



# Strengthening Somalia's Systems Smartly:

A Country Systems Risk Benefit Analysis

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*By Dan Honig and Sarah Louise Cramer*

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## Contents

ABBREVIATIONS .....	III
EXECUTIVE SUMMARY .....	IV
1 INTRODUCTION .....	1
2 BACKGROUND .....	3
2.1 AN EVOLVING DIALOGUE ON USE OF COUNTRY SYSTEMS .....	3
2.2 PUBLIC FINANCIAL MANAGEMENT (PFM) SYSTEMS IN SOMALIA.....	4
3 USE OF COUNTRY SYSTEMS IN SOMALIA .....	7
3.1 DIVERSIFICATION OF DELIVERY MODALITIES .....	7
3.2 STATUS OF UCS DIMENSIONS.....	8
3.3 DRIVERS OF DONOR DECISION-MAKING ON UCS .....	13
4 WEIGHING RISKS AND BENEFITS: CHOOSING BETWEEN IMPERFECT STRATEGIES.....	16
4.1 FIDUCIARY RISKS.....	17
4.2 OPERATIONAL & STATEBUILDING RISKS .....	20
4.3 REPUTATIONAL RISKS .....	24
4.4 COMPARING RISKS AND BENEFITS.....	26
5 DISCRETE USES OF COUNTRY SYSTEMS AND THE WAY FORWARD.....	28
6 CONCLUSION .....	33
ANNEXES.....	35
ANNEX A. INTERVIEWEES & CONSULTATIONS.....	35
ANNEX B. REFERENCES .....	36

## Boxes

Box 1. UCS Decisions Depend on More than Public Financial Management (PFM) Assessments .....	1
Box 2. Iterations of the UCS Roadmap .....	4
Box 3. Recent Achievements in Strengthening Somalia's Financial Governance at Federal Level .....	5
Box 4. The Somalia Development and Reconstruction Facility (SDRF): Enabler of Greater UCS.....	15
Box 5. Risk-Benefit Categories .....	16
Box 6. Comparing the Quality of Different Uses of Country Systems in the Security Sector.....	19
Box 7. Supporting Recurrent Costs in Somalia through an Iterative Approach .....	23
Box 8. The Legacy of the Special Financing Facility.....	29

## Figures

Figure 1. Estimated Breakdown of Development Assistance by Implementing Partner, 2016 .....	7
Figure 2. On Budget Aid in Five Low Income Fragile States, 2015 .....	11
Figure 3. Breakdown of Aid Delivered on Treasury, 2016.....	11
Figure 4. Reliance on External Grants in Five Low Income Fragile States, 2015.....	21

## Abbreviations

ACU	Aid Coordination Unit
AfDB	African Development Bank
DfID	United Kingdom Department for International Development
EC	European Commission
FGC	Financial Governance Committee
HIPC	Heavily Indebted Poor Countries Initiative
IFI	International Financial Institution
IMF	International Monetary Fund
MoF	Ministry of Finance
MoPIED	Ministry of Planning, Investment, and Economic Development
MPF	Multi Partner Fund for Somalia (World Bank administered)
MPTF	Multi Partner Trust Fund for Somalia (UN Administered)
NDP	National Development Plan
NGO	Non-governmental organization
NPS	New Partnership for Somalia
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PBF	UN Peacebuilding Fund
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
RCRF	Recurrent Costs and Reform Financing project
SDRF	Somalia Development and Reconstruction Facility
SFF	Special Financing Facility
SFF-LD	Special Financing Facility for Local Development
SFMIS	Somalia Financial Management Information System
SIF	Somali Infrastructure Fund (AfDB administered)
SNA	Somali National Army
SPF	Somali Police Force
SSF	Somalia Stability Fund
UCS	Use of country systems
UN	United Nations
USAID	United States Agency for International Development

## Executive Summary

Somalia's donors are unambiguous: statebuilding is a key, if not *the* key, goal of their development assistance. This paper examines donors' decision-making about the use of country systems (UCS), an internationally recognized tool for statebuilding, exploring both the perceived and actual risks and benefits associated with it.<sup>1</sup> UCS refers to a variety of ways in which international partners can engage with national counterparts to deliver aid ranging from alignment with national priorities to direct implementation by government. While using country systems comes with risks, so do alternative delivery modalities. Considering the risks and benefits both of UCS and its alternatives side-by-side may help in achieving a mix of delivery modalities that better serves donors' and government's shared statebuilding objectives.

Despite the high-level commitments made on UCS, Somalia continues to trail other fragile states in critical dimensions, including the proportion of aid delivered "On Budget." Only 4% of development aid was delivered on budget in Somalia in 2015, compared with 28-44% in the Central African Republic, Mali and Liberia in the same year. Given the explicit focus on statebuilding in Somalia, the preferencing of short-term operational concerns over long-term government systems building appears to run counter to the international community's stated objectives.

The risks of UCS must be balanced against the potential benefits. Donors' use of country systems can help focus donor and government attention on strengthening those systems as well as incentivize dialogue and reform. Government-executed projects can help build government legitimacy and public support, strengthening accountability between the State and its citizens. UCS can also maximize the effectiveness of aid, directly benefitting donors by providing better value for money. This is a critical consideration in a high cost environment like Somalia where 30-60% of project funds are estimated to be consumed by additional overheads related to project monitoring and delivery in this fragile environment. In contrast, bypassing country systems can undermine the legitimacy of the state, lead to greater fragmentation, and diminish the cost effectiveness of investments in the long term.

In practice, international partners often focus on the risks and benefits of country systems in a narrow fiduciary sense, by examining the strength of country public financial management (PFM) systems. This makes little sense. Fiduciary risk is an important, but far from the only, consideration in determining what tools are best. Furthermore, the risks and benefits of country systems need to be examined alongside those of alternative delivery channels (e.g. the use of nonprofit, private sector or multilateral implementers) rather than in isolation.

Framing the risks and benefits of implementation modalities in comparison to one another brings into relief the fiduciary, operational, statebuilding, and reputational risks both of using country systems and failing to use them. While there is no one-size-fits-all solution, this report suggests that country systems are substantially under-used in Somalia at present. This is not because there are no risks to using country systems, but rather because all donor choices in Somalia carry risks.

*Fiduciary risks:* Somalia's fiduciary systems are, as might be expected given the country's fragility, improving from a low base. While the fiduciary risks of UCS are a substantial topic of conversation and concern in Somalia, less examined are the fiduciary risks associated with *not* using Somalia's PFM systems. Moreover, donor funds can, and sometimes are, mismanaged when delivering assistance outside country systems. Fiduciary risk and the efficiency of spending are real concerns in Somalia, whatever the implementation

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<sup>1</sup> Members of the International Dialogue on Peacebuilding and Statebuilding recommitted to the need for greater UCS in the Stockholm Declaration in 2016. International Dialogue on Peacebuilding and Statebuilding 2016.

modality; it is less obvious that these concerns, taken as a whole, clearly augur for or against the use of country systems.

The extra measures required to operate in Somalia come at a high cost. Monitoring and overhead costs are not normally thought of under the banner of fiduciary risks, but if the concern at the root of discussions of fiduciary risk is value for money, then the magnitude of these costs is due some consideration. In some cases, UCS can deliver more “cents on the dollar” than alternative delivery channels, even after considering the fiduciary challenges of Somalia’s PFM systems.

*Operational & Statebuilding risks:* In many regards the Somali Government – at both federal and state levels – has very weak implementation capacities. In the short-term, making full use of Somalia’s systems to implement projects may result in delayed and lower quality implementation than could be achieved through other implementation modalities. Yet, balanced against these weaknesses is the simple truth that parallel delivery systems are not a sustainable solution for sectors and activities that will be provided by the state in the long-term. The question in these sectors from an operational standpoint is arguably not whether to transition towards country systems, but when and how to do so.

UCS has the potential to strengthen medium-term capacity by focusing donor and government attention on the quality of government systems, both financial and non-financial (e.g. payroll, human resources systems). Where used, international attention and resources are shifted from the operational challenges of a parallel system towards those of government, creating “positive spillovers” for country systems. This approach not only “uses the muscles” of government systems, but – perhaps a bit like exercise for the human body – actually strengthens systems as a result of their use.

*Reputational risks:* Just as the Government of Somalia has valid legitimacy concerns, so too are Somalia’s donors concerned with their domestic legitimacy. Donors can only continue to operate so long as they have the continued support of their publics, parliaments, or executive boards. While failure to deliver on long-term objectives also carries reputational risk, short-term risks with the potential to grab domestic headlines (e.g. misappropriation of funds) often weigh more heavily on international partners’ decision-making when it comes to using country systems. If Somalia were to slip backwards into conflict, it would not be seen in donor capitals as an aid success story; but neither would its collapse be directly attributable to a particular donor project, or even a particular donor. The mechanisms by which reputational risk is realized and success attributed may lead to an asymmetric focus on short-term risks, pushing international partners towards undue conservatism in their tactics.

In making allocative decisions, donors feel the need to justify the choice to use country systems much more rigorously than alternatives. There is arguably no financial management system in the world that can confidently avoid a single misspent dollar. Donors will have to find ways to accept and frame the continued potential for adverse fiduciary and operational risk events if they wish to substantially increase UCS.

There are myriad ways of using country systems while mitigating operational and fiduciary risks. Some possible ways forward in transitioning towards greater UCS identified in the report include:

**1. Build on What’s Worked:** Apply Adaptive Approaches to Drive Iterated Improvements: An incremental, iterative approach needs to be applied more often and more broadly – not just to programs but also planning frameworks and aid coordination structures. Doing so also offers the prospect of driving iterated improvement in country systems themselves.

**2. Increase Recurrent Costs Support Using Country Systems:** Country systems have been successfully used to pay civil servant salaries at the federal and state level while catalyzing system strengthening and reforms. Support for recurrent costs could be scaled up at the state level, perhaps

absorbing the support international partners are currently providing in parallel to country systems for both salaries and operational costs. Stipend support for the Somali National Army could also be transitioned to formal national channels, focusing donor and government attention on government's, rather than parallel, payroll and human resources systems.

**3. Maximize the Benefits of Current and Future Uses of Country Systems:** One of the simplest way to increase the UCS would be to commit greater resources to the SDRF windows that focus on using country systems. Both government and international partners can also do more to ensure that existing uses of country systems maximize the benefits of this approach. Not all uses of country systems have equivalent effects in their ability to catalyze iterated learning, improve systems, and support meaningful national ownership.

**4. Use Country Systems to Strengthen Somali Federalism:** More interventions need to promote inter-governmental dialogue and the establishment of fiscal federalism linkages. Bringing a greater share of money on country systems for particular sectors – e.g. education – may assist in forwarding the demarcation of operational responsibilities between federal and state governments. In addition, large infrastructure projects that require collaboration across states, or collaboration between Somalia and neighboring countries, could enable some donors to unlock additional “regional” funding on Somalia's behalf while facilitating inter-state and state-federal collaboration.

**5. Increase the Legitimacy Benefits of UCS by Contracting Out:** In some sectors and areas contracts currently managed by donors could be transitioned to government management. Implementing partners could then be contracted to implement on behalf of the government, helping to strengthen the government's capacity to effectively oversee and regulate in the targeted sector.

**6. Next Steps for the UCS Dialogue:** There is much that the Somali Government can do to encourage increased and improved use of country systems, e.g. by redoubling its commitment to PFM improvements and delivery system strengthening, continuing to work with the International Monetary Fund to reach decision point under the Highly Indebted Poor Countries (HIPC) Initiative, and investing in making existing aid coordination structures more effective. The government should not – and indeed cannot, if it wants to see increased UCS – simply wait for donors to act.

International partners should further engage government in both political and technical discussions as to their vision of how precisely they will move forward in their use of country systems. They should do more to ensure that their UCS commitments are actually delivered upon. International partners should also recognize the limitations that their own security procedures place on dialogue, and do more to create space for informal conversation and trust-building with government counterparts.

Greater use of country systems will not maximize the benefits of aid in every case. The current “balance” between UCS and alternatives seems far from optimal, however. Explicitly comparing the use of country systems and their alternatives when considering interventions, and considering both short- and long-term risks, may serve to help rebalance the scales and allow a more accurate, transparent comparison of risks across implementation modalities.



# 1 Introduction

The use of country systems (UCS) is critical for supporting countries emerging from conflict and fragility. UCS refers to a variety of ways in which international partners can engage with national counterparts to deliver aid, ranging from alignment with national priorities to direct implementation by government. While it also carries risks for donors, the use of country systems can serve as a means to achieve broader ends. An internationally recognized tool for statebuilding, UCS can increase national ownership, incentivize dialogue and reform, focus attention on strengthening national systems while using them, and provide governments with the tools to build legitimacy and public support. Greater use of country systems can also reduce fragmentation and deliver better value for money.

Increased UCS continues to be a stated priority for both the government and international community in Somalia, echoing a broader international agenda regarding the use of country systems in fragile states.<sup>2</sup> Despite high-level commitments, Somalia continues to trail other fragile states in critical dimensions of UCS. Given the international community's explicit focus on statebuilding in Somalia, the preferencing of short-term operational concerns over long-term government systems building appears to run counter to the international community's stated objectives. There is no single explanation for this disconnect between stated objectives and choice of implementation modality. One thing that is clear is that decisions regarding UCS are not merely a function of the quality of public financial management (PFM) systems (see Box 1).

This study explores both the perceived and actual risks and benefits of using of country systems in Somalia, providing insight into the decision-making of international partners and proposing a few discrete areas in which the use of country systems might fruitfully be expanded. It thus includes a discussion of PFM systems, but places this discussion in a broader framework of donor decision-making and risk considerations. It also aims to inform the UCS dialogue that has evolved in Somalia since 2014 through a process of collective target setting and monitoring.

## *Box 1. UCS Decisions Depend on More than Public Financial Management (PFM) Assessments*

Existing explorations of UCS often focus narrowly on technical issues related to PFM performance, notably using the Public Expenditure and Financial Accountability (PEFA) framework. Given their backward-looking focus on whole-of-system performance, PEFA indicators fail to “give a view of how systems are performing now, how they will perform in the future, or if there are islands of excellence which may still permit the use of country systems.”<sup>3</sup> There is also, other observers have argued, “little link between progress on PEFA scores and whether donors are prepared to use Country Systems.”<sup>4</sup>

PFM performance is far from the only determinant in donor decision-making regarding UCS. A 2014 assessment of seven development partners revealed that donors such as the European Union, Germany, the United Kingdom and the United States “tend to include non-fiduciary factors in determining eligibility” such as democracy, human rights, and governance. Indeed, no bilateral donor in the study focused primarily on fiduciary issues to determine eligibility for using country systems. The study also highlighted the importance of “perceived risk” in decision-making.<sup>5</sup>

<sup>2</sup> See e.g. g7+ et al. 2016; Manuel et al. 2017; Hart, Hadley, and Welham 2015a; OECD 2012.

<sup>3</sup> Hart, Hadley, and Welham 2015a, 22.

<sup>4</sup> Manuel et al. 2016, 26.

<sup>5</sup> OECD/UNDP 2016b, 69.

Section 2 provides background on the evolution of the UCS agenda and a brief overview of the state of PFM systems and reforms in Somalia. Section 3 then describes the current status of different UCS “dimensions” in Somalia (e.g. “On Plan”) and what seems to matter to donors in their decision-making regarding the degree of use of Somalia’s systems.

An overly narrow framing of both the risks and benefits of using country systems in Somalia has, our interviews suggest, served to frustrate government and international partners alike. Section 4 articulates a framework for comparing the risks and benefits of UCS and alternative delivery modalities in Somalia. Section 5 articulates recommendations for improving and increasing UCS. Our hope is that this report can play a role in charting a productive path forward.

