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Piloting Results-Based Financing Programs

Asian Development Bank

ABBREVIATIONS

ADB	—	Asian Development Bank
ADF	—	Asian Development Fund
CCT	—	conditional cash transfer
CPS	—	country partnership strategy
DLI	—	disbursement-linked indicator
DMC	—	developing member country
EC	—	European Commission
EU	—	European Union
FSS	—	franchise shipping scheme
GACAP	—	governance and anticorruption action plan
GAVI	—	Global Alliance for Vaccines and Immunization
GPOBA	—	Global Partnership on Output-Based Aid
HSDP	—	health sector development program
IDB	—	Inter-American Development Bank
M&E	—	monitoring and evaluation
MCC	—	Millennium Challenge Corporation
MDB	—	multilateral development bank
MFF	—	multitranches financing facility
MTEF	—	medium-term expenditure framework
OBA	—	output-based aid
OCR	—	ordinary capital resources
OECD-DAC	—	Organization for Economic Co-operation and Development-Development Assistance Committee
PAI	—	project administration instructions
PBC	—	performance-based contracting
PDL	—	performance-driven loan
PEDP	—	primary education program
PNG	—	Papua New Guinea
PPP	—	public and private partnerships
RBFH	—	results-based financing in health
RBF	—	results-based financing
RBM	—	results-based management
SPS	—	Safeguard Policy Statement
SPSP	—	social protection support project
SWAP	—	sector-wide approaches

NOTE

In this report, "\$" refers to US dollars.

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

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EXECUTIVE SUMMARY

It is proposed that the Asian Development Bank (ADB) introduces a results-based financing (RBF) program modality. The RBF programs will directly link disbursements with achievements of results in government-owned programs. These programs will be based on *ex ante* assessments, supported by *ex post* results verification, and underpinned by systematic institutional development. The objectives of RBF programs are to increase accountability and incentives to deliver results, improve the effectiveness and efficiency of a government owned sector program, support institutional development, facilitate development coordination and harmonization, and enhance development effectiveness.

The defining characteristic of the RBF approach is that it directly links payments with results. This differs from modalities which link payments with expenditure for inputs. RBF can be implemented at both the program and project levels. This paper focuses on the RBF at the program level.

The RBF program modality will have the following key features:

- (i) **Purpose:** supporting government sector programs.
- (ii) **Basis:** results based. The results will be sector outcomes, outputs, and other related results, as compared to policy conditions under the policy-based lending.
- (iii) **Focus:** results and program systems.
- (iv) **Financing:** sector expenditure programs.
- (v) **Disbursement:** against credibly verified evidence of achievements of program results—the disbursement-linked indicators (DLIs). Each DLI will be supported by a transparent and credible verification protocol.
- (vi) **Partial disbursement:** can be provided for partial achievements.
- (vii) **Implementation systems:** using program systems. ADB will be hands-on in assessing the systems, working with the borrower and other development partners to improve these, and monitoring their performance. These will be guided by commonly agreed good practice principles.
- (viii) **Capacity building:** aimed at delivering results. RBF programs will focus on systems that are essential for achieving sector results, including monitoring and evaluation (M&E), governance (financial management, procurement, and anticorruption), and safeguards. Institutional development of these systems will be centered on achieving and sustaining sector results. The close integration and feedback between systems and results will support government ownership and buy-in.
- (ix) **Risk mitigation:** through rigorous risk assessment, follow-up capacity development measures, and implementation support
- (x) **Partnerships:** a natural platform. RBF programs will support development partnerships through sharing a common government owned results' framework, using common systems, and financing common expenditure programs.

A RBF program will have four key building blocks—the program, financing, results, and institutions. Results and institutional development will both occupy center stage in RBF programs. In each of these building blocks, ADB will carry out assessments, seeking to ascertain their strengths and weaknesses guided by commonly accepted good practice principles.

The assessments will cover the whole program to be supported, not just the part related to ADB financing. The assessment will inform the risk identification and mitigation measures, capacity development needed, and other implementation support required. ADB will assist the

borrower in implementing the program, building capacity, and monitoring progress. Through rigorous assessments, capacity development, and other measures, RBF programs will seek to ensure that the program results are achieved, that program systems are adequate and strengthened, and that fiduciary and safeguard risks are adequately addressed.

To enable learning-by-doing, it is proposed that ADB pilot the RBF programs for six years. This is the minimum timeframe required to process and implement RBF programs to yield sufficient information for the subsequent review of the experience. During the pilot, ADB should put in place a program for training, dissemination, consultation, and learning. ADB should proactively learn from its own experiences, and exchange experiences with other development agencies. The experience from the pilot will inform the future policy direction about the RBF program modality.

RBF programs are expected to deliver many potential benefits. They will complement ADB's existing project-based and policy-based lending operations. The programs will help ADB to better meet the needs of ADB's developing member countries, enrich ADB's operations, support good governance, and contribute to realizing the goals of the aid effectiveness agenda.

I. PROPOSAL

1. It is proposed that the Asian Development Bank (ADB) introduces a results-based financing (RBF) program modality. The RBF programs will directly link disbursements with achievements of results in a government-owned program. These programs will be based on ex ante assessments, supported by ex post results verification, and underpinned by systematic institutional development. The RBF programs will be designed to enhance the achievements and sustainability of development results from government-owned programs, promote institutional development in developing member countries (DMCs), foster development coordination, and strengthen development effectiveness.

