ADB

THE GOVERNANCE BRIEF

ISSUE 51 • 2023

What Can Be Done to Improve the Use of Country Governance Systems?

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Introduction: Use of country systems—what has happened to it?

Recognizing the importance of strong governance institutions and systems in public service delivery, this brief reviews the progress of development partners in fulfilling their commitment to use country governance systems to ensure the effectiveness of development aid. This brief will first look back at how development partners have fared in their commitments to use country systems in their respective programs and identify the specific challenges they faced in fulfilling such commitments. Having identified and analyzed the root causes of these challenges, this brief will then propose steps that development partners and their government counterparts can take to address the underlying issues and progress in their respective commitments to use country governance systems.

The use of national systems can provide incentives and momentum to strengthen the capacity and performance of developing countries, enhance domestic accountability mechanisms, and improve the effectiveness of public expenditure, regardless of the source of financing (i.e., whether from the national budget or from development assistance).[1] Although there is varied understanding of what the term "country systems" covers, the Paris Declaration on Aid Effectiveness gives the following broad perspective: "Country systems and procedures typically include, but are not restricted to, national arrangements and procedures for public financial management (PFM), accounting, auditing, procurement, results frameworks and monitoring."[2]

The aid effectiveness commitments agreed upon in Rome, Paris, and Accra call for an increase in the use of partner country systems, particularly with respect to PFM systems (footnote 1). The Addis Ababa Action Agenda on Financing for Development (2015) calls for more and better official development assistance (ODA) that is aligned with national development goals and targets, and is in accordance with national budget allocation processes.[3] The Operational Plan on Strengthening Governance and Institutional Capacity of the Asian Development Bank (ADB), under its Strategy 2030 (Operational Plan for Priority 6), expresses ADB's commitment to increase the

[1] OECD DAC. What Are the Benefits of Using Country Systems? *Policy Briefs.* No. 1.

[2] OECD. 2012. *Paris Declaration on Aid Effectiveness.* Paris. p. 4. Cited in World Bank. 2021. *Following the Government Playbook? Channeling Development Assistance for Health Through Country Systems*. Washington, DC. p. 8.

[3] United Nations. 2015. *Addis Ababa Action Agenda of the Third International Conference on Financing for Development*. New York. para. 53.

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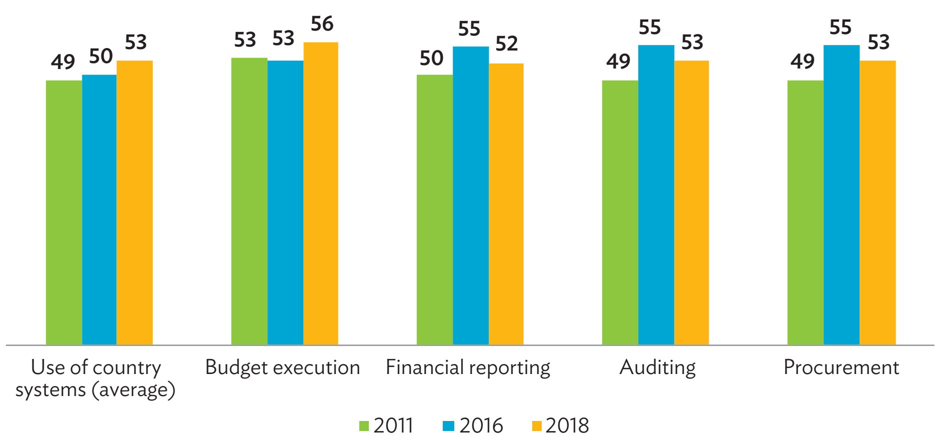
use of country systems (UCS) in delivering public sector operations. It also acknowledges that UCS could reduce delays in project implementation, cut transaction costs, improve country ownership, and strengthen institutions and systems for service delivery.[4] In February 2015, ADB published the paper, *Promoting the Use of Country Systems in ADB's Operations: A Systematic Approach*, where it declared its commitment to strengthen and promote UCS in its operations. The paper highlights the benefits of UCS, which are also mentioned in Strategy 2030 Operational Plan for Priority 6, and it notes that the strengthening of institutions and systems of ADB's developing member countries (DMCs) can lead to improved service delivery and sustainable development.[5] It also identified the three areas of country systems that are considered central to achieving sustainable development impact: PFM, procurement, and environmental and social safeguards (involuntary resettlement and indigenous peoples) (footnote 5). This is similar to the World Bank's definition of "use of country systems," which refers to its reliance on the borrowing country's systems for the safeguard and fiduciary aspects of operations it supports—that is, the financial management, procurement, environmental, and social aspects of project implementation.[6] This brief focuses on the first two areas of country systems identified in ADB's 2015 paper (footnote 5): PFM and procurement.

Despite the wide acknowledgment of the importance of UCS in delivering aid and the significant amount of attention it has had over the past 2 decades, developing countries' reliance on PFM and procurement systems has not progressed meaningfully, especially when one excludes sovereign budget support. The 2019 report of the Global Partnership for Effective Development Co-operation (GPEDC), which tracks progress toward the effectiveness principles under the 2030 Agenda for Sustainable Development, shows that progress in development partners' use of country PFM systems (including procurement) has been slow over the past few years (Figure 1).[7]

All development partners regard the assessment of a country's financial management functions as

Figure 1: Development Partner Use of Country PFM Systems as a Proportion of Disbursements to the Public Sector by System Component
(%)



PFM = public financial management.

Source: Global Partnership for Effective Development Co-operation. 2019. *Making Development Partner Co-operation More Effective: 2019 Progress Report*.

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[4] ADB. 2019. *Strategy 2030 Operational Plan for Priority 6: Strengthening Governance and Institutional Capacity (2019–2024)*. Manila. p. 27.

[5] ADB. 2015. *Promoting the Use of Country Systems in ADB's Operations: A Systematic Approach*. Manila. p. 1.