This report draws on more than 40 interviews with government officials, international partners, and others with insight on UCS in Somalia. This is complemented by a desk review of the existing literature on the risks and benefits of UCS both internationally and in Somalia. Annex A provides a list of interviewees, to whom we are grateful. To protect confidentiality, interviewees have been given randomly assigned numbers for reference to these conversations.<sup>6</sup>

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<sup>6</sup>With the exception of when doing so would serve to de-anonymize. That is, for example, if there was an interview with a JICA representative (there was not) and the text read “JICA has done X, Y, Z”, we would not list an interview number in the citation as doing so would serve to pierce the confidentiality of the interviewee for all other references.

## 2 Background

### 2.1 An Evolving Dialogue on Use of Country Systems

The New Deal for Engagement in Fragile States called for increased use of country systems (UCS) in 2011,<sup>7</sup> demonstrating the relevance of this core aid effectiveness principle for countries transitioning out of conflict and fragility. Members of the International Dialogue on Peacebuilding and Statebuilding recommitted to the need for greater use of country systems in the Stockholm Declaration stating that it is “a crucial principle of the aid effectiveness agenda” and “can determine a country’s leadership and thus contribute to the legitimacy of state institutions, an important element for statebuilding.”<sup>8</sup>

Despite the prominence of this issue, many stakeholders have a limited understanding of what UCS actually entails in practice. It is still perceived by many to be synonymous with budget support.<sup>9</sup> While it is “perhaps the purest use of country systems,”<sup>10</sup> budget support is only one of the means by which partners can use country systems. Other dimensions, such as alignment with national priorities, are relevant for all international partners, regardless of their preferred implementation modalities.

There is also a growing sense amongst some that international interest in UCS may be ebbing amongst donors due to shifts in their domestic policies and interests, with the exception of a few champions “swimming against the stream.”<sup>11</sup> Some donor agencies have explicitly ruled out certain tools for using country systems (e.g. as of 2015, DfID is no longer able to provide traditional, general budget support),<sup>12</sup> while others are now subject to additional bureaucratic hurdles when using country systems (e.g. USAID must now notify Congress if any contribution to a trust fund administered by an International Financial Institution will be channeled through country systems).<sup>13</sup> While both of these agencies are still able to use country systems in ways other than providing general budget support, these signals from headquarters appear to run counter to global commitments to scale up use of country systems.

Whereas the aid effectiveness agenda has stalled to some extent at the global level, fragile states like Somalia continue to innovate in this field, as they work with international partners to translate policy commitments into tangible changes in the delivery of aid, with the aim of improving development outcomes.<sup>14</sup> UCS featured prominently in the New Partnership for Somalia agreed in London (May 2017), in which government and international partners committed to “work together to make quantifiable, tangible progress annually against the mutual commitments and benchmarks laid out in the UCS Roadmap” (Box 2).<sup>15</sup> The importance of UCS as a tool for building state legitimacy is not lost on the Federal Government of Somalia, which is under pressure to deliver tangible results for citizens. A representative of the Office of the Prime Minister stressed the need for a mix of delivery modalities that includes UCS, enabling the government to deliver short-term results to citizens while strengthening their systems in the longer term.<sup>16</sup>

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<sup>7</sup> The New Deal was endorsed at the Busan Fourth High Level Forum on Aid Effectiveness. Hearn 2016.

<sup>8</sup> International Dialogue on Peacebuilding and Statebuilding 2016, 3.

<sup>9</sup> A New Partnership for Somalia for Peace, Stability and Prosperity 2017.

<sup>10</sup> Hart, Hadley, and Welham 2015a, 11.

<sup>11</sup> Interview #7.

<sup>12</sup> HM Treasury 2015, 11.

<sup>13</sup> Interviews.

<sup>14</sup> Interview #7, Interview #43.

<sup>15</sup> A New Partnership for Somalia for Peace, Stability and Prosperity 2017.

<sup>16</sup> Interviews.

Through the establishment of a dedicated working group, bringing together government and international partners,<sup>17</sup> a regular process of dialogue, monitoring and collective target setting has worked to forward the UCS agenda in recent years. This process has been “gradually closing the gap between what government and development partners understand by UCS” in Somalia.<sup>18</sup> The UCS Roadmap used by the group has been revised several times based on the group’s evolving understanding and needs (Box 2).

### *Box 2. Iterations of the UCS Roadmap*

In 2014, the use of country systems was starting to become a more prominent topic of conversation in Somalia.<sup>19</sup> The year prior, Norway had established the Special Financing Facility (SFF), which paved the way for greater delivery of programmatic support on treasury. UCS in Somalia received attention at the High-Level Partnership Forum in Copenhagen (Nov 2014), where a concept note that laid out an interim roadmap towards greater use of country systems.<sup>20</sup> To monitor the roadmap’s implementation, a UCS working group was established in 2015.

The UCS Working Group developed an updated Roadmap for 2016, which was eventually expanded to cover monitoring of all of the Partnership Principles articulated in the Somali Compact. The result was an expansive monitoring framework that failed to build momentum or motivate change, both by government and international partners. In its latest iteration, the 2017 UCS Roadmap was refocused around a limited set of targets, with the aim of better focusing attention on priority areas where progress is needed.

The 2017 Roadmap also sets more explicit targets for both international partners and government,<sup>21</sup> in order to clarify responsibilities for achieving targets while emphasizing the importance of mutual accountability. The government benchmarks laid out in the 2017 UCS Roadmap maintain a focus on PFM performance, despite the shortcomings of a narrow PFM approach. The Roadmap was revised alongside the New Partnership for Somalia (NPS), which captures the broader political commitments donors also factor into their UCS decision-making. The revised roadmap was, therefore, designed to be complementary to the NPS Mutual Accountability Framework as a tool for monitoring progress and UCS decision-making factors.

## 2.2 Public Financial Management (PFM) Systems in Somalia

Somalia has made significant strides in improving its PFM systems in recent years. Box 3 highlights a few of financial governance achievements. Given the rapid pace of change in Somalia, this report focuses on the upward trajectory of the government’s PFM track record, rather than individual achievements, as any assessment of the latter would be quickly out of date. Any decisions on whether to use or bypass country systems need to be based on up-to-date analysis, as Somalia’s PFM systems are evolving quickly in this

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<sup>17</sup> On the government side, members include Federal Government of Somalia representatives from the Ministry of Finance; Ministry of Planning, Investment and Economic Promotion; Central Bank of Somalia, Accountant General’s Office; and the Aid Coordination Unit. On the international partner side, members include representatives of the European Union, Norway, Sweden, the United Kingdom, the United States, UNDP, UN Resident Coordinator’s Office, and the World Bank. Representatives of the g7+ group of fragile states, the International Dialogue for Peacebuilding and Statebuilding, the Financial Governance Committee (FGC) and the International Monetary Fund (IMF) also engage with the group, providing insight and guidance.

<sup>18</sup> Federal Republic of Somalia 2016, 52.

<sup>19</sup> Interview #37.

<sup>20</sup> Interim Roadmap Towards the Use of Country PFM Systems 2014.

<sup>21</sup> The targets for international partners, which are largely quantitative, were based largely on an assessment of past performance. The milestones-based targets for the government were aligned with select targets of the IMF Staff Monitored Program (SMP) and additional areas deemed to be relevant and feasible for demonstrating strengthened systems.

highly dynamic context. According to the IMF, Somalia's PFM systems are getting closer to international and regional standards and are ready to handle a greater share of development assistance.<sup>22</sup> The IMF asserts that the next set of Staff Monitored Programme (SMP) structural benchmarks, if achieved, will further demonstrate readiness to handle donor funding.<sup>23</sup>

While recognizing the improvements in Somalia's PFM capacity, some donors would like to see technical achievements matched by high-level political ownership of the PFM reform agenda.<sup>24</sup> Whereas the Ministry of Finance has been viewed as a champion of PFM reforms in recent years, persistent PFM challenges have been attributed to a lack of political will at higher levels in the previous administration. For example, the lack of wage bill controls and poor prioritization of expenditures that undermined the credibility of the 2016 budget have been attributed to decision-making over which the Ministry of Finance had limited control. Moreover, "serious problems with raising revenue and accounting for [...] revenue"<sup>25</sup> have been attributed to an inability to pass key legislation and enforce systems for accountability, in addition to limited technical capacity. The current administration has yet to demonstrate greater political leadership and broader ownership of PFM reforms.

### *Box 3. Recent Achievements in Strengthening Somalia's Financial Governance at Federal Level*

- Under the first IMF Staff Monitored Program with Somalia (May 2016-April 2017), the government met all but one of its six PFM structural benchmarks.<sup>26</sup>
- The Federal Government approved a PFM Reform Action Plan and an Arrears Clearance Plan.<sup>27</sup>
- The Central Bank of Somalia has developed a Currency Reform Road Map<sup>28</sup> as well as key Commercial Bank and Money Transfer Business regulations, under which it has issued annual licenses to six banks and 12 MTBs.<sup>29</sup>
- The Procurement Act and Anti Money Laundering Act were passed and a new PFM law has been approved by Cabinet and submitted to Parliament.<sup>30</sup>
- As of early 2017, approximately 50% of federal operations costs were paid directly by electronic funds transfers to vendor bank accounts.<sup>31</sup> An electronic system for paying civil servants salaries was introduced in 2016, "ensuring an automated and controlled monthly payroll processing."<sup>32</sup>
- An Interim National Procurement Board was established to review all contracts and concessions above the threshold of US\$ 2 million in value.<sup>33</sup>

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<sup>22</sup> Interviews.

<sup>23</sup> Interviews.

<sup>24</sup> Interview #25; Interview #6.

<sup>25</sup> Manuel et al. 2016, 31.

<sup>26</sup> International Monetary Fund 2017e, 10.

<sup>27</sup> Financial Governance Committee 2017, 2.

<sup>28</sup> Ibid.

<sup>29</sup> World Bank 2017, 79.

<sup>30</sup> Financial Governance Committee 2017, 2.

<sup>31</sup> Until 2015, expenditures were paid by advancing cash to civil servants tasked with paying vendors. World Bank 2017, 56.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid., 64.

While it is easy from a distance to conceive of “Somalia’s system”, there is no more a single system of unvarying quality in Somalia than there is a single donor view of those systems. Existing capacity as well as challenges vary tremendously across federal and state levels and between states. To take just one example, more established member states have more PFM experience than newly emerging member states on which to draw.<sup>34</sup> However, their legacy systems and practices can also make it more challenging, in some cases, for them to adopt new procedures that meet international standards.<sup>35</sup> The need to harmonize state and federal PFM systems adds complexity to the overall PFM reform effort. There is also substantial diversity in system quality across government units. Some ministries (at both the federal and state level) have emerged as particularly effective in delivering on their varied mandates, while others have lagged behind.<sup>36</sup> The g7+ group of fragile states has often highlighted the importance of identifying “islands of excellence” within governments, rather than judging performance based on average performance, or alternately be assessing where systems are weakest.

While it may be easier to focus attention where systems are stronger, both government and international partners will need to be thoughtful in balancing the desire to invest in established systems with equity concerns, ensuring that weaker systems receive adequate attention and strengthening.<sup>37</sup> Donors can usefully coordinate in this regard, based on their different comparative advantages and field access.<sup>38</sup>

Somalia will benefit from careful thinking about how both federal revenues and donor investments can be used to better knit together the varied Federal Member States as well as federal and state-level ministries.<sup>39</sup> The government continues to work towards a political settlement and agreement on administrative arrangements and the precise powers and responsibilities of federal and state authorities.<sup>40</sup> Donors’ use of country systems can play a supportive role both in encouraging dialogue and strengthening the ability of both the federal and state governments to deliver on newly clarified mandates.<sup>41</sup> Rather than looking at systems in isolation, more interventions – from support for core government functions to service delivery projects – need to promote inter-governmental dialogue and the establishment of fiscal federalism linkages.<sup>42</sup> Smart, strategic use of country systems has the potential to play an important part in improving the coherence and quality of systems across Somalia’s governance “quilt”.

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<sup>34</sup> Interview #32; Interview #38.

<sup>35</sup> Interview #38.

<sup>36</sup> Interview #38; Interview #12.

<sup>37</sup> Underscoring this, debates in the Somali parliament in August 2017 focused in part on unequal distributions to Federal Member States; these distributions were donor-funded. Interview #12.

<sup>38</sup> For example, the Somalia Stability Fund (SSF) supported many of the newly formed FMS to meet the minimum eligibility requirements to receive funding through Recurrent Costs Reform Program financed through the World Bank administered Multi Partner Fund (MPF). While all Federal Members States will have met the eligibility criteria to receive funds through the MPF, other partners may require states meet different standards. Moreover, delivery through country PFM systems currently requires the application of considerable safeguards. Greater reliance on government oversight and controls would also require government to meet higher standards of performance.

<sup>39</sup> Interview #38; Interview #40;

<sup>40</sup> A constitutional review roadmap was being finalized at the time of report writing, which will identify critical areas for review, chief among them the need to enhance Somalia’s federal system, delineate federal and state powers, and harmonize federal and state constitutions.

<sup>41</sup> While the Somali constitution of 2012 reserves some powers for the Federal Government, it leaves the remainder of “the allocation of powers and resources” to be “negotiated and agreed upon by the Federal Government and the Federal Member States”. (Federal Republic of Somalia Provisional Constitution, Article 54). While some interviewees seemed frustrated by the perceived slow pace at which these responsibilities have been resolved, defining federal and state responsibilities has historically been both a lengthy and iterated process. To focus narrowly on powers of taxation, in Australia the modern-day balance of federal and state taxation powers arguably dates only to the 1940s, some four decades after the nation’s constitution; Canada, too, has seen multiple episodes of clarification and re-allocation of fiscal powers between provinces and the Federal Government. (See James 1998’s report to the Australian Parliament for a cogent summary of these issues in Australia, Germany, and Canada).

<sup>42</sup> Interview #38.

### 3 Use of Country Systems in Somalia

#### 3.1 Diversification of Delivery Modalities

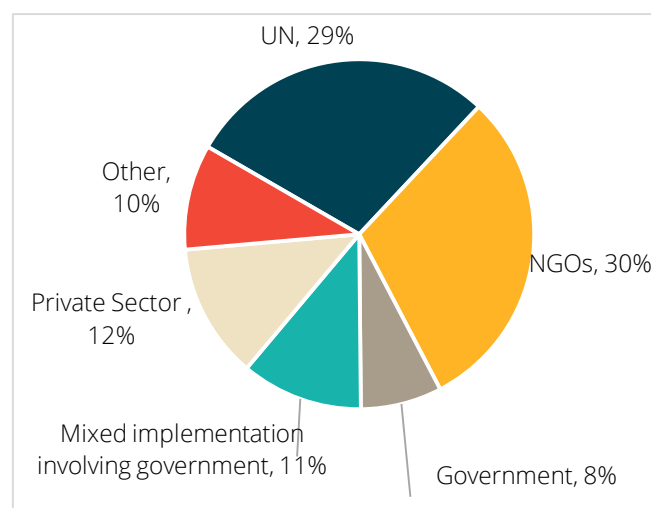
The range of implementing partners has diversified in recent years. Interviewed donors recall a heavy reliance on United Nations (UN) agencies and non-governmental organizations (NGOs) to deliver aid for primarily humanitarian activities, and in some cases stabilization activities, prior to 2014.<sup>43</sup> International reengagement was galvanized by the transfer from a transitional to the Federal Government in 2012,<sup>44</sup> followed shortly thereafter by the endorsement of the Somali Compact in September 2013.<sup>45</sup> This brought increased support towards the priorities of the Peacebuilding and Statebuilding Goals articulated in the Somali Compact, alongside the continued delivery of lifesaving humanitarian support.

