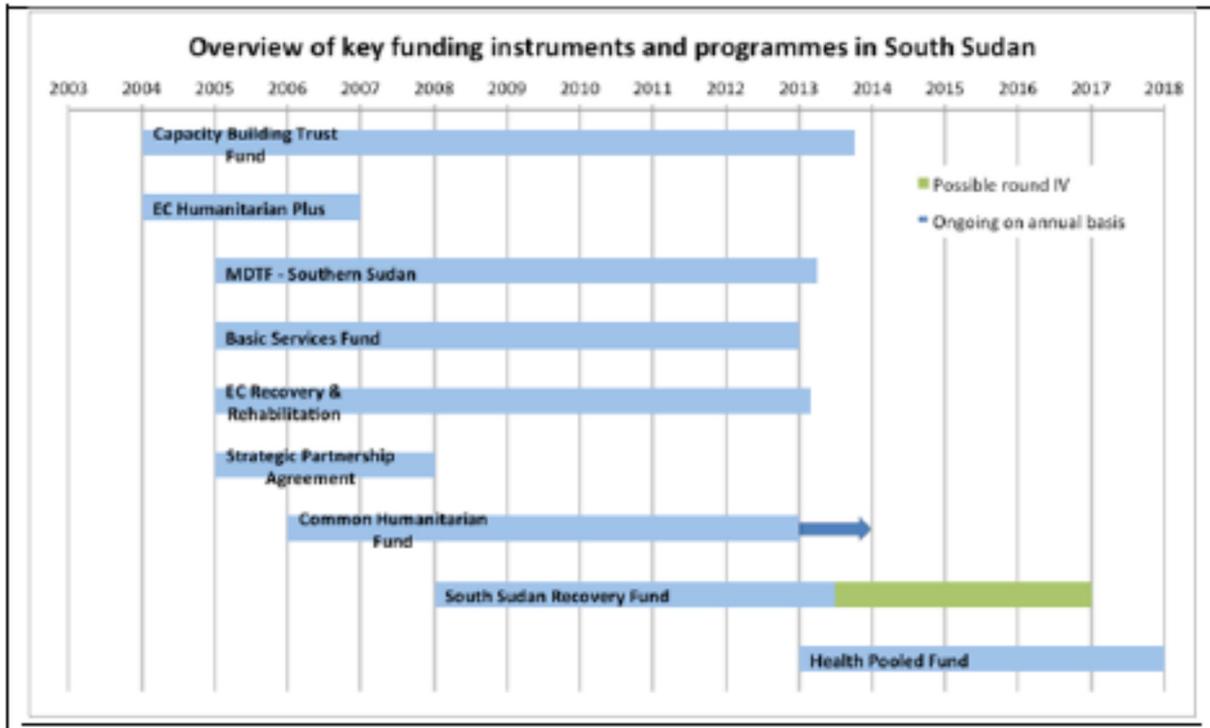
The perception of the level of risk in South Sudan mean that very little use has been made of country systems beyond putting aid on plan, as demonstrated in Budget Sector Plans and the Ministry of Finance Donor book (Government of the Republic of South Sudan, 2014). Efforts at alignment and harmonization have focused on the use of pooled funding mechanisms.

### Aid Modalities

Multiple different pooled funding modalities operated in South Sudan between the signing of the Comprehensive Peace Agreement in 2005 and independence in 2011. It is difficult to assess the proportion of aid provided through pooled mechanisms as this information is not available on a consistent basis from any source. OECD Creditor Reporting System (CRS) data is only available for South Sudan from 2011. The South Sudan donor book reports that 11% of donor funding was provided through pooled funds in 2012/13 (Government of the Republic of South Sudan, 2014). This is a decline from the 25% reported in 2010 (Government of the Republic of Southern Sudan, 2011). This decline reflects an increase in bilateral, rather than pooled assistance, following South Sudan’s independence. However, this figure is far smaller than the estimate of funding pooled funds and funds managed by international organisations from OECD CRS data, of 30% for 2013, as shown in figure 1 above.

The focus of this discussion is on the funds with a development, rather than a humanitarian focus: the World Bank administered Multi-donor Trust Fund (MDTF), the Capacity Building Trust Fund (CBTF), the DFID-led Basic Services Fund (BSF) and the Sudan Recovery Fund (SRF).<sup>24</sup>

**Figure 11: Timeline of Pooled Funds in South Sudan**



Source: *Commins, et al., 2013.*

The MDTF was designed to be the centre-piece of reconstruction efforts, and included government contributions.<sup>25</sup> However, the slow pace of disbursement of funds by the MDTF led to the proliferation of other funding mechanisms (OECD, 2010b). The CBTF and BSF had been established prior to the peace agreement and were expected to hand-over their capacity-building and service delivery responsibilities to the MDTF. However, the failure of the MDTF to meet expectations led to these funds being continued alongside the MDTF. The Basic Services Fund transitioned from a bilateral DFID programme into a multi-donor-funded programme.

The Sudan Recovery Fund (SRF) was established in 2008. It was intended to fill a gap in programming which the MDTF could not address – local and community-level activities, including community security, peacebuilding, governance, livelihoods, and basic services, as opposed to the MDTF’s focus on large-scale investment projects, and the fact that its mandate did not cover security issues. The funding would also be available to UN agencies which found it difficult to access funding from MDTF (OECD, 2010b).

In response to this fragmentation and proliferation of funding instruments, government in 2009 proposed the following division of labour between the pooled funds:

<sup>24</sup> Analysis of the humanitarian funds (the EC Humanitarian Plus Programme and the Common Humanitarian Fund) is not included here, nor is analysis of programmes purely implemented by one partner (the EC Recovery and Rehabilitation Programme is the EC’s rural development programme, and the Strategic Partnership agreement is the agreement between DFID, Netherland and Denmark to fund UNDP).

<sup>25</sup> Overall, government contributed 25% of the funds to the MDTF (Fafo Institute for Applied International Studies, 2013).

- the MDTF would remain responsible for large-scale infrastructure and economic interventions that require long lead times;
- the CBTF would lead on public sector reform;
- the SRF would lead on decentralization and sub-national development;
- the BSF would lead on basic service delivery by non-state actors

The government recommended that over \$100 million of funds be allocated away from the MDTF to other pooled funds to implement this division of labour (OECD, 2010b).

**Table 12: Pooled Funds in South Sudan**

<b>Trust Fund</b>	<b>Objective</b>	<b>Size</b>	<b>Management</b>	<b>Oversight</b>
Basic Services Fund	Improve coverage of service delivery during the transition from humanitarian to development financing.	\$60m	Administered by contracted private firm.	Steering committee chaired by government.
Capacity Building Trust Fund	Enhance the capacity of government to effectively manage human, organisational, and financial resources to serve its citizens	\$70m	Initially Unicef as the fund trustee with a private firm as a fund management agent, subsequently administered by a private firm.	Steering Committee chaired by government, with a larger government than donor representation, supported by a Technical Secretariat based in the Joint Donor Office.
Multi-donor Trust Fund	Provide a swift, flexible and coordinated donor response to Southern Sudan's priority recovery and reconstruction needs, including establishing and effective public sector administration.	\$728m	Administered by World Bank.	Government and donor co-chaired oversight committee.
Sudan Recovery Fund	Facilitate a transition from humanitarian to recovery assistance, addressing post-conflict recovery and reconstruction needs through delivery of catalytic, high impact projects. Refocused in 2009 on addressing insecurity caused by inter-communal conflict in four states.	\$141m	Administered by UNDP.	Steering committee co-chaired by government and UN Deputy Resident Coordinator.  Supported by a Technical Secretariat

Sources: Commins, et al., 2013; OECD, 2010b; <http://mptf.undp.org/factsheet/fund/SRF00>; Fafo Institute for Applied International Studies, 2013.

---

The slow start the MDTF made to delivering led to the extension and establishment of further pooled funding mechanisms as a response to its perceived failure to deliver.<sup>26</sup> This points to a trade-off between delivering quickly and building government capacity. When these roles were separated into the Capacity Building Trust Fund and the Basic Services Fund, these were more effective than the MDTF which tried to accomplish the two tasks together (Commins, et al., 2013). A further key issue in the MDTF's failure to deliver up to 2009 was that the Oversight Committee became used for wide-ranging policy discussions, rather than for monitoring performance, and as a result was not used to hold the administrator responsible for fund performance (OECD, 2010b).

