

Annex F

Terms of reference: Framing Paper on Risks and Risk Management Strategies Associated with the Delivery of International Aid to Fragile and Conflict-Affected Countries

I. Background

The New DAC International Network on Conflict and Fragility (INCAF) has decided to do more detailed work to explore different financing issues during the transition from humanitarian to development activities, as part of its 2009-10 Programme of Work and Budget (PWB).¹ The overall objective of this work is to develop specific recommendations that can enable earlier and faster release of funds during the transition period through allowing for higher tolerance of risk and facilitate more effective implementation. The efforts will be spearheaded by the Financing and Aid Architecture Task Team and the outcomes will feed into the INCAF's intermediate output 1.2, "Progress report on implementing the 2007 High Level Meeting Policy Commitment to improved development effectiveness in situations of conflict and fragility including tracking resource flows."

Recent experiences show the crucial importance of providing and delivering adequate financing to situations of conflict and fragility, to ensure that life-saving activities are continued while at the same time providing targeted peace dividends and livelihood support, and to start building the foundations for sustainable recovery, peace building and state capacity. However, donors have found it difficult to provide such effective and targeted support to countries recovering from conflict for a variety of reasons, including:

- The lack of clarity on how to prioritise between short and medium term activities;
- The existence of different, and often segmented, aid systems and paradigms;

- The different priorities, funding cycles, procurement rules, targets and indicators guiding engagement;
- The particularly difficult coordination and cooperation challenges between different operational and policy communities during the transition period, which would require a shared space between humanitarian and development actors;
- The proliferation and fragmentation of mechanisms at country and headquarters levels in response to urgent priorities and the limited donor field presence;
- The lack of effective procurement procedures that are tailored to the specific transition challenges;
- The lack of consensus on how to ensure that funds can flow freely between different instruments, based on the comparative advantage of each, and how to properly manage the transition points and enable financing of key activities;
- The political bias of aid with regards to who benefits and who implements (*e.g.* influencing power sharing arrangements and the political economy of transition governments), and;
- The lack of neutral partner organisations capable of handling funding inflows.

A particular constraint to the delivery of international assistance is that transitions are by definition risky environments, where the needs are high, the context is complex and capacity to deliver is limited. Crises are often high profile and politically charged both for the country in question as well as the international community. Aid in these situations is easily politicised, and can be powerful incentives as well as subject to conflict dynamics. The risks associated with delivery of aid are thus high, and donors often adopt complicated and process-heavy risk management strategies to compensate for these risks that generate an operational environment that is not well configured to deliver adequate financing to situations of conflict and fragility.

An important part of the Task Team's efforts will thus be to better understand the political economy of aid in situations of conflict and fragility and to uncover the specific risks and risk management strategies that can be applied to ensure delivery of sufficient, flexible, timely and effective aid during the transition period. These efforts will in particular need to take account of and recognise existing principles for engagement and the importance of maintaining minimum but sufficient levels of accountability. The following outlines the terms of reference for a study that explore these issues.

II. Aim and objectives

The overall aim of the study is to develop practical guidance that can help the donor community develop strategies for better identifying, assessing, mitigating and managing risks associated with early release and flexible use of development funds during the transition period. More specifically, the study will produce a framing paper that will inform and help INCAF members understand the following issues:

- Analyse major trends in international engagement in situations of conflict and fragility and how these may influence the relative value of and risks from using different aid delivery tools;
- Identify how donors and agencies are currently approaching and addressing risks, including through specific procedures, timelines involved etc;
- Provide an overview of the political economy of aid during the transition period;
- Identify the main risks and opportunities posed by the transition and by the international community's response, highlighting those risks that cannot realistically be reduced and those risks that are under the control of the development and humanitarian communities;
- Develop a matrix that spells out the various risks, shows how they impact on each other, notes how they are influenced by the different transition contexts (*i.e.* clear victory in a conflict vs. power sharing arrangements), and pinpoints the political implications for donors of taking on the risk, along with specific implications of inaction;
- Make the case for why it is necessary for the donor community to take on more risk in fragile and conflict-affected situations to capitalise on opportunities that might arise and maximise the effectiveness and efficiency of assistance; and
- Provide specific recommendations on what risks can be addressed and suggest specific risk mitigation strategies and measures and the sort of financing and procurement models that could be applied to balance risks and the need for minimum accountability.

The objectives of the framing paper are to promote greater consensus and clarity inside and outside the DAC on how development funds can be released more rapidly and with greater flexibility, and provide specific recommendations that the Task Team can consider when producing guidance on transition financing. In doing this, a key challenge for the consultants will be to make a balanced assessment of the multiple risks involved in

the international community's financial response to transition situations. Decisions will need to be made regarding which risks are unavoidable and what risk threshold might be necessary if the international community is to effectively support a transition with the significant potential improvements and opportunities for development it will usually present. For this to happen, a more detailed understanding of risks, current approaches taken by donors and possible future approaches and risk management strategies will be needed.