Somalia experienced greater engagement by International Financial Institutions (IFIs), notably the World Bank Group,<sup>46</sup> African Development Bank (AfDB),<sup>47</sup> and International Monetary Fund (IMF).<sup>48</sup> Their engagement increased technical support for strengthening core government functions and expanded options for donors to channel funds through government-executed projects, with the support and oversight of trusted institutions.<sup>49</sup>

A limited number of donors provide budget support. In 2016, only Saudi Arabia and Turkey provided general or sector budget support. Budget support constituted about half of the 8% of development aid implemented directly by government. The remainder went towards programming and support for recurrent costs delivered on treasury, primarily through the Multi Partner Fund (discussed further below), which is administered by the World Bank.<sup>51</sup>

The private sector is playing an increasingly important role in aid delivery, having implemented an estimated 12% of development aid in 2016.<sup>52</sup> The private sector is perceived by some donors to be

Figure 1. Estimated Breakdown of Development Assistance by Implementing Partner, 2016<sup>50</sup>



<sup>43</sup> Interview #25, Interview #37, Interview #31, Interview #22.

<sup>44</sup> World Bank 2013, 4.

<sup>45</sup> Federal Republic of Somalia 2013.

<sup>46</sup> The World Bank Group renewed its engagement with the federal and regional authorities in 2013 as it prepared its Interim Strategy Note (FY14-FY16). World Bank 2013, 5.

<sup>47</sup> ADB put forward an internal proposal for an enhanced program for Somalia under the institution's Fragile States Facility in 2012. African Development Bank 2012.

<sup>48</sup> "The IMF Executive Board concluded the 2015 Article IV Consultation with Somalia in July 2015, the country's first in more than a quarter-century.", 2.

<sup>49</sup> Recipient execution is the preferred delivery modality of both the World Bank and AfDB.

<sup>50</sup> Based on co-author's calculations using the 2016 Aid Mapping Database. "Other" includes implementation by IFIs, bilateral agencies, research and academic institutions, and regional actors as well as mixed implementation by various categories of partners (including UN and NGOs) in which government was not listed as an implementing partner. It also includes financing for projects for which no implementing partner was reported. Aid Coordination Unit / World Bank 2017a.

<sup>51</sup> Aid Coordination Unit / World Bank 2017b, 10.

<sup>52</sup> Based on co-author's calculations using the 2016 Aid Mapping Database. Aid Coordination Unit / World Bank 2017a.

more responsive to their needs.<sup>53</sup> For example, donors have been keen to see an expansion of programming from northern parts of Somalia into southern and central Somalia, which some UN agencies have struggled to do as quickly as donors hoped; in response some donors have turned increasingly to the private sector.<sup>54</sup> Donors also note that they have more control over programming when they deliver through private sector actors both in determining their programmatic focus and managing operations; this is in tension with the principle of strengthening government ownership by using country systems.<sup>55</sup>

A majority of aid is still delivered through the UN and NGOs,<sup>56</sup> which jointly implemented approximately 59% of development aid in 2016.<sup>57</sup> With globally established track records and relationships, many UN agencies and NGOs have a perceived mandate and legitimacy to deliver development and humanitarian programming, especially in certain sectors.<sup>58</sup> As the UN and NGOs primarily implement through parallel mechanisms, they stand to lose financing if they do not adapt to make greater use of country systems (UCS), if donors place greater emphasis on this implementation modality in the future.

### 3.2 Status of UCS Dimensions

The government and international partners have made significant strides since 2014 in defining what the UCS means in the Somali context, setting collective targets, and monitoring progress. Using the international CABRI definitions as a starting point, the 2017 UCS Roadmap (Box 2) provides explanations and guidance for each UCS dimension and outlines benchmarks and indicators to motivate and monitor progress.<sup>59</sup> This section provides a brief assessment of the current status of UCS dimensions in Somalia and compares it with progress globally where comparable data is available. It focuses more heavily on those dimensions identified as priorities in the development partner benchmarks of the 2017 UCS Roadmap, namely putting partner assistance on plan, on budget, on treasury, and on report.<sup>60</sup>

#### **On Plan**

The 2017 UCS Roadmap breaks down the “On Plan” dimension into three dimensions: consultation with government, alignment with national priorities, and engagement of government in implementation.

*Consultation:* The majority of Somalia’s international partners consult with government counterparts to inform the design of their country strategies and programming. The UN,<sup>61</sup> World Bank<sup>62</sup> and many donors

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<sup>53</sup> Interview #22; Interview #31; Interview #37.

<sup>54</sup> Although some would argue that the cautious approach has been necessary, as some projects require certain pre-conditions be met before activities are expanded into a given area. For example, the Joint Program for Local Governance (JPLG) requires that its beneficiary districts be at post-reconciliation stage and have an established, representative local government (selected either through direct elections or a community selection process). This helps ensure the program’s package of support does not pre-empt critical steps recognized to be critical for the sustainability and legitimacy of the district councils it supports. Based on information provided in informal briefing by JPLG team on program status.

<sup>55</sup> Interview #22; Interview #31; Interview #37.

<sup>56</sup> The breakdown between international and national NGOs is not known based on the data available. Many of the projects implemented by the UN and international NGOs are delivered in partnership with national NGOs. The levels of sub-contracting are not captured in the annual aid mapping exercise.

<sup>57</sup> 29% UN, 30% NGOs. Excludes humanitarian aid, for which the UN and NGOs are the primary implementing partners in Somalia. Based on co-author’s calculations using the 2016 Aid Mapping Database. Aid Coordination Unit / World Bank 2017a.

<sup>58</sup> Interviewed donors relied on different types of implementing partners depending on the sector of engagement. Preferences were not uniform across donors.

<sup>59</sup> CABRI 2008; Somalia Use of Country Systems Working Group 2017.

<sup>60</sup> Ibid., 4.

<sup>61</sup> The UN Strategic Framework was formally agreed and signed with the FGS in August 2017. It covers all of the UN’s activities in Somalia for 2017-19 and is aligned with the National Development Plan.

<sup>62</sup> The World Bank is finalizing its Systematic Country Diagnostic for Somalia as a basis for preparing a Country Partnership Framework (CPF) FY2018-FY2023 in consultation with government, donors and World Bank technical teams.



have formal processes for discussing and agreeing multi-year country strategies with government. Consultation at the project level varies across agencies, from the European Commission's formal processes for co-signing contracts with government<sup>63</sup> to more informal processes of consultation to inform project design. These vary depending on the institutional requirements and the choice of delivery modality, as the government has not established clear guidelines for consultation on projects. Only projects financed through the Somalia Development Reconstruction Facility (SDRF) Funds (Box 4) require more rigorous consultation and formalized agreements based on clear-cut procedures.

It is not always clear with whom or at which level of government international partners should consult. High levels of turnover and the lack of communication within government – not only between the levels of government, but even within certain Ministries – contributes to the common perception within government that they are not being sufficiently consulted. International partners can exploit this lack of coordination, as it is easy to find a like-minded government counterpart within the system who does not necessarily speak for the government's broader interests and priorities.

*Alignment:* Given the broad priorities outlined in the Somali Compact (2014-16), it was relatively easy for international partners to be aligned with Somalia's priorities at a strategic level. The National Development Plan (2017-19) now provides more specific guidance to inform programmatic alignment. While a majority of development activities fall easily within the broad priorities of the NDP pillars, an assessment has not been undertaken to determine the extent to which internationally funded activities are programmatically aligned.<sup>64</sup> Measuring alignment is challenging exercise in any context; in the absence of a costed plan, it can be especially challenging.

*Implementation:* In 2016, 8% of development financing was implemented directly by government and an additional 11% of financing had a government entity listed as one of the implementing partners.<sup>65</sup> The share is expected to increase to 11% and 19% respectively in 2017, indicating greater engagement of government in implementation of activities.<sup>66</sup>

The Global Partnership monitoring framework<sup>67</sup> provides the only global comparison for assessing alignment. Based on self-reporting by development partners, 85% of new development interventions globally draw their objectives from country-level results frameworks, including national development plans, sector plans and strategies, and development partners' strategies agreed with government. Somalia fell below the global average, with 76% of new projects reported to be in alignment. However, both the global statistics and those for Somalia likely overstate the extent of alignment, as they are based on incomplete and inconsistent self-reporting by development partners across countries.<sup>68</sup>

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<sup>63</sup> The European Commission has established a National Authorizing Office within the Ministry of Planning, Investment and Economic Development (MoPIED) through which a majority of the Commission's contracts are submitted for government co-signature as a means of ensuring alignment with national priorities.

<sup>64</sup> Ibid.

<sup>65</sup> Based on co-author's calculations using the 2016 Aid Mapping Database. Aid Coordination Unit / World Bank 2017a.

<sup>66</sup> Somalia Use of Country Systems Working Group 2017.

<sup>67</sup> This monitoring framework is used to monitor adherence to the political commitments agreed in the Global Partnership for Effective Development Co-operation in Busan in 2011 at the Fourth High Level Forum on Aid Effectiveness. The most recent round monitoring round was completed in 2016.

<sup>68</sup> Country-level reporting in 34 of the 81 participating countries was based on fewer than 20 interventions. In comparison, partners in Somalia had reported 131 activities, the most of any participating countries. Moreover, the monitoring round was conducted before Somalia had formulated its NDP, the key document against which partners are now expected to align. OECD/UNDP 2016a.

## On Treasury and On Budget

To be considered on budget, externally financed projects must be listed in the national budget in alignment with government budget units and expenditure classifications. Being on budget does not require that funds are disbursed into the government's accounts. Currently, the Federal Government only includes external grants that are delivered "on treasury" in its core budget.<sup>69</sup> Aid delivered on treasury is disbursed to central government and managed through government systems.<sup>70</sup>

The extent to which aid is captured on budget varies significantly across countries. Figure 2 presents the share of aid delivered on budget in five low-income fragile states, distinguishing between the share of official development assistance (ODA) and the share of development-focused aid (calculated as total ODA minus humanitarian aid). In 2015, donors channeled 74% of development-focused aid through the Afghan national budget.<sup>71</sup> This high figure may overstate the share of aid over which the Afghan government has the ability to exercise control, as some of these funds are managed through special bank accounts set up with additional safeguards and are not channeled through the mainstream treasury accounts.<sup>72</sup> However, it still demonstrates a high level of compliance with the government's request for aid to be on budget.

While the political interests of donor governments in Afghanistan may well play a role in Afghanistan's outlier status, use of country systems in Somalia also trails countries of arguably substantially less global geo-strategic interest. On budget aid in Somalia also lags considerably behind the Central African Republic, Mali and Liberia, in which the share of on budget aid ranges from 28-44% of development-focused aid. While access to concessional financing could help increase the share of on budget aid in Somalia, it is far from being the only determinant of on budget aid.<sup>73</sup>

In Somalia, government and international partners set a target for 15% of external development spending to be channeled through the treasury and on budget.<sup>74</sup> This target has been constant since the first UCS Roadmap in 2014. Falling short of this target, only 4% and 8% of development aid was delivered on treasury and on budget in 2015 (Figure 2) and 2016 (Figure 3), respectively.<sup>75</sup> Had all budgeted external grants been delivered as planned in 2016, the share would have been 16%, which would still be significantly lower than levels seen in the other low-income fragile states in Figure 2.<sup>76</sup> Slower than

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<sup>69</sup> The Ministry of Finance elected to focus on external grants delivered on treasury based on the advice of the World Bank in 2015. There were concerns that a significant effort to capture off-treasury flows would overwhelm FGS budget processes at a stage when the government is still getting to grips with its own budget management procedures.

<sup>70</sup> "On Treasury" aid refers to external financing that is disbursed into the FGS Treasury Single Account (TSA), recorded on the Somalia Financial Management Information System (SFMIS), and managed through the government's financial systems. In Somalia, a looser definition of "On Treasury" is applied to include funds disbursed into the TSA with additional safeguards.

<sup>71</sup> Based on co-author's calculation using data from International Monetary Fund 2017b; International Monetary Fund 2017a; International Monetary Fund 2017c; International Monetary Fund 2016b; OECD.Stat n.d.; World Bank n.d.; International Monetary Fund 2017e.

<sup>72</sup> Hart, Hadley and Welham 2015b, 8. The Afghan Treasury manages an estimated 180 special bank accounts that "while on budget, have their own set of parameters for each." This highly fragmented, "projectized" approach has an impact on performance. Whereas the operational budget in Afghanistan has high execution rates (often above 95%), rates for the development budget are "typically around 50% or lower." Ashcroft, Laing, and Lockhart 2017.

<sup>73</sup> In 2015, the biggest source of on budget aid in the Central African Republic was budget support from the European Union. International Monetary Fund 2015, 24.

<sup>74</sup> The share of development aid excludes humanitarian aid in order to provide a consistent point of comparison across years. Humanitarian aid fluctuates significantly in response to crises, whereas development aid should, in theory, be more predictable.

<sup>75</sup> International Monetary Fund 2015.

<sup>76</sup> Aid Coordination Unit / World Bank 2017b. On budget aid in all included countries, save Afghanistan, are below the 50% target for development cooperation channeled through country PFM systems, a target established in the Global Partnership for Effective Development Co-operation in Busan in 2011 at the Fourth High Level Forum on Aid Effectiveness. OECD/UNDP 2016b.

expected disbursements by programmatic support delivered on treasury prevented the achievement of the target, for which responsibility is shared by both government and development partners.<sup>77</sup>

Figure 2. On Budget Aid in Five Low Income Fragile States, 2015<sup>78</sup>

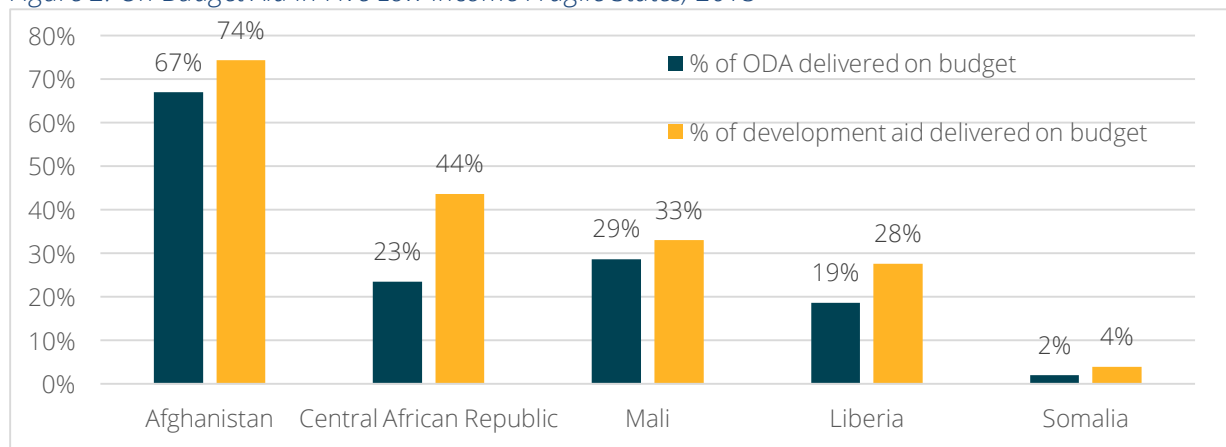
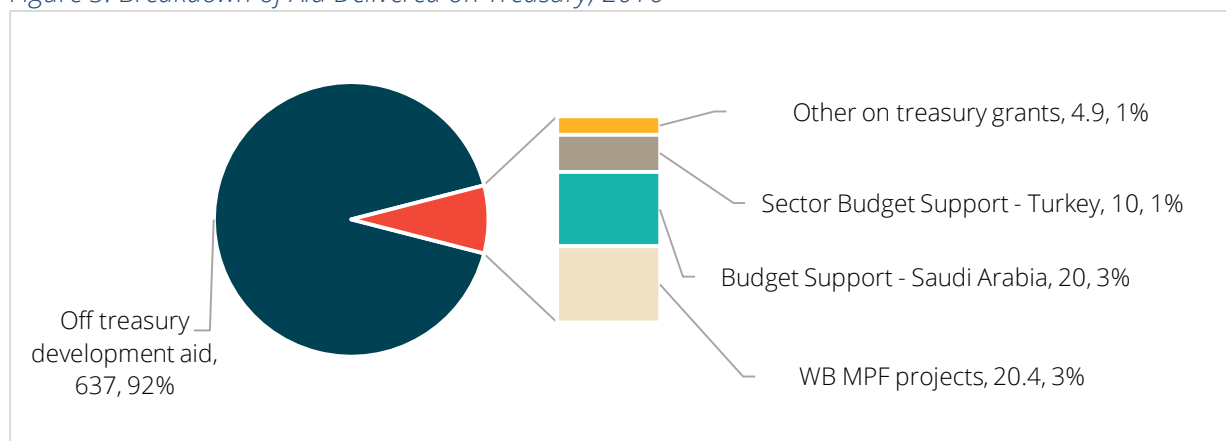


Figure 3. Breakdown of Aid Delivered on Treasury, 2016<sup>79</sup>



The international community also provides significant support for government operations off treasury, such as financing and in-kind support for vehicles, computers, office furniture, utilities, and travel (within and outside of Somalia). For example, international partners finance more than 300 government positions outside of the government’s payroll (which is also financially supported by the 10 donors contributing to the Multi Partner Fund), including embedded advisors and line positions.<sup>80</sup> The full scale of this direct support for government is not currently distinguishable from the overall flow of development assistance, as it is neither on budget nor on treasury.<sup>81</sup>

<sup>77</sup> The failure to deliver all external grants as budgeted is due to several reasons. In some cases, donors did not deliver all of the on treasury funding that had been pledged, for various reasons. In other cases, projects did not disburse their full allocation due to delays associated with government performance issues. For example, the Recurrent Costs Reform Financing Project, which reimburses government for civil servant salaries, “disbursed 42% (US\$ 13 million) of what had been budgeted due to cash management issues within government.” Aid Coordination Unit / World Bank 2017b, 11.