The BSF was able to implement rapidly and expand service delivery (Commins, et al., 2013), but did not build government capacity as there was no government role in planning and implementation, as discussed further below. The CBTF was seen as “flexible, responsive and with tangible results” and therefore regarded highly by government, and with a high degree of ownership (DFID, 2014a).

Despite the BSF's success in delivering services it had little government ownership. Government chaired the steering committee, but in practice this had a limited role. Once partner NGOs for implementation had been selected, there was little subsequent strategic or operational decisions made by the Steering Committee and thus little ownership by government. There was similar lack of ownership at sub-national levels, although there was more success in engaging state and county-level officials in the education sector than the health sector, and in both cases the lack of capacity at sub-national levels made this task challenging (Johnson, et al., 2013).

After independence, and with the establishment of a full donor presence in Juba, which had been only a regional capital within Sudan prior to this, funding modalities became preponderantly bilateral. One exception to this was the Health Pooled Fund, led by DFID, which was part of a well-designed donor division of labour in the health sector. The three largest donors in the sector, the World Bank, the United States and the Health Pooled Fund divided South Sudan's ten states between them, each implementing primary healthcare programmes in each state. This contrasts with the education sector which has several overlapping projects.<sup>27</sup>

During the preparation of the South Sudan New Deal Compact, the government and donors were also negotiating the establishment of a new pooled “Partnership Fund” which could have acted as a source of financing for priority programmes for government (International Dialogue on Peacebuilding and Statebuilding, 2014).

Donor coordination mechanisms have not been well institutionalized. The Government's Aid Strategy (Government of the Republic of South Sudan, 2011) sets out a set of mechanisms for coordination through an annual Partnership Forum and Quarterly Government–Donor Forum at the strategic level, and at the more operational level, Working Groups at the sector-level, together with an Inter-ministerial Appraisal Committee to review country strategies and major projects over \$20 million. However, there is no effective formal donor coordination agreement, and the structures and aid coordination are generally weak (OECD, 2011b). In practice the strategic function of the Partnership Forum and Quarterly Government–Donor Forum was displaced by a parallel structure chaired by the Vice-President, who was sacked in 2013, as noted above (Bernardi, et al., 2015).

---

<sup>26</sup> Although MDTF performance did improve after 2009 – over 60% of disbursements were achieved in the last three years of the MDTF to 2012 (Fafo Institute for Applied International Studies, 2013)

<sup>27</sup> The health programmes are the DFID-led Health Pooled Fund, the World Bank's Health Rapid Results Project, and USAID's Integrated Service Delivery Project (which covers service delivery) and Health Systems Strengthening Project (which covers capacity-building).

---

## Country systems used by donors

As set out above, there was no use of country systems by donors in the interim period 2005-2011 (OECD, 2011b). The MDTF was meant to be recipient executed, but in practice, it was implemented through PIUs within government ministries using World Bank systems, not government systems.<sup>28</sup> Government contributions to MDTF projects were included in the annual budget, under the relevant government agency, but once transferred to the MDTF these funds were effectively executed off-budget through the MDTF's parallel systems.

In 2005, several core government functions were contracted out because of the weakness of government systems, including government accounting, external audit, project accounting (for the MDTF) and procurement (for both MDTF and government purchases). However, the need to develop the capacity of government to take over these functions was not adequately addressed: "capacity development was not put at the centre of the contracting-out design, and none of the contracts had a clearly identified exit strategy". This situation was exacerbated for some functions where capacity-building was designed to be provided through a separate intervention which was never implemented. This experience suggests that if contracting out is to lead to sustainable capacity-building, contracts must be designed correctly to include capacity-building and an exit strategy, or alternatives such as contracting in additional support should be considered (Davies, 2009). Following this early experience, and in the run-up to independence there was better coordination of technical assistance on core governance functions, although there remained no agreed action plan for improving public financial management (OECD, 2011b).

Following independence, there has been limited use of country systems by the World Bank and African Development Bank. This has focused on putting projects on budget, and establishing project implementation units (PIUs) within the responsible Ministry. These handle procurement and accounting. More use of country systems has been made by the World Bank (and co-financed by Denmark, Netherlands and Norway) Local Governance and Service Delivery Project which provides block grants to local governments for community-selected development projects. These projects are handled through the core systems of the local governments, rather than through parallel PIUs (World Bank, 2013c).<sup>29</sup>

As part of the support package under the New Deal Compact, the IMF, World Bank, African Development Bank and EU would have provided budget support. The largest proposed amount was by the EC, under a State Building Contract (approximately \$110 million), and other support included an IMF Rapid Credit Facility (\$47 million), and budget support from the World Bank (around \$10 to \$30 million, with potential to increase to \$100 million) and the AfDB (approximately \$10 million).

For the EU State Building Contract, the safeguards proposed were to target the financing on the conditional salary transfers for the education and health sectors, and carry out an audit of the payroll process. The second tranche of the State Building Contract was to be conditional on a financial audit of the conditional transfer budget lines for education and health salaries to provide assurance that these expenditures have been made (Bernardi, et al., 2015).

Where country systems cannot be used due to fiduciary concerns, there have been some attempts at "shadow aligning" donor projects with country systems. The DfID Girls' Education South Sudan (GESS) Project is financing capitation grants for secondary schools.

---

<sup>28</sup> For procurement, there was no procurement law in place. Instead, government procurement was guided by the Interim Public Procurement and Disposal Regulations, which had no legal backing.

<sup>29</sup> This programme is based on support local government planning processes and providing resources for interventions to address these priorities. Earlier experiences from similar programming in South Sudan suggests its potential role in state-building (Conway, 2013).

---

These funds are paid directly to the secondary schools outside of government systems for financing schools. However, this is aligned with the government system in the following way:

- Government introduced capitation grants for primary schools at the same time the project introduced them for secondary schools. The GESS project worked together with the Ministry of Education to design a common set of procedures for all schools receiving capitation grants, and with common approval, disbursement and monitoring processes.
- This means that from a school's perspective there is no difference in the procedures for accessing the capitation grant, which means there is potential for future joint funding between donors and government, and means schools do not face a change in procedures if a transition is made to government funding.
- The project provides technical assistance to government in overseeing the capitation grant system for primary schools, and a single management database is used for both primary and secondary schools.

However these efforts have been the exception rather than the rule in South Sudan. The 2011 Report on International Engagement in Fragile States for South Sudan reported that donors had not made a systematic attempt to assess whether their interventions could have a negative effect, and that there were rising concerns around aid dependency, and that the continued bypassing of government in the delivery of basic services could cause harm in the “medium to longer term.” (OECD, 2011b)

### **Factors affecting the use of country systems**

The level of revenues from oil that South Sudan had access to before the oil shutdown, together with the perceived risks means that donor did not consider the use of country systems. However, this calculus changed following the shortage of funds experienced as a result of the oil shutdown. Once relations had improved between South Sudan and the international community and a deal had been made with Sudan, demonstrating a way forward out of the fiscal crisis, the calculus changed.

The commitment of support under the New Deal Compact, including the decision by the EC to go forward with the design of a State-Building Contract was explicitly based on the judgement that provision of budget support would both protect basic services and provide backing for reforms that no other modality was able to (Bernardi, et al., 2015 ). The rationale was thus based on providing support at a unique window of opportunity, and the benefits perceived are unlikely to outweigh the risks at other times.

### **Risk**

The low scores South Sudan receives for PFM and budgetary management in both the CPIA and the PEFA demonstrate a high fiduciary risk. However, there appears to be little political will in the government to tackle corruption, and the international community has not adopted a joint stance to take to the government on it (OECD, 2011b). This has led to little use of country systems by donors. As discussed above, the underlying political economy is also not supportive of improved financial management.

The World Bank and African Development Bank have mitigated this risk by setting up Project Implementation Units in the responsible Ministries. These projects are on budget, but largely operate through parallel structures (they are not “on treasury”, “on account” or “on audit” in the definitions used for the Global Partnership Monitoring Indicators).