2. RBF has become an increasingly common approach in both government and development agency financed operations. RBF can be implemented at both program and project levels. This paper focuses on RBF programs.¹

II. WHAT IS RESULTS-BASED FINANCING

3. *All aid is supposed to deliver results – otherwise why would we do it?*² Indeed, all development operational modalities share the same objective of delivering results. What distinguishes the RBF is that it directly links payments with results. This differs from modalities which link payments with expenditures for inputs, and thus has an indirect relationship between payments and results.

4. Different agencies have used different terms to describe RBF approaches. However, essentially, RBF involves the establishment of a method through which a funder makes payment to an agent for the results achieved. The result relationships can be defined in legally binding contracts, memoranda of understanding, or other partnership arrangements.³

5. This paper distinguishes between two result relationships: RBF programs and RBF projects. A RBF program involves a contractual relationship between two institutions stipulating how disbursement is linked with results from a program. The results relationships can be between a development agency and a DMC government, between a government and a ministry, or between a central government and a local government. This paper focuses on the result relationship between ADB and a DMC national or sub-national government.

6. RBF programs by development agencies generally involve payment for results rather than payment by results. Development assistance is generally one of the financing sources contributing to the program results. It will thus be difficult to single out the 'cost' of each result indicator. Development financing is to contribute to the sustainable delivery of all results from the program and strengthen a DMC's incentives and abilities for delivering the results.

7. The design of RBF programs also stresses the importance of identifying the right results. For this reason, a key lesson is to define the results from the standpoint of the ultimate beneficiaries to ensure that results are relevant and meet their needs.

¹ ADB is also developing guiding documents for RBF at the project level.

² M. Pearson. 2011. *Results based aid and results based financing: What are they? Have they delivered results?* London, U.K.: HLSP Institute.

³ This section draws from S. Klingebiel. 2011. Results Based Aid: Limitations of New Approaches. *Briefing Paper*. No. 17. Bonn, Germany: German Development Institute.

8. RBF programs cover a wide spectrum of specific operations, for example, sector-wide approaches (SWAP) and the World Bank's program-for-results financing approved in January 2012. The results under RBF programs can be outcomes, outputs, and system improvements which address sector performance bottlenecks. Many RBF programs use a combination of results at different levels.

9. RBF projects involve a contractual relationship between the contracting entity (e.g. a department in a DMC) and a contractor and/or service provider for delivering goods or services. Service providers can be private, public, or civil society organizations. The payments are made either to the service providers or to beneficiaries. Payments to beneficiaries aim to increase access to services, while payments to service providers such as a water company, teachers, and health workers aim to improve the provision of services. The service providers are generally paid per beneficiary or unit of service (e.g., the maintenance of a kilometer of road). RBF projects include such examples as output-based aid (OBA), performance-based contracts, and conditional cash transfers (CCTs). The results under RBF projects are generally outputs in the form of goods or services.

10. RBF programs or projects can be funded from domestic and external resources. Often it involves a combination of both. The program and project level results relationships can be combined in an operation. For example, a program can include a result relationship between a development agency and a DMC government, and a result relationship between the DMC government and service providers.

III. WHY RESULTS-BASED FINANCING

A. The Quest for Development Results

11. There is a growing demand worldwide for governments and development agencies to deliver measurable results from public expenditure. The quest for results needs little defense: better results are critical for fiscal sustainability, economic growth, human development, and poverty alleviation. The increasing demand for results has propelled wide ranging public sector reforms since the 1990s. Many innovative instruments have emerged.

12. Among these, results-based management (RBM) is especially relevant to the RBF programs. RBM is a public sector management approach which shifts emphasis from inputs and activities to greater accountability for results through strategic planning; systematic implementation; effective resource usage; performance measurement; and monitoring and evaluation (M&E).⁴ RBM has been implemented by many OECD countries. It has also gradually been adopted in Asian countries such as Malaysia. These reforms have provided greater autonomy to the heads of line departments to manage their budget appropriations—under a philosophy of letting the managers manage and holding them accountable for results. These efforts have been echoed by other DMC governments. For example, the Government of Andhra Pradesh in India instituted a Performance Accountability Act in 2003.

13. The RBM and similar public sector reforms have profound implications for development agencies operations. With the growing global demand towards demonstrating accountability and results, more and more DMCs are expected to adopt RBM. Development agencies are stepping up their efforts to lead or keep pace with these developments. Managing for development results

⁴ K. Thomas. 2008. *Integrated Results Based Management – Country Experiences from Asia and Africa*. A paper prepared for the Asia Pacific Community of Practice on Managing for Development Results.

has been adopted as a key component of the Paris Declaration on Aid Effectiveness. Introducing RBF programs constitutes one important step in this broad agenda.

B. Key Drivers of Results-Based Financing Programs

14. **Incentives and accountability for results.** Under RBF, payments are based on what is delivered, rather than expenses incurred. Directly linking payments with results strengthens incentives for results. As lack of results can mean reduced, delayed, or lack of payments, RBF also creates stronger accountability by aligning the consequences with those who receive payments.

15. **Institutional development.** While there is overwhelming emphasis on results, RBF programs also stress the importance of public institutions as cornerstones for achieving results. Development effectiveness depends on the availability of resources, but also the soundness of government institutions to implement policies and manage public resources. Building sound institutions and pursuing development results are two complementary elements to achieve sustainable development. Institutional capacity development is therefore a key component of RBF programs.