<sup>78</sup> Based on co-author’s calculation using data from International Monetary Fund 2017a; International Monetary Fund 2017c; International Monetary Fund 2016b; OECD.Stat n.d.; World Bank n.d.; International Monetary Fund 2017b; International Monetary Fund 2017e. It should be noted that the figures for these countries may include flows that are managed through the budget but that are not delivered through national treasuries. This does not factor in military aid or the enforcement aspects of peacekeeping, which are not classified as ODA.

<sup>79</sup> Aid Coordination Unit / World Bank 2017b.

<sup>80</sup> UN/World Bank 2017.

<sup>81</sup> International monitoring efforts do not collect data on aid delivered on treasury. For example, the Global Partnership Monitoring Framework focuses on the use of government systems for budget execution, financial reporting, auditing and

## On Report

International partners are invited to report on progress as well as financial flows in order to be considered “on report” in Somalia.<sup>82</sup> Progress is reported through the structures of the aid architecture, which provides a platform for coordination and partnership for the government and international partners. In the past, international partners contributed sector-level reporting through working groups, which was then fed into annual reports on implementation of the Somali Compact. This process for reporting was being re-established at the time of report writing, under the framework of the revised aid architecture.<sup>83</sup>

The government collects aid data from international partners for both on and off-treasury grants through an annual aid mapping exercise, which it then prepares as an annex to the federal budget. In 2016, 45 international partners and funds – approximately 82% of active partners in Somalia – reported to the government’s aid mapping exercise.<sup>84</sup>

## Other UCS Dimensions

*On Audit:* Only projects delivered on treasury are subject to government audit in Somalia. As most partners need to “conduct external audits to compensate for capacity constraints within government,”<sup>85</sup> the UCS Roadmap is largely focused on the actions needed for government to strengthen its audit capacity. Less emphasis is placed on monitoring development partner adherence to guidelines at this stage.

*On Procurement:* Government involvement in procurement processes has been part of the larger conversation around the need to engage government counterparts in project design, implementation and monitoring. The 2017 UCS Roadmap guidance encourages international partners to align with the regulations and procedures of the Procurement Act, which have yet to be fully implemented. It also urges increased involvement of government in procurement processes. However, this aspect was not deemed a priority for monitoring and is not included in the development partner benchmarks.

In the Somali context, the following two dimensions do not require dedicated action by partners, as they overlap with the procedures associated with on treasury and on report dimensions. As they do not require special action by international partners, they are not covered in detail in the 2017 UCS Roadmap.

*On Parliament:* In Somalia, on-treasury grants reported as part of the core federal budget and off-treasury aid reported in the budget annex are both included in the Appropriations Act that goes to Parliament. As such, as long as international partners have reported their data to the government’s annual aid mapping exercise, they are considered to be on parliament.<sup>86</sup>

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procurement, but does not capture data on use of the treasury. Instead data focuses on external financing under the control of national budget execution (i.e. “on budget” aid). These data were not used for comparison in this report due to reporting issues. The figures self-reported by development partners as disbursements for the public sector at the country level, in some cases, were greater than the total ODA received by that country in a given year. This indicates that projects were most likely being double reported by development partners contributing towards or implementing joint activities. OECD/UNDP 2016a. Therefore, it is not possible to make a global comparison at this time.

<sup>82</sup> Based on guidance articulated in Somalia Use of Country Systems Working Group 2017, 15.

<sup>83</sup> This annual reporting exercise, carried out for 2014 and 2015, was not completed for 2016 due to the transitional arrangements associated with the national elections in early 2017 and the shift from the Somali Compact to Somalia’s National Development Plan (NDP). Pillar Working Groups are expected to play a key role as fora for collecting reports on progress for the NDP Monitoring and Evaluation Framework.

<sup>84</sup> Ibid., 22.

<sup>85</sup> Ibid., 16.

<sup>86</sup> Ibid., 18.

*On Account:* All on treasury aid in Somalia is recorded in the Somalia Financial Management Information System (SFMIS).<sup>87</sup>

*Non-fiduciary country systems:* It should be noted that the dimensions mentioned in this section are not a comprehensive list of the ways in which international partners can use country systems. The CABRI UCS dimensions have been criticized for their lack of nuance about what UCS entails and their inability “to monitor early steps towards their greater use.”<sup>88</sup> On treasury has also been called out as a “relatively narrow way to think about how government manages resources,” as it fails to capture other tools such as human resource management, payroll and procurement systems.<sup>89</sup>

### 3.3 Drivers of Donor Decision-Making on UCS

Donors have exhibited strong verbal support for using country systems, matched by steady, albeit slow, progress on certain dimensions.<sup>90</sup> One substantial driver of donors’ use of country systems is the defined purpose of their assistance. A number of donors argued that – in contrast to their agency’s goals in the vast majority of developing countries - their development (non-humanitarian) assistance in Somalia was aimed explicitly at statebuilding, with welfare improvements for Somalis seen as a logical consequence of a strengthened, peaceful state.<sup>91</sup> This allowed agency staff flexibility that might not be present in a less fragile country where delivery efficiency calculations were even more central to donor decision-making regarding delivery modalities.<sup>92</sup> Projects that do not incorporate capacity constraints are unlikely to succeed; as one donor representative put it, “how do you build a state without involving the Ministries?”<sup>93</sup> This serves to sharpen the puzzle presented by section 3.2’s data; what prevents these donor intentions from being realized, particularly if some donors are cognizant of how use of country systems might be critical to the strategic objectives of their development assistance?

It was remarkable how often both international partners and government interviewees articulated political motives for donors’ statebuilding goals, with statebuilding serving the political interests of developed nations.<sup>94</sup> Prominent in these narratives was international interest in reducing terrorism and pressures driving international migration.<sup>95</sup> In the eyes of some interviewees, these broader objectives suggested that donors would do what they wished – i.e., use country systems or not – based on decisions made wholly in their capitols, with little regard for what happens in Somalia. We are not as sure this is the case. To say that interest in Somalia’s statebuilding may for some donors be driven by geostrategic considerations is not to say that what actually occurs in Somalia is irrelevant. For the vast majority of donors, political and strategic considerations clearly frame, but do not dictate, agency decisions regarding UCS.<sup>96</sup>

Interviewees made clear their view that seeing UCS as a tool for statebuilding still leaves open considerations as to whether the funds provided via country systems, or the fiscal space freed up (e.g. by the payment of government recurrent costs), will actually serve to build the Somali state.<sup>97</sup> The strength

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<sup>87</sup> Ibid.

<sup>88</sup> Davies and Hingorani 2014, 19.

<sup>89</sup> Hart, Hadley, and Welham 2015a, 14.

<sup>90</sup> Manuel et al. 2017, 16.

<sup>91</sup> Interview #6; Interview #25; Interview #31.

<sup>92</sup> Interview #25.

<sup>93</sup> Interview #6.

<sup>94</sup> Interview #21; Interview #32; Interview #9; Interview # 13; Interview #31; Interview #41.

<sup>95</sup> Interview #9; Interview #17.

<sup>96</sup> Discussed further in the next section, notably in Section 4.4.

<sup>97</sup> Interview #31

of public financial management systems certainly impact donors' use of government systems.<sup>98</sup> So too do perceptions regarding the government's ability to deliver with adequate quality and speed.<sup>99</sup> This tension gets at the heart of the "chicken and egg" dilemma that sometimes seems to characterize the UCS dialogue. While using country systems is likely to strengthen them, systems' current weakness can be seen as a reason not to use country systems. Sections 4 and 5 further explore this tension and articulate potential resolutions.

By far the most prominent driver of UCS articulated by interviewees was the quality and direction of "policy dialogue". The ODI Compact Review highlighted the role the New Deal and Somalia Development Reconstruction Facility (Box 4) played in enabling greater use of country systems by donors, as it established a regular forum for dialogue and coordination between the government and international community.<sup>100</sup>

Perceptions of the reform-mindedness of government leaders seem critical to donor decision-making, and are linked to the quality and frequency of contact between donor representatives and government officials.<sup>101</sup> This need for frequent, high-quality dialogue is particularly challenging in Somalia, where security restrictions limit both the frequency and the potential informality of donor-government contact. Unlike in many other developing settings, there are no casual after-work meetings or dinners possible in Mogadishu, even when international partners are based in Somalia or stay for extended periods, rather than e.g. Nairobi.<sup>102</sup> There is a kind of "security-dialogue paradox"; the acuteness of the security situation makes close collaboration with government and the strengthening of country systems all the more important. However, the security situation precludes the contact that is a necessary condition for the dialogue and development of inter-personal trust that might further forward that collaboration.<sup>103</sup>

Many donor representatives seem to hold a genuine and earnestly held belief in the importance of using country systems, perhaps in part as a result of the Somali Compact and the broader New Deal process.<sup>104</sup> But this commitment to UCS as a matter of principle does not always translate into these individuals, much less their organizations, embracing the use of country systems in practice. The lack of dialogue, of interpersonal trust with government counterparts, discussed above may be part of the answer. That is not to say there has been no increased use of country systems; the low level of donor country system use ought not obscure the real increase in use in recent years, e.g. that brought about by the Somalia Development Reconstruction Facility (see Box 4).

Individual donor field staffs' beliefs and perceptions of reform trajectory and dialogue quality, the broader strategic considerations of donor agencies, and the actual PFM system quality and reform all play roles

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<sup>98</sup> Interview #26; Interview #38; Interview #36; Interview #37; Interview #32; Interview #22.

<sup>99</sup> Interview #31; Interview #40.

<sup>100</sup> "While some contributors may have delivered support to the government regardless of the Compact (Turkey, Saudi Arabia, maybe AfDB), it is likely that none of the others would be delivering support on-treasury if it had not been for the New Deal." Manuel et al. 2016, 34.

<sup>101</sup> E.g. Interview #37; Interview #6; Interview #25; Interview #32. There was variety in what donor representatives saw as the ultimate goal of that dialogue in terms of forwarding Somalia's reforms. Some donors explicitly saw the use of country systems as a way to push government for reforms they believed prudent (e.g. Interview #38; Interview #39, Interview #25); others felt that donors could only be useful in catalyzing reforms when "pushing against an open door", when endorsing reforms government actors wished to do in their own right (e.g. Interview #31).

<sup>102</sup> This point made explicitly by Interview #37; echoed by Interview #32. It is not clear that being based in Somalia substantially forwards dialogue relative to being based in Kenya, given the security situation; e.g. Interview #37 commented that inter-implementer coordination had suffered as a result of the shift of implementers from Nairobi to Mogadishu, given the rise in transaction costs.

<sup>103</sup> The lack of physical presence and ease of access also limits opportunities to seize opportunities as they arise. One interviewer noted the importance of physical presence and patience as critical for advancing reform in fragile contexts.

<sup>104</sup> Interview #6; Interview #25; Interview #31; Interview #22; Interview #37; Interview #21; Interview #7; Interview #11.

in driving donors' use of country systems. This section has aimed to take stock of the current use of country systems in Somalia. The risks and benefits articulated in the next section attempt to provide a framework for weighing the costs and benefits of further use of these systems.

#### *Box 4. The Somalia Development and Reconstruction Facility (SDRF): Enabler of Greater UCS*

Established to guide implementation of the Somalia Compact, the SDRF has endured as the aid architecture for coordinating efforts under the National Development Plan (NDP). In addition to its broad coordination role for government and international partners, the SDRF serves as a financing architecture, bringing together “three multi-partner trust funds under common governance arrangements to promote: (a) coordination across activities and instruments, (b) alignment with national priorities, and (c) reduced transaction costs for government.”<sup>105</sup> These SDRF Funds are commonly referred to as the UN Multi Partner Trust Fund (MPTF), the World Bank Multi Partner Fund (MPF) and the African Development Bank (AfDB) Somali Infrastructure Fund (SIF).

The SDRF Funds have enabled greater use of country systems in a number of ways:

- *On Plan:* The government-led SDRF makes decisions for funding allocations, essentially mandating consultation with government and alignment with national priorities.
- *On Report:* All three funds are required to provide updates on progress to the SDRF Steering Committee (fund level reports) and Pillar Working Group meetings (project-level updates).
- *On Treasury:* The World Bank MPF and the UN National Window – with established, consistent procedures and safeguards – provide a means for donors to indirectly channel funds through government PFM systems. As of mid-2017, the World Bank MPF, had US\$ 105 million (of which US\$ 73 million disbursed) in committed donor funds for government implemented grants. Denmark, the European Commission, Finland, Italy, Norway, Sweden, Switzerland, the United Kingdom, the United States, and the World Bank State-and Peace-building Fund have all contributed to the fund.<sup>106</sup> Sweden and the UN Peacebuilding Fund have committed U\$ 6.5 million to the “National Window” under the UN MPTF.<sup>107</sup>

Pooled funding instruments can also “enable donors to adopt a collective approach to the risks inherent in transition situations,”<sup>108</sup> including those associated with UCS. One of the objectives of the SDRF as a financing architecture is to “mitigate risks through innovative, collective approaches to risk management.”<sup>109</sup> To support this collective approach to risk management, a Joint Risk Management Strategy was established in Somalia in 2015 to address risks that extend across the three SDRF Funds through collective analysis and mitigation measures. A Risk Management Group, comprised of the fund administrators, government and donors, meets on a regular basis to support this collective approach to risk management, which serves to complement but not replace institutional requirements for project- and fund-level risk management.<sup>110</sup>

From the perspective of contributors to the funds, the pool serves to mitigate the UCS risks described in Section 4, including reputational risks. However, multiple interviewees involved in pooled fund administration reported that they often felt they had to operate within the constraints of the least flexible or most risk-averse fund contributor.<sup>111</sup>

<sup>105</sup> Operations Manual for SDRF Funding Windows 2017.

