(Re)Building Core Government Functions in Fragile and Conflict Affected Settings

Joint Principles for Assessing Key Issues and Priorities

7. Aid Management, Financing and Donor Relations
Disclaimer

This redacted and revised version of “Rebuilding Core Government Functions in Fragile and Conflict Affected Settings” is an Exposure Draft being released for public interest and consideration. The thinking on core government functions is continuing to evolve, and this paper is one of several efforts at engaging on this topic. The principles and guidelines explored here will be tested over the next few years, and a revised version will be produced subsequently in light of the lessons learned. It does not reflect the views and opinions of the World Bank Group or its Board of Directors, nor of the United Nations.
**Preface**

This report forms part of a response to growing calls for the United Nations, the World Bank and the International Monetary Fund to engage more systematically and coherently in fragile and conflict-affected contexts and indeed in major crises affecting security and development. In 2013, the Secretary-General’s Policy Committee called on these institutions to develop a joint approach and methodology to assess needs and improve the provision of support to core government functions in the immediate aftermath of conflict. This was echoed recently by the High-Level Independent Panel on Peace Operations in 2015 and falls within the scope of the Partnership Framework Agreement for Crisis-Affected Situations signed in April 2017 by the UN Secretary General and the WB President.

In the immediate aftermath of conflict, understood as the first three years after the cessation of widespread violence, the short-term objectives of assistance are usually focused on stabilization: to provide a minimum level of security, set in motion the beginning of an economic recovery and lay the initial foundation for long-term institutional development. The importance of restoring core government functions has been repeatedly identified as critical to sending confidence-raising signals to the population in the aftermath of conflict, to both project the authority of the state and for the delivery of services that improve development outcomes.

The lessons learned over the past decade emphasize the importance of incorporating a political economy approach to building core government functions, the need for flexibility and adaptation to changing political and security circumstances, the management of risk and the importance of staying the course in the face of crises and temporary reversals. Rather than adopting comprehensive reforms or entirely new business processes, it is about building on existing institutional legacies, adapting existing systems and working in an incremental manner. Tradeoffs between introducing the basic building blocks of public financial management, and understanding the need to distribute rents that create stability will need to be recognized and addressed. A key requirement for a durable recovery is a political settlement that is sufficiently inclusive of the major elite coalitions with the capacity to mobilize organized violence. Partnerships between the United Nations and the World Bank can enable greater flexibility in providing support, through enhancing the areas where one partner has a comparative advantage, whether it be geographical access, depth of technical expertise or an explicitly political mandate.
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Table of Contents

Disclaimer 2
Preface 3
Acknowledgements 4

Chapter 7. Aid Management, Financing and Donor Relations 6
  7.1 Objective 6
  7.2 Aid Management in a post-conflict setting 6
  7.3 Principles 7
  7.4 Priorities 7

Annex: Diagnostic Questions – Context and Core Government Functions 12
  A.7 Aid Management, Financing and Donor Relations 12
Chapter 7. Aid Management, Financing and Donor Relations

7.1 Objective

Development assistance - in terms of aid flows and technical assistance - is often critical to (re)establish the five core functions previously discussed, as well as to compensate for particularly depressed GDP and revenues due to the conflict. However, a large influx of aid and experts can overwhelm a still fragile country struggling with basic capacity and can lead to a range of negative impacts. The objective of the sixth core function is thus effective management of aid to direct it toward strategic priorities, mitigate the effects of aid dependency and eventually manage a transition from recovery and relief to a more steady development partnership.

7.2 Aid Management in a post-conflict setting

In the immediate aftermath of conflict, a large influx of aid is often necessary to compensate for significant losses in GDP and tax revenues to fund core functions, sometimes including basic recurrent costs and security provision. Aid can help shore up a political settlement by incentivizing cooperation by potential spoilers, and enabling political actors to carry through on commitments. External assistance can also help build citizen trust by supporting “quick wins” and “peace dividends”, while it helps set in motion the beginning of an economic recovery and lays the initial foundation for long-term capacity development.