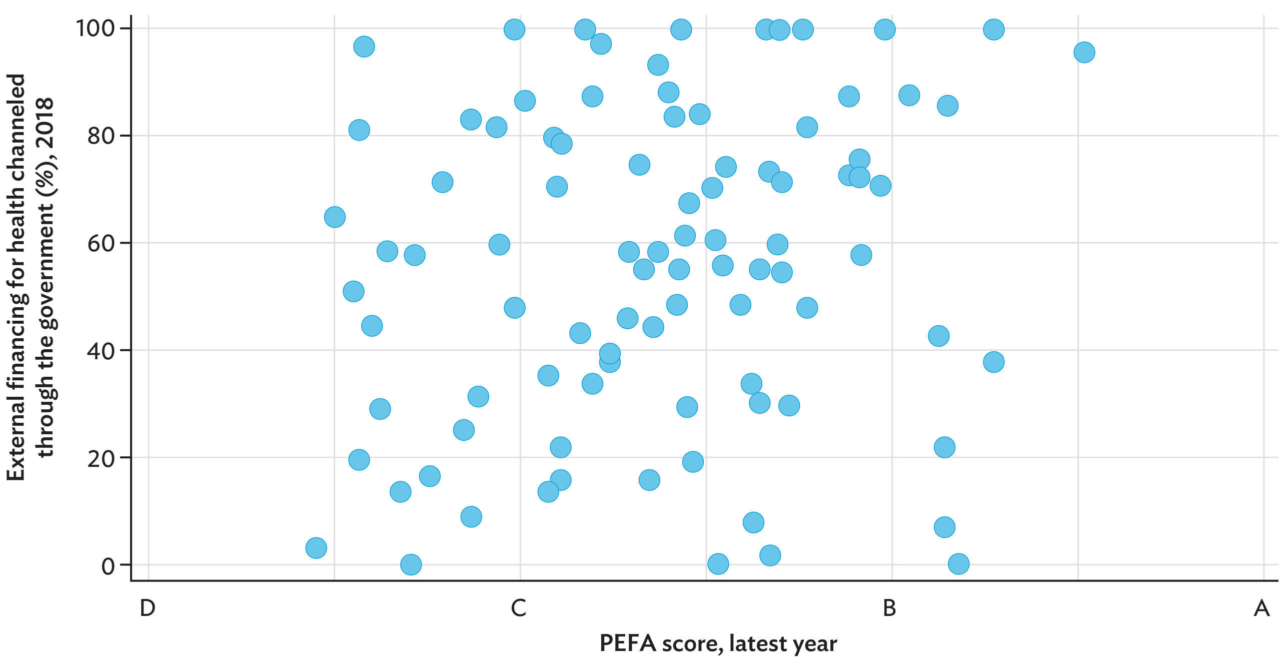
[6] World Bank. 2007. *Use of Country Systems in Bank-Supported Operations: Status Report*. Washington, DC.

[7] OECD and UNDP. 2019. *Making Development Partner Co-operation More Effective: 2019 Progress Report*. Paris. p. 114.

a priority when deciding to use country systems.[8] Although each development partner may have its own assessment requirements and objectives, the Organisation for Economic Co-operation and Development (OECD) reported that a large percentage of them use harmonized tools like the Public Expenditure and Financial Accountability (PEFA) assessment and the Methodology for Assessing Procurement Systems (MAPS), and that they all assess budget preparation and classification systems, with only a few looking at treasury, budget execution, and accounting systems (footnote 8). The prominence of country system assessment tools and the commonality of focal areas may lead one to think that measures to strengthen legal and institutional frameworks, improve processes, and build capacity would augur well with development partners, and would thus increase their reliance on national governments' systems. Indeed, given the amount of country assessments undertaken to date and the various types of technical assistance provided by development partners to help developing countries strengthen their PFM and procurement systems, one might expect a higher rate of reliance on country systems as compared with that reported by GPEDC.

Unfortunately, this does not seem to be the case. A recent World Bank study in the health sector found that the actual relationship between PFM capacity and willingness to channel funds through government systems appears unclear and is not always driven by the strengths of the PFM systems (footnote 2). Figure 2 correlates data on the extent to which development assistance in the health sector is channeled through government systems, on the one hand, with country PEFA scores on the other. The correlation shows that, in some countries with high PFM capacity, development partners are still reluctant to channel funds through such systems, while the inverse is also true (footnote 2). In other words, there appears to be no link between country system strengthening measures and the use of such country systems, regardless of whether these have benefited from ODA.

Figure 2: Noncorrelation between PFM Capacity and Use of Country Systems



PEFA = Public Expenditure and Financial Accountability, PFM = public financial management.
Sources: World Bank. 2021. *World Development Indicators*; and PEFA Secretariat. 2021.

8 OECD. 2011. *Using Country Public Financial Management Systems: A Practitioner's Guide*. p. 24.

How has ADB fared?

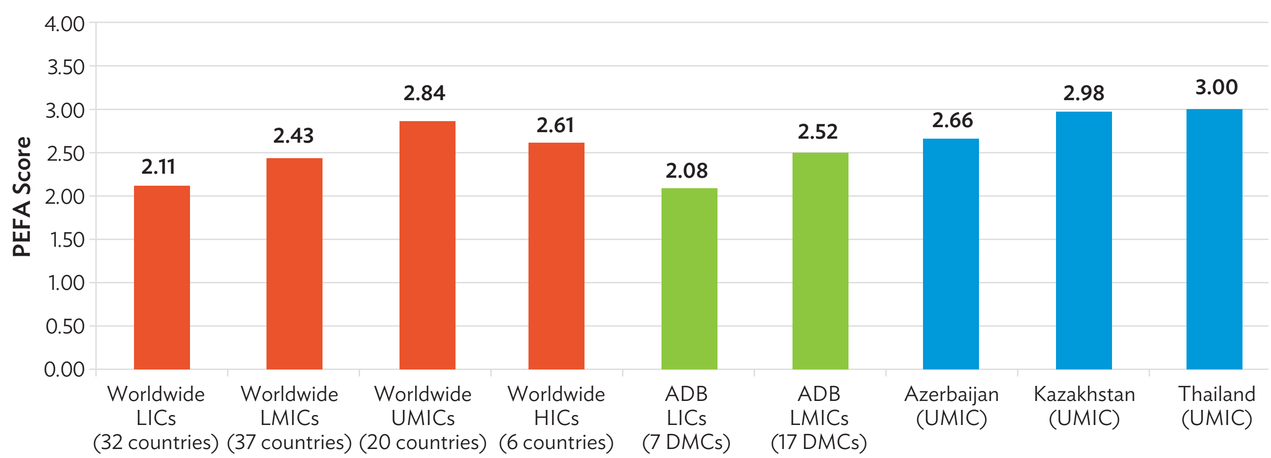
ADB's 2015 paper on promoting UCS proposes a systematic approach for ADB to use country systems in its operations (footnote 5). ADB also undertook other notable measures in this field, which include the use of high-level indicators to monitor and report on its progress toward UCS, and the enhancement of its governance risk assessment approaches to better identify and analyze the PFM and procurement systems of its DMCs.

ADB's 2015 Paper on Promoting Use of Country Systems

The approach in ADB's 2015 paper on promoting UCS started with a consideration of upper middle-income countries (UMICs), as the expectation was that UMICs generally had higher institutional capacities and well-functioning country systems and were hence expected to be associated with lower fiduciary risks (footnote 5). The planned scope of the approach appeared sound, as an analysis of worldwide PEFA scores (as a proxy for PFM performance) that was conducted at that time showed that PFM performance tended to improve with country income levels (Figure 3). The analysis also reached the same conclusion with respect to procurement, because the worldwide procurement risk ratings based on the PEFA-related procurement indicator at that time (PI-19) showed that procurement performance (average procurement score) tended to improve with country income, from an average of 2.19 in worldwide low-income countries (LICs) to 2.65 in UMICs (footnote 5).[9]

The findings gathered from PEFA on PFM performance appeared to support the focus on UMICs, at least in theory. However, GPEDC's 2019 progress report revealed that (i) the global average of development partners' UCS notably increased for lower middle-income countries (LMICs) rather than for UMICs (Figure 4); and (ii) such increase seemed to largely reflect greater reliance on loans to deliver development cooperation, especially since the share of disbursements to the public sector in the form of loans (as opposed to grants) rose from 30% for LICs to 74% for LMICs) (footnote 7).