The EU State Building Contract proposed to mitigate risk by ear-marking the funding for specific budget lines. By making the second tranche conditional on an audit of these budget lines, the second tranche would have in effect functioned as a reimbursement of the expenditures. As set out in the other case studies, this is thus a common method of mitigating risk in fragile situations.

## New Deal principles

As part of the New Deal for engagement in fragile states (International Dialogue on Peacebuilding and Statebuilding, 2011), members of the International Dialogue signed up to the FOCUS<sup>30</sup> principles on new ways of engaging with fragile states, and the TRUST<sup>31</sup> principles of providing aid more effectively.

The first New Deal Monitoring Report (International Dialogue on Peacebuilding and Statebuilding, 2014) set out a traffic light system for evaluating progress on these goals. Green indicates substantial progress on New Deal Commitments, amber some progress and red insufficient or no progress. The FOCUS principles are measured on a country-by-country basis, and are summarised in the table below. Overall, significant progress in drafting a New Deal Compact was made in South Sudan, with both government and donors making mutual commitments, before the conflict erupted in late 2013. However, the conflict has halted this progress. As a result more progress was made on engaging in line with the FOCUS principles as the compact was prepared than in changing aid practices in line with TRUST principles.

**Table 13: Progress on FOCUS PRINCIPLES**

Principle	Progress in South Sudan
Fragility assessments	A fragility assessment was conducted before the conflict broke out in 2013.
One Vision, one Plan	Not rated.
Compacts	South Sudan made considerable progress in developing a New Deal Compact before conflict broke out, but the launch was postponed following the Legislature's rejection of exchange rate reform, and then the Compact approach has been suspended during the current conflict.
Use of PSGs to monitor	The PSGs were to be used to monitor progress in the Compact that was drafted during 2013.
Support political dialogue and leadership	South Sudan's consultations on the New Deal involved over 1,000 people from Government, civil society and development partners at over 80 events across the country. Since the conflict broke out, IGAD has taken a lead in supporting peace talks between the Government and the opposition, which also provide a voice for civil society.

Source: *International Dialogue on Peacebuilding and Statebuilding (2014: Annex A)*

The New Deal Monitoring Report does not provide an equivalent scoring by country for the TRUST principles, which are instead evaluated on overall donor performance. However, it is possible to get a sense of implementation from the discussions presented so far.

**Table 14: Progress on TRUST PRINCIPLES**

Principle	Progress in South Sudan
Transparency	South Sudan is not ranked on the Open Budget Index. Donors scored a C in the 2012 PEFA assessment for financial information provided by donors for budgeting and reporting on project and program aid.
Risk Sharing	Multiple different pooled funding modalities operated in South Sudan between the signing of the Comprehensive Peace Agreement

<sup>30</sup> Engagement based on a country-led **Fragility assessment** developed by the g7+ with the support of international partners, a country-led **One vision and one plan**, a country **Compact** to implement the plan, **Use** of the PSGs to monitor progress, and **Support** inclusive and participatory political dialogue and leadership.

<sup>31</sup> Enhanced **Transparency**, **Risk-sharing**, **Use** and strengthen country systems, **Strengthen** national capacities, and **Timely** and predictable aid.

<b>Principle</b>	<b>Progress in South Sudan</b>
	in 2005 and independence in 2011. However since, then pooled funding has been used less, although before the violence erupted in 2013, the design process for a new pooled partnership fund had started.
<b>Use and strengthen country systems</b>	No budget support has been provided to South Sudan, although an EU State Building Contract was planned prior to the onset of violence. Little use has otherwise been made of pooled funds.
<b>Strengthen capacities</b>	South Sudan has received extensive capacity building support. Prior to independence, the Capacity Building Trust Fund was an effective pooled modality. However, most assistance is now provided on a bilateral basis.
<b>Timely and predictable Aid</b>	As South Sudan does not receive direct budget support, the predictability of disbursements was not scored in the 2012 PEFA assessment.

## Conclusions and key lessons

The combination of South Sudan’s high level of revenues combined with its low quality PFM systems meant that there was almost no use of country systems. South Sudan was starting from a very low base, and early missteps in contracting out services without associated capacity-building slowed progress. Since then some progress has been made in the budget process, and in implementing payroll reforms, but budget execution remains a major issue.

In using country systems, some progress has been made following independence to put projects on budget and to start making use of government systems, but this has been exclusively done by the African Development Bank and World Development Bank.

In the interim period the Multi-Donor Trust Fund was originally designed to be the principle channel for development assistance. However, the slow start the MDTF made in its first four years (2005-09) undermined donor confidence in it as an instrument, and led to the establishment, or continuation of other pooled funds. As such it could not play the coordination role original envisaged. Beyond this, donor coordination structures have generally remained weak. This highlights the need for realistic expectations when establishing pooled funds if there are to play the envisaged role in coordinating assistance, and for considering the trade-off between delivering quickly and building government systems.

---

# West Bank and Gaza

## Introduction

This case study reviews developments in the use of country systems in West Bank and Gaza. Rather than providing a full overview of the use of country, the case study focuses mainly on decisions to use budget support and pooled funds, particularly in West Bank where there has been more international engagement. This provides a useful illustration of the importance of political factors in decisions to use country systems, and where a partner government has successfully used external technical assistance to strengthen PFM systems.

**Table 1: OECD 2011 monitoring report and PEFA assessment**

Indicator	West Bank and Gaza
CPIA score for budgetary and financial management (2010)	N/A
Aid reported in the 2011 survey	US\$1,589m
Indicator 5a: Use of financial management systems	37%
Budget execution	43%
Financial reporting	42%
Auditing	25%
Indicator 5b: Use of procurement systems	51%
Mean PEFA score for country systems (2012 and 2010, respectively)	2.22
D-1 Predictability of Direct Budget Support	D+
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	D
D-3 Proportion of aid that is managed by use of national procedures	D

Source: OECD 2011; PEFA Secretariat 2014

## Country background

Unlike the other countries reviewed as part of this research, West Bank and Gaza is not a sovereign state. Until the 1993 Oslo Agreement handed control to the Palestinian National Authority (PA), West Bank and Gaza were governed by Israel. Later in 2007, the two territories separated politically following armed conflict between Hamas and Fatah – though they are regularly analysed together in international statistics. Gaza has since been controlled by Hamas, while the West Bank has been led by Fatah. Together they are sometimes referred to as the Occupied Palestinian Territories.

This unusual political status creates its own dimensions of fragility. The PA does not have control over its borders and depends on donors and ‘clearance revenues’ from Israel for most of its public revenues (Krause, 2012). Political institutions are still being established, with the democratic process impeded on numerous occasions, and conflict is still a feature of life in Gaza in particular (Krause, 2012). These have been key dimensions of fragility over the past two decades, exacerbated by restrictions on labour and trade movements with Israel since the early 2000s. The World Bank (2013d) notes that exports represented just 7% of the economy in 2011, one of the lowest ratios in the world, most of which go to Israel. Furthermore, Israeli control over “Area C” has restricted construction and the provision of new services by the PA in 60% of the West Bank.

Aside from the narrow economic base and complex political environment, socio-economic indicators are not characteristic of most fragile states, though they lag significantly behind Israel. Poverty rates in 2007 were 50% in Gaza and 19% in West Bank, highlighting important differences between the two regions. In 2010, GDP per capita for West Bank and Gaza was over US\$4,000 when adjusted for purchasing power parity and the human development index scores are comparable to middle-income countries such as Botswana and Indonesia. However, GDP per capita is nearly US\$29,000 in Israel, and life expectancy at birth is nearly ten years longer there than in the West Bank and Gaza. Unemployment has also emerged as a political concern, estimated at over 18% in West Bank in 2012 and over 32% in Gaza (World Bank, 2013d). Youth unemployment rates are higher still – nearly 50% in Gaza. The public sector employment is a crucial part of the economy and the *de facto* social welfare system in the absence of a viable private sector economic base.