C. A New Development Paradigm

16. The quest for results and institutional development has significantly shaped development financing since the 1990s.⁵ Consensus emerged through successive development fora, including the Monterrey Consensus in 2002, the Rome Declaration on Harmonization in 2003, the Marrakesh Roundtable on Results in 2004, the Paris Declaration on Aid Effectiveness in 2005, the Accra Agenda for Action in 2008, and the Busan Partnership for Effective Development and Cooperation in 2011. The international communities, including multilateral development banks (MDBs) have committed through these fora to measure development effectiveness by achieving results on the ground, supporting institutional development, strengthening partnerships, enhancing country ownership, and harmonizing development initiatives.

IV. RESULTS BASED FINANCING IN MULTILATERAL DEVELOPMENT BANKS

17. Bilateral agencies have spearheaded the use of the RBF approach. In recent years, MDBs have also been actively pursuing the RBF approach. The Inter-American Development Bank (IDB) introduced performance-driven loans (PDLs) in 2003. The World Bank added a results-based financing instrument to its tool box with the approval of Program-for-Results Financing in January 2012.⁶ Appendix 1 summarizes the RBF modalities and operations by MDBs and other development agencies.

A. Asian Development Bank

1. Strategic Transformation

18. ADB's Long Term Strategic Framework (Strategy 2020) is transforming ADB's core business model guided by a set of corporate-wide core values, including responsiveness to

⁵ See e.g. OECD-DAC Working Party on Aid Effectiveness. 2005. *Harmonisation, Alignment, Results: Report on Progress, Challenges and Opportunities*. Paris, France.

⁶ World Bank. 2011. *A New Instrument to Advance Development Effectiveness: Program-for-Results Financing*. Washington, D.C.

DMCs' specific needs, recognition of country ownership, commitment to partnerships with DMCs and other development partners, and accountability for results.

19. In line with the commitment on aid effectiveness, ADB has defined an ambitious reform agenda to enhance its organizational effectiveness and to make ADB a more responsive, relevant, and result-focused organization. ADB has adopted a results framework incorporating four categories of results areas: (i) regional outcomes, (ii) contribution to country development outcomes, (iii) operational effectiveness, and (iv) organizational effectiveness.

20. ADB's Development Effectiveness Review (DEfR), started in 2009, tracks ADB's achievements in meeting results targets on an annual basis. Recent DEfRs have shown both successes and opportunities for improvements in ADB operations, especially in delivering outcomes. Developing new financing instruments and streamlining the business processes constitute a major part of the ADB reforms.

2. Operations

21. Even without a dedicated modality on RBF programs, RBF features have already emerged in some recent operations, such as in the Bangladesh Third Primary Education Sector Development Project. This project is supported by 10 development partners, wherein ADB financing is linked with clearly defined 'disbursement-linked indicators' (DLIs).⁷ The project uses the Government's Treasury System for financial management, thereby increasing development coordination and reducing transaction costs. The RBF features resonate well with development partners' commitment to results, reduction in transaction costs, and enhanced government ownership and leadership. ADB has also been involved in various other SWAP operations, for example, the Philippines Health Sector Development Program approved in 2004⁸ and the Indonesia Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project approved in 2011.⁹ The performance of these operations has been positive, and their implementation progress suggests that they have the potential to increase the focus on results.

22. ADB's implementation of results-based operations has yielded several lessons.

- (i) **Need for an enabling policy framework.** Due to a lack of clear policy and processes, project teams often have to search for the ways to process these operations. Further, operations with RBF features are often provided as projects to governments programs. The dualistic nature of providing project-based support to government programs means that these projects have to simultaneously meet both government and ADB procedural requirements. This has led to high transaction costs. ADB should put in place enabling policies and procedures to guide RBF operations.
- (ii) **Efficient procedures.** Lengthy and complex procedures limit ADB's impacts and timely contribution to some programs. Efficiency gains can be achieved by

⁷ ADB. 2011. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan to the People's Republic Bangladesh on Third Primary Education Development Project*. Manila. (Loan 2671-BAN, \$320 million ADF, approved on 5 July 2011).

⁸ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on the Proposed Loans to the Republic of the Philippines for the Health Sector Development Program*. Manila. (Loan 2136/2137-PH, \$213 million (OCR), approved 15 December 2004).

⁹ ADB. 2011. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Administration of Technical Assistance Grant Republic of Indonesia: Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project*. Manila. (Loan 2768-INO, \$100 million (OCR), approved on 5 Aug 2011).

improving government institutions, capacity, and procedures; as well as simplifying business processes in ADB.

- (iii) **Capacity constraints.** Operations such as SWAPs are resource intensive. Their implementation has sometimes been hampered by insufficient resources from both ADB and the borrowers. Improving both government and ADB capacities are essential for the success of RBF programs. Development coordination can help to save time and costs, but can also be resource and time intensive when the operations are supported by multiple agencies. Program design needs to clearly factor in these costs.
- (iv) **Flexibility.** Flexibility in design and implementation is the key to ensure constant improvements in a program.
- (v) **Government commitment.** RBF programs require careful consideration of the local context and need strong government commitment.

23. Appendix 2 provides examples of ADB operations with RBF features which were processed either using policy based or project based lending modality.

B. The World Bank

24. **Program-for-Results Financing.** The Executive Board of Directors of the World Bank approved a new program-for-results financing instrument in January 2012. Program-for-Results Financing assists government's development programs, uses results as the basis for disbursement, and supports institutional development. The World Bank is the first MDB that formally adopt the RBF approach at the program level.

25. Under Program-for-Results, the World Bank will align its assistance with government programs and help countries improve the design and implementation of their programs. Program-for-Results will finance the government program expenditures. It will focus directly on systemic improvement and capacity building, and work in partnership with governments and other stakeholders. The World Bank expects that this instrument will help it to increase the development impact and sustainability from the World Bank financing.