Figure 3: PFM Performance by Country Groups, Worldwide, and ADB



ADB = Asian Development Bank, DMC = developing member country, HIC = high-income country, LIC = low-income country, LMIC = lower middle-income country, PEFA = Public Expenditure and Financial Accountability, PFM = public financial management, UMIC = upper middle-income country.

Note: Average PEFA scores were calculated for different country groups and countries using the *Adjusted World Bank Approach for Assessing Fiduciary Risks*. PEFA scores range from A (4) low risk to D (1) high risk.

Source: An elaboration of data from PEFA Secretariat. 2014 PEFA Performance Indicator Scores of Completed and Final Draft National Level PEFA Based Assessment Reports. Unpublished.

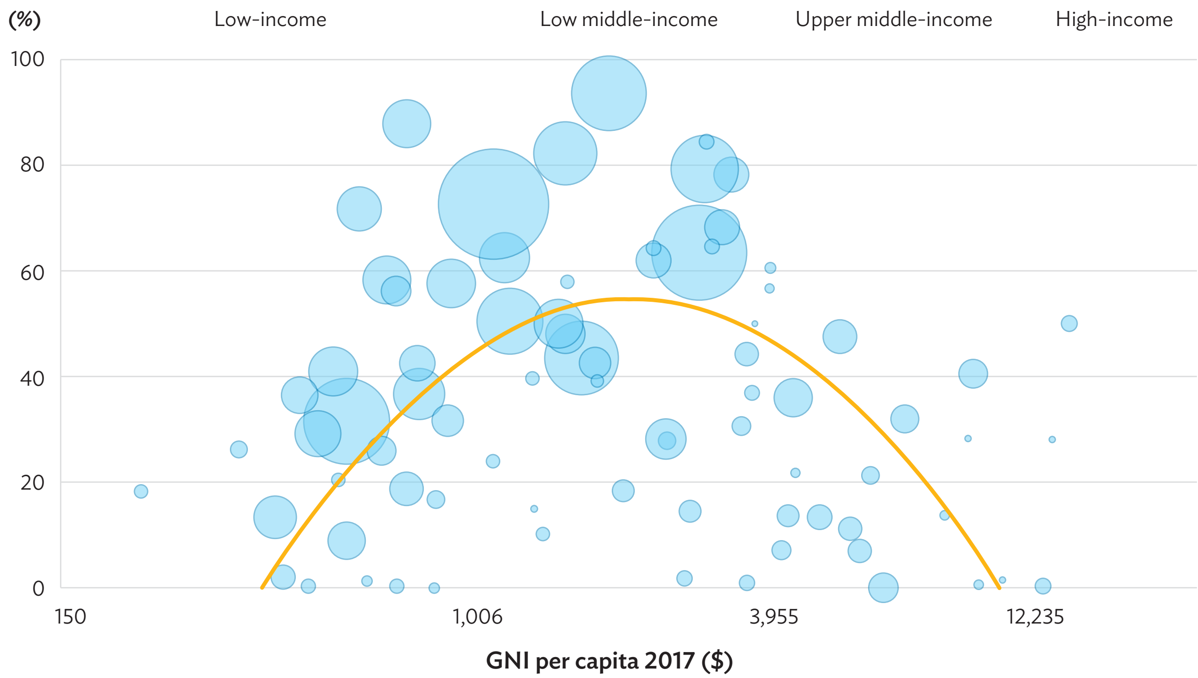
[9] The PEFA program assesses the condition of country public expenditure, procurement, and financial accountability systems. Of the 93 countries worldwide for which PEFA scores were publicly available at that time, 24 were ADB DMCs. The PEFA scores for an additional two DMCs (Azerbaijan and Kazakhstan) were not publicly available then but were obtained separately.

Other factors also appeared to influence this trend, such as the presence of small island developing states (SIDS) that were either classified as UMICs or high-income countries (HICs) but still faced PFM capacity challenges. Thus, strong PFM systems do not necessarily lead to greater reliance on country systems and country income classifications are not, by themselves, sound determinants for development partners' reliance on country systems. In fact, although ADB's 2015 paper focused on UMICs, it still recognized that variable risk ratings can still exist among UMICs, and that some UMICs posed higher fiduciary and governance risks than others, and hence were not suitable candidates for UCS. It also called for a context-specific approach for each DMC, consistent with the strengths of a country's systems and capacities, and the demand for the use of its systems in ADB operations (footnote 5).

ADB's 2015 paper also reflected several lessons learned from the World Bank's earlier efforts to pilot UCS on procurement, such as the limitations of the methodology used by World Bank to determine equivalence and acceptability of country systems. It also cited the following observations in ADB operations (footnote 5):

- The use of country PFM systems in ADB operations decreased from 70% in 2012 to 67% in 2013.
- The use of country procurement systems in ADB operations decreased substantially from 48% in 2012 to 33% in 2013.
- The use of country PFM and procurement systems varied widely in the six UMICs covered by the paper (i.e., Fiji, India, Indonesia, Kazakhstan, the People's Republic of China, and Sri Lanka), and UCS was minimal (less than 1%) in most of them.

Figure 4: Use of Country Systems Plotted against Gross National Income per Capita



GNI = gross national income.

Notes: Shaded areas correspond to World Bank income classifications (GNI per capita, 2017): low-income is up to $1,006; lower middle-income is up to $3,955; upper middle-income is up to $12,235; high-income is above $12,235. Circle surfaces are proportional to disbursements (grants and loans) of all development partners in a given country. The figure also plots a quadratic fit (statistically significant, R-squared: 0.32) showing a positive correlation between the use of country systems and GNI per capita until (on average) a GNI of about $1,752, after which a negative correlation between use of country systems and GNI per capita (on average) is shown thereafter. Calculations are based on 80 partner countries participating in the 2018 Monitoring Round for which data on the use of country systems are available.

Source: GPEDC. 2019. Draws on Assessment of Use of Country Public Financial Management Systems (Indicator 9b); see also GPEDC. 2018. *2018 Monitoring Guide for National Co-ordinators.* pp. 58–61.

In line with these observations, ADB's 2015 paper raised two important recommendations:[10]

(a) **Monitoring and reporting on use of country systems.** Although ADB has been monitoring the use of country PFM and procurement systems through its development effectiveness reports since 2013 (in line with its commitments to international aid effectiveness declarations), ADB's 2015 paper noted that ADB needed to develop a more systematic approach to sustain improvements.

(b) **Strengthening governance risk assessments.** ADB's 2015 paper also noted that ADB needed to introduce more rigor in its governance risk assessments and risk management plans, as the diagnostics used at that time identified neither the risks of using country systems, nor the dimensions of country PFM and procurement systems that can be relied on.

Monitoring and Reporting on the Use of Country Systems

ADB has been monitoring and reporting on its organizational performance through its annual development effectiveness reports. ADB's Corporate Results Framework, 2019–2024 (CRF) serves as the yardstick for its development effectiveness reports. The CRF therefore gives a good idea of how ADB assesses its corporate performance against its strategic priorities.