III. Issues to be addressed

In responding to these TORs, the consultants will need to address the following issues:

1. What is the political economy of aid during the transition period?

1. International assistance to countries transitioning out of conflict does not take place in a vacuum, but needs to be positioned within the context of the complex local, regional and global environment these fragile and conflict affected countries face. Countries in transition are not only dealing with conflict, armed violence and poverty but are also contending with externalities such as climate change, environmental degradation, international crime, population migration etc. that may influence stability and prospects for development as well as creating significant negative spill-over effects on neighbouring countries and the international community when transition fails. The international system is not yet well equipped to deal with these larger regional and global issues and their local impacts, and humanitarian and development actors represent just one, relatively small player when it comes to addressing these themes. The paper should thus identify, recognise and take account of the risks to successful transitions posed by these global elements and the opportunities that reducing regional and international negative spill-over effects present. At the same time, it should identify and focus its attention on those risks which are inherent in development and humanitarian aid modalities, and in the current financing and procurement models, and which are under the control of development and humanitarian actors.
2. The paper should build on and further a broad understanding of the political economy of transition situations. A post-conflict situation is often characterised by very weak political institutions, a charged political environment and an economic system in crisis, which heightens the risk of slipping back into conflict. Therefore, a clear understanding of the characteristics of each of these three aspects

and the dynamics between them is necessary to identify the main risks to a smooth emergence from crisis. The discussion should address the short and long-term political, social and macro-economic factors which impact on stabilisation. The analysis should be broad enough to include the most common elements found in transition situations such as international crime, illegal trade in natural resources, migration, gender aspects and refugee flows. It should furthermore look at how regional settings and dynamics impact the political risks of aid during the transition period as well as the impact of destabilizing global issues mentioned above, and how all of this relates to risk and aid modalities.

3. The paper should also consider the political economy of the international community's engagement in transition situations. This would include identifying the principle objectives of the donor community's involvement in these situations; the tools and instruments available and donor policies and procedures for identifying needs and allocating funds; the main patterns and dilemmas of aid provision in transition situations; key issues such as funding gaps, difficulties in dove-tailing humanitarian and development programmes; confusion created by different objectives and principles (short term vs. long term, delivering services vs. national ownership) etc. Furthermore, it should explore the rationale behind donor countries' engagement in transition situations, identifying the main factors which influence the degree to which they get involved (the amount of financing and political capital expended). Together, these aspects will shed light on the extent of the risk donors are prepared to take to achieve their goals in transition situations.

2. What are the different risks associated with delivery of aid during the transition period?

1. The consultants should attempt to identify the range of risks (known and unknown) that might be encountered during the transition period, to identify specific options for addressing and managing these. Risks may cause negative departures from desired transition scenarios and trajectories. More knowledge of risks and a better understanding of the risk factors may allow donors to anticipate and account for risks, and on that basis mitigate risks better and be able to take more risks. Nonetheless, as the effects of risks are rarely certain, factors such as poor policies and procedures that will almost certainly cause problems will not be covered by the study. Conversely, even the best planned and implemented development activities will always entail risks and uncertainties that need to be considered systematically.

2. In an effort to order the discussion, and for the purpose of this paper, risks have been grouped together under three headings; (i) political risks; (ii) financing risks; and (iii) technical risks.
3. **Political risks** should be broken into risks for the country in transition and political risk for the donor:
 - An analysis of the **political risk to the country in transition** needs to rest on the understanding that aid rarely remains neutral in a post-conflict transition environment. Rather, association with or exclusion from projects and funding decisions influence local power politics and often creates winners and losers. Different aid modalities can lend support to different sides of or entities within a conflict; project approaches which bypass local authorities can serve to undermine governments' authority in the eyes of the population, whilst channelling funds through governments may prop up one side of a political divide. These dynamics can affect how local partners interact with the international community and their willingness to cooperate. Similarly, the patterns and perceptions of aid flows to states within a region can also have an impact on regional dynamics which may in turn affect stability at a regional, national and local level.
 - For the **donor** there are a set of reputational risks that influence levels and types of engagement in a transition situation. The donor will consider its ability to deliver assistance and to achieve results in a complex transition environment, the security risk to staff involved in delivering assistance, the security and reputational risk resulting from doing nothing. These risks (the list is by no means comprehensive) influence the donor's decision to engage in the transition, how much to invest (politically and financially) and what aid instruments to use. The extent to which a donor is prepared to broker the multiple risks and engage in transitions is also influenced by domestic public opinion and geo-political considerations. The study should consider what contributes and effects the perception of risk, including issues such as access to and availability of information and the presence of other donors.
 - There are a further set of issues around donors acting as a group or individually. A coordinated and coherent response by the international community during transitions is particularly difficult due to the urgency of a transition context, the rapidly changing situation the lack of clear structures, weak national leadership, and the multiple actors and stakeholders involved that tend to create a high level of volatility and uncertainty. Lack of coherent political messages and uncoordinated aid

risks confusing local actors at best, at worst contributes to destabilising an already fragile situation.