While necessary, a large influx of aid and experts also comes with risks. The perennial problem of coordination among donors with multiple, and sometimes conflicting agendas, budget cycles, aid modalities and fiduciary requirements is heightened in conflict situations where donors are responding to a range of political, security and humanitarian imperatives. For the same reasons, aid flows may be more volatile, hindering effective planning and implementation in ways that can undermine stability and the credibility of the post-conflict government.

The urgency of “getting money out the door” and high fiduciary risks can result in poor programming, favoring fast disbursement, quantifiable outputs and use of parallel systems over steady institutional and capacity development. These conditions also exacerbate donor tendencies to fund best-practice solutions and forms that meet international standards, leaving recipients with fiscally unsustainable and functionally ineffective institutions. Worse, it may crowd out local innovation and collective action, and undercut critical efforts to maintain stability through rent distribution and other means.

While aid is needed precisely because of depressed levels of domestic tax revenues, the reliance on external funds can further undermine the relationship between the state and its citizens by making the state less responsive to their demands. Aid dependency has been likened to the natural resource curse: the more the state relies on revenues from the international community, the fewer incentives it has to build the public institutions necessary to mobilize domestic revenues through taxation. And the less that states rely on their domestic tax base, the more state-citizen accountability erodes. Without an understanding of the complex contextual realities, the security situation and the nature of the political settlement, aid can inadvertently exacerbate social divisions and open up opportunities for corruption and abuse.

The donor community and aid recipients are increasingly aware of these dangers and much effort has gone into learning lessons and developing good principles for aid delivery and management aimed at mitigating these risks and maximizing the positive effects. It is to this we now turn.
7.3 Principles

There is broad agreement in the development community on the core principles of good aid management in post-conflict settings, perhaps most authoritatively enshrined in the 2011 Busan Partnership for Effective Development Cooperation and the New Deal for Engagement in Fragile States. Institutionalizing these in practice, of course requires careful adaptation to context and attention to fast changing political dynamics in both host and donor states. For purposes of supporting aid management as a core government function in the immediate aftermath of conflict, key principles include:

- **Development assistance must be owned and led by the recipient country.** Donor aid should be aligned to agreed national priorities through a mutual accountability framework. While fundamental, the concept of country ownership can be very thorny, especially in fragile environments where policies, identities and possibly even the government itself may be highly contested and deeply political. At its best, aid delivery and management can support the emergence of the kind of leadership and systems needed to develop country-owned national priorities. At a minimum, it must be alert to contestation and seek to avoid being complicit in problematic partisan agendas.

- **Donors should strive to reduce transaction costs and ensure predictability of aid flows.** While donors also need to respond to their own political imperatives, accountability requirements and institutional incentives, they should make use to the extent possible of mechanisms to enhance donor coordination and harmonization and to limit the volatility of aid flows.

- **Facilitate functional solutions to immediate needs with an eye to the longer-term need for sustainability.** As noted throughout this guidance, introducing international standards and best practice may lead to overly complex, costly and unsustainable structures. Effective aid management can help promote functional solutions that fit the local context and take into account fiscal and capacity realities.

- **Balance the aim of fast results with that of ownership, adaptation and accountability.** In crisis situations aid can be used to shortcut cumbersome domestic political processes and fiduciary risks by working through parallel systems. Under the circumstances, this may be the best way of promoting immediate security, stability and emergency assistance. But shortcuts can also undermine other critical goals such as fostering citizen-state accountability and building local capacity for the long term.

- **Invest in a functional and adaptive government-donor interface.** Allow aid management capability to support both the strategic and accounting aspects of aid management as well as a robust platform for ongoing dialogue.

7.4 Priorities

7.4.1. Organization of the aid management function

The government-donor interface is normally provided through a government aid management unit. In some countries, the aid management architecture was not seriously affected during the conflict period and there may be significant continuity with structures and personnel. In others countries, an aid management entity may need to be created. While context will determine the most appropriate form, experience suggests the following good practice for the aid management function:
• A single aid management unit (AMU) responsible for interfacing with the donors on all economic and financial aid and technical assistance to the government can maximize coordination and alignment with national priorities. In order to develop constructive contacts with multiple donors, the unit should build capability to interact with the various procedures and requirements of different donors. Ideally, the AMU should be housed in the Ministry of Finance and Planning.