26. **Operations.** While the Program-for-Results is a new instrument, many operations at the World Bank have already incorporated features of RBF over the past decade.¹⁰ Most of these have been processed as investment lending operations. These projects disburse against eligible expenditure programs based on the achievement of DLIs, which include outcomes, outputs, and institutional change indicators. The numbers of these operations have increased since the 1990s because of strong demand from borrowers. The World Bank's review of these operations indicates that their performance compares favorably with the overall investment lending portfolio. Linkages between disbursement and results have strengthened incentives for results.¹¹

27. **Learning lessons and developing the Program-for-Results Financing Policy.** Although operations with RBF features have emerged, the World Bank found that the absence of an enabling policy framework created problems, necessitating the development of a dedicated instrument. The World Bank's review concluded that RBF operations were 'squeezed'

¹⁰ Examples of project with RBF features include the Pakistan-Punjab Education Project, Pakistan-Sindh Education Project, Brazil-Rural Health Improvement Project, Mexico-Decentralized Infrastructure Development Project, the Brazil-Bolsa Familia, Indonesia-Bos Kita, Mexico-Strengthening Private Housing Finance Markets, Ethiopia-Protection of Basic Services, and the India-PMGSY Rural Roads Project.

¹¹ The review covered 41 projects with a total lending volume of US\$9 billion.

into ring-fenced investment lending frameworks. This had several drawbacks (para. 14, footnote 6).

- (i) It often required a double layer of controls to ensure the operations comply with both government and the World Bank requirements, imposing additional transaction costs without additional value. Staff reported that internal processing costs were excessive and diverted time and attention away from substantive matters.
- (ii) The absence of clear policies and guidance also led to confusion and inconsistent applications, as staff must revisit the same sets of issues for each project.
- (iii) Squeezing RBF operations into the investment lending framework led to operation designs biased towards activities that were easier to accommodate within the investment lending procedures rather than being driven by delivering results.
- (iv) “Cherry-picking” specific activity types within a program limited the World Bank’s ability to partner with a country on improving the effectiveness and efficiency of the entire program. Across projects, as the RBF operations had to be designed to comply with investment lending frameworks, many potential candidates opted to be designed as conventional investment lending to avoid the high transaction costs, creating missed opportunities and depriving the World Bank of the opportunity to help the borrowers improve their program systems.
- (v) Concerns about applying the World Bank rules to country programs resulted in giving greater attention to procedural compliance than to institutional issues.
- (vi) Uncertainty about the World Bank policies and procedures heightened risks for both countries and the World Bank.

28. The experience of the India PMGSY Rural Roads Project highlights these problems (footnote 6).¹² In this project, the World Bank accepted modified government procedures for procurement and safeguards. However, the project still encountered several problems. First, the project excluded ongoing contracts at the project’s effectiveness, reducing the World Bank’s ability to positively influence these contracts. Second, much of the Government and World Bank’s project preparation resources were spent in finding an acceptable way for the Government to conform to the World Bank’s investment lending requirements, rather than on important design and implementation issues for achieving program efficiency and effectiveness. Third, because of the transaction focus of investment lending policies, the project has over 7,000 contracts spreading over about one-third of India. This has made project management difficult.

29. While Program-for-Results has benefitted from the World Bank’s experience with the investment lending operations with RBF features over the past decade, after a careful review of the lessons learned, the World Bank concluded that a dedicated policy was required as the absence of an enabling policy framework increased processing costs, diverted time and attention from substantive matters, caused inconsistencies, and created missed development opportunities. This led to the adoption of the Program-for-Results Financing instrument. The World Bank has tentatively identified 16 operations that are likely to use the Program-for-Results in the first year after the policy approval. These operations cover a wide range of country incomes and program types. The sectors are also diverse to include health, education, transport, rural infrastructure, and public sector management.

¹² World Bank. 2010. *Project Appraisal Document on a Proposed Credit in the Amount of SDR 636.3 million (US\$1,000 Million Equivalent) and a Proposed Loans in the Amount of US\$500 Million to the Republic of India for the PMGSY Rural Roads Project*. Washington, D.C.

C. Inter-American Development Bank

30. **Policy.** The IDB adopted its Performance-Driven Loans (PDLs) in 2003—a project level RBF instrument.¹³ The main features of PDLs include: (i) disbursement against meeting result targets, except for advance payment which can be up to 20% of the IDB financing; (ii) results are defined by outcomes; (iii) results are audited by independent performance reviewers; and (iv) use of country systems in procurements.

31. **Operations.** The PDL was used in both infrastructure and social sector projects. For example, the health sector PDL project in Colombia played an important role in delivering vaccinations to a large number of disadvantaged people;¹⁴ the solid waste management project in Chile added flexibility in supporting a large number of sub-projects;¹⁵ and the agricultural project in Paraguay helped a large number of farmers to get access to input and technological support.¹⁶

32. However, demand for PDLs had been moderate—17 projects from 2003 to 2009. There are two main reasons for this slow uptake. First, PDLs require the delivery of outcomes which often takes longer to achieve. A lesson is that disbursement indicators should strike a balance between outcomes, outputs, and other related indicators. Outcomes should drive RBF operations. However, basing disbursement largely on outcome can be problematic. Second, PDLs require ex post performance as well as verification of expenditures to achieve results. This is considered burdensome by borrowers and project teams as investment lending projects are generally only subject to financial accounting and reporting. Effectively, PDLs have added the result requirements on top of investment lending. This double-layered requirements increased transaction costs. Moreover, it is difficult to attribute outcomes directly to IDB financing, as these are achieved through financing from various sources.