Given the importance placed by ADB's 2015 paper on systematically monitoring progress, it would be reasonable to expect ADB's CRF to provide some high-level indicators to guide its progress toward UCS. Unfortunately, the CRF only uses the following indicators at the operational management level: (i) operations using country procurement systems, and (ii) contracts using government e-procurement systems.[11] As these are the only indicators pertaining to governance-related UCS under the results for operations supporting poverty reduction and inclusiveness, one may note the absence of a specific indicator covering PFM systems. An opportunity therefore exists for ADB to pursue the recommendation in its 2015 paper—to develop a more systematic approach to monitor and report on the use of country PFM systems.[12]

Strengthening Governance Risk Assessments

In terms of its country assessments, ADB has recently improved its approach and methodology for assessing governance risks and development opportunities at the country and sector levels. This effort was meant to improve the rigor of ADB's implementation guidelines and diagnostic tools to better analyze country PFM and procurement systems, identify the risks of using such systems, and introduce a systematic pathway toward institutional development and UCS. In 2022, ADB issued the new *Staff Guidance on Governance Assessments* which has strengthened the identification and definition of governance risks within the context of ADB's Second Governance and Anticorruption Action Plan (GACAP II) and in line with Strategy 2030 Operational Plan for Priority 6. The staff guidance has also enhanced the development approach of ADB's governance assessments and distinguished these from fiduciary risk assessments. It has also created a clearer link between the governance assessment and other diagnostic tools, and ADB's country partnership strategies. Based on the findings of the assessment, a holistic country system strengthening pathway is now required to be formulated to outline key actions that will strengthen a DMC's PFM and procurement systems. In turn, these pathways will inform ADB's country partnership strategies and will be monitored during annual country programming missions.

Further to its governance-related initiatives, ADB is also developing an integrated fiduciary risk assessment (IFRA) approach that involves the development of a country, sector, and/or agency financial management assessment methodology. The IFRA will incorporate ADB's existing country and sector procurement risk assessment.[13] It aims to ascertain the level of fiduciary risk that ADB faces when financing projects of its DMCs and assist in identifying areas of country PFM and procurement systems that require strengthening, particularly by providing key inputs to the governance assessment.

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[10] Footnote 5, p. 7.

[11] ADB. 2019. *ADB Corporate Results Framework, 2019–2024*. Manila. ADB's 2021 Development Effectiveness Review (May 2022) reported that, in 2021, contracts that used electronic government procurement systems reached $3.6 billion, which is a 20% decrease from $4.5 billion in contracts processed before the pandemic and from $4.6 billion in 2020. It also reported that, in 2021, the use of country procurement systems shrank from 76% in 2020 to 57% for ADB sovereign operations overall and from 76% to 14% for concessional assistance.

[12] ADB plans to further develop this indicator.

[13] ADB. 2020. *TA Report 54162-001: Integrated Fiduciary Risk Assessments and Strengthening Country Systems.* Manila.

The PFM and procurement thematic areas of ADB's governance assessment focus on the following six major components: budgeting, treasury, accounting, auditing, reporting, and procurement. These are consistent with the OECD's list and definitions of the components of national PFM systems that development partners can use at different stages of the budget cycle (footnotes 1 and 8). The governance assessment also uses these major components to capture an aggregate picture of the extent to which ADB's operations within its DMCs use country PFM and procurement systems. A glance at ADB's governance assessments for seven of its DMCs from 2021 to the first quarter of 2023 reveals a more nuanced perspective of UCS across the six major components (Table 1).

The following interesting observations can be drawn from Table 1:

(a) The governance assessments conducted within the covered period reveal that ADB tended to rely mostly on the budget planning and preparation systems of its DMCs. These are closely followed by DMCs' accounting, reporting, and treasury systems which include any treasury single account (TSA) that may exist in a DMC, and by their auditing systems. The results of these governance assessments show that DMCs' procurement systems appeared to have the lowest levels of use.[14] Interestingly, the major components that reflect the highest levels of use by ADB match those that the OECD highlights as minimum-use requirements, which are the planning, budget, and reporting systems of a partner country. According to the OECD, these components promote a level of transparency that is essential for country ownership of ODA, alignment of aid, donor harmonization, managing for results, and mutual accountability (footnote 8).

(b) The level of use appears to roughly match the amount of development financing and the support that ADB provides to a DMC. DMCs with larger commitments tend to reflect higher levels of UCS. For instance, India, which has the largest aid commitment in the group ($57.65 billion as of April 2022), also reflects the highest UCS. On the other hand, Armenia, which has one of the lowest aid commitments in the group ($1.60 billion as of April 2022), reflects the lowest UCS. Timor-Leste comes out as an exception because it has the lowest aid commitment in the group ($671.45 million as of April 2022), but it still reflects the third highest UCS (below India and Viet Nam, and above Kazakhstan). Because Timor-Leste falls under the fragile and conflict-affected situation (FCAS) and SIDS categories, it also appears to be an exception to the observation that UCS in SIDS tends to be low due to capacity challenges such countries face in setting up and operating PFM systems that can manage financial flows from various development partners (footnote 7).

(c) In any case, the general observation on the correlation between the amount of development support commitments and UCS appears consistent with the findings of the GPEDC—increases in development partners' funding to the public sector have also increased their use of country PFM systems (footnote 7). From these figures, it could be argued that one reason why DMCs with higher values of commitments also reflect a greater UCS is that they have benefited more from projects, programs, and technical assistance aimed at strengthening their PFM and procurement systems. However, such an argument would not be consistent with the broader findings discussed earlier (in relation to Figure 2) that no link appears to exist between country system strengthening measures and the use of such country systems, regardless of whether these benefited from ODA. It seems that a more plausible explanation could be found in GPEDC's report, which states that such a situation could indicate that when development partners are firmly set on working with the public sector, they are also set on strengthening and using national systems (footnote 7).

(d) With the exception of Timor-Leste, the level of UCS for each DMC appears to coincide with the length of the country's development engagement with ADB. DMCs that have been ADB members for a longer period tend to reflect higher levels of UCS. While this correlation seems to run parallel with the levels of ADB's aid commitments, it needs to be discussed separately because it involves a different set of dynamics than those pertaining to development financing. A longer period

[14] Each major component involves a different set of risk factors.

Table 1: ADB Governance Assessment Findings on Use of Country Systems, 2021–2023

Comp. DMC	Budgeting	Treasury	Accounting	Auditing	Reporting	Procurement
India (LMIC) $57.65 billion[a] Member since 1966	Fully used	Fully used	Fully used	Partially used	Fully used	Partially used
Viet Nam (LMIC) $17.69 billion[a] Member since 1966	Not used	Partially used	Fully used	Fully used	Fully used	Partially used
Timor-Leste (LMIC) $671.45 million[a] Member since 2002	Partially used	Partially used	Fully used	Not used	Fully used	Not used
Kazakhstan (UMIC) $6.55 billion[a] Member since 1994	Not used	Partially used	Partially used	Partially used	Partially used	Not used
Kyrgyz Republic (LMIC) $2.41 billion[a] Member since 1994	Fully used	Not used	Partially used	Not used	Partially used	Not used
Azerbaijan (UMIC) $5.21 billion[a] Member since 1999	Fully used	Partially used	Not used	Not used	Not used	Not used
Armenia (UMIC) $1.60 billion[a] Member since 2005	Fully used	Partially used	Not used	Not used	Not used	Not used
Total fully used	4	1	3	1	3	0
Total partially used	1	5	2	2	2	2
Total not used	2	1	2	4	2	5

ADB = Asian Development Bank, DMC = developing member country, LMIC = lower middle-income country, UMIC = upper middle-income country.