4. Looking at **financing risks** would involve exploring and addressing questions around levels, patterns and sustainability of financing.
 - There are a number of risks associated with the interplay between issues around financing gaps, absorption capacity, scaling up and front loading. Different approaches to financing levels will expose different risks. Bearing in mind the need for quick impact post emergency and the importance of reducing the lag time in implementing projects, donors need to start planning for the transition phase during the crisis itself and be prepared to take indicative decisions on financial engagement at an early stage when risks are even higher.
 - Financing risks should be addressed through a lens of realism, noting what is aspirational but focussing on what is achievable.
 - There are important fiduciary risks associated with aid during the transition period. In particular, the lack of functioning accountability mechanisms and capacity combined with an increased inflow of external assistance risk generating corruption at all levels. Financing during this period will thus need to accept a higher level of risk due to the lack of effective in-country budgeting and accountability mechanisms, in particular in cases where aid is made available before a political settlement has been established.
 - Nascent accountability, financial management and procurement capacity will also be placed under increasing stress during the transition period due to the highly political nature of aid (as discussed above) and because external financing would normally represent a higher proportion of the overall resource envelop during this period.
 - Donors need to carefully consider issues related to longer term macro-stability and fiscal planning. There are specific financing risks associated with the dilemma of matching immediate financing needs while at the same time ensuring that aid levels in the short term do not exacerbate the risk of creating unsustainable fiscal structures in the long term.
 - Similarly, the issue of debt relief needs careful consideration during the transition period. Debt relief plays a critical role in helping states achieve debt sustainability and stabilise the macro-economic situation. It is also often used as a primary carrot to achieve a political settlement. Nonetheless, debt relief can have

adverse effects on the macro economy of a country if the additional fiscal space created undermines broader macroeconomic stability and public finance management objectives, and donors thus need to carefully consider the various financing flows in a given country context.

5. The study should also look at different **technical risks** associated with different aid instruments have different risks associated with them.
 - Fragile and conflict environments are often characterized by a lack of technical implementation capacity that increases the risk of problems in the delivery of aid through local systems and partners. This risk may to some extent be mitigated through direct delivery through international agencies and NGOs, but this modality will have to be balanced against the need to ensure that long-term statebuilding and sustainability objectives are met.
 - In addition, there is also often a lack of fundamental data and information that are normally considered necessary for proper needs assessment, planning, decision making and monitoring of aid activities. This includes the lack of economic and social statistics, including statistics that is sensitive to gender and ethnic/regional criteria that may be the basis for exclusion and drivers of conflict. In addition, there is often a lack of effective media and accurate and balanced reporting of events.
 - Project approaches reduce the fiduciary risk related to working with governments, however, they have increased risks relating to a lack of sustainability and ownership, but in the case of budget support the benefits and risks are reversed. It would thus seem important to delve into the detail on each of the pros and cons posed by using the various aid instruments outlined by the mapping study of the transition period.
 - Technical risks can also be found when looking at disbursement and capacity to deliver. For instance, what are the specific risks associated with international and local procurement systems, and how can these be improved to better reflect capacity, implementation and accountability needs during the transition period.
 - Finally, technical risks might be associated with the sustainability of aid interventions (in particular development investments). In volatile situations, and given the urgency for implementation, there might not be sufficient information or capacity available to make qualified judgements for ensuring sustainability of activities.

While quick and visible results are needed to consolidate peace in the short-term, the impact of these investments could be reversed if they are not perceived to result in sustainable improvements in service delivery.

3. What are options for mitigating different types of risks?

1. Once the various risks are clearly mapped out, the study should explore options for how to address, mitigate, and to some extent accept the risks involved (noting that risks are higher in transitions than in regular development contexts, but that positive opportunities for development are also much greater if fragility and conflict can be overcome). The study should suggest a basic framework for cost-benefit analysis that would indicate the implications of both inaction and accepting higher risk thresholds. This cost-benefit analysis framework should build on either existing or new quantitative analysis as far as possible. The consultants should also take care to address moral hazards around the various choices and trade-offs. Furthermore, the paper should explore whether and how the risks identified can be mitigated, looking at the full range of options.
2. The consultants would also be expected to address the question of whether the international community should to be prepared to take on a higher risk threshold in transition situations, arguing the case for why this is necessary and appropriate, while bearing in mind the need for a minimum level of accountability, and giving recommendations on how this could best be achieved. This discussion would draw on the political economy section, identifying what is necessary to achieve the various goals. It should then evaluate the balance between the risks encountered through action and engagement at a sufficient level to achieve these goals versus the risks of doing nothing, or not enough, building on the cost-benefit analysis framework.