V. THE NEED FOR RESULTS-BASED FINANCING PROGRAMS IN ADB

33. This section demonstrates that adopting a RBF program modality will fill a gap in ADB's existing lending modalities, and has numerous potential benefits.

A. Existing ADB Modalities

34. ADB's existing lending modalities can be broadly categorized as project-based and policy-based loans.¹⁷ Project-based lending finance expenditures of specific transactions, and policy-based lending provides budget support to governments to address development financing needs and support policy and institutional reforms.¹⁸

¹³ Inter-American Development Bank. 2003. *Proposal for a Pilot Program for Performance-Driven Loans*. Washington, D.C.

¹⁴ Inter-American Development Bank. 2005. *Colombia: Strengthening the Expanded Program on Immunization (EPI) 2005-2008 (CO-L1002) – Loan Proposal*. Washington, D.C.

¹⁵ Inter-American Development Bank. 2008. *Chile: Integrated Solid Waste Management (CH-L1026) – Loan Proposal*. Washington, D.C.

¹⁶ Inter-American Development Bank. 2006. *Paraguay: Modernization of Agricultural Support Management (PR-L1001) – Loan Proposal*. Washington, D.C.

¹⁷ In this paper, “instrument” (or “product”) covers the generic means of providing or facilitating financing—debt (mostly loans), equity, guarantees, or grants. A “modality” involves the specific application of these instruments within a defined legal, policy, and operational structure - multitranches financing facility, additional financing, and so forth.

¹⁸ ADB's sector development program is not a separate lending modality but combines existing project- and policy-based lending modalities. See ADB. 2003. *Sector Development Programs. Operations Manual*. OM Section D5/BP. Manila.

1. Project-Based Lending

35. ADB has various specific modalities which fall within the project lending ambit.¹⁹ In addition to stand-alone projects, ADB provides sector lending to finance investment in multiple (relatively small) sub-projects in a sector. ADB's emergency assistance loans provide immediate, short-term transitional assistance to help rebuild high-priority physical assets and restore economic, social, and governance activities after emergencies. Financial intermediary loans finance projects wherein individual financing requirements are not large enough to warrant the direct supervision of ADB. In recent years, ADB has introduced some new project modalities. These include: (i) A multitranche financing facility, which allows ADB to finance a time slice of an investment program; (ii) a nonsovereign public sector financing facility to finance or guarantee selected nonsovereign public sector entities without a sovereign guarantee; and (iii) additional financing to scale up ongoing projects that are performing well, to finance changes in project scope, or to meet cost overruns and financing gaps.

36. Project-based lending has various key features:
- (i) **Purpose:** commonly supporting the construction of physical infrastructure.
 - (ii) **Bases:** transaction based.
 - (iii) **Financing.** Expenditures for the purchase of inputs for a project, such as works, goods, and services.
 - (iv) **Disbursement:** against the evidence of expenditures.
 - (v) **Partial disbursement:** permitted as disbursement takes place incrementally as expenditures are incurred.
 - (vi) **Implementation systems:** ring-fenced by setting up project management units (PMUs) specifically for the project, using dedicated accounts (imprest accounts), and follow ADB rules and procedures. Through ring-fencing project implementation systems, projects are implemented under parallel systems.
 - (vii) **Risk mitigation:** through ring-fencing.
 - (viii) **Capacity building:** can be provided to support project design and implementation.
 - (ix) **Partnerships:** different agencies can finance different parts of a project or through ADB administered cofinancing.

2. Policy-Based Lending

37. On the other end of the spectrum is policy-based lending.²⁰ Policy-based lending supports policy reforms. It comprises three modalities: (i) standard policy-based lending to improve the policy environment in the short to medium term, (ii) cluster policy-based lending to address complex reforms over a longer time frame (typically, between 4 to 7 years), and (iii) special policy-based loans to provide DMCs with assistance in times of emergency.

38. Policy-based lending has several key features:
- (i) **Purpose:** supporting policy reforms.
 - (ii) **Bases:** results based as policy conditions are a type of results.
 - (iii) **Financing:** general budget support to address development financing needs.

¹⁹ ADB. 2012. Lending Policies for Sovereign and Sovereign-Guaranteed Borrowers (Ordinary Capital Resources). *Operations Manual*. OM Section D1/BP. Manila.; ADB. 2007. Lending and Grant Policies (Asian Development Fund). *Operations Manual*. OM Section D2/BP. Manila.

²⁰ The policy-based lending was referred to as program lending until the Board approved the revision to of the program lending policy in July 2011.

- (iv) **Disbursement:** against the evidence of the fulfillment of policy conditions.
- (v) **Partial disbursement:** Not permitted. A tranche is either disbursed or withheld. Noncompliance with policy conditions requires a waiver from ADB before a tranche is released.
- (vi) **Implementation systems:** using country systems. ADB does not monitor or trace the fund flow of ADB financing as the fund is disbursed into the government's general budget. Utilization of country systems is based on the existence of a stable macroeconomic environment, and knowledge of the financial management systems.
- (vii) **Capacity building:** can be provided to achieve policy conditions.
- (viii) **Risk mitigation:** Knowledge of the public financial management environment in the country is required.²¹ Risk assessments, as mandated by the Second Governance and Anticorruption Action Plan (GACAP II),²² are to be carried out at the country, priority sector, and operation levels to evaluate public financial management, procurement, and corruption issues. Safeguard assessments are based on policy conditions, and policy-based operations are generally classified as Category C.
- (ix) **Partnerships:** generally requiring unique policy matrix for each partner.