[a] ADB's cumulative commitments for loans, grants, and technical assistance as of April 2022, including ADB-administered cofinancing, equity investments, and private sector programs. Commitment means financing approved by the ADB Board of Directors or Management for which the legal agreement has been signed by the borrower, recipient, or investee company and ADB.

Note: The OECD Development Assistance Committee policy brief on *What are the Benefits of Using Country Systems* states that, in order for aid to "use country systems," it has to pass through some or all of the components of existing mainstream national systems; respect the same laws, rules, procedures, and formats; and be managed by the same institutions. Aid can "use" different components of a country's PFM system, such as those considered in this table (budgeting, treasury, accounting, auditing, reporting, and procurement).

Source: Asian Development Bank staff's elaboration based on governance assessments conducted from 2021 to 2023.

of development engagement between ADB and a DMC can encourage a deeper level of understanding and trust of each other's policies, priorities, and operating environments, including nuanced fiduciary risks at the operational level within specific sectors. In turn, such understanding and trust can serve as the foundation for greater UCS. This view is best expressed by GPEDC as follows:

> Building trust takes time. So does identifying both shared priorities and areas for potential, larger scale development cooperation programs to justify initial transaction costs in starting to use country systems. Moreover, using country systems might require both the development partner and partner country to first better understand each other's relevant institutional arrangements and legal provisions.[15]

(e) There appears to be no correlation between a DMC's status as a UMIC and the amount of reliance on its national systems. For example, Azerbaijan and Armenia are both UMICs, but they both have the lowest levels of UCS. This appears to confirm the earlier observation that the global average of development partners' UCS does not necessarily align with a country's status as a UMIC (in relation to Figure 4).

Why is there a reluctance to use country systems?

In 2005, the World Bank took a significant step toward UCS by implementing a pilot program to use a country's procurement system in its operations. The methodology for the pilot program was approved in April 2008, and its formal implementation covering 17 countries started in 2009. The methodology involved three rigorous stages: (i) an assessment of countries' procurement system through a MAPS exercise; (ii) an assessment of such systems' consistency and equivalence with the World Bank's own procurement policies; and (iii) an assessment of compliance, performance, capacity, and fiduciary risks at the sector and executing agency levels. By 2010, the World Bank eventually admitted that the pilot program had proved to be challenging and had not been a success from the perspective of its original objective.[16]

The experience gained from the World Bank's pilot program to use country procurement systems generated several lessons that would prove to be highly informative for the broader UCS discourse in the succeeding years, particularly in the governance space. For instance, the World Bank itself reported that countries that participated in the pilot found that (i) the requirements were too stringent and mechanistic, (ii) the all-or-nothing process prevented countries to progress and adjust incrementally, and (iii) the approach was too onerous and detailed to be practical.[17] Subsequent stakeholder consultations also revealed that private sector contractors and suppliers had actually favored the use of the World Bank's systems over country systems because the World Bank's systems were perceived to have embedded safeguards (footnote 16). Interestingly, an important conclusion that the World Bank has drawn from its experience is that the area of contention is not necessarily the systems of multilateral development banks (MDBs) versus country systems, but rather the advantages of using MDBs' systems, with the concomitant benefits of experience and transparency.[18] The World Bank further pointed out that the adjustment of MDB processes to provide greater upstream and downstream support, raise efficiencies, and better define accountabilities could help ease the move toward country systems (footnote 18).

The World Bank's experience highlights two important challenges to UCS. The first pertains to the use of stringent preconditions and assessment methodologies, while the second pertains to the preference of stakeholders to use the systems of development partners. The former pertains to challenges that arise from the side of a development partner, while the latter focuses on challenges that arise from the side of an ODA-recipient country. These are two different perspectives that will be discussed separately.

[15] Footnote 7, p. 117.
[16] World Bank. 2014. *The World Bank and Public Procurement – An Independent Evaluation. Volume II: Achieving Development Effectiveness through Procurement in Bank Financial Assistance.* Washington, DC. p. 12.
[17] Footnote 16, pp. 25–28.
[18] World Bank Group. 2014. *The World Bank Group and Public Procurement: An Independent Evaluation.* Washington, DC. p. 18.

Reluctance among Development Partners to Use Country Systems

Although the World Bank's pilot exercise on the use of country procurement systems has been terminated, its initial approach toward assessing the equivalence and consistency of a country's systems as a gauge for acceptability reflects a deeper concern about fiduciary risks and country contexts. This concern was clearly laid out as early as 2009 in the World Bank's first progress report on the pilot program, where measures were proposed "to maintain the Bank's fiduciary oversight."[19] This is a natural area of interest on the part of development partners, and subsequent reports continue to highlight its importance. For instance, ADB's 2015 paper on promoting UCS stressed the importance of fiduciary requirements and flagged the lack of equivalence as a major factor that made it unfeasible for ADB to adopt a uniform approach to UCS (footnote 5). Further, in its 2010 survey on donor preferences and practices on UCS, the OECD found that 56% of donor agency respondents indicated that operational and fiduciary risks presented a constraint to UCS (footnote 8).

In addition to fiduciary risks, the OECD also reported that several donors raised other concerns such as the "critical view of parliament," the reluctance caused by persistent political and reputational risks, macroeconomic instability, weak political commitment in partner countries to implement important reforms, and corruption in the public sector (footnote 8). Reports and perceptions of corruption are a strong disincentive to UCS, not only because corruption can be regarded as a symptom of PFM weakness, but also because development partners are naturally sensitive to the misuse of funds (footnote 2). Other disincentives can also include the diversion of aid to other objectives, potential delays from using country systems, democratic processes, human rights, inadequate presence of a pro-poor stance, and political governance. For instance, the United States Agency for International Development employs a democracy and governance assessment, while the African Development Bank looks at a government's commitment to poverty reduction, political stability, and macroeconomic stability, alongside a fiduciary risk assessment.[20]

It is thus evident that varied reasons can exist for the reluctance of a development partner to fully use a specific country's systems. To complicate matters, each development partner can have its own thresholds for each of the risks identified, based on its own organizational objectives and priorities, policy frameworks, and political commitments. These same considerations and thresholds naturally influence and frame any rigorous country assessment that could be linked to a UCS-related decision, even if, based on the OECD's survey, almost all donor policies encourage UCS or require "maximum use of country systems" (footnote 8). There is indeed a need to strike a balance between a transaction compliance culture that primarily aims to meet project-level fiduciary requirements and the development objective of systematically building national institutional capacities through UCS (footnote 5). Unfortunately, despite repeated commitments of development partners to achieve greater UCS, the progress in using such systems is reportedly slow (footnote 2).