<sup>106</sup> World Bank 2017.

<sup>107</sup> Information provided by the UN Somalia Resident Coordinator's Office as of September 2017

<sup>108</sup> OECD 2010, 79.

<sup>109</sup> Operations Manual for SDRF Funding Windows 2017.

<sup>110</sup> Ibid.

<sup>111</sup> Interviews.

## 4 Weighing Risks and Benefits: Choosing Between Imperfect Strategies

Ultimately donors have money to spend and need to decide how best to spend it. The potential risks and benefits of the use of country systems (UCS) are often considered by focusing solely on the quality of country systems, without considering the alternatives to use of government treasury and execution systems. As mentioned in section 3, the United Nations (UN) and non-governmental organizations (NGOs) are the primary channels through which donors channel funds (approx. 60% of development financing in 2016, see Figure 1). This section will take the approach of comparing implementation modalities across common dimensions.

Interviewees occasionally did this implicitly. One interviewee noted that while some donors are reticent to channel funds through national systems due to concerns about the government's accountability to the Somali people, the alternative is to execute funds in a way with even less accountability to the public.<sup>112</sup> If e.g. a given donor is concerned about the democratic legitimacy of a specific Ministry, turning to a UN agency or NGO to implement does not obviously lessen (and may well exacerbate) the accountability gap between the implementer and Somali citizens.

This section will explore the relative risks and benefits of using country systems as compared with their alternatives in three well-established risk categories: fiduciary, operational, and reputational. This section will add one additional, novel category to operational risk: statebuilding risk, to reflect the centrality of statebuilding to the operational aims of both government and donor actors. Box 5 more fully defines each of these risk categories as employed in this report.

### *Box 5. Risk-Benefit Categories*

*Fiduciary:* Commonly used to capture the risk of leakage or fiscal mismanagement; defined by the UK's Independent Commission for Aid Impact as "the likelihood that aid is not used for its intended purposes or cannot be properly accounted for."<sup>113</sup>

*Operational & Statebuilding:* Despite monies being used for their intended purposes, the operational objective (e.g. improving transport links, delivering health care) of a given intervention may remain unaccomplished. The World Bank defines operational risks as "risks to achieving project development objectives."<sup>114</sup> We add statebuilding risk as an extension of operational risk, given that statebuilding is the stated long-term operational objective of many donors to Somalia. We define statebuilding risk as the risk that narrow project objectives may be achieved but the overarching statebuilding objectives desired by donors will go unfulfilled.<sup>115</sup>

*Reputational:* Anything that will reflect poorly on donors' reputation vis-à-vis their authorizing environments (executive boards, parliaments, donor domestic publics, etc.). Defined by the Organisation for Economic Co-operation and Development's (OECD) Development Assistance Committee as "damage to a donor's reputation if it fails to achieve its objectives, or from financial/fiduciary failure."<sup>116</sup> Reputational risk thus may also be experienced as a consequence of operational, fiduciary, or statebuilding failings, depending on a given donor's authorizing environment.

<sup>112</sup> Interview #39.

<sup>113</sup> Independent Commission for Aid Impact (UK) 2016, i.

<sup>114</sup> World Bank 2011, 2.

<sup>115</sup> The g7+ has also highlighted the benefits of UCS for statebuilding, as we do here, in recent policy guidance (g7+ 2017). The same report also echoes our findings on value for money, ownership, and legitimacy, amongst other themes.

<sup>116</sup> OECD 2012, 27. What we describe as a definition is in fact an instantiation in the OECD report (that is, it begins "e.g. ..."), but is clearly intended to serve a definitional purpose.



There are a great number of overlapping but distinct risk frameworks in use by a variety of donors. The OECD's framework for managing risks in fragile and transitional contexts, for example, frames what we refer to as reputational risk as "institutional risk", and effectively combines what we call operational and fiduciary risk as "programmatic risk".<sup>117</sup> By contrast, fiduciary risk is broken out as a separate category by most donors.<sup>118</sup> As such we take a hybrid approach in this report, using what we see as the most common names (e.g. reputational rather than institutional) and categories (operational, fiduciary) for considering risk, to which we add "statebuilding" as described in the main text.

## 4.1 Fiduciary Risks

Somalia's systems are improving, but are still very weak.<sup>119</sup> Budget execution and public financial management (PFM) systems remain areas in need of significant further strengthening, despite progress in recent years.<sup>120</sup> A full description of the Somalia's PFM weaknesses is beyond the scope of this report. That said, specific concerns raised by both donors and government interviewees included the limited oversight the Ministry of Finance currently has over payments made by the federal government;<sup>121</sup> the absence of an interface between federal and state-level Financial Management Information Systems;<sup>122</sup> and the weakness of government audit functions.<sup>123</sup> As evidenced by a number of reports that document these weaknesses,<sup>124</sup> there are real fiduciary risks to using Somalia's PFM systems. Donors are concerned that funds will be misspent – that corruption and malfeasance are risks to UCS – and there is foundation for these concerns.

Often less examined are the fiduciary risks associated with *not* using Somalia's PFM systems. Donor funds can, and sometimes are, mismanaged when delivering assistance outside country systems.<sup>125</sup> A report commissioned by the European Union and UK Department for International Development (DFID) to evaluate their joint work on strengthening civil society in Somalia (work that did not use country PFM systems) found that "It is frequent that project costs do not comply with required standards or that actual costs in project implementation are not fully reflecting those in the internal budget."<sup>126</sup>

The widespread use of third-party monitoring arrangements – even for funds implemented by non-government actors – speaks to donors' concerns regarding the use of their funds. As noted above, security concerns severely restrict donors' ability to visit the physical locations of many projects with great frequency, or in some cases to visit at all. As such, donors must either trust implementers to act appropriately or hire monitoring agents that can provide assurances that work is being done in line with agreed standards. According to donor interviewees, these third-party monitoring arrangements provide some assurance, but can leave a great deal unexamined even in the best of circumstances.<sup>127</sup> The UK's

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<sup>117</sup> OECD 2012.

<sup>118</sup> E.g. the World Bank (World Bank 2016); DFID (DFID 2013); and USAID (USAID 2014), amongst many others.

<sup>119</sup> E.g. Interview #38; Interview #32; Interview #1; Interview #37; Interview #33; Interview #9; Interview #13; Interview #26. This is also broadly the position of IMF staff; see International Monetary Fund 2017e; International Monetary Fund 2017d.

<sup>120</sup> International Monetary Fund 2017e.

<sup>121</sup> Less than half of vendor payments are currently made on time and in full through Somalia's Financial Management Information System (SFMIS), the Federal Government's expenditure management platform; this limits the range of transactions to which SFMIS' controls apply. There are also anecdotal reports of payments being made by bulk cash withdrawal, which poses problems for expenditure traceability. The current IMF SMP structural benchmark (benchmark 5, for December 2017) is for 50% of federal electronic vendor payments to transit SFMIS. Ibid.

<sup>122</sup> Interview #12, Interview #15

<sup>123</sup> Interview #37; Interview #34; Interview #33; Interview #15

<sup>124</sup> e.g. Notably those related to Somalia's IMF Staff Monitored Program provide regular, updated analysis.

<sup>125</sup> A point made by donors themselves; e.g. Interview #36

<sup>126</sup> EU Somalia Unit and DFID 2012, 24.

<sup>127</sup> Interview #36; Interview #1; Interview #6; Interview #15; Interview #38.

Independent Commission on Aid Impact found in a recent review of DFID's activities in Somalia that "DFID lacked sufficient visibility of its own portfolio and of risk arising further down the delivery chain."<sup>128</sup> When donors choose to spend money in Somalia – whether through direct implementation or by delegating to others – they run real fiduciary risks in an environment where realized misappropriation may well go undetected. Concern over the accuracy of third party monitoring has led in some cases to what might be thought of as fourth party monitoring: the hiring of firms to provide oversight on third party monitors.<sup>129</sup>

The extra measures required to operate in Somalia come with additional costs. A recent review by the World Bank identified a "higher than average cost of support and supervision with limited access for on-site engagement."<sup>130</sup> Donors operating in Somalia estimated their non-programmatic costs – that is, the costs of monitoring, overheads, security, logistics, etc. other than the costs associated with paying those actually directly delivering the services – at between 30-60% of project budgets.<sup>131</sup> While concrete, comparative data is difficult to acquire, the additional costs associated with doing business in Somalia were generally perceived by the interviewed donors to be higher than in many other countries. Monitoring and overhead costs are not normally thought of under the banner of fiduciary risk; these are, after all, legitimate, budgeted expenses. But if the concern at the root of discussions of fiduciary risk is value for money, then ensuring that the maximum possible proportion of intended funds is spent on project objectives is due some consideration.

In some cases, using country systems can deliver more "cents on the dollar" than when donors employ alternative delivery channels, even after considering the fiduciary challenges of Somalia's PFM systems. This was the conclusion Norway came to in deciding to establish the Special Financing Facility (SFF) in Somalia in 2013. The Government of Norway's decision was driven in part by the outcome of a cost-benefit analysis explicitly comparing country systems to alternative delivery mechanisms.<sup>132</sup> More generally, by using country systems international partners can avoid the costs associated with establishing and eventually handing over parallel systems to government.<sup>133</sup>

Both Somalia's country systems and donors' alternatives bring with them fiduciary risk in the traditional sense.<sup>134</sup> The risks of "corruption" – where this means malfeasance, fraud, and/or simple misdirection of funds away from the original budget purpose – are real. But they apply both to use of country systems and alternative delivery channels. What's more, alternative delivery channels carry with them additional overheads which surely also warrant consideration in determining value for money. Fiduciary risk and the efficiency of spending are real concerns in Somalia, whatever the implementation modality; it is less obvious that these concerns, taken as a whole, clearly augur for or against the use of country systems. Actively comparing the use of Somalia's PFM systems and alternate implementation methods on a case-by-case basis would facilitate donors' minimization of fiduciary risk and maximization of spending efficiency.

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<sup>128</sup> Independent Commission for Aid Impact (UK) 2017, 23. The quotation is a restatement of previous findings in ICAI 2016 that the commission found to also be true in Somalia. See paragraph 3.50 and footnote 51 of ICAI 2017 for more detail.

<sup>129</sup> Interview #1;

<sup>130</sup> World Bank 2017, 19.

<sup>131</sup> Interview #36, Interview #15, Interview #25, Interview #31

<sup>132</sup> Workshop Summary: Sharing Lessons Learned on Salary and Stipends Payments in Somalia 2017.

<sup>133</sup> Ibid.

<sup>134</sup> This is not to imply that the fiduciary risk of using country systems is not on average greater, or that a given donor's concern about malfeasance and fraud ought not be weighed against the possibly greater expenditure efficiency of using Somalia's country systems. This discussion is meant to raise issues for consideration, not dictate how donors ought to adjudicate between these concerns in making decisions.

### *Box 6. Comparing the Quality of Different Uses of Country Systems in the Security Sector*

According to the Somalia Security and Justice Public Expenditure Review, payroll reform is urgently needed for both the Somali National Army (SNA) and Somali Police Force (SPF). In this critical sector, “the maintenance of parallel government and donor payroll systems and under investment in the former reduces the efficiency, effectiveness and accountability of public spending in Somalia.”<sup>135</sup>

Three major donors currently support stipend payments to officials in the SNA – the United Arab Emirates, the United States, and the United Kingdom. Paid through a third-party agent outside of country systems, these stipends are in addition to regular salaries which are paid (or are intended to be paid) to army personnel by government. The payroll systems and payment lists for the donor-funded stipends are separate from those of government and are not fully reconcilable with each other, much less those of the Somali Government.<sup>136</sup> Donors spend substantial time working to verify “their” payroll lists, but this effort does not in any way strengthen the government systems that pay the very same individuals their salaries. Both SNA salary and stipend payments are largely made in cash, presenting additional fiduciary risks. The SNA has been somewhat resistant to a shift towards electronic payments for salary payments, claiming such a move would hinder their ability to muster troops.<sup>137</sup> The use of biometric check-ins to maintain eligibility for both salaries and stipends would help overcome this challenge.

In its payment of police stipends, the European Commission (EC) began to channel its support through the treasury in 2016, shifting from a parallel system to greater UCS. The EC made non-cash payment systems a condition for paying stipends through country systems. This helped prompt the government to shift from cash to bank account transfers for all salary payments to police officers; all salary and stipend payments for police personnel, including those made using domestic revenue, are now delivered directly to officers’ individual bank accounts.<sup>138</sup> Yet, even with one major donor providing support, multiple registers are still maintained for personnel data across the SPF.<sup>139</sup> The impact of EC support could be strengthened further if paired more directly with policy dialogue and technical assistance, focusing both government and international attention on strengthening systems to yield better security outcomes, rather than just the payment of individuals.

The current suite of approaches taken to stipend payments for the army and police demonstrate that use of country systems does not necessarily entail greater risk than use of parallel implementation systems. It is also possible for use of country systems to lead to better operational outcomes than parallel systems in a particular instance. The security sector experience also shows that donor investment in a sector – such as the payment of stipends – may not work to strengthen the underlying government system (e.g. payroll and human resources management systems).

The “devil is in the details” when it comes to UCS, as the Somali security sector example shows. Security sector stakeholders recognize the flaws of the current system. Use of country PFM systems may not, however, automatically yield better results. Moreover, donors face hurdles in transitioning to country systems due to legacy systems in the Somali security sector that were not an issue for support to the civil service.<sup>140</sup> While non-use of country systems can focus attention on parallel systems to the expense of country systems, care needs to be taken to ensure that a particular use of country systems actually promotes development results.

<sup>135</sup> UNSOM/World Bank 2017, p. 102.

<sup>136</sup> Abyrint 2017a, p. 41.

<sup>137</sup> Interview #40,

<sup>138</sup> Abyrint 2017b, p. 19.

<sup>139</sup> Abyrint 2017b, p. 41.

<sup>140</sup> A key hurdle preventing donors from greater UCS in this sector is the lack of civilian oversight of the SNA. If civilian oversight were strengthened, international partners would be more likely to shift towards greater use of country systems, addressing weaknesses in payroll validation, control, and management through technical assistance.

## 4.2 Operational & Statebuilding Risks

Different delivery channels may be differentially able to, in fact, deliver what they intend. This is conventionally framed at the project level as the ability to deliver on operational goals. We submit it makes little sense to focus on individual projects but not the overall objectives of strategic assistance. Inasmuch as donors' efforts in Somalia have building the Somali state as their central thrust, we think of operational risks and benefits as essentially the short-term cousin to longer-term statebuilding objectives. Operational and statebuilding considerations are linked, inasmuch as donor assistance is comprised of individual projects. But if project operational results are trees, then statebuilding is the forest; paying attention to the former at the expense of the latter is unlikely to maximize long-term returns to donor assistance.

The variation across project types and locations makes it difficult to neatly summarize operational risks. In many regards the Somali Government – both at federal and state levels – has very weak implementation capacities. If massive new inflows of resources were to flow through Somalia's PFM systems, the government would likely struggle to make efficient use of those resources to deliver on development objectives.<sup>141</sup> This is especially true when projects are not designed with the government's level of capacity in mind, which essentially sets them up for failure. As one former government advisor pointed out, the speed and quality of delivery could be improved if programming were more flexible and better tailored to the current capacity of government.<sup>142</sup>

In the short-term, making full use of Somalia's PFM systems to actually execute projects may result in delayed and lower quality implementation than could be achieved through other delivery modalities.<sup>143</sup> Yet, balanced against these weaknesses in government delivery is the simple truth that parallel delivery systems are not a sustainable solution for sectors and activities that will be provided by the state in the long-term. The question in these sectors from an operational standpoint is arguably not whether to transition towards country systems, but when and how to do so.