**Table 2: Key indicators and statistics**

Indicator	Source	West Bank and Gaza
Period of conflict	Various	Intermittent since 1948
Real GDP growth (2006-2010)	WB WDI 2015	1.7%
GDP p.c. (2010, PPP)	WB WDI 2015	4162.7
Population (2010 est, millions)	WB WDI 2015	3.8
Land area (sq km)	WB WDI 2015	6,020
HDI score (2010)	UNDP 2014	0.671
Infant mortality rate per 1000 live births (2012)	WB WDI 2015	19.1
Adult literacy rate	WB WDI 2015	96%

Public sector institutions are relatively new, and highly personalised, but have proved capable of identifying strategic priorities, selectively seeking external aid to support those priorities and sustaining reforms (Krause, 2012). Even during the disruption caused in West Bank during the Hamas-led government of 2006-2007, capacity remained dormant and quickly revived thereafter (Krause, 2012). This resilience has been partly attributed to the long tenure of key staff, especially in the Ministry of Finance, many of whom have been part of the administration since the late 1990s (Krause, 2012). However, not all institutions have been as resilient. Most notable has been the absence of a formal legislative body – the Palestinian Legislative Council was effectively been suspended from 2007 due to the Hamas-Fatah conflict.

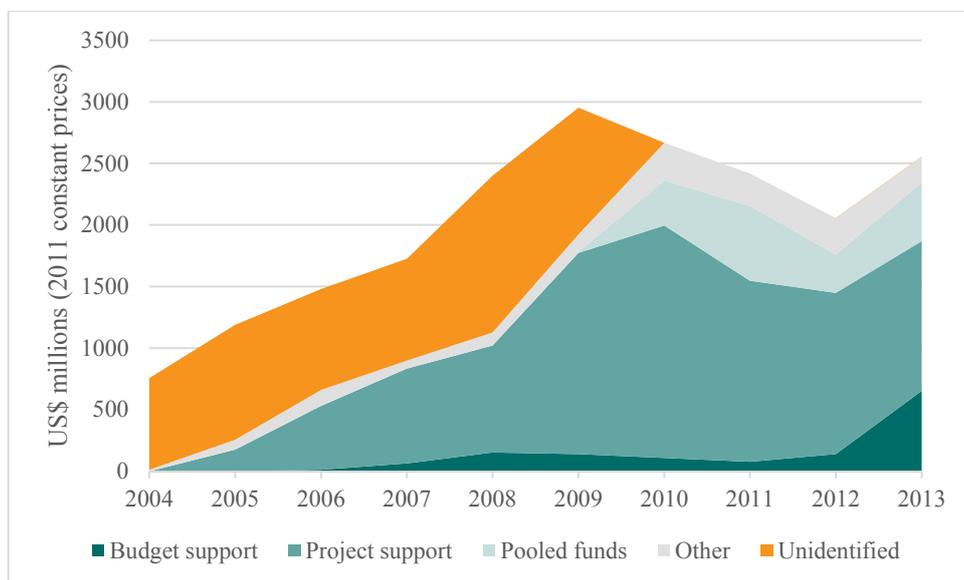
### Overview of donors and aid flows

Gaza and West Bank have been among the largest per capita recipients of foreign aid in the world (Zanotti, 2014; Krause, 2012). Aid initially played a role in encouraging a peace deal in the early 1990s, and then grew substantially following the second *intifada* in 2000. In recent years, donor assistance has accounted for nearly 40% of revenues for the PA, while domestic revenues come mainly from customs and value-added taxes collected and ‘cleared’ by Israel. Many donors (including the EU and USA) do not support the Hamas government which governs Gaza, and so channelled their aid through the Fatah government in West Bank (GSDRC, 2010).

Data on aid to West Bank and Gaza may not be reliable due to the legal status of the territories and the important role of Saudi Arabia and other Gulf states as donors which are not monitored in the same way as OECD DAC donors. With that in mind, half of official development assistance (as reported by the OECD Creditor Reporting System) uses project modalities, generally directed at the education and justice sectors, but this has fallen from over two-thirds in just three years. In contrast to global trends, the share of aid delivered through budget support has risen in West Bank and Gaza between 2010 and 2013. This mainly reflects recent increases in sector budget support from the United States (earmarked for social

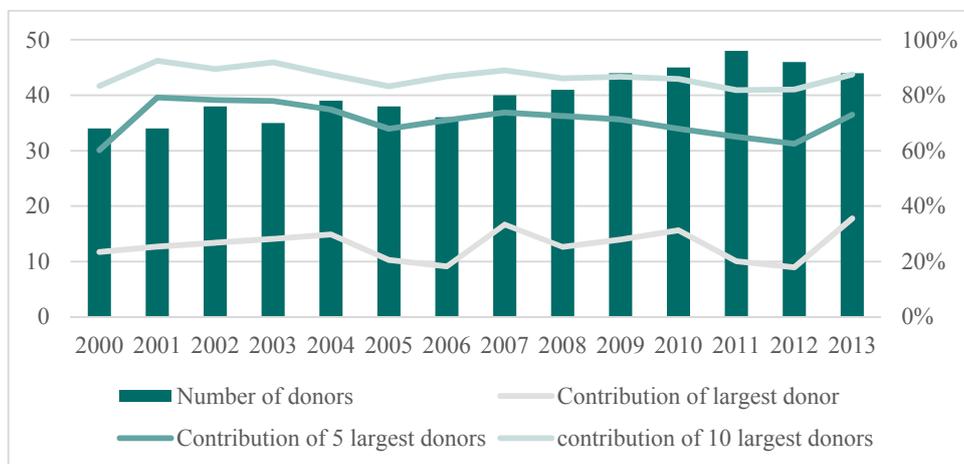
welfare services). In addition, a number of donors provide considerable financial support for humanitarian assistance – which peaked at around US\$ 1.2 billion in 2009 before falling below US\$ 660 million in 2012 according to Development Initiatives.

**Figure 1: Official Development Assistance to West Bank and Gaza**



Source: OECD Creditor Reporting System, May 2015

**Figure 2: Aid fragmentation in West Bank and Gaza**



Source: OECD Statistics, May 2015

Aid fragmentation is relatively low, though there are many diverse players providing a wide range of assistance. In 2013, the largest donors were the United States and the European Union, along with UNRWA<sup>32</sup>, which together accounted for 63% of country programmable aid to West Bank and Gaza. Other large donors include Germany, United Arab Emirates, UK, Norway and Turkey. This combination of significant per capita aid flows, support from non-DAC donors and large scale humanitarian assistance is unique, even among fragile states.

<sup>32</sup> The United Nations Relief and Works Agency for Palestine Refugees provides humanitarian relief and basic services to Palestinian refugees living in the West Bank and Gaza Strip, as well as in the neighbouring states. Jordan, Lebanon and Syria. The largest contributors to UNRWA are the EU and USA (GSDRC, 2010).