• The AMU can help ensure that all external aid is reflected in the government budget. Military and humanitarian assistance may be handled through different channels, but should also be reflected in the government budget. While aid to non-state entities such as NGOs may be provided directly, donors should provide regular updates to the AMU.

• For good aid management, reliable and timely information is critical. The AMU should establish an aid information system to focus on the basic requirements of recording and tracking commitments and disbursements according to type of assistance and beneficiary sector.

• The AMU should interact closely with the line ministries, but should “function to facilitate”, without interfering in their decisions. In the immediate aftermath of conflict, the unit may temporarily have a major advisory role in project selection decisions.

Where regular government agencies have severe capacity constraints, the aid management function may need to play a stronger role in managing aid-financed programs. The structure and modalities of this transition function must necessarily be country- and situation-specific, but in general it can play the following roles:

• Function as the primary source of initial government ownership and the bridge between donors and government, interfacing with donors to regulate aid “traffic” and monitor aid activities.

• Be the government’s focal point to formulate the reconstruction program, and perhaps even directly implement a number of projects and activities.

• Serve to incubate initial capacity in the various sectors that will eventually transform into regular ministries of government.

These roles should be progressively relinquished as the regular organs of government begin to function. When an aid and program management agency functions badly, aid is wasted or misallocated. When it functions too well, an equally difficult problem arises: donors prefer to engage with it; the agency hangs on to its responsibilities instead of progressively devolving them to the new line ministries; and the development of capacity in the regular organs of government to exercise the regular functions of government is thwarted. The key lesson is that government and donors should agree from the outset on a clear sunset clause, by which the special entity will be closed and its functions absorbed into the regular structure of government at a specified time. To do so meaningfully, however, institutional capacity must be built at the same time within the regular organs of government to create a sound alternative to a monopoly of decision-making by a special agency.

7.4.2 Financing recovery: the need for fungibility and predictability
The largest projects, humanitarian relief and security-related programing can be financed individually. In all other areas a unified budget reflecting a unified agreed program requires a unified financing mechanism. There are five
main requirements for effective donor financing of the budget: (i) prior agreement between the government and the donors on a program of activities; (ii) systematic interface between government and the donors; (iii) an administrative mechanism that minimizes transaction costs and delays; and (iv) a robust system for timely reporting of expenditures without undermining the fungibility of the assistance; (v) predictability - it is important that donors actually execute what they said they would.

A variety of aid sources and channels exist for countries in the aftermath of conflict. In many post-conflict countries, untied budget financing has been channeled through an “umbrella” multi-donor trust fund (MDTF), usually administered by the UN or the World Bank. An MDTF can avoid aid fragmentation and duplication; helps the predictability of aid flows; builds a close link with the budget; protects against fiduciary risk; and provides the basis for a robust government-donor dialogue on recovery, peace-building and development policy. A well-designed and well-run MDTF can also significantly reduce transaction costs for both donors and the government.

The key features of an effective MDTF are as follows:

• It should fulfill both a fiduciary and an executive function - legal custodian of the resources as well as manager of their effective use.

• It should cover both investment and current expenditure, including a part of the wage bill, reflecting understandings on the size and compensation of the government workforce.

• It should reassure individual donors that their money goes for their priority purposes while avoiding earmarking. This can be facilitated by co-mingling all contributions in a common pool, while acknowledging donor preferences and reporting to donors along broad expenditure categories.

• The governance arrangements usually include a steering committee composed of the principal donors and chaired by an administrator, meeting frequently and regularly to review funding proposals endorsed by the government. Once approved, the project can be managed under the responsibility of the administrator, based on rules for procurement, financial management and other functions, pre-agreed with the government and the main donors.