One concern raised by multiple donors was the unsustainability of a large increase in UCS, given the government's currently limitations in raising its own revenue.<sup>144</sup> It is not clear why this concern applies uniquely to the use of country systems. Whether routing funds through government or delivering directly to implementing partners such as NGOs or the private sector, the reliance on donor financing to deliver services remains the same.<sup>145</sup> Moreover, the risk of promoting a reliance on external grants has not prevented donors from providing significantly greater support to government budgets in other fragile states. Figure 4 compares the budgets of five low income fragile states and their reliance on external grants compared with domestic revenue. Nearly 60% of the Afghan budget was financed by external grants in 2015. External grants financed approximately 50% and 30% of the government budgets in the Central African Republic and Liberia, respectively, in the same year.

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<sup>141</sup> Interview #15, Interview #36

<sup>142</sup> Working at the pace of government is also considered a best practice under the New Deal; "countries and development partners need to work at the pace of the country and within the capacity of the national staff." Ashcroft, Laing, and Lockhart 2017, 11.

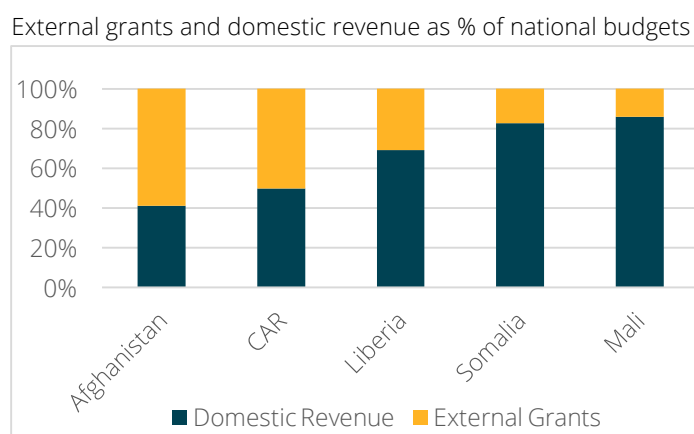
<sup>143</sup> E.g. The 2017 World Bank Country Portfolio Performance Review identified government procurement processes as a "critical factor contributing to delays." World Bank 2017, 38.

<sup>144</sup> Interview #36; Interview #15.

<sup>145</sup> The responsibility for delivering many of these services is certain (e.g. justice) or highly likely (e.g. health, basic education) to fall in part or in whole to government in the long term. Thus, it is not clear why increasing delivery through government would greatly alter this medium-term sustainability concern one way or the other.

As the OECD has put it, “Aid that uses recipient country systems can provide incentives and momentum to strengthen national capacity and performance.”<sup>147</sup> The delivery of salary support through Somalia’s PFM systems<sup>148</sup> has focused both donor and government attention on strengthening the processes by which payments are made and incentivize a broader reform agenda (see Box 7).<sup>149</sup> Had salaries been paid instead through parallel mechanisms, civil servants and police would have still been paid, but the support would not have achieved the same impact in strengthening Somalia’s payroll systems.

Figure 4. Reliance on External Grants in Five Low Income Fragile States, 2015<sup>146</sup>



The systems building benefits from using country systems are normally conceived of as being fiduciary in nature.<sup>150</sup> This narrow focus fails to capture the wide array of benefits UCS can yield. One of the most striking points made by interviewees was the extent to which UCS has served to stimulate improvements in non-financial country systems such as human resource systems and payroll identity verification systems.<sup>151</sup> Where country systems have been used, international attention and resources were shifted from the operational challenges of a parallel system towards those of the government’s systems; as a result, international partners’ natural focus on operational effectiveness has had positive spillovers for country systems. This use of country systems not only “uses the muscles” of government systems, but – perhaps a bit like exercise for the human body – actually strengthens systems as a result of their use.

By contrast, donor-funded payment of stipends to the military has proceeded using both financial (payment) systems that are outside government and non-government payroll lists and identity verification processes (see Box 6).<sup>152</sup> As a result, a great deal of energy and money has been invested in developing systems – both financial and non-financial – that are outside government’s normal salary payment systems for the military, which remain substantially weaker than the donor-funded parallel stipend payment systems.<sup>153</sup>

Strengthening individual and system capacity is far from the only potential statebuilding benefit of the UCS. So-called “bypass aid”, which involves NGO implementation of donor-funded projects, has been

<sup>146</sup> Based on co-author’s calculation using data from International Monetary Fund 2017a; International Monetary Fund 2017c; International Monetary Fund 2016b; International Monetary Fund 2017b; International Monetary Fund 2017e. The underlying data presented domestic revenue and external grants as a share of Gross Domestic Product (GDP). The comparison in this figure examines the reliance on external grants by presenting the relative weight of domestic revenue with that of external grants.

<sup>147</sup> OECD Development Assistance Committee Task Force on Public Financial Management 2011, 2.

<sup>148</sup> The Recurrent Costs and Reform Financing Project (RCRF) under the World Bank MPF is a government-implemented project supports the payment of civil servant salaries in the FGS and Federal Member States (See Box 7). The EU provides support for police stipends using country systems through a project managed by UNOPS.

<sup>149</sup> Interview #25; Interview #38; Interview #39; Interview #1.

<sup>150</sup> This may be a result of the budgetary and fiscal focus of the Collaborative Africa Budget Reform Initiative (CABRI), the creators of the dominant framework for considering the dimensions of UCS (and that employed by the Somalia Use of Country Systems Working Group). Somalia Use of Country Systems Working Group 2017; CABRI 2008.

<sup>151</sup> Interview #38; Interview #11; Interview #1; Interview #39.

<sup>152</sup> Interview #41; Interview #1; Interview #11; Interview #40; Interview #17.

<sup>153</sup> Interview #41; Interview #1; Interview #17; Interview #40.

associated with reduced government legitimacy in the eyes of citizens in randomized, controlled trials.<sup>154</sup> Framed one way, the Federal Government of Somalia is engaged in a bargaining game for the loyalty of Somalis with actors who pose an existential threat to the continued existence of the State (e.g. Al-Shabaab). Government-executed projects can help build the government's legitimacy and public support.<sup>155</sup>

Putting money in the hands of government can also encourage dialogue and incentivize collaboration. UCS can be used to expand the remit of the government, encouraging actors to engage with the government.<sup>156</sup> Interviewees noted that funds are currently being used to promote dialogue and integration between the Federal Government and member states and amongst member states.<sup>157</sup> In the Somali context, inter-governmental fiscal transfers, financed through external grants, are playing an important role in helping establish the foundations of fiscal federalism.<sup>158</sup>

To the extent that donors dangle UCS "carrots" to induce government reforms that donors believe forward statebuilding objectives, there is a risk that a lack of donor reward via increased use of country systems will serve to undermine the momentum of reform.<sup>159</sup> Incentivized by the potential for on treasury aid and the desire to regain access to concessional financing, government has been taking concrete steps to improve its systems. If government actors are motivated by - or able to convince internal spoilers with the promise of - greater funds flowing through national coffers, UCS can be a powerful motivator of reforms.

Given the international community's explicit focus on statebuilding in Somalia, the preferencing of short-term operational concerns over long-term government systems building appears to run counter to the international community's stated objectives. There is an inherent tension in purporting to support Somalia's statebuilding while ensuring, via programmatic decisions, that donor-funded support is executed outside the government.

While there are indeed short-term operational risks to greater UCS, as well as transition costs from shifting towards country systems from current channels, there are a variety of potential hybrid approaches that allow greater, incremental use of country systems while mitigating risks and without employing every component of Somalia's PFM regime.<sup>160</sup> The following are just a few examples:

- Pairing government execution with technical assistance and continued independent monitoring is one such solution suggested by both international partners and government interviewees.<sup>161</sup>
- Donors can minimize transition costs by increasing their use of established mechanisms that use country systems, such as the World Bank MPF and the National Window of the UN MPTF. These SDRF Funds provide "ready-made" channels for donors to indirectly use country systems without having to establish their own procedures and safeguards (See Box 4).

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<sup>154</sup> Baldwin and Winters 2017. This study of local governments in Uganda finds that providing information about bypass aid reduced citizens' sector-specific perceptions of local government quality, but interestingly not compliance with the government.

<sup>155</sup> Interview #12; Interview #13.

<sup>156</sup> Interview #40.

<sup>157</sup> Interview #12; Interview #32.

<sup>158</sup> The World Bank-administered Multi Partner Fund (MPF) supports transfers to four Federal Member States (Puntland, South West, Galmudug and Jubaland) through the RCRF. The only remaining established state is expected to meet the eligibility criteria to receive transfers by the end of 2017.

<sup>159</sup> Interview #26.

<sup>160</sup> For example, the civil service salary component of the RCRF (see Box 7) reimburses eligible recurrent costs, meaning execution does not involve procurement systems or contracting, but only the successful transfer of funds to intended recipients.

<sup>161</sup> Interview #38; Interview #37; Interview #13; Interview #33; Interview #29; Interview #30.

- Donors could also begin to transition services to government oversight while retaining existing providers, e.g. routing funds through government, which in turn contracts existing incumbents to provide services in the short-term.

Set against short-term operational risks are the broader medium- and long-term statebuilding risks that alternative delivery channels may engender. Using country systems has the potential to strengthen medium-term capacity by focusing both donor and government attention on the quality of government systems, both financial and non-financial. It can strengthen the government’s convening role and the remit of the government’s authority. Greater UCS for service delivery also has the potential to build government’s legitimacy in the eyes of the Somali people.

*Box 7. Supporting Recurrent Costs in Somalia through an Iterative Approach*

The Recurrent Costs and Reform Financing Project (RCRF) is designed to “enable the Somali Government to achieve reliable and transparent financing of critical civil service operations to help strengthen the legitimacy of the State.”<sup>162</sup> The 5-year, US\$ 144 million project is implemented by government and financed by ten donors through the World Bank MPF.<sup>163</sup>

The project adopts an approach based on iterative learning and adaptation whereby budget execution and payment systems are improved slowly but surely, while creating incentives for political dialogue and policy reforms.<sup>164</sup> The RCRF reimburses eligible government expenditures; when expenditures are declared ineligible, reimbursement is withheld. In this way, fiduciary risk is minimized and both government and project staff are focused on improving the same government system month-on-month. This approach promotes broader system strengthening (thus reducing fiduciary risks of country systems, to the benefit of both government and future donor uses of these systems) while minimizing the fiduciary risks to the RCRF itself. Through a series of annual reviews, government counterparts (both federal and state) and the World Bank agree on allocations and benchmarks for the coming year. This work has triggered reforms related to issues ranging from domestic revenue mobilization<sup>165</sup> to improved Know Your Customer procedures by commercial banks.<sup>166</sup>

In addition to providing a platform for inter-governmental dialogue, the RCRF has supported the establishment of an intergovernmental fiscal transfer system to core government functions of eligible federal member states. Designed to reward accountability and transparency, states must meet a defined set of readiness criteria before receiving financing through the RCRF. The project now supports transfers to Puntland, Jubaland, Galmudug and South West, while Hiirshabelle is expected to receive its first transfer by the end of 2017.<sup>167</sup> In Puntland, a service delivery component of the RCRF supports

<sup>162</sup> World Bank 2015, 13.

<sup>163</sup> Denmark, the EC, Finland, Italy, Norway, Sweden, Switzerland, the UK, the US, and World Bank State-and Peace-building Fund have all contributed to the MPF. World Bank 2017, 13.

<sup>164</sup> While beyond the scope of this report, it is notable that the process of problem identification and improvement that has emerged for RCRF civil service payments (as outlined in Interview #1, Interview #38, Interview #39 and background documents made available by the World Bank) has echoes of a broader focus on iteration and adaptation emerging in broader development partner practice. The World Bank’s agile management pilot, DFID’s Smart Rules, USAID’s Local Systems framework, and the broader Doing Development Differently and Problem Driven Iterative Adaptation movements all focus on iterated, adaptive problem identification and resolution. See Honig and Gulrajani 2017 for an overview of these broader movements and Andrews, Pritchett, and Woolcock 2017 for Problem Driven Iterative Adaptation.

<sup>165</sup> For example, at a Fiscal Forum event in February 2017, the FGS and Federal Member States agreed to harmonize “sin taxes” on Qat and cigarettes, as well as departure taxes. World Bank 2017, 53.

<sup>166</sup> Interview #39; Interview #5.

<sup>167</sup> World Bank 2017, 50.

the salaries of 2,117 teachers.<sup>168</sup> This support has been accompanied by technical support for Puntland's education sector payroll management.

The RCRF continues to test innovative approaches in Somalia. In 2017, additional results-based financing was provided via the RCRF as a pilot activity. An initial package of US\$6 million in "surge support" was made available as policy-based financing linking tranche disbursements with the government's achievement of specific policy benchmarks.<sup>169</sup>

While the RCRF remains one of the most flexible, adaptive financing instruments in Somalia, there have been calls by some for international institutions to further adapt tools such as the RCRF to the specific needs of fragile states, e.g. by simplifying program design based on the capacity constraints of government and improving the speed with which such instruments can change course based on evolving needs.<sup>170</sup>

### 4.3 Reputational Risks

Just as the Government of Somalia has valid legitimacy concerns, so too are Somalia's donors concerned with their domestic legitimacy. Donors can only continue to operate so long as they have the continued support of their publics and parliaments (for bilateral donors) or executive boards and member nations (for multilateral donors). At the core of reputational risk are the perceptions of those who will never understand the country context as well as the development agencies that operate in that context. Reputational risk cannot be eliminated by simply making the "right" decision; a program can be net beneficial and yet carry substantial reputational costs.

The OECD Development Assistance Committee puts this quite eloquently in arguing that

"Development agencies are naturally aware of risks that foster scepticism of development assistance. This could be anything, and includes specific cases of corruption, theft, blatant mismanagement, or other matters that sound scandalous; but also includes failure to deliver on objectives, such as preventing state collapse. Even small transgressions can become a major scandal if taken out of context. The presence of these risks is never the scandal itself – the scandal only follows if things go visibly wrong. Importantly for development agencies, the financial and development consequences of exposed corruption or mismanagement are typically small in relation to the whole portfolio, but the reputational damage can be much greater."<sup>171</sup>

A number of interviewees thought mismanagement of funds – if e.g. funds were to go missing – would make continued use of country systems exceedingly difficult.<sup>172</sup> Reputational risks can, as the OECD report suggests, be related to real fiduciary or operational risks but unrelated to the actual performance impacts of risks. As one interviewee put it, "If one dollar goes to Al-Shabaab from our funds, we're done. They'd shut us down."<sup>173</sup> This comment deserves further scrutiny. The concern expressed here is not plausibly about a risk to project performance; surely if a very small amount of money was found to have gone to Al-Shabaab, this would not play a substantial role in a given project's direct success. Concerns about corruption and misdirection of funds are not necessarily linked to project performance, also flowing

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<sup>168</sup> As of June 2017. Ibid., 53.

<sup>169</sup> Interviews.

<sup>170</sup> Interview #19.

<sup>171</sup> OECD Development Assistance Committee 2014, 13.

<sup>172</sup> Interview #15, Interview #37, Interview #32.

<sup>173</sup> Interview #37.



from the consequences for donor agencies' reputation and project staff's careers of malfeasance even if that malfeasance were to have had no impact at all on project performance.

A number of implementing agencies also raised the concern that the risk appetite of their least-risky donor or funder served to constrain their actions.<sup>174</sup> Implementers worried how donors, having provided them funds, would react were malfeasance to come to light; would donors respond by pulling back their funds? While no interviewee suggested this had led them to less than fully investigate potential fiduciary risk events, this concern regarding "shooting the messenger" is surely counter-productive.