Reluctance among Stakeholders to Use Country Systems

It seems natural to assume that, while development partners may show a level of reluctance to use country systems, particularly from a fiduciary perspective, governments tend to prefer the use of their own systems for PFM and procurement operations. Possible reasons for such preference may be familiarity with national processes; the avoidance of having to learn and apply two systems; a sense of having a "home-court advantage"; or favorable national legal provisions, such as public bidding rules that favor domiciled entities, national dispute resolution mechanisms, and domestic preferences in public contracts. However, this is not necessarily the case, and the OECD reported that some countries do not always want development partners to use their national PFM systems for the provision of aid (footnote 8). Some reasons given by governments for not preferring their own systems pertained to the extent of due diligence checks performed by development partners, the time it can take to reach an agreement on UCS, the perceived assurance of funding, and the additional workload associated with UCS, such as the burden of control over fund execution or additional reporting requirements (footnote 8).

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[19] World Bank. 2009. *Use of Country Procurement Systems in Bank-Supported Operations: First Progress Report on the Piloting Program*. Washington, DC.

[20] See footnote 2, p. 35.

There may also be cases where country systems are not themselves standardized, especially in countries with federal governments, and where federal legislation and state legislation are not harmonized. This specific scenario was reported by the World Bank's Independent Evaluation Group (IEG) (in its analysis of the procurement UCS pilot program) as another reason why some governments preferred donors' systems (footnote 16). The World Bank's IEG also reported that some clients perceived that suppliers were more responsive to tenders under the World Bank's guidelines, especially in international competitive bidding, and that procurements under the World Bank's mantle gave a competitive advantage (footnote 16).

The World Bank's IEG further mentioned that private sector contractors and suppliers clearly favored the use of World Bank's procurement systems over country systems because they perceived these as having embedded safeguards that help maintain equal opportunities (footnote 16). Suppliers and contractors pointed out that the World Bank's procurement system provided greater transparency and assurances of integrity, more efficient payment, and effective recourse in cases of complaints, and that it saved them from the administrative burdens of government processes.[21] Such observation highlights the impact that corruption vulnerabilities can have on both the quality of PFM and procurement systems, and the level of stakeholder confidence on these systems. It may also lead one to ask how development partners should respond to the challenges posed by integrity issues. For example, should they prioritize supporting the government in developing and implementing stronger country systems or should they instead increase fiduciary measures at the project level? Relatedly, is there some sort of middle ground where fiduciary requirements can be balanced with development priorities and progressively adjusted as country strengths increase?

A closer look at each of the reasons given by government counterparts and the private sector for their reluctance to use country systems shows that these could be placed in either of two categories: (i) concerns about weaknesses in a country's systems, such as those pertaining to corruption vulnerabilities, nontransparent processes, a lack of harmonization between federal legislation and state legislation, gaps in complaint mechanisms, payment delays, and burdensome administrative processes both on the management of funds and the processing of claims; and (ii) concerns about the conditions and requirements imposed by development partners before country systems can be used, such as the extent of due diligence checks required, the effort to reach an agreement on UCS, and the additional compliance and reporting requirements. A further analysis of these reasons also reveals that the first category generally deals with private sector concerns, while the second category generally deals with the concerns of government counterparts. This distinction is important, because it helps one to appreciate the various perspectives and contexts that underpin a reluctance to use country systems. Relatedly, it is apparent that the second category, which relates to the difficulties experienced by governments on the extent of due diligence checks, touches on the same challenges discussed earlier with respect to the reluctance of development partners.

A Battle of Perspectives?

It is important to focus on the reasons given for the reluctance to use country systems, rather than on the reluctance itself, because these reasons will help identify the practical causes for the slow progress of UCS. It also helps us to avoid the trap of thinking that a preference for development partners' systems, especially on the part of in-country stakeholders, equates with better development outcomes, because it reminds us that the benefits of UCS are institutional and long-term, rather than project-specific and short-term. We also need to remember that even if the reluctance to use country systems comes from different sides of the table, whether from development partners or in-country stakeholders, it can be rooted in common issues, albeit viewed from different angles. For instance, perceived weaknesses in a country's PFM systems can lead a development partner to introduce stringent fiduciary preconditions for UCS, which in turn lead to a rather short-term preference by government counterparts to choose an easier route of using the systems of development partners to administer ODA, which then leads back to the reluctance of both parties to move out of their comfort zones. This resembles a circular causality that draws one's attention away from the key concern that exists at the middle, that is, the opportunity for the country to strengthen its governance-related systems and environment in a holistic and inclusive manner. It deprives the

[21] See footnote 16, p. 28.

government of the valuable long-term lessons and benefits that can only be gained from the experience of using their own systems to manage ODA and maintains an environment where private sector contractors and suppliers continue to favor foreign-assisted projects over those funded by the national budget.

In some instances, the circular causality of issues seems to be compounded by an outright dichotomy between a reluctance to use country systems and the actual state of such systems, especially when these have been strengthened through organically owned reform programs. ODA in Azerbaijan stands out as a good example of such dichotomy. One PFM component where the Government of Azerbaijan has been exhibiting notable strengths is in its treasury operations, in relation to the specific PEFA dimension that looks at whether a government has established a TSA, or accounts that are centralized at a single bank (usually the Central Bank), to facilitate the consolidation of bank accounts and through which the government transacts every receipt and payment.[22] Azerbaijan has consistently held a score of "B" for this dimension in both its 2008 and 2014 PEFA performance reports, because it has been maintaining a TSA where cash balances are calculated daily and consolidated, and the State Treasury Agency manages a system of regional Treasury offices that use TSA subaccounts for transactions.[23] Further, the State Treasury Agency manages the Treasury Information Management System (TIMS), which is a centralized system that captures all account information across all ministries and agencies, and ensures that detailed data on budget execution is available based on information from each budgetary institution. However, despite these strengths, international financial and credit organizations continue to prefer to channel their project funds through commercial bank accounts outside of the TSA. Ironically, the reluctance of international financial and credit organizations to channel their funds through the TSA, despite the TIMS, is a factor cited by the 2014 PEFA that prevents Azerbaijan from garnering an "A" score for this particular dimension. Relatedly, Table 1 shows that Azerbaijan's treasury system is only partially used by ADB.[24]

In other cases, government counterparts have themselves reached out and expressed an interest to be more engaged in the administration of foreign-assisted projects, thus creating entry points for meaningful UCS that benefits from a government's own initiative to lead the process. For example, during one of ADB's recent governance assessment consultations, officials from a DMC's Chamber of Accounts expressed an interest and readiness to undertake joint compliance and performance audits for ADB-financed projects, and to gradually build their institutional experience and capacity to audit foreign-assisted projects.

These two examples show that there are instances where governments do manage to establish strong PFM systems that can accommodate external financial flows, or at least demonstrate an interest to expand their capacity to handle external financing; however, these are not always matched by well-timed complementary efforts from development partners. This lack of alignment can emanate from a difference in perspectives or priorities surrounding country systems and can lead to missed opportunities. It also shows that, to successfully achieve UCS, all the key players would have to focus on an outcome that can be considered from a common vantage point. Given the various reactions we have seen so far on UCS, such outcome needs to go beyond merely setting UCS as an objective by itself.