## PFM systems and other risks

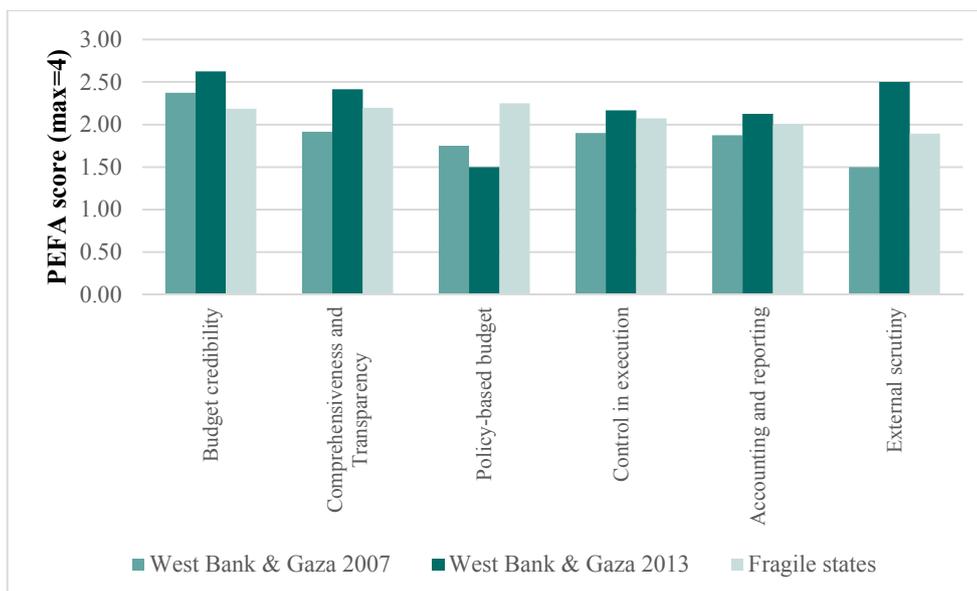
### Public financial management systems

PFM systems in the early 2000s were generally weak (World Bank, 2011), resulting in large budget deficits, high levels of arrears and concerns that funds were being diverted to finance terrorism. This was viewed by many as holding back the viability of a future independent state of Palestine (Krause, 2012). Growing international and domestic pressure came to a head after the Second *Intifada*, and led to a period of reforms between 2002 and 2005 under a new, reformist minister of finance (World Bank, 2011). These were disrupted during the Hamas-led government from 2006–07, but have resumed since. A major focus of these efforts was on the credibility and control of budget execution and efforts were underpinned by a political view that functioning PFM systems are central to the viability of a possible future state (Krause, 2012).

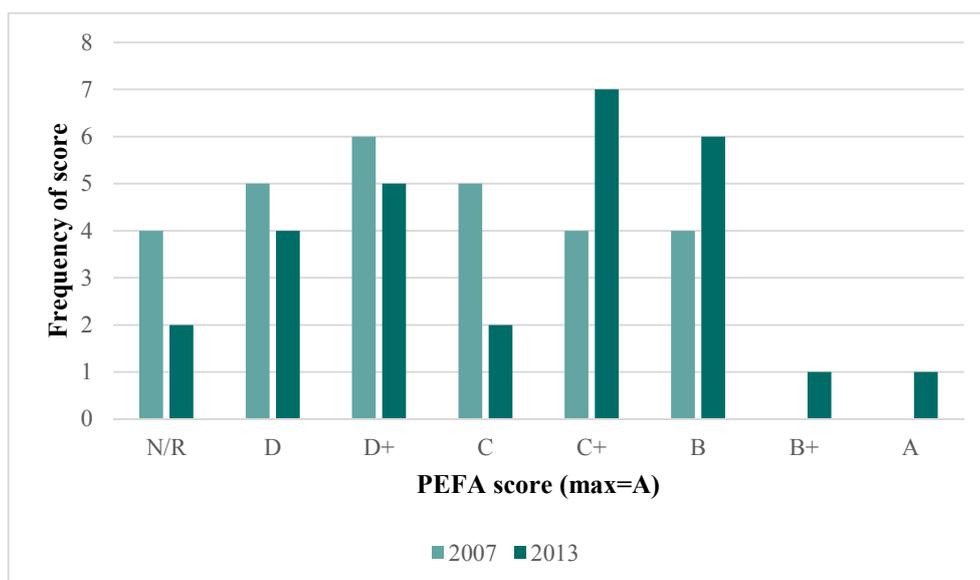
The political status of West Bank and Gaza means there is no CPIA score for the quality of country PFM systems as a basis of comparison. However, there have been a number of diagnostic assessments, including two using the PEFA framework (published in 2007 and 2013). PEFA scores compare favourably to other fragile states, but the written assessments continue to be critical. For example, the 2013 assessment notes that there were improvements after 2007, but claims that “Systemic weaknesses in budget preparation, budget execution, and accounting/reporting” remain (World Bank, 2013e). Other qualitative assessments have been more positive, suggesting that early efforts by the ministry of finance to establish controls over spending were effective (World Bank, 2011). Other efforts to reform the legal framework and redistribute powers were more modest, at least until 2010, when reform objectives broadened (Krause, 2012).

Progress in PFM reforms was not always smooth, or evenly distributed. The new cash management and control systems were compromised in 2006 when donors no longer felt they could support the Government directly under Hamas. Later, the West Bank lost control of its computerised systems when Gaza split under Hamas. However, the systems have shown a high degree of resilience, even if the periods under scrutiny are relatively short. It should also be noted that budget support managed by the World Bank for a number of donors is conditional on performance against criteria for PFM reforms and indicators of fiscal sustainability. This arrangement may even have had some success in supporting reforms for strengthening PFM systems in West Bank.

**Figure 3: Average PEFA scores by cluster**



**Figure 4: Distribution of PEFA scores**



**Other concerns/risks**

The greatest risks to Palestinian efforts to build public institutions, deliver services and maintain sound macroeconomic management are political. Fraught relations with Israel and between the Hamas and Fatah factions form a constant backdrop. In addition, economic restrictions imposed by Israel mean that public sector wages function partly as a social safety net, in an environment where alternative employment opportunities are limited (Krause, 2012). Realistically, the economic and fiscal position in West Bank and Gaza can only become sustainable in the long run if Israeli restrictions are relaxed (World Bank, 2013d; World Bank, 2013e). This places considerable importance on donor support and international political engagement.

In terms of basic macro-fiscal management and service delivery, operations are extremely vulnerable to the disruption of clearance revenues (and foreign aid) which are out of the control of the PA. These revenues are even more important today than they were in the early years of the PA (Kock & Qassis, 2011). Between 2010 and 2012, shortfalls in budget support and clearance revenues led to a dramatic build up in arrears from 3% of the operational budget in 2010 to nearly 18% in 2012, despite efforts to reduce wage expenditures (World Bank, 2013d). In 2014, resumption of conflict in Gaza prompted the Government of Israel to suspend clearance revenues. The resulting cash shortages forced a return to in-year cash rationing by the PA, and deep cuts to wages and public expenditures (IMF, 2015). These challenges represent a genuine threat to the legitimacy of the PA and pose significant difficulties for fiscal management in an environment where aid and public spending – especially the wage bill – forms the main basis for economic activity and social welfare (IMF, 2015).

In addition, there have been longstanding concerns over politicisation of the administration. When the Palestinian National Authority was established in the 1990s, top positions were filled by returnees with political connections, but not always the skills to meet the demands of their posts (Krause, 2012). This has largely been phased out since 2002, as less competent officials were side-lined and more competent staff promoted over time. This was achieved in the West Bank under the direction of Minister of Finance Fayyad and at a time when PFM reforms were a priority for the government. In 2011, the Ad Hoc Liaison Committee was informed by the World Bank (2011) that institutions were functioning at a similar capacity to those in countries of a similar income group and by the UN (2011) that “governmental functions are now sufficient for a functioning government of a state”, though this has not led

---

to any major advances towards the establishment of a new state of Palestine. Whether such high-level political support will be sustained is a critical concern. Reforms were shown to be reversible during the Hamas government in 2006-07, and may be in the future should political support wane. The longer the political impasse drags on over the future state of Palestine, the more likely it is that commitment to reforms will wane.

However, the overwhelming risks to donors engaging in West Bank and Gaza are reputational and operational (i.e. that the goals of interventions will not be met). Foremost for many is the risk that money will be used to finance terrorist activities. This has been the primary factor behind the decision of many donors not to support the Hamas administration in Gaza, which is considered by many to be a terrorist organisation.<sup>33</sup> Furthermore, a number of commentators have raised concerns that the provision of aid has helped to legitimise the Israeli occupation of large parts of West Bank and removes the obligation on the Government of Israel to protect the Palestinian people (GSDRC, 2010; Ibrahim & Beaudet, 2012). Overall, the developmental or aid policies of most donors are heavily related to their political objectives – specifically to promote a negotiated settlement between Israel and the PA that will lead to a sovereign Palestinian state and support long-term stability in the Middle East and North Africa region (DFID, 2014b).