IV. Approach and methodology

The framing paper will address a very wide agenda and will need to aim for breadth rather than depth to address the various risks outlined above. It will need to draw on a wide range of both historical and contemporary sources and take a multidisciplinary approach as well as examine policy sources. In order to ensure a sufficiently broad approach to the topic, the consultant team will need a multinational character.

The study would be initiated by a desk review looking at work done by the DAC as well as by other partners to explore issues related to transition

financing. It would then move on to a more detailed analysis of the key risks involved, which would involve in-depth interviews with key donor representatives and external experts, and possibly through specific field work to highlight good practices for risk mitigation strategies.

More specifically, the study would be based on:

- The findings of the two mapping studies that have been prepared on (i) instruments and tools available during the transition period and (ii) donor policies and procedures;
- A literature review of recent academic and policy work;
- Interviews with DAC representatives and other stakeholders working on financing issues in the transition period, including with humanitarian and private sector actors;
- A review of relevant published and grey literature produced by DAC members and others;
- Interviews with national and regional policy makers and other relevant actors such as think tanks (from both fragile and “stabilised” post-conflict countries);
- Field work to draw specific lessons on risk mitigation strategies in situations of conflict and fragility.

Given the large effort involved, and the need to bring in expertise in humanitarian, development, economic and political analysis from both HQ and the field, a Consultant Consortium might be the preferred option.

Given the political dimensions of the study, several steering group meetings would be foreseen to enable members to follow and guide the process, to engage in and handle any emerging sensitivities on an ongoing basis, and to advise the consultants on an ongoing basis. Furthermore, an expert advisory panel will be contracted to support the steering group and advise on emerging findings. The final product will be presented during a workshop with donors and others, aimed at highlighting the practical and political implications of the findings for a wider audience outside INCAF.

Following completion of the framing paper, the work might be complemented by a more detailed cost-benefit analysis of certain types of risks or specific case studies. The final work will be presented at a workshop with donors mid 2010, following which it will feed into the development of specific guidance by the Financing and Aid Architecture Task Team.

V. Outputs

The first output will be an inception report and a literature review (maximum 15 pages) outlining the proposed approach, focus and methodology that the consultants will adopt for the main study. In particular, the inception report should include a detailed outline of what risks will be addressed during the study and why these specific risks were chosen. Furthermore, it should set out a proposal for possible country and/or case studies that should be covered in the framing paper, as well as the criteria that should be applied when deciding on the sample (based on the elaborated understanding of the risks that will be explored). Finally, it should propose a more specific set of questions that should be explored in each case study, which will serve as a basis for the Steering Group discussion on the purpose and content of these cases.

A first draft of the framing paper should be delivered by end February 2010 (maximum 40 pages). This should analyse major trends in international engagement in situations of conflict and fragility, provide an overview of the political economy of aid during the transition period and identify the main risks and opportunities posed by the transition and by the international community's response and suggest ways in which these can be mediated. The paper will contain an executive summary of not more than 3 pages; a full bibliography; a list of interviewees; and any annexes the authors feel are necessary. This should be delivered by 15 February 2010.

Following presentation and discussion of the framing paper in an experts meeting, the consultants will produce a second iteration of the framing paper (maximum 60 pages plus annexes). This paper should be delivered by 30 April 2010 for a final round of comments from the Task Team.

The final paper should be delivered by June 2010, and should include an executive summary; a full bibliography; a list of interviewees; and annexes covering each of the case studies as well as any other annexes the authors feel are necessary. It should also include a matrix that spells out the various risks, shows how they impact on each other, notes how they are influenced by the different transition contexts (*i.e.* clear victory in a conflict vs. power sharing arrangements), and pinpoints the political implications for donors of taking on the risk, along with implications of inaction. In addition, a shorter summary paper should be prepared, highlighting policy and operational recommendations for how donors can manage and mitigate specific risks.

Note

1. During its first meeting on 15-16 January 2009, the Task Team agreed that the broader term “transition financing” will be used to cover the wider set of issues that might be experienced during the transition from humanitarian crisis towards longer-term development. As such, the term might include activities that are currently labelled early recovery, recovery, transitional etc., recognising that this period can start before there is peace and carry on into the post conflict period.



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