• The steering committee reports periodically to the larger group of all contributing donors, and the trust fund resources are replenished from time to time as previously negotiated.

7.4.3 Balancing short and long-term needs: country systems, technical assistance and donor distortions

Using country systems - The Busan Partnership for Effective Development Cooperation and the New Deal for Engagement in Fragile States build on the Paris Declaration and the Accra Agenda for Action in their strong advocacy for the use of country systems (mainly procurement and financial management, and secondarily M&E) in aid-financed projects and programs. This is not always possible in the immediate aftermath of conflict when weakness of national fiduciary systems can limit implementation of projects, as well as facilitate corruption and loss of government legitimacy. Progressively engaging with government systems over time has emerged as a practical way to manage the risks associated with low capacity institutions in a post-conflict environment.

For most countries, there are existing reviews of the quality of the pre-conflict national systems for procurement, financial management and monitoring and evaluation. The central diagnostic need is to assess how existing systems can be made operational, and how quickly this can be done.
Complementing the diagnosis, priorities are to:

- Assure that the procurement and FM systems used by donors are themselves based on sound principles and good practice, and, to the extent possible, uniform among donors;

- Implement the donor procurement and FM procedures in a manner consistent with the realities on the ground and with the maximum possible flexibility;

- In general, support the strengthening of the country’s own procurement and financial management systems, with a view to increasing their later use in donor-financed activities;

- In particular, twin investment assistance with appropriate technical assistance to develop the country’s own systems; and,

- To the extent possible, design the project implementation units also as incubators of local capacity and training of national civil servants.

**Technical assistance and capacity** - Self-standing technical assistance, normally for institutional development, has made significant contributions in some contexts, but has also too often been the source of conflicting advice, and inappropriate solutions, as well as conflicts of interest and integrity problems. Donor processes for deploying experts can be lengthy, with recruitment periods lasing nine months or longer.

It is especially important to be aware of the persistent tendency of external actors to recommend the introduction of complex public management practices unsuited to local circumstances, and carrying high transaction costs for highly dubious benefits. This tendency is either generated by lack of understanding of the local circumstances, or is deliberately intended to create a future demand for the consulting advice necessary to implement those practices. Finally, while core government functions cannot be re-established without some external advice and direct involvement by a few competent individuals or firms, persistent dependence on external technical assistance is lethal to long-term capacity development.

To maximize potential benefits while mitigating risks, the aid management function should:

- Work with donors to avoid both duplication of advice as well as gaps;

- Be active in defining requirements so as to seek the highest quality and ensure suitability to the local context;

- Facilitate innovative and cost-effective ways to mobilize experts of demonstrated high competence and experience;

- Ensure that the transfer of knowledge and capacity building is a contractual requirement, rather than the mere provision of one-off advice;

- Formulate a strategy for gradual exit from external technical assistance and its replacement with national expertise with support from the donor community.
**Donor generated distortions** - National donor interests inevitably come into play. The close links between a bilateral donor’s foreign policy and commercial interests and its aid policy are well known, but less well analyzed. These links will influence what a given donor will, or will not, finance, and under what conditions. Further, at a practical level, the time perspective and objectives of individual donor agents are not necessarily congruent with those appropriate to post-conflict recovery and overall development impact.

A major manifestation of this disconnect is evident in the practices relating to the hiring of national staff. Donors have an understandable incentive to make their own project succeed, including to attract the best local staff by paying whatever salaries are required. In the process of facilitating individual projects, the already-limited capacity of the government is thus weakened, compromising both short-term recovery and long-term development. The incentives of both the individual donor staff and managers and the local staff and government officials concerned are too strong to be able to fully eliminate the distorting effects of certain donor practices in post-conflict situations. However, it is possible to reduce and minimize these effects a number of measures by attempting to change the risk calculus.

Donors should openly agree on and abide by clear provisions to avoid creating incentives for government employees to leave government service. These provisions should include public guidelines for compensation of local staff and experts, which should be roughly comparable to the compensation of permanent government employees, and should be embedded in formal multi-donor agreements with consequences for violation.