## Use of country systems

### Aid modalities

A relatively large proportion of aid is transferred through budget support. While the United States provides support directly to the Palestinian National Authority, with its own conditions, a number of other donors use a multi-donor support mechanism administered by the World Bank. Participating donors include Australia, France, Kuwait, Norway, the United Kingdom, and Japan. Disbursements are linked to conditions on the implementation of the National Development Plan commitments for budget execution and macro-fiscal management (World Bank, 2014). However, there are other bilateral agreements, many of which introduce additional conditions on financial assistance. For example, DFID has its partnership principles, which are negotiated bilaterally with the PA, along with specific agreements on wage payments to prisoners in Israeli jails. The EU also provides earmarked budget support for paying PA workers and pensions (PEGASE). This is paid on the basis of a list of payees which is vetted before and after payment, allowing the EU to demonstrate that funding has not been used to pay for controversial activities or individuals, while allowing the PA to reallocate resources to other needs (because money is fungible).

The World Bank has also managed two multi-donor trust funds for infrastructure development and the Municipal Development Programme. The Municipal Development Programme is now closed, but provided capacity building alongside performance-based grants for infrastructure to municipalities. The new Partnership for Infrastructure has received nearly US\$75 million from seven donors, of which Denmark was the largest. This fund supports a number of projects for urban development and water, as well as providing resources for the Gaza emergency response in 2014.

It is important to note that mechanisms for providing financial and technical support are more complicated than in most other countries because the territories<sup>7</sup> are not sovereign countries, or member states of the World Bank and IMF. For this reason, the World Bank has provided its financial support through the Trust Fund for Gaza and the West Bank since 1993 (Krause, 2012). Many donors also have restrictions against funding Hamas, including Australia, Canada, Israel, Egypt, Japan, UK, and the United States.

---

<sup>33</sup> This also has a fiscal dimension, with West Bank paying salaries for its civil servants based in Gaza (though not those employed by Hamas) without receiving taxes from in return.

**Table 3: Trust funds coordinated by the World Bank**

<b>Trust fund</b>	<b>Purpose</b>	<b>Opened</b>
Trust Fund for Gaza and the West Bank	To provide a vehicle for World Bank support.	1993
Palestinian Reform and Development Plan Multi-donor Trust Fund	Coordinates budget support from various donors to the PA	2008
Municipal Development Programme	Now closed, but provided capacity building and performance-based grants for municipal infrastructure.	2009
Palestinian Partnership for Infrastructure Trust Fund	Funds infrastructure projects in the water, urban development, and energy sectors.	2012

The main vehicle for coordinating political engagement and donor support is the Ad Hoc Liaison Committee, which was established as part of the 1993 Oslo Agreement. It is chaired by Norway, but co-chaired by the European Union and United States, and comprises 15 members: Palestinian Authority, Israel, Canada, Egypt, IMF, Japan, Jordan, United Nations, Russia, Saudi Arabia, Tunisia. The World Bank provides Secretariat functions. There are no explicit assessments on the impact of the Committee, but Menocal (2011) concludes that “aid resources have remained largely uncoordinated and on the whole have not led to the type of strategic, more politically aware, and less risk-averse support that is required for the building of state institutions that are grounded on legitimacy and robust state-society relations.” This may also be a reflection on the challenges faced by the Local Aid Coordination Secretariat – that operates in East Jerusalem and Ramallah to coordinate donor working groups – the effectiveness of which is unclear.

### **Country systems used by donors**

The 2011 Paris Declaration Monitoring report stated that 37% of aid to the government sector used country systems for public financial management and 51% for procurement the West Bank and Gaza (OECD, 2011c). In the 2014 Global Partnership Progress Report the proportion of aid to the government sector using country systems for financial management and procurement had risen to 57% (OECD/UNDP, 2014). However, the amounts reported are relatively low (the funds covered in the reports are only \$357 million against 2012 CPA figures of US\$1.5 billion) so need to be treated with a degree of caution. Also, the political status of West Bank and Gaza effectively preclude them from the explicit targets set in the Paris Declaration.

The 2013 PEFA noted that funding from the World Bank trust fund and budget support from Arab donors did not use all country systems and were subject to donor-supplemented auditing procedures (World Bank, 2013e). Planned disbursements for some major projects were also not reported to PA officials, raising doubts about the value of aid reported on plan and on budget (World Bank, 2013e). There was no explanation for why donors were able to use systems for procurement more widely than those for budget execution and audit, nor if there are agreements to extend the use of country systems in the future. Speculatively, it may be that donors (or their governments) require greater oversight or derogations for execution and oversight because of the reputational risks associated with financing the PA. Alternatively, donors may be avoiding the use of national audit procedures because of the absence of legislative oversight since 2007, or other such weaknesses.

Financial assistance has also been accompanied by large volumes of technical support. This has been strongly directed by the government. Unlike many low-income and low-capacity

---

fragile states, the PA has more capability to direct technical assistance.<sup>34</sup> Occasionally, this has led to more disagreement between government and donors where government priorities were differed from what international experts thought was necessary. The first stage of reforms, as discussed already, focused on re-establishing fiscal controls. Critical interventions included the centralisation of banking under a treasury single account and of payroll controls in the Ministry of Finance. The introduction of zero-balance bank accounts reportedly forced a number of donor accounts to close (Krause, 2012). While politically difficult, such reforms were generally supported by both domestic and international actors (Krause, 2012).

### **Risks and other factors affecting the use of country systems**

Public financial management systems appear to be stronger in West Bank and Gaza than in many other fragile states. PEFA scores are not dissimilar to countries like Sierra Leone which have received budget support for long periods, and arguably these scores underestimate the strength of systems for budget execution (Andrews, et al., 2014). Therefore, the quality of country systems should not be a major barrier to the use of those systems in executing donor funding.

One of the principal barriers to the use of country systems in Gaza and West Bank is the overall risk that donor funding will be used to finance terrorist activities. Notably a number of donors consider Hamas to be a terrorist organisation. When Hamas was elected into power in 2006, many donors withdrew budget support and reduced communications with the Palestinian Authority. In addition, some donors have added new procedures for approving, disbursing and auditing budget support to West Bank – still using country systems but arguably losing some of the benefits pursued by the global commitments to increase the use of country systems without derogations. These procedures are often highly political as Zanotti (2014) explains in more detail for the United States:

*USAID's West Bank and Gaza program is subject to a specialized vetting process (for non-U.S. organizations and individuals) and to yearly audits intended to ensure that funds are not diverted to Hamas or other organizations classified as terrorist groups by the U.S. government. This vetting process has become more rigorous since around 2008-2009, presumably in response to allegations that U.S. economic assistance was indirectly supporting Palestinian terrorist groups, and following an internal audit in which USAID reportedly concluded it could not "reasonably ensure" that its money would not wind up in terrorist hands...Even after money is transferred to the PA's treasury account, the United States retains prior approval of any transactions from that account, along with a power of audit over those funds and a three-year right of refund.*

On the other hand, there is a strong recognition that financial support is necessary to reduce the risks of further instability in the region. Certainly, without donor funding, the PA – in its current form – would be unsustainable and so be lost as a potential partner for peace. DFID (2014) set out this rationale in its operational plan for programmes in Gaza and West Bank:

*Several countries in MENA remain at severe risk of instability and in danger of moving into deeper crisis. The immense costs of growing instability in the region, and increased risks to the UK of further deterioration, justify upfront engagement by the UK and international partners with MENA countries, focussed on dealing with ongoing crises, addressing the drivers of conflict, and tackling longer-term causes of poverty.*

---

<sup>34</sup> Interestingly, some ministries – notably the ministry of finance – have declined to use embedded technical advisers to supplement domestic capacity (Krause, 2012). Such support for PFM reforms has been a common practice elsewhere, but has been treated cautiously by some officials.

Overall, donors using country systems under the PA are balancing between the political objective of supporting a resolution to the Israeli-Palestinian conflict and the fiduciary and reputational risks of providing direct funding. On the one hand, infrastructure, services and even macroeconomic fundamentals are regularly under threat from the resumption of armed conflict or deteriorating political relations. Reputational risks stem from perceptions in donor countries that tax money may be funding terrorist organisations or exacerbating insecurity. However, fiduciary risks are arguably lower than in many other fragile states and far greater risks stem from the lack of a political settlement between the Government of Israel and the PA. This can only be resolved through political engagement, and arguably, the provision of aid to Gaza and the West Bank supports the space for those discussions to continue, even if only slowly.