39. Appendix 3 provides more details on ADB's existing lending modalities.

B. Results-Based Financing Programs as a Third Lending Modality

40. The project- and policy-based lending modalities serve different purposes.
- (i) Project-based lending is suitable for infrastructure or other facilities. By focusing on using ADB rules, controlling the process for procuring and using the inputs, and monitoring transactions, project-based lending seeks to ensure that the right inputs are in place and the operation process is implemented as planned.
 - (ii) Policy-based lending is suitable for addressing policy weaknesses. Policy conditions such as enacting new regulations or adopting new policy frameworks aim to create an enabling environment for public and private sector operations.
41. RBF programs will be suitable for supporting the delivery of sector results in a government program. The delivery of such results will require expenditures. Institutional development will be important for achieving and sustaining the results, and the government is willing to engage development partners to improve the institutions. Results and institutions will both occupy center stage in RBF programs.
42. Thus, projects-based operations, policy-based operations, and RBF programs each has its own specific suitability for addressing different development constraints. If adopted, RBF programs will be a third major lending modality for ADB, and will be positioned between the two existing modalities. RBF programs cannot replace, but will complement, the policy-based and project-based lending operations.
43. The RBF program modality will have numerous key features:
- (i) **Purpose:** supporting government sector programs.
 - (ii) **Basis:** results based. The results will be sector outcomes, outputs, and other related results, as compared to policy conditions under the policy-based lending.
 - (iii) **Focus:** results and program systems.

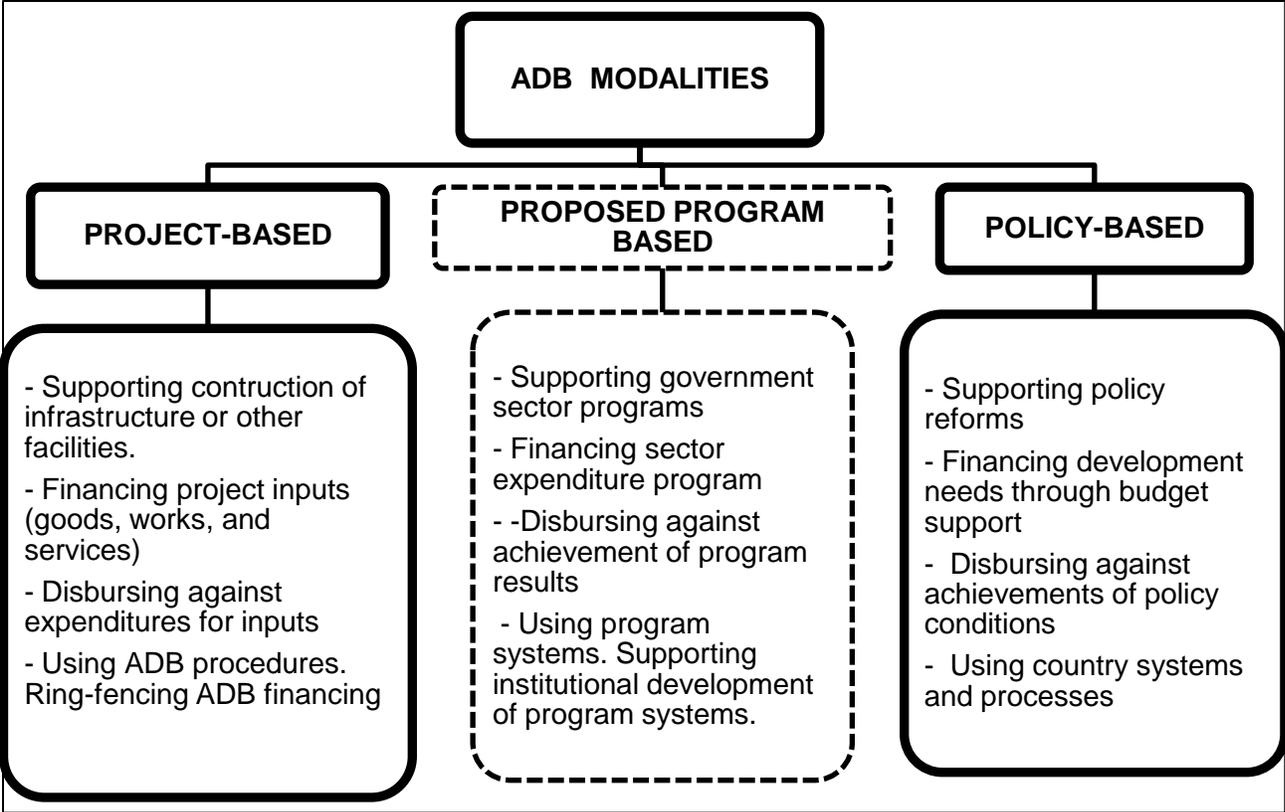
²¹ ADB. 2011. *Review of ADB's Policy-Based Lending*. Manila.

²² ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

- (iv) **Financing:** sector expenditure programs.
- (v) **Disbursement:** against credibly verified evidence of achievements of program results—the DLIs. Each DLI will be supported by a transparent and credible verification protocol.
- (vi) **Partial disbursement:** can be provided for partial achievements.
- (vii) **Implementation systems:** using program systems. ADB will be hands-on in assessing the systems, working with the borrower and other development partners to improve these, and monitoring their performance. These will be guided by commonly agreed good practice principles.
- (viii) **Capacity building:** aimed at delivering results. RBF programs will focus on systems that are essential for achieving sector results, including M&E, governance (financial management, procurement, and anticorruption), and safeguards. Institutional development of these systems will be centered on achieving and sustaining sector results. The close integration and feedback between systems and results will support government ownership and buy-in.
- (ix) **Risk mitigation:** through rigorous risk assessment, follow-up capacity development measures, and implementation support
- (x) **Partnerships:** a natural platform. RBF programs will support development partnerships through sharing a common government owned results' framework, using common systems, and financing common expenditure programs.