The risks that individual donor practices weaken government capacity can be mitigated, in part, by channeling as much external aid as possible through a multi-donor trust fund that is managed in accordance with standards and provisions agreed to by all major donors.

**7.4.4 Beyond post-conflict: transitioning out of emergency aid modalities**

Aid to post-conflict countries tends to be at its highest when the country’s absorptive capacity is at its lowest. By the time the country has become capable of absorbing substantial aid, donors may have “lost interest” and moved on to the next crisis hotspot. At the same time, as the political settlement is consolidated and recovery takes root - including domestic revenue mobilization - there ought to be a gradual reduction in aid dependency.

As the country moves out of the immediate post-conflict period, the mix of aid modalities ought to shift progressively away from “emergency” to ordinary modalities, and reliance on the use of national fiduciary systems ought to gradually increase. Because of the greater simplicity and rapidity emergency aid procedures, staff and managers may be reluctant to switch to normal and lengthier procedures. It is useful therefore to consider organizing, toward the end of the early post-conflict period, a review and dialogue among donors and with the government on how and when to begin transitioning out of emergency projects implemented through emergency modalities.
Annex: Diagnostic Questions

A.7 Aid Management, Financing and Donor Relations

Aid and the economy
- What percentage of GDP does aid account for? How does this compare to (i) the pre-conflict levels (ii) other post-conflict countries and (iii) neighboring countries?

- Are major distorting factors present, e.g., a large military intervention that is itself a source of major spending, contracts and inflationary pressures?

- What are the main geographic challenges (topography, population dispersal, local insecurity) to channeling aid to where the needs are greatest?

- What are the main sources of aid? Is there one large donor whose contributions dominate external financing?

Organizational framework
- Is the pre-conflict framework for aid management still in existence? Where in the government is it located? Is there any continuity in structures or personnel?

- Which among the various linkages between aid management and other government structures is currently operative and which needs to be restored as a matter of priority?

- How and when can provisions be established for the normal interaction between the aid management unit and the line ministries?

- How is the aid management unit internally organized (by donor or by sector)?

- Is the government effectively in charge or is most aid in practice driven by the donors?

Information and systems
- What are the information and communication technology (ICT) infrastructure assets that survived the conflict?

- Was there an adequate aid information system before the conflict and, if so, is it functional?

- Was there before the conflict a comprehensive and reliable database of information on economic and financial aid and, if so, can it be restored?

- Do the technical and human resources still exist to update and maintain the aid database?

- Does a simple but reliable system exist for linking aid information to the budget?

- When and how can formal understandings and protocols be put in place for donor reporting to the government on their aid commitments, disbursement plans, and actual disbursements?
Financing the recovery
• To what extent is aid “on-budget”?
• What are the sources of untied aid?
• Is there a need for an “umbrella” multi-donor trust fund?
• How are humanitarian and emergency aid handled?

Progressive engagement with country systems
• Are there pre-existing reviews of the quality of the pre-conflict national systems for procurement, financial management and monitoring and evaluation?
• Are the major gaps in procurement or in financial management?
• When and how can plans be made for the eventual transition to country systems for financial management and procurement?

Technical assistance and capacity building
• How are technical assistance experts mobilized? What are the plans for utilizing diaspora experts?
• Is there tension between diaspora and national experts, and how is it likely to be managed?
• What provisions can be put in place to assure the competence of the expatriate experts and the quality/relevance of their advice?
• Have capacity gaps in key functions been identified?
• How can genuine transfer of knowledge be assured between expatriate advisors and local staff for key positions?

Donor-generated distortions
• What are the existing donor practices with regards to compensation for local staff?
• Are there incentives for civil servants to leave government employment to work in aid-financed projects or organizations?
• Is there evidence of salary “top-ups” of government employees as counterparts of aid-financed projects?
• Are there other donor practices with the potential to distort the local economy or undermine capacity building?
• What are the concrete prospects for clear and binding agreements among donors to avoid capacity-destroying practices?