### Impact of use of country systems

It is difficult to judge comprehensively the impact of using country systems from the assessments available, though some tentative conclusions may be inferred. Certainly, donor support has provided significant additional resources to the PA to deliver services, and virtually all investment projects are thought to have been externally financed. There is consensus that international engagement has supported locally-driven reforms to build state PFM capacity since 2002. This may also support the PA as a legitimate political entity as explicitly recognised in the 2011 UN statement to the Ad Hoc Liaison Committee.

However, the use of derogations (such as earmarking to salaries and parallel frameworks for conditionality) and substantial aid flows that do not use country systems does mean that donor activities are not as well coordinated as would be ideally the case. Though not raised in the literature reviewed, this could create challenges for the PA in fiscal management and the provision of services. Some commentators have also suggested that the high dependence of the economy on aid has induced “Dutch disease”, constraining the manufacturing sector, though there is no obvious consensus and evidence is certainly weak (Cali, 2011; Adam, et al., 2004). Either way, there does not appear to be an obvious alternative to the provision of large scale aid as long as partner governments aim to support negotiations between the PA and Israel.

### New Deal principles

Unlike the other countries selected for this paper, the West Bank and Gaza is not a member of the g7+, did not participate in the International Dialogue on Peacebuilding and Statebuilding, and has not signed up to the New Deal. However, the New Deal principles can still be considered in the context of the issues presented so far. These are summarised for the two sets of principles in the tables below, first for the FOCUS<sup>35</sup> principles on new ways of engaging with fragile states, and second for the TRUST<sup>36</sup> principles of providing aid more effectively. These are not rated (green, amber, red) as in the other case studies.

**Table 4: FOCUS PRINCIPLES**

Principle	Gaza and West Bank
Fragility assessments	Not a member of the g7+, so no fragility assessment has been conducted.
One Vision, one Plan	The Palestinian National Development Plan acts as the single plan for donors to align behind.
Compacts	There is no single compact-like document between the Palestinian Authority and the donor community.

<sup>35</sup> Engagement based on a country-led **Fragility assessment** developed by the g7+ with the support of international partners, a country-led **One vision and one plan**, a country **Compact** to implement the plan, **Use** of the PSGs to monitor progress, and **Support** inclusive and participatory political dialogue and leadership.

<sup>36</sup> Enhanced **Transparency**, **Risk-sharing**, **Use** and strengthen country systems, **Strengthen** national capacities, and **Timely** and predictable aid.

Principle	Gaza and West Bank
Use of PSGs to monitor	As West Bank and Gaza is not a member of G7+, PSGs are not used to monitor progress.
Support political dialogue and leadership	The West Bank and Gaza undertakes an inclusive, mutual accountability, assessment of progress with donors, that includes non-executive stakeholders, and the results of which are made public.

Source: OECD/UNDP (2014)

**Table 5: TRUST PRINCIPLES**

Principle	Progress in the West Bank and Gaza
<b>Transparency</b>	West Bank and Gaza are not ranked on the Open Budget Index, and progress on transparency has been limited to some extent by the suspension of the Legislative Council. Donors scored a D in the 2013 PEFA assessment for financial information provided by donors for budgeting and reporting on project and program aid.
<b>Risk Sharing</b>	The main vehicle for coordinating political engagement and donor support is the Ad Hoc Liaison Committee, which was established as part of the 1993 Oslo Agreement. However, joint risk assessments are performed by the World Bank for all donors contributing to the Palestinian Reform and Development Plan Multi-donor Trust Fund.
<b>Use and strengthen country systems</b>	The Global Partnership for Effective Development Cooperation (GPEDC) Progress Report states that 0% of aid to West Bank and Gaza was on budget (OECD/UNDP, 2014: Annex A). It also reports that 57% of aid to the government sector uses country public financial management and procurement systems. However, coverage of this survey is low. Large amounts of aid are provided through country systems through the PRDP Trust Fund administered by the World Bank, and the EU's PEGASE programme.
<b>Strengthen capacities</b>	Donors have utilised several generations of multi-donor trust funds to finance the PA, linked to a policy reform agenda centred on PFM. Other arrangements made quasi-salary payments to support the PA's administrative capabilities. From 2002 to 2011, sufficient progress was made to consider that the PA had established many of the fundamentals of a functioning state.
<b>Timely and predictable Aid</b>	Predictability of direct budget support disbursements were ranked D in the 2007 PEFA assessment and D+ in the 2013 assessment. Similarly, the GPEDC reports a low score for medium-term predictability with only 33% of estimated funding covered by forward spending plans (OECD/UNDP, 2014: Annex A).

## Conclusions and key lessons

In summary, West Bank and Gaza are not typical fragile states. They are not sovereign countries, which affect the PA's ability to grow the economy, establish fiscal controls and deliver services to residents. The decision to use country systems is closely tied to this special political status and the desire to maintain Palestinian engagement to end conflict in Israel, and the Middle East more widely.

However, providing aid through country systems in this environment has specific challenges. While fiduciary risks are relatively controlled compared with many fragile states, thanks in part to donor assistance to the PA's PFM reforms, major reputational risks have prompted widespread use of conditionality. On the one hand, international financial institutions cannot directly support the PA due to limitations in their governing mandate (i.e. to serve recognised

---

countries). On the other there are perceptions over the risk that donor funding will be used to finance terrorist activities.

Overall, the compromise has prompted large scale aid – the highest in the world in per capita terms – with around 40% of aid to the government sector using country systems. Continuing challenges remain in streamlining of conditionality and improving harmonisation of aid. Numerous derogations have been imposed by development partners serve to address perceived risks. This is despite the use of pooled funds for managing budget support from some prominent donors. While this support may have been enough so far to support a measure of peace and significant efforts at building the foundations for a future state of Palestine, considerable uncertainties will remain as long as a political settlement is not found.

---

# References

- Adam, C., Cobham, D. & Kanafani, N. (2004) Budgetary and fiscal policy for a new Palestinian state. In: D. Cobham & N. Kanafani, eds. *The Economics of Palestine: Economic Policy and Institutional Reform for a Viable Palestinian State*. London: Routledge.
- Andrews, M. et al. (2014) 'This is PFM', Cambridge, MA: Center for International Development at Harvard University.
- Bernardi, M., Hart, T. & Rabinowitz, G. (2015) 'EU State Building Contracts: Early lessons from the EU's new budget support', London: Overseas Development Institute.
- Cali, M. (2011) 'Military occupation, foreign aid and the elusive quest for a viable Palestinian economy', London: Overseas Development Institute.
- Cohen, N. P., et al. (2010) 'An evaluation of USAID/Liberia's GEMAP activities', Washington D.C.: USAID.
- Commins, S. et al. (2013) 'Pooled Funding to Support Service Delivery: Lessons of Experience from Fragile and Conflict-Affected States', London: DFID.
- Conway, G. (2013) 'Lessons on transition in South Sudan', *Humanitarian Exchange*, Issue 57, pp. 24-26.
- Davies, F. (2009) Contracting out Core Government Functions and Services in Southern Sudan. In: OECD, ed. *Contracting Out Government Functions and Services: Emerging Lessons from Post-Conflict and Fragile Situations*, Paris: OECD, pp. 79-96.
- de Waal, A. (2014) When kleptocracy becomes insolvent: brute causes of the civil war in South Sudan. *African Affairs*, 113(452), p. 347-369.
- de Weijer, F. (2013) 'A capable state in Afghanistan: A building without a foundation?' WIDER Working Paper No. 2013/063, Helsinki: UNU-WIDER.
- DFID (2013) 'DFID's Anti-Corruption Strategy for Sierra Leone and Liberia', London: Department for International Development.
- DFID (2014a) 'Capacity Building Trust Fund Phase II Project Completion Review', London: DFID.
- DFID (2014b) 'Operational plan 2011-2016: DFID Palestinian programme', London: Department for International Development.
- Fafo Institute for Applied International Studies (2013) 'Independent Evaluation of the Multi-Donor Trust Fund- South Sudan (MDTF-SS)', Oslo: Fafo Institute for Applied International Studies.
- Fölscher, A. & Allan, S. (2014) 'Use of country system inventory for Liberia's New Deal Compact Process', Oxford: Mokoro Ltd.
- Fritz, V. et al. (2012) *Public financial management reforms in post-conflict countries*. Washington DC: World Bank.