The way forward

To effectively embark on a meaningful journey toward UCS, we first need to clearly mark a point from where to start such journey. Since UCS pertains to an acceptance by development partners of the systems of ODA-recipient countries, the best starting point would be to look at how specific development partners approach and measure UCS in relation to their respective organizational strategies, systems, and processes. This would need some introspection on the part of a development partner, and one question it can ask itself is whether it has seriously been pursuing UCS as part of its development strategy and acknowledging its long-term impact in areas such as country

22 PEFA Secretariat. 2019. *Framework for Assessing Public Financial Management.* Second edition. Washington, DC. p. 61.

23 World Bank Group. 2014. *Azerbaijan Public Expenditure and Financial Accountability Performance Report: Repeat Assessment*. p. 67.

24 In some ongoing ADB projects approved prior to 2011, the advance account procedure (formerly called the Imprest account procedure) is used for smaller payments, while for large amounts, the direct payment is used. Under the advance account procedure, the executing or implementing agency opens and maintains a dedicated account in a commercial bank acceptable to ADB.

ownership, institutional capacity and sustainability, and government accountability for development outcomes. To answer this question, we can consider how a development partner regards UCS in its results measurement framework, such as the extent to which its results indicators incorporate UCS to track its operations and measure performance. For example, it was already mentioned earlier that ADB's CRF measures the use of country procurement systems and the use of government e-procurement systems under operational management, and that there is no specific indicator on the use of country PFM systems. Similarly, the African Development Bank has indicators to measure procurement contracts using national systems under Level 3 of its Results Measurement Framework on effectively managing operations.[25]

By establishing clear organizational targets and reflecting these in its results measurement framework, a development partner can categorically convey its strategic UCS objectives and commitments to its country teams and match these with the development priorities of its partner governments and other stakeholders. To avoid the temptation of adopting a top–down approach that proceeds from a development partner's operational priorities, the pursuit of these UCS commitments needs to be anchored on a governance and development program that addresses the unique challenges of each partner country. It will thus require a significant amount of effort on the part of the development partner to translate its organizational results framework indicators effectively and efficiently to country-level strategies. Such effort will involve (i) the assessment of governance risks and identification of opportunities to strengthen PFM and procurement systems at the country partnership strategy level, (ii) the rollout of systems strengthening pathways and action plans that are context-specific to each partner country, and (iii) the design of project implementation arrangements that are paced with the level of progress in each country.

The World Bank's procurement UCS pilot program has shown the difficulties of a top–down approach that focuses on equivalence with standards laid out by development partners. Given the difficulties reported by countries that participated in the pilot program, one can see how this experience had been a major factor influencing the reluctance of governments to use their own PFM and procurement systems for ODA, especially if one looks at the reasons given for such reluctance, like the extent of due diligence requirements and the time involved to reach an agreement on UCS. Learning from this experience, a development partner that wishes to significantly progress in its UCS may need to approach UCS with a different mindset, where adequate focus is given to the development aspects of the exercise in relation to risk identification, mitigation, and management. A development partner would also have to ensure that all stakeholders in the country are engaged in each step of the journey, including central ministries, line agencies, the private sector, and civil society. A number of practical measures can be adopted to facilitate the journey for all parties and stakeholders, and these can be applied at two levels: (i) country and sector levels, and (ii) project level.

Approaching Use of Country Systems at the Country and Sector Levels

An important tool that a development partner can use to introduce UCS at the country and sector levels is a governance-related assessment that informs its country partnership or development strategy. Such a tool would look at various governance-related risks that may compromise development and poverty reduction objectives in a country, and would at least cover PFM, procurement, and anticorruption mechanisms, as well as other related themes such as citizen engagement, FCAS, and SIDS. An example of this would be ADB's GACAP II and its related governance assessment approach, which covers the same themes. Since such an assessment would generally be risk-focused, a number of adjustments may be applied to balance the risk perspective with a development approach, and to carefully incorporate a UCS objective. Some of these adjustments are the following:

(a) Although the methodology would still primarily assess governance-related risks, it would need to equally highlight the strengths and weaknesses of a country's PFM and procurement systems, as well as any ongoing and pipeline reforms to build capacity and improve legal, regulatory, and institutional frameworks, and align these with external resources and technical support that may be available to the country. These nuanced aspects will help ensure that the assessment adequately captures a picture that is context specific. Internationally recognized standards

[25] African Development Bank. 2017. *The Bank Group Results Measurement Framework, 2017–2025*. Abidjan, Côte d'Ivoire.

could certainly be used to establish criteria and performance indicators, such as those found in the PEFA and MAPS methodologies, but these should be presented as high-level objectives rather than prescriptive measures that a government would need to follow. For instance, PEFA dimensions can be applied to define the adequacy of a treasury system, flag the importance of a TSA or a similar arrangement, and indicate that such a system should effectively facilitate budget control, as reflected by a high expenditure outturn and minimal variations in expenditure composition. If a government's PFM systems reflect these dimensions, then it may be regarded as robust under international standards, especially if it is supported by an information management system, regardless of any specific requirements that are laid out in a development partner's disbursement handbook.

(b) The context-specific assessment would need to be followed by an equally contextualized pathway that will support systems strengthening in a country, particularly those on PFM and procurement. This pathway will effectively match various strengths in a country's systems with remaining gaps; flag the risk levels these gaps pose from a governance perspective; and consider how such risks will be addressed, mitigated, or managed by the ongoing or pipeline reform programs and external technical assistance. It then needs to propose an action plan to address the remaining gaps, and support further strengthening measures that can feed into the development partner's development strategy with the country and be monitored. This contextualized approach is consistent with the OECD's view that good practices in UCS are very much defined by specific circumstances and priorities in the countries receiving external financing.[26]

(c) The presence of strong PFM and procurement systems does not necessarily mean that such systems can be automatically relied upon by development partners. Various other risks are considered by a development partner, such as fiduciary risks, macroeconomic risks, integrity risks, and reputational risks. The OECD's *Practitioner's Guide on Using Country PFM Systems* outlines these risks, and a closer look at each would show that they cannot be completely resolved by strong PFM and procurement systems. For example, even if a country manages to pass a procurement law that meets international standards and that allows international contractors and suppliers to compete in open competitive biddings, a closer look at agency practices may reveal that direct contracting is still being used for a majority of contracts or that selected firms are still being favored, and that these practices discourage competent firms from participating in national public biddings. Even when country PFM systems feature strong budget control requirements, as well as a sound procurement environment, the reluctance of a development partner can still be driven by cases or perceptions of corruption, or even by decisions taken by a government to leave international initiatives or partnerships that promote good governance. The importance of internal and external audit systems also needs to be highlighted, because a strong national oversight function can help increase stakeholder confidence and impact UCS decisions.

Each development partner can have its own set of considerations and priorities that can ultimately influence its decision to use a country's systems. In this scenario, it may not be practical to apply a single set of standards that development partners would need to consider, or even suggest a harmonization of conditions. The argument for contextualized approaches applies to countries and development partners alike. Recognizing the importance of contextualization, a more practical approach would be for a development partner to clearly indicate and define the various risk factors it considers, not only for a particular country, but also for the specific sectors in that country with which it is engaged. This should be accompanied by a set of indicators that, if met, would lead to an increased confidence in a country's systems. These indicators should not be mistaken for prescriptive measures, and they should not take the form of equivalence or acceptability standards. Instead, they should focus on the types of risks that a development partner considers as crucial if it were to use a particular country's systems.