44. Figure 1 summarizes the key features of policy-based, project-based, and RBF program modalities.

Figure 1. Key Features of Project-, Program-, and Policy-Based Modalities



C. Expected Benefits from Results-Based Financing Programs

45. Adopting the RBF program modality will be a timely evolution in the new development financing paradigm. The RBF programs are expected to deliver many benefits.

1. Meeting Developing Member Country Needs

46. RBF programs can assist DMCs to improve sector performance and results. As noted by the World Bank (footnote 6, para. 18.c), improving service delivery (e.g., better maintained roads, functioning schools and health clinics, effective agricultural extension services) may require both policy actions (e.g., a decentralization law) and investment (e.g., constructing new schools or contracting out road maintenance work). But in many cases, these measures are insufficient for the achievement of results. Schools can be built, but teachers may remain absent; health clinics may have new equipment, but essential drugs may not be available; and rural roads may remain unmaintained despite the existence of contracts. Addressing these challenges requires a focus on the results that meet beneficiaries' needs. It also requires improving institutions and systems, and changes in incentives and behavior by the government, service providers, as well as users.

47. DMCs are implementing holistic and comprehensive programs to improve service delivery and sector results. DMCs want a RBF program approach from development partners that is integrated, tackles a program's system weaknesses, and focuses on performance and results. DMCs need development partners' finance and expertise in supporting them to implement and improve these programs. Through consultation as part of this policy development, DMCs expressed strong desire for ADB to put in place a RBF program modality.²³ The strong demand from borrowers is also confirmed by experience of other MDBs, especially the World Bank.

2. Enriching ADB Operations

48. **Supporting the results-based reforms.** ADB's development assistance has evolved to become more country-owned and results-focused. At the strategic level, ADB's country partnership strategies (CPSs) are fully aligned with DMCs' strategies. At the operations level, ADB's lending modalities are becoming increasingly flexible and responsive. Developing a RBF program modality will enrich ADB operations and advance ADB's reform agenda.

49. **Increasing ADB's leverage.** The RBF programs will enhance ADB's leverage. As DMCs grow, development financing shares in DMCs' total public finance have become smaller over time. Development agencies are shifting from being primary providers of funds to being catalysts for development. RBF programs will provide an opportunity for ADB to finance a small part of a large government program, while being able to positively influence the whole program, thereby scaling up ADB's development impacts.

50. **Mutual learning.** RBF programs will provide a vehicle to deepen links between ADB's knowledge and lending products. ADB assistance will aid DMC systems to converge with internationally accepted good practices. This can have far reaching implications for sustaining results. ADB itself will have an added opportunity to understand government sectors and systems. RBF programs will therefore help ADB to integrate its finance, knowledge, and expertise into an overall sector perspective. Under these programs, the emphasis will shift from knowledge-transfer to DMCs based on training and equipments to mutual learning-by-doing by ADB and DMCs.

²³ ADB received 51 responses from the survey it conducted with the DMCs. All respondents expressed support for the RBF program modality except one respondent who stated that pre-financing by the government could be a constraint for the government.

51. **Enhancing ADB operations.** A dedicated policy will guide the RBF operations which are already gaining momentum in ADB. Feedback from staff indicates that the RBF programs will be well suited to many sectors. For example, these programs can help to integrate the more scattered interventions in some sectors. Climate change interventions and carbon finance payments are usually results-based, for example, through payments on reduction in carbon emission or increased use of renewable energy. As international negotiations on climate change are increasingly focusing on measurable, reportable, and verifiable results, adoption of RBF programs in climate change mitigation operations will be increasingly relevant.

3. Promoting Good Governance

52. By focusing on institutional development at the sector level, RBF programs will also provide an opportunity for ADB to mainstream good governance. Accountability will increase as public funding is linked to the delivery of results which will be credibly verified. Transparency will be supported through disclosing of results and system related information to the public. RBF programs will cover all the key components of governance: financial management, procurement, and anticorruption. RBF programs will support governments to have adequate systems in place to prevent fraud, corruption, and other prohibited activities from occurring in the programs. Through application of local laws and enforcement arrangements, and the anticorruption guidelines specifically designed for the RBF programs, allegations of fraud, corruption and other prohibited activities will be investigated, and those found to have engaged in them will be held accountable.

4. Contributing to the Aid Effectiveness Agenda

53. RBF programs will contribute to realizing the goals of the aid effectiveness agenda.

54. **Sharpening the result focus.** The RBF approach makes achieving results a precondition for receiving ADB financing. It can thus provide a powerful incentive for borrowers to achieve results. Through focusing on results, RBF program will provide flexibility for DMCs to manage processes, fostering country ownership, and creating opportunities to discover new and better ways to achieve desired results.²⁴ ADB can add further value in assisting the DMCs' development journey by devoting more resources to program design, problem solving, and capacity building.

55. **Strengthening program institutions.** Institutional development and achievement of results go hand in hand in the RBF programs. Institutional development serves as both a means to achieve results and as a vehicle for risk mitigation. Closely linking institutional development with development results makes the institutional development focused, purposeful, and owned by governments. RBF programs will directly confront institutional weaknesses and bring about incremental, positive, and sustainable changes. Organizational learning is an intrinsic part of RBF programs.