- 
- GoL (2014) 'Establishing and managing a National Trust Fund to fight the Ebola outbreak in Liberia', Monrovia: Ministry of Finance and Development Planning, Republic of Liberia.
- Government of the Republic of Southern Sudan (2011) 'South Sudan Donor Book 2011', Juba: Ministry of Finance & Economic Planning.
- Government of the Republic of South Sudan (2011) 'Aid Strategy for the Government of the Republic of South Sudan' Juba: Ministry of Finance & Economic Planning.
- Government of the Republic of South Sudan (2014) 'Donor Book: International Assistance to South Sudan in 2012/13', Juba: Government of the Republic of South Sudan.
- GSDRC (2010) 'Helpdesk research report: role of aid in the Occupied Palestinian Territories', Birmingham: Governance and Social Development Resource Centre.
- House of Commons International Development Select Committee (2012) 'Afghanistan: Development progress and prospects after 2014, Volume I: Report', London: The Stationery Office Limited.
- Hughes, J., Glassman, A. & Gwenigale, W. (2012) 'Innovative financing in early recovery: the Liberia Health Sector Pool Fund', Working Paper 288, Washington D.C.: Center for Global Development.
- Ibrahim, N. & Beaudet, P. (2012) Effective aid in the Occupied Palestinian Territories?, *Conflict, Security and Development*, 12(5), pp. 481-500.
- IMF (2015) 'West Bank and Gaza: concluding statement of an IMF staff visit' [Online] Available at: <http://www.imf.org/external/np/ms/2015/012915.htm> [Accessed 7 May 2015].
- Independent Commission on Aid Impact (2012) 'The Department for International Development: Programme Controls and Assurance in Afghanistan', London: Independent Commission on Aid Impact.
- International Dialogue on Peacebuilding and Statebuilding (2011) 'A New Deal for engagement in fragile states', Paris: International Dialogue on Peacebuilding and Statebuilding.
- International Dialogue on Peacebuilding and Statebuilding (2014) 'New Deal Monitoring Report 2014', Paris: International Dialogue on Peacebuilding and Statebuilding.
- Islamic Republic of Afghanistan (2012) 'Development Cooperation Report', Kabul: Ministry of Finance
- Johnson, R., Ockelford, J. & Power, T. (2013) 'Learning from BSF: Lessons from the Basic Services Fund, South Sudan, 2006 to 2012', London: DFID.
- Kaldor, M. & Vincent, J. (n.d.) 'Evaluation of UNDP assistance to conflict-affected countries: case study Sierra Leone', Geneva: UNDP.
- Kock, U. & Qassis, H. (2011) 'West Bank and Gaza: recent developments in clearance revenues', Washington D.C.: International Monetary Fund.
- Krause, P. (2012) 'Public financial management reforms in fragile states, the case of West Bank and Gaza', London: Overseas Development Institute.
- Lawson, A. (2007) 'DFID budget support to Sierra Leone, 2004-2007: achievements and lessons for the future', London: Overseas Development Institute.

- 
- Liberia Poverty Reduction Forum (2008) 'Financing instruments: towards increased budget support', Berlin: Liberia Poverty Reduction Forum.
- Livingston, I. S. & O'Hanlon, M. (2015) 'Afghanistan Index, February 10, 2015' Washington, D.C.: Brookings Institution.
- Maxmen, A. (2015) Frontline health workers were sidelined in \$3.3bn fight against Ebola. *Newsweek*, 19 April.
- Menocal, A. R. (2011) 'The Palestinian state-building agenda', report prepared for the United Nations Development Program/Program of Assistance to the Palestinian People (UNDP/PAPP), London: Overseas Development Institute.
- OECD (2010a) 'Monitoring the principles for good international engagement in fragile states and situations, country report 5: Sierra Leone', Paris: Organisation for Economic Co-operation and Development.
- OECD (2010b) 'Transition Financing: Building a Better Response', Paris: Organisation for Economic Cooperation and Development.
- OECD (2011a) 'Afghanistan' in *Aid Effectiveness 2011: Progress in Implementing the Paris Declaration – Volume II Country Chapters*, Paris: OECD.
- OECD (2011b) '2011 Report on International Engagement in Fragile States: Republic of South Sudan', Paris: OECD.
- OECD (2011c) *Aid Effectiveness 2005-10: Progress in Implementing the Paris Declaration*, Paris: OECD.
- OECD/UNDP (2014) *Making development co-operation more effective: 2014 progress report*, Paris: OECD.
- Poate, D. et al. (2008) 'Evaluation of DFID country programmes: Sierra Leone', Evaluation Report EV690, Hove: ITAD.
- Sandefur, J. (2013) 'In Defense of Aid to the Afghan Government', Rethinking US Development Policy blog, <http://www.cgdev.org/blog/defense-aid-afghan-government> [accessed 7 May 2015]
- Save the Children (2012) 'Sierra Leone Health and Sanitation Budget Tracking 2012', Freetown: Save the Children.
- Senate Foreign Relations Committee (2011) 'Evaluating U.S. Foreign Assistance to Afghanistan', Washington, DC: U.S. Government Printing Office.
- Schick, A. (1998) *A Contemporary Approach to Public Expenditure Management*, Washington, DC: International Bank for Reconstruction and Development
- Short, J., Harnett, P. & Mackie, A. (2008) 'The Republic of Sierra Leone: public financial management performance assessment report', Washington, DC: World Bank
- Simson, R. and Welham, B. (2014) 'Incredible Budgets: Budget credibility in theory and practice', Working paper 400, London: Overseas Development Institute
- Special Inspector General for Afghanistan Reconstruction (2013) 'Direct Assistance to the Afghan Government Presents Risks, Testimony Before the Subcommittee on National Security, Homeland Defense, and Foreign Operations, Committee on Oversight and Government Reform', House of Representatives, Arlington: SIGAR.

- 
- Special Inspector General for Afghanistan Reconstruction (2015) 'Quarterly Report to the United States Congress', April 30 2015, Arlington: SIGAR.
- Sud, I. (2013) 'Afghanistan: A Synthesis Paper of Lessons from Ten Years of Aid', Washington, DC: World Bank.
- Tavakoli, H., Cessay, I. & Cole, W. (2014) 'Success when stars align: public financial management reforms in Sierra Leone', WIDER Working Paper 2014/081, Helsinki: UNU-WIDER.
- Thomson, B. (2007) 'Sierra Leone: reform or relapse? Conflict and governance reform', London: Chatham House.
- UN (2011) 'Palestinian state-building: a decisive period, Ad Hoc Liaison Committee meeting', Brussels: Office of the United Nations Special Coordinator for the Middle-East peace process.
- Welham, B. & Hadley, S. (2015) 'The capabilities of the Sierra Leone Ministry of Finance and Economic Development', London: Overseas Development Institute.
- World Bank (2011) 'Sustaining achievements in Palestinian institution-building and economic growth', Washington D.C.: World Bank.
- World Bank (2012) 'Public Finance Management Assessment: South Sudan', Washington, DC: World Bank.
- World Bank (2013a) 'Afghanistan Public Financial Management and Accountability Assessment', Washington, DC: World Bank.
- World Bank (2013b) 'Public Expenditures In South Sudan: Are they Delivering?', Washington, DC: World Bank.
- World Bank (2013c) 'South Sudan - Local Governance and Service Delivery Project', Washington DC: World Bank.
- World Bank (2013d) 'Fiscal challenges and long term economic costs, economic monitoring report to the ad hoc liaison committee', Washington D.C.: World Bank.
- World Bank (2013e) 'West Bank and Gaza Public Expenditure and Financial Accountability (PEFA) public financial management performance report', Washington D.C.: World Bank.
- World Bank (2014) 'World Bank operations in the West Bank and Gaza', Washington D.C.: World Bank.
- World Bank/DFID (2008) 'Afghanistan Public Financial Management Performance Assessment', Washington, DC: World Bank.
- Zanotti, J. (2014) 'U.S. foreign aid to the Palestinians', Washington D.C.: Congressional Research Service.