The identification and definition of UCS-related risk factors and indicators would help a government to better understand the impediments to an increased reliance on

[26] See footnote 8, p. 15.

its systems, at least for its key development partners, and would help it to address such impediments in a more systematic manner. For instance, if a development partner flags a country's ranking in Transparency International's Corruption Perceptions Index (CPI) as an indicator of corruption that impacts its decision to rely on a government's systems, regardless of the strengths of its PFM and procurement institutions and practices, then the government would be better informed and can even consider addressing the underlying corruption issues that impact its CPI ranking. On the other hand, if a development partner is not comfortable with sensitive political risks in a country and feels that a reliance on such country's systems can create reputational risks, then it would either have to reconsider its entire approach to UCS, in relation to its international commitments, or consider the practicality of using selected components of that country's systems where the impacts of such political and reputational risks are limited.

(d) The OECD stresses that the use of a country's PFM systems is not an "all-or-nothing" approach, and that a development partner can use some or all components of such systems in specific sectors or institutions, as appropriate.[27] It further points out that development partners can opt to use country systems in varying degrees across ODA flows or for any single program or project. Donors can opt to (i) use only some of the components of the country PFM systems; (ii) limit the degree to which each component is used; and (iii) use a mix of modalities across their programs, each of which uses country systems to a greater or lesser degree.[28] This approach is also emphasized in ADB's Strategy 2030 Operational Plan for Priority 6, which states that ADB can move progressively toward using country systems based on agreements between DMC governments and development partners.[29] This is an important matter to note, because it highlights three things: (i) even if a development partner faces sensitive political, corruption, and reputational risks in its decision to use a country's systems, it still has the option to use aspects of these systems that are not directly impacted by such risks, like those on budget planning and reporting, or to even partly use other components; (ii) when risks impact specific sectors in a country, but not the others, then a development partner can use more of a country's systems in the sectors that pose lesser risks; and (iii) when UCS is applied flexibly across components and across sectors, it can better perform a development role by allowing systems to gradually develop in a manner that is in step with the experience gained within both central and sector-specific agencies. For example, Table 1 not only shows that ADB has been taking a selective UCS approach across components within specific country contexts, but also that its UCS generally tends to deepen and expand to other components as its development assistance grows within each of its partner countries.

Some PFM components are more important than others in terms of country ownership, and some components are less prone to fiduciary and integrity risks than others. For instance, the OECD stresses that, at a minimum, all assistance programs, regardless of modality, should be reflected in a partner country's planning and budgeting documentation, not only because it is important for budget transparency, but also because it assures that the government has a comprehensive overview of all the resources used to deliver public goods and services.[30] The OECD further notes that development assistance that is reflected "on plan" and "on budget" carries neither risks nor costs to development partners; on the other hand, fully using country planning and budgeting systems to program ODA (i) enables countries to improve their macroeconomic management as well as transparency and accountability in the budget process, and (ii) contributes to improved policy coherence and efficiency of allocation (footnote 8). In contrast, the level and potential impact of fiduciary and integrity risks increases as we move toward budget execution systems, particularly with respect to procurement operations and contract management, because these are the areas where government agencies directly deal with third parties.

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27 See footnote 8, p. 29.
28 See footnote 8, p. 46.
29 See footnote 4, p. 19.
30 See footnote 8, p. 49.

Given the focus on systems and institutions, one might be led to think that the key actors needed for UCS to succeed are just the government and the development partner. However, it is important to remember that one key element of governance is participation, and that the value of participatory approaches appears in various stages and aspects of a country's PFM and procurement systems. For instance, development partners and governments alike have flagged the benefits of consulting with civil society organizations (CSOs), communities, and citizens during the preparation of the national budget so that it adequately reflects the needs of communities and disadvantaged sectors, as well as the benefits of partnering with CSOs and communities to observe public biddings and monitor contract implementation. Through its governance assessment consultations, ADB also identified opportunities to support participatory audits in its DMCs, where interest did not only come from CSO representatives but also from the audit offices themselves. Incorporating participatory approaches in the consideration of country PFM and procurement systems should help increase a development partner's confidence in using such systems, because it increases transparency, participation, and accountability in the administration, management, and execution of ODA. For these same reasons, it can also increase the confidence of in-country stakeholders such as the private sector.

Approaching Use of Country Systems at the Project Level

If a development partner successfully establishes a robust country- and sector-level UCS approach with its government counterpart, and effectively cascades such an approach down to the line ministries and implementing agencies, then a decision to use country systems that flows from such an approach should lead to a decrease in compliance requirements at the project level. Otherwise stated, a transaction control culture at the project level needs to gradually give way to a more strategic reliance on country PFM and procurement systems. This approach will help establish a balance between a development partner's fiduciary requirements and the development objectives of UCS, and minimize the effort of compliance at the project level. In practical terms, line ministries and implementing agencies should not be burdened by a multiplicity of requirements that may serve the purposes of both development partners and their government counterparts but are nevertheless redundant from an operations point of view. For example, if a development partner decides to use a country's accounting and reporting systems for a given sector, then it should be justified in assuming that the government's accounting and reporting requirements adequately capture and reflect the information prescribed in internationally accepted standards, even from a fiduciary perspective, and such development partner should be able to rely on these requirements for the projects it finances in that sector.

Conclusion

A conscious effort to focus on the development aspects of UCS at the country, sector, and project levels presents clear advantages if these are adequately reflected in the relevant country development or partnership strategy. First, the tailored approach of such country development or partnership strategy will naturally infuse country-owned development goals in the UCS approach. At the same time, it contextualizes the entire approach to the realities and operating environment of the country and its relevant sectors. Second, the alignment with the country development or partnership strategy process ensures that the UCS approach becomes a product of meaningful dialogue between the development partner and the government, rather than a top–down determination by the development partner of equivalence or acceptability. This will strengthen the government's ownership of the process and increase its confidence to rely on its own systems, especially if such process is done in a transparent manner. Third, it helps establish a common understanding between the government and the development partner of what UCS is, the risks that need to be considered for each component within specific sectors, how UCS can be achieved in a paced manner, and the implications of UCS for both central ministries and line agencies. Needless to say, this will require a development partner to reevaluate its entire approach to fiduciary and governance risk assessments, and to adjust these so that they are attuned to the development aspects of UCS.

Once both the government and the development partner establish a common and contextualized understanding of UCS and its practical advantages at all levels, as well as the risks that need to be addressed, they can then work toward a holistic strengthening of the country's PFM and procurement systems. This approach will then underpin the deliberate steps that they can jointly take toward increasing reliance and use of such systems. This paced and collaborative approach builds trust between partners, particularly on their respective priorities, systems, and practices, because it is characterized by a commonality of development perspectives coming from the same side of the table.

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https://www.adb.org/publications/series/governance-briefs
ISBN 978-92-9270-316-5 (print)
ISBN 978-92-9270-317-2 (electronic)
Publication Stock No. BRF230345
http://www.adb.org/publications/corrigenda
pubsmarketing@adb.org
ISSN 2520-6591 (print)
ISSN 2520-6605 (electronic)
DOI http://dx.doi.org/10.22617/BRF230345