There are clear risks of using country systems. There is also a clear risk of failing to use country systems. The precise nature of risks and how to mitigate them are difficult to articulate clearly on both sides. What, exactly, is the expected risk and relative spending efficiency of using country systems vs. implementing a project through a local NGO in a given case? It is hard to say on either side; in either case, there are a good deal of unknowns that make precise estimation impossible.

In making allocative decisions, however, it is clear that donors feel the need to justify the choice to use country systems much more rigorously than the choice *not* to use country systems.<sup>175</sup> Some donors need to explicitly compare modalities when using country systems directly, but not when choosing to implement through multilaterals or NGOs.<sup>176</sup> One interviewee drew the analogy to mailing a package using the post office; if the package does not arrive, no one blames the person who mailed the package, but rather the post office.<sup>177</sup> Donors seem to believe that sending money to a multilateral or an NGO largely shifts a large portion of the responsibility (and thus reputational risk) to the implementer; however, when using country systems directly, donors themselves act and speak as if they believe they are much more likely to be blamed for fiscal or operational failures. This asymmetry in what needs to be justified serves to constrain additional use of country systems. Some donor representatives feel that in clearly articulating risks in program documents they immunize themselves from blame if the risk does indeed come to fruition;<sup>178</sup> for others this is clearly not the case.<sup>179</sup> While some of this variation may be due to individual personalities and perspectives, a good deal of this variation is likely due to the differences in how donor organizations operate, which has demonstrated impacts on the behavior and risk taking of donors' field representatives.<sup>180</sup>

There is arguably no financial management system in the world – donor, developed country government, multinational corporations, etc. – that can confidently avoid a single misspent dollar (i.e. the risk of "one dollar going to Al-Shabaab").<sup>181</sup> Donors will have to find ways to accept and frame the continued potential for adverse fiduciary and operational risk events if they wish to substantially increase the use of country systems. The risk in using Somalia's country systems can be mitigated by Somali government actions, but in the medium-term fiduciary and operational risks will remain high.

Some of the risks articulated above are more salient to donors and their field representatives than others. The OECD report quoted above also suggests that failure to deliver on long-term objectives carries reputational risk; that e.g. statebuilding failure in Somalia may also reflect poorly on donors. Precisely

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<sup>174</sup> Interview #15, Interview #38, Interview #1, Interview #11.

<sup>175</sup> Interview #1; Interview #6; Interview #22; Interview #3.

<sup>176</sup> Interview #6

<sup>177</sup> Interview #1

<sup>178</sup> Interview #6

<sup>179</sup> Interview #37; Interview #11

<sup>180</sup> Honig 2017.

<sup>181</sup> Interview #37, as quoted above.

zero interviewees mentioned the risk of long-term failure, including in response to open-ended questions about risks, and explicit discussions of reputational risk.<sup>182</sup>

Interviewees' consideration of reputational risks focused more on short-term matters with the potential to grab domestic headlines than the risk of failing to achieve long-term results. By the time long-term results are realized, donor agents will have rotated to new posts. If Somalia were to slip backwards into conflict, Somalia would clearly not be seen in donor capitals as an aid success story; but neither would Somalia's collapse be directly attributable to a particular donor project, or even a particular donor. If, on the other hand, an auditor was to uncover "corruption" in a project, blame *can* be linked to particular projects, donors, and project personnel. The mechanisms by which reputational risk are realized and success attributed may lead to an asymmetric focus on short-term risks, encouraging undue conservatism in donor approaches.

#### 4.4 Comparing Risks and Benefits

This section has focused on use of government treasury and delivery systems. This is not because the other UCS dimensions— being on plan, on report, etc. — carry no benefits, but rather because they carry fewer risks. Beyond the additional administrative costs of consulting government and reporting on program performance to government, there are fewer fiduciary, operational, statebuilding, or reputational risks to these dimensions of UCS. Donors should continue to increase their use of country systems in these regards.

More complex is the use of government treasury and execution systems. Donors are understandably concerned to avoid "the C word" — corruption. We believe the label "corruption" is overbroad. Some things that get called "corruption" may well be reasons to avoid substantial UCS. But some examples of "corruption" are symptoms of the broader systemic weakness that careful, thoughtful UCS can help address. If money is spent without proper documentation, perhaps the funds were channeled to unsavory actors who did not deliver services. But perhaps value for money was delivered, and additional process would have simply added transaction costs. Scholars have argued that donors ought to focus more on, as one recent book title puts it, Results Not Receipts.<sup>183</sup> What better way to do so than to focus donor and government attention on the performance of government systems via their use?

Donors have important and complicated choices to make; on the one hand the use of country systems can forward policy dialogue, help improve government systems, and assist donors' statebuilding objectives, amongst other benefits. On the other hand, alternative implementation modalities seemingly promise faster delivery (albeit with a narrow focus on short-term project outputs), greater donor control of funds, and lower short-term risks, particularly in a reputational sense. While alternative implementation modalities have operational and fiduciary risks, if these risks are realized they are far less likely to serve as substantial reputational risks to the donor agency and its staff than if risks are realized through using country systems. By contrast, if failing to use country systems increases the risk of state failure in Somalia, that failure will not be attributable to any individual or donor agency.

Somalia's fiduciary systems are, as might be expected given Somalia's fragility, improving from a low base. If one were to administer e.g. a full Public Expenditure and Financial Accountability (PEFA) review, Somalia would likely have substantial areas of deficiency.<sup>184</sup> Somalia's fiduciary weaknesses have significant

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<sup>182</sup> This is not meant to connote that every interview involved a discussion of risk in general or reputational risk specifically, though these issues were raised in a vast majority of interviews.

<sup>183</sup> Kenny 2017.

<sup>184</sup> Somalia has conducted two PEFA self-assessments in early 2015 and mid-2016 using the 2016 PEFA framework. Full PEFA assessments are planned to be conducted by external parties in 2018 and 2020. Federal Government of Somalia 2016.

implications for decisions to use of country systems in practice. Multiple donor interviewees noted that, their personal commitment and that of their agencies to UCS notwithstanding, internal organizational approval processes for the use of country systems included an assessment of PFM system quality.<sup>185</sup> If a given assessment protocol finds e.g. Tanzania's systems wanting, it is unlikely to find Somalia's systems of adequate quality.

In other words, a fiduciary assessment of Somalia's financial systems conducted in a vacuum (that is, without considering the fiduciary and statebuilding risks of both UCS and alternatives) can effectively preclude substantial use of country treasury, budget, and execution systems in Somalia.<sup>186</sup> If a given donor couples rhetorical commitment to UCS with an internal approval process that requires such a technical sign off, it may be tantamount to *de facto* committing not to use Somalia's country systems in the short-term.

A more constructive approach would be for international partners to move from technical assessments of Somalia's country systems in isolation to an explicitly comparative framework of delivery modalities. Comparing the use of country systems (both directly and through pooled funding mechanisms) with alternatives when considering interventions, considering both short- and long-term risks, may serve to rebalance the scales and allow a more accurate, transparent comparison of risks across implementation modalities. It also may avoid what one interviewee described as the constantly shifting risk appetite of donors, typified by the acceptance of risk by project designers and managers, only for financial management staff at headquarters to effectively veto the increasing use of country systems.<sup>187</sup>

Making explicit comparisons of short- and long-term risks across implementation modalities may lead to what both the UCS Roadmap and interviewees call for: a gradual increase in the use of country systems.<sup>188</sup> In deciding what specific funding should be routed through country systems, the focus should be on where use of country systems is least likely to lead to a decline in short-term operational performance and most likely to lead to improvements in government systems. The next section articulates some of the possible next steps in increasing the use of country systems in Somalia.

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<sup>185</sup> Interviews. The US Government, for example, assesses country system quality using a Public Financial Management Risk Assessment Framework. USAID 2014.

<sup>186</sup> Ashcroft, Laing, and Lockhart 2017, 7 suggests that in Afghanistan and East Timor this has been a problem as well, with fiduciary risk being prioritized over development effectiveness (that is, statebuilding risk as framed in this report).

<sup>187</sup> Interview #1.

<sup>188</sup> Use of Country Systems Working Group 2017. Interview #15; Interview #36;

## 5 Discrete Uses of Country Systems and the Way Forward

Inasmuch as this risk-benefit framework forms part of the larger Somalia Use of Country Systems (UCS) Roadmap,<sup>189</sup> this section is meant to help shed light on some of the potential next steps forward on that road. Some broad suggestions drawing heavily from interviewees include:

- **Build on What's Worked: Apply Adaptive Approaches to Drive Iterated Improvements**

Many of the UCS successes in Somalia have adopted an iterative approach of piloting and adapting based on lessons learned, scaling up as appropriate. The Special Financing Facility (SFF) – a Norwegian-established project that supported government recurrent costs and small-scale infrastructure – has been scaled up by both the World Bank and United Nations (UN) through flexible arrangements that allow for continued learning and adaptation (Box 8). Several projects financed through the World Bank Multi Partner Fund (MPF) were initially piloted through smaller projects supported by the State- and Peacebuilding Fund.<sup>190</sup> The UN's first pilots using country PFM systems in Somalia, financed by the Peacebuilding Fund, are serving to test how the UN could increase its UCS in the coming years.

This incremental, iterative approach needs to be applied more often and more broadly – not just to programs but also planning frameworks and aid coordination structures. Doing so also offers the prospect of driving iterated improvement in country systems themselves, as noted in Box 7. The examples above also highlight the importance of coordination and information sharing so partners can learn from one another. It is critical that partners using country systems coordinate amongst themselves to ensure they apply consistent, complementary standards and procedures. Government has a key role to play in facilitating this coordination to ensure provided support can achieve more than the sum of its parts.

- **Increase Recurrent Costs Support using Country Systems**

Country systems have been successfully used to pay civil servant salaries at the federal level and catalyze system strengthening improvements and reforms. As the Federal Government takes on an increasing share of its wage bill, financial support and system strengthening under the RCRF is being shifted to Somalia's Federal Member States, as described in Box 7. The RCRF could be scaled up at the state level, perhaps absorbing the support international partners are currently providing bilaterally for civil servant salaries and government operational costs in parallel to country systems.<sup>191</sup> The RCRF or a similarly structured mechanism could be expanded to additional types of public servants at both the state and the federal level.<sup>192</sup> For example, the RCRF is currently supporting teacher salaries in Puntland, which shifted support donors were already providing from bilateral arrangements to a centralized mechanism using country systems. This approach could potentially be expanded geographically or to other service delivery sectors. Where appropriate expansion could be tied with payroll, pay and grading reforms, and the hiring of appropriately skilled civil servants where current personnel quality is in need of strengthening.<sup>193</sup>

Inasmuch as donors are already providing support for the army and police outside of country systems (in addition to the European Commission's on-treasury support for police), these funds could be transitioned

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<sup>189</sup> It is explicitly called for in Use of Country Systems Working Group 2017, 6. See Box 2 for further detail.

<sup>190</sup> E.g. First phases of the PFM Reform Project and ICT Sector Support were financed through the SPF and later scaled up under the MPF. The SFF-LD is also currently being tested as a government-managed emergency response instrument through SPF funding of US\$ 2.8 million. World Bank 2017, 91.

<sup>191</sup> A recent mapping of supported positions revealed more than 300 positions – both line positions and embedded advisors – were financed by international partners outside of the government payrolls at Federal and state levels. UN/World Bank 2017.

<sup>192</sup> Interview #36; Interview #38.

<sup>193</sup> Interview #36.

to formal government channels.<sup>194</sup> This would likely focus donor and government attention on government's, rather than parallel, payroll and human resources systems. For the army, this could be coupled with a focus on increasing civilian oversight of the armed forces, thus achieving a policy reform many security sector actors feel critical to the continued reform of the armed forces.<sup>195</sup>

#### *Box 8. The Legacy of the Special Financing Facility*

The Special Financing Facility (SFF) was established as a pilot to deliver programmatic support on treasury to support recurrent costs (primarily civil service salaries) and quick impact community-driven projects.<sup>196</sup> When Norway signed the US\$ 30 million grant agreement with the Federal Government in December 2012, it was with the view that this pilot should serve as a catalyst for greater UCS and that the project itself should, over time, be scaled up by multilateral partners.

The SFF enabled the Somali Government to complete 12 infrastructure rehabilitation projects through collaboration between federal and local authorities.<sup>197</sup> The infrastructure component of this project is being scaled up by the World Bank Special Financing Facility for Local Development (SFF-LD) and UN National Window, a pilot initiative financed through the Peacebuilding Fund (PBF). Both the World Bank and UN use the same project implementation unit to deliver small-scale infrastructure rehabilitation projects through government. This collaboration has enabled the project to be expanded to additional regions and to tackle issues that extend beyond the World Bank's mandate (e.g. prison rehabilitation).<sup>198</sup> Both the SFF-LD and UN National Window projects have started small with initial grants of US\$ 8.8 and 2 million respectively, with a view to scale up incrementally over time, allowing flexibility for adaptation.<sup>199</sup>

The SFF also "laid the foundations for payroll reform and strengthened financial management and procurement processes within government."<sup>200</sup> The recurrent costs component was scaled up by the RCRF, expanding the support for the reform agenda as well as establishing an intergovernmental transfer system that extended financial support for core government costs in the Federal Member States. The RCRF is designed as a "Series of Projects" to enable adaptation over the course of the project's lifespan. While the first project in the series presents the rationale of the overall approach, the indicative funding envelope of US\$ 144 million is for a series of projects that are then prepared and appraised individually based on performance.<sup>201</sup> Other elements of the RCRF's iterative approach are further discussed in Box 7.

- **Maximize the Benefits of Current and Future Uses of Country Systems**

Use of country systems is a means to broader ends, including statebuilding, increased country ownership, and improved value for money.<sup>202</sup> The definitions and standards we use to categorize UCS<sup>203</sup> cannot capture the nuance of any particular use of country systems. As Boxes 6 and 7 collectively illustrate, not all uses of country systems have equivalent effects in their ability to catalyze iterated learning, improve

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<sup>194</sup> Interview #38; Interview #41; Interview #40.

<sup>195</sup> Interview #40; Interview #17; Interview #41.

<sup>196</sup> Somalia Use of Country Systems Working Group 2017, 12.

<sup>197</sup> Projects were completed in Bay, Benadir, Gagaduud, Hiiran, Lower Juba and Middle Shabelle, in what are now the Federal Member States of in South West, Galmudug, Hiirshabelle and Jubaland. Ibid.

<sup>198</sup> World Bank 2017, 90.

<sup>199</sup> Ibid.

<sup>200</sup> E.g. The SFF supported the introduction of a biometric registration system for civil servants in Mogadishu and linked the payroll system to the SFMIS. Somalia Use of Country Systems Working Group 2017, 12.

<sup>201</sup> World Bank 2015, 14.

<sup>202</sup> Which in turn might operate through decreased financial and non-financial transaction costs, decreased overheads, and/or greater allocative efficiency.

<sup>203</sup> e.g. CABRI dimensions of "On Treasury," "On Audit," etc.

systems, and support meaningful national ownership.

As an illustrative example, there are a limited number of cases in which a shift to fuller use of Somalia's treasury systems will quite clearly *reduce* fiduciary risk, while simultaneously increasing the extent to which a particular use of country systems serves broader objectives. According to both government and international interviewees, some international partners continue to use accounts established on behalf of ministries without any central government oversight,<sup>204</sup> a practice discouraged by the IMF and the Federal Ministry of Finance.<sup>205</sup> These arrangements assume all the risks of UCS without helping to improve overall allocative efficiency or take full advantage of the existing expenditure controls which do exist in Somalia's PFM architecture. In these cases, international partners are taking substantially greater fiduciary risk than if funds came on treasury and on budget, given the lack of oversight and transparency associated with these "off system" arrangements.

While this is an extreme example of a use of country systems that could be improved, it speaks to a broader need to continue to examine the discrete effects of particular projects and funding mechanisms and work to maximize benefits. Were donors and government to declare victory upon meeting agreed UCS Roadmap targets rather than focus on the actual impacts of UCS application, they will have hit the target but missed the point.<sup>206</sup> Both government and development partner stakeholders can do more to ensure that uses of country systems maximize the benefits of this approach.

In some regards, the simplest way to increase UCS would be to commit greater resources to existing SDRF funds that focus on using country systems.<sup>207</sup> The World Bank's preferred means of delivery globally is through country systems with recipient execution. As such, the Multi Partner Fund (MPF) administered by the World Bank is designed to prioritize this delivery modality; 85% of MPF project grants have been through government-implemented projects.<sup>208</sup> The UN has also been innovating to increase its use of country systems in Somalia through an established "National Window" under its Multi Partner Trust Fund (MPTF). The Peacebuilding Fund is financing two types of pilots through this window: dedicated projects designed for government implementation and government-implemented project components of larger joint programs implemented by UN agencies.<sup>209</sup> Both mechanisms – the World Bank MPF and UN MPTF National Window – have substantial room for expansion.<sup>210</sup> Routing funds through these mechanisms can also allow for expansions of the scope and geographic coverage of existing activities, and is thus additionally compatible with some of the other suggestions in this section.

- **Use Country Systems to Strengthen Somali Federalism**

Rather than looking at states in isolation, more interventions – from support for core government functions to service delivery projects – need to promote inter-governmental dialogue and the establishment of fiscal federalism linkages. Bringing a greater share of money on country systems for particular sectors – e.g. the education sector – may assist in forwarding the demarcation of operational

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<sup>204</sup> These accounts in the Central Bank of Somalia (CBS) are separate from the Treasury Single Account (TSA) and are not mapped to the SFMIS.

<sup>205</sup> Interview #36; Interview #29; Interview #2. IMF comments on initial draft of this report. While a number of the accounts held by the Central Bank of Somalia have been closed, some remain; there were also suggestions that some international partners may have established Ministry accounts outside the central bank (either in commercial banks or other more informal arrangements), though it is not clear if this is true and if so the magnitude of the problem.

<sup>206</sup> This formulation of concern about target-setting draws from Bevan and Hood 2006. Honig 2017 investigates when target-setting and reporting undermines development partner effectiveness in particular.

<sup>207</sup> In the longer term, normalization of IFI operations in Somalia through the debt relief process will enable greater UCS.

<sup>208</sup> As of 30 June 2017. World Bank 2017, 12.

<sup>209</sup> More recently, Sweden has also contributed to the National Window to scale up pilot activities.

<sup>210</sup> Individuals associated with both mechanisms confirmed this account; interview numbers not cited as this would serve to de facto allow the anonymization coding to be broken.

responsibilities between the federal and state governments.<sup>211</sup> In addition, large infrastructure projects that require collaboration across states, or collaboration between Somalia and neighboring countries, could enable some donors to unlock additional “regional” funding on Somalia’s behalf while facilitating inter-state and state-federal collaboration.<sup>212</sup> Delivering such projects through country systems brings focus on government procedures – such as budgeting, procurement, procedures for inter-governmental fiscal transfers and reporting – in a way that could not be achieved through parallel systems. The prospect of money being channeled through government PFM systems also creates extra incentives for government counterparts from different administrations to engage in dialogue around areas mutual interest.

- **Increase the Legitimacy Benefits of UCS by Focusing on Contracting Out**

In some sectors, contracts currently managed by donors could be transitioned to government management. Implementing partners could then be contracted to implement on behalf of the government, helping to strengthen the government’s capacity to effectively oversee and regulate in the targeted sector.<sup>213</sup> This transition could initially be accompanied both by donor technical assistance and donor monitoring to ensure a smooth transition and continued quality delivery of services, and contracts could transition gradually into government management in the targeted sector to mitigate the risk of service interruption and declines in service quality.

- **Next Steps for the UCS Dialogue**

There is much that the Somali government can do to encourage increased and improved UCS. The government should not – and indeed cannot, if it wants to see use of country systems increase – simply wait for donors to act. It should redouble its commitment to PFM improvements and delivery system strengthening. The government can also tighten its fiscal controls in collecting and spending its own domestic revenues, to assuage donor concerns that the fiscal space created by the greater use of country systems will be executed in opaque, and perhaps unproductive, ways.<sup>214</sup> There are also measures the government should take to encourage greater UCS in specific areas; e.g. on military recurrent costs, the government can work to improve civilian oversight.

The government should continue its commitment to working with the International Monetary Fund (IMF) and reach decision point under the Highly Indebted Poor Countries (HIPC) Initiative as quickly as possible as this will enable normalization of Somalia’s relations with International Financial Institutions (IFIs), potentially increasing the volume of financing available to be channeled through country systems.<sup>215</sup> A continued track record of strong performance under IMF programs (including the IMF Staff-Monitored Program in force at the time of writing) will do much to address development partner concerns regarding reform commitment.<sup>216</sup> Formal performance evaluations are arguably even more important in Somalia

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<sup>211</sup> Interview #12; Interview #25

<sup>212</sup> Interview #31; Interview #25; Interview #12

<sup>213</sup> The Liberian health sector is a case in point where donor use of country systems and government contracting of NGOs have been successfully combined. See e.g. Hughes, Glassman, and Gwengale 2012. This article also discusses USAID’s use of a Fixed Asset Reimbursement Agreement (FARA) in Liberia, which operates somewhat like the RCRF (see Box 7); that is, ex-post reimbursement occurs against performance targets, suggesting another means of mitigating donor fiduciary risk in fragile contexts.

<sup>214</sup> Interview #31; Interview #1; Interview #32; Interview #38.

<sup>215</sup> For a brief overview of the HIPC process see IMF 2016a. There is much donors can do to forward HIPC decision point as well, of course. Most notably, in casual conversation with donors in August 2017 there was some dispute about whether the current IMF Staff-Monitored Program was considered upper credit tranche-equivalent and thus whether completion of the program would unlock HIPC. Donor consensus on this, as well as on the discrete timeline to arrears clearance, Paris Club negotiations, etc. would likely have a salutary effect on the Somali government’s intensity of commitment to the current IMF program.

<sup>216</sup> Interview #6; Interview #37; Interview #36; Interview #15

than in other countries in light of the “security-dialogue paradox” highlighted above; that is, the logistical and security challenges to thickening the quality of dialogue and inter-personal trust between donors and government.

Beyond PFM performance, the government should invest in making existing aid coordination structures function more effectively. These mechanisms provide a platform for the government to demonstrate political leadership and ownership of its own development and reform agenda, which should enable the government to better direct support towards national priorities. Yet, government officials continue to strike bilateral deals with donors that benefit their individual ministry, department or agency, often at the expense of their own country systems.<sup>217</sup> Government officials may think they are getting the best deal when “shopping for donors,” but any short-term gains come at a cost to medium-term system strengthening. This fragmented bargaining for aid diminishes impact by increasing the potential for duplication and poorly coordinated interventions.

The government and international partners can both do more to overcome the tension between dialogue and security. Government can make greater efforts to reach out to international partners to engage in policy dialogue and signal political commitment to difficult reforms. International partners can do more to recognize the limitations that their own security procedures place on dialogue, and do more to create space for trust-building and more informal conversation with government interlocutors.

International partners should further engage government in both political and technical discussions as to their vision of how precisely they will move forward in their use of country systems (including how they will weigh the risks and benefits of country systems against alternatives). For those who wish to tie increasing UCS to performance benchmarks, partners should be more explicit regarding what precisely needs to be done by government; better still, partners can link concrete actions to delivery of existing structural benchmarks under e.g. the existing IMF program. Individual partners will of course make their own judgments, hopefully in conversation with Somali Government officials, regarding how best to scale up UCS and the appropriate time to do so. The UCS working group could serve as a productive venue for facilitating these conversations. The working group can also serve as a forum for discussing concrete hybrid arrangements as a transition to full use of country systems, effectively lessening the risks donors perceive in transitioning to greater UCS use.

Last but by no means least, international partners should do more to ensure that commitments made in the field are actually delivered upon. The best intentions of field representatives to use country systems are sometimes thwarted by financial management staff at headquarters that do not share field representatives’ richer perspective regarding the benefits of UCS.<sup>218</sup> International partners need to do the internal organizational work to ensure they are able to follow through on commitments they have made. They can also ensure that evaluation of the use of country systems occurs in the context of a holistic consideration of the risks and benefits of both UCS and delivering via alternative channels.

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<sup>217</sup> For example, international partners are often requested to finance embedded advisors directly, rather than hire advisors through the Capacity Injection Mechanism (CIM) in the Civil Service Commission. The CIM provides a pathway for transitioning away from fragmented, parallel arrangements. It serves as a coordination mechanism for standardized recruitment of highly qualified advisors and civil servants to fill critical capacity needs within government, applying a harmonized salary scale. Linking pay with performance, higher rates applied within the system are accompanied by higher performance standards.

<sup>218</sup> Interview #1



## 7 Conclusion

This report has framed the use of country systems (UCS) mainly as a choice international partners must make between modalities. This is not because government has no role in motivating the use of country systems; it is rather because the government is not the party upon whom the choice ultimately rests. Some readers of this report may feel that this emphasis leaves too rosy an impression of the Somali Government. We do not want to leave the impression that the Somali Government does not have substantial work to do in a variety of areas, or that it is without significant weaknesses; myriad reports (including those related to Somalia's IMF Staff Monitored Program) document the challenges of Public Financial Management (PFM) in Somalia. What we hope to contribute to the conversation is to prompt a deeper consideration of how donors ought to respond to the broader challenges of operating in Somalia.

To use country systems requires international partners and government to work together; "it takes two to tango," as they say.<sup>219</sup> While government has a critical role to play in the dance, many international partners remain unsure about whether or how to join government on the dance floor. This report has focused on international partners because it is they who, in a quite explicit sense, need to decide whether, where, and how to use country systems. This report has explored what international partners could potentially do given Somalia's current condition and trajectory. Donor government political considerations surely explain some of the variation in why certain states (e.g. Afghanistan) see greater use of country systems; but the relative lack of use of country systems is all the more troubling in light of donors' explicit statebuilding objectives for their assistance to Somalia. Given Somalia's existing strengths, weaknesses, and challenges, when does it make sense for development partners to use country systems given the objectives that international partners themselves articulate?

In making their decisions as to how to best deliver development assistance, this report has argued that in addition to fiduciary, operational, and reputational risks, donors would do well to consider both value for money – particularly in light of the 30-60% non-programmatic costs associated with the use of non-UCS modalities reported by interviewees – and the effect of use or non-use of country systems on the statebuilding objectives to which donors remain committed.

This report has also suggested that something seems amiss in how donors frame risks and consider the quality of country systems. Considering Somalia's country systems purely in terms of fiduciary risk (or requiring such an evaluation for use of country systems), without consideration of the broader risks and benefits of system use as compared to alternatives, is essentially the same in practice as committing not to use country systems. Donors' internal "plumbing" may be undermining their own higher-level policy ends and commitments.<sup>220</sup>

There also seems to be something amiss in the way reputational risk operates in practice. Reputational considerations seem to systematically bias decisions away from the use of country systems and towards delivery by multilaterals, NGOs and the private sector over and above actual relative differences in fiduciary and operational risks of UCS and alternatives. This situation persists in spite of what we believe are the real reputational risks to donors of outcomes the lack of use of country systems may increase in likelihood, e.g. state failure in Somalia.

Donors would also do well to more explicitly consider value for money maximization, not merely risk minimization. Greater expected benefits may well be – as they often are in financial markets – associated

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<sup>219</sup> An American idiom, "takes two to tango" dates to the 1950s (Miedler 1997, 126) and indicates a situation in which two parties are required for something to occur. E.g. a dance, a negotiation, a marriage, etc. This image for donor-government relations and bargaining is also used in Swedlund 2017.

<sup>220</sup> This image draws from Bain, Booth, and Wild 2016.

with courses of action that do not minimize risks. In financial market parlance, maximizing alpha is not coincident with minimizing beta. Donors can mitigate (but not eliminate) these risks via e.g. technical assistance, third party monitoring, or building a system of small risks that can allow iterated learning (see e.g. Box 7).

The actions of international partners in Somalia, particularly in light of their explicit statebuilding objectives, may currently lag behind their stated commitment to UCS. One donor representative described government and donors as in a boat together; this interviewee suggested that donors could either look at the waves, or grab the oars and start paddling.<sup>221</sup> This report has argued that in making their allocation decisions international partners would facilitate the boat's forward motion by making more explicit comparison between government systems and the alternatives. This requires thinking both about the available choices of oars (delivery modalities) and the destination towards which both donors and government have committed to rowing (statebuilding). Some part of the solution to the seemingly big, "political" issue of greater use of country systems may lie in the details of how projects are vetted and approved.

No delivery modality is without risk; both country systems and alternative delivery channels have drawbacks. But these options also have differing strengths, depending on the type of project, sector or situation. In finding the right mix of tools, both government and international partners need to focus more on the statebuilding goals towards which they are jointly committed.

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<sup>221</sup> Interview #6

## Annexes

### Annex A. Interviewees & Consultations

Name	Organization
Abdi Dirshe	Ministry of Planning, Investment, and Economic Development
Abdirahman Abdullahi	Office of the Prime Minister
Abdirisak Mohamed	Accountant General's Office
Abdulqafar Abdullahi	World Bank
Abukar Osman	Aid Coordination Unit
Abukar Sanei	Ministry of Planning, Investment, and Economic Development
Adil Korfa Garane	Ministry of Finance
Ahmed Ainte	Aid Coordination Unit
Albert Soer	United Nations Development Programme
Alex O'Riordan	University of Stellenbosch
Alican Aksoy	Deputy Ambassador, Turkish Embassy
Daniel Mwanje	Ministry of Finance
Elisabeth Loacker	European Commission
Farahan Mohamoud	Ministry of Finance
Fiona Davies	Financial Governance Committee – World Bank Delegate
Geoff Handley	World Bank
Greg Larson	N/A
Greg Wilson	Financial Governance Committee – Donor Delegate
Habib ur Rehman	g7+ Secretariat
Hodan Osman	Ministry of Finance (former)
Hugh Riddell	World Bank
Ian Hawley	Abyrint
Idiris Loyau	Ministry of Finance
Jacob Hughes	United States Agency for International Development (USAID)
Jeff Sims	United Nations Assistance Mission in Somalia (UNSOM)
Jessie Evans	United States Department of State
Jimaale Ahmed	Ministry of Planning, Investment, and Economic Development
Kathryn Nwajiaku	International Dialogue for Peacebuilding and Statebuilding
Khalif Mohamud	Central Bank of Somalia
Kobi Bentley	United Kingdom Department for International Development (DfID)
Maryan Abdullahi Yusuf	Central Bank of Somalia
Mehalah Beckett	DfID
Merita Jorgo	UN Resident Coordinator's Office / Risk Management Unit
Mohamed Hashi	Central Bank of Somalia
Mohamed Tahlil	Ministry of Finance
Mustakim Waid	Office of the Prime Minister
Nina Bowen	USAID
Per Karlsson	Embassy of Sweden
Rima das Pradhan-Blach	United Nations Office for Project Services (UNOPS)
Sagal Sheikh-Ali	Central Bank of Somalia
Said Mohamed	Central Bank of Somalia
Samba Thiam	International Monetary Fund (IMF)
Shirwa Adan	Office of the Prime Minister
Steen Andersen	World Bank
Victoria Ayer	USAID
William Irunga	IMF

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