56. **Increasing alignment and harmonization.** Under RBF programs, development assistance will be aligned through shared results and common systems. In many development operations funded by multiple agencies, DMCs have to comply with the requirements of each agency, resulting in dual or multiple systems which stretch DMC administrative capacity and cause delays. By using the program systems, resources will be saved through removal of parallel practices. This will help reduce transaction costs for DMCs in the long run.

²⁴ A program focus on education outcomes, for example, allows borrowers and service providers to implement a range of approaches that achieve better results.

57. For these reasons, RBF programs will have a great potential to increase development effectiveness.

VI. CONSULTATION AND LEARNING LESSONS FOR THE RESULTS BASED FINANCING MODALITY

58. ADB has carried out internal and external consultations on the proposed RBF program modality. An interdepartmental team was established, which has provided a forum for exchanging experiences and augmenting ideas. An informal Board seminar was held in November 2011. ADB surveyed all the DMCs with the support of resident missions. ADB also fielded missions with selected DMCs in different subregions. A broad web-based public consultation will be conducted.

59. ADB also consulted development partners, especially the World Bank and the IDB, both have rich experience in RBF operations and policies. During the development of the World Bank's program-for-results financing, two World Bank missions visited ADB for consultation and dissemination of information. ADB has carefully studied the stakeholder feedback to the World Bank's consultations on the Program-for-Results Financing.

60. Stakeholder feedback indicates that there is broad support for developing a RBF program modality in ADB. All appreciated the potential of the RBF programs for focusing on results, strengthening institutions, enhancing government ownership, and facilitating development coordination. Stakeholders have also provided many constructive comments and suggestions, and asked many useful questions. Major questions were raised about how to define results, how to monitor the results, how to carry out effective capacity building, how to mitigate fiduciary risks, how to manage safeguard systems, and how to reduce transactions costs. Appendix 4 summarizes the key points from the consultations. All comments, suggestions, and questions have been carefully considered in drafting the policy.

61. ADB has carefully studied the experience of implementing operations with RBF features both within ADB and among similar organizations, and surveyed numerous publications on development effectiveness, especially by OECD-DAC. The practical experiences and analytical work point to numerous lessons that should be considered in designing a RBF program modality. In addition to the lessons learned from MDB operations (paras. 22, 27, and 31), ADB has also carefully studied lessons relates to institutional development. Key lessons are summarized in Appendix 5. The designing of a RBF program modality will keep abreast these lessons.

VII. PREPARING AND IMPLEMENTING RESULTS-BASED FINANCING PROGRAMS

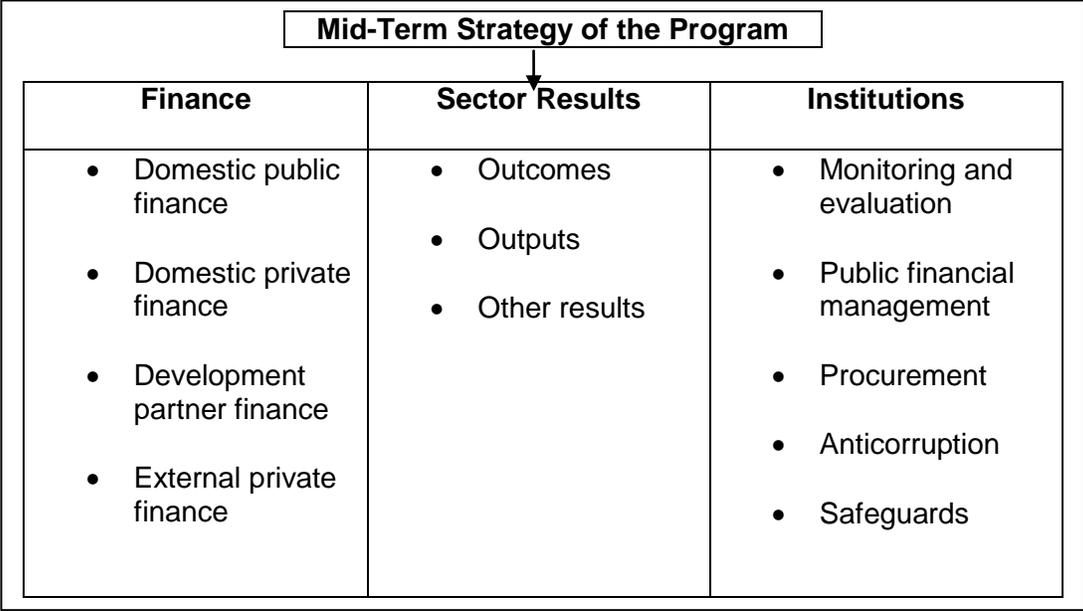
A. Definition, Objectives, and Building Blocks

62. The proposed RBF program modality will support a government-owned sector program and disburse against program results. A 'program' covers the whole or key aspects of a sector which aims to improve the sector performance. A program can be new or ongoing, and can be carried out by public or non-public sector organizations. The 'government' can be a national or lower level government. A 'sector' includes a sector, a subsector, or a cross-sectoral theme such as environmental protection, poverty reduction, women in development, public financial management, and private sector development.

63. The objectives of a RBF program are to increase accountability and incentives to deliver sector results, improve the effectiveness and efficiency of a government-owned program, support institutional development, facilitate development coordination and harmonization, and enhance development effectiveness.

64. A RBF program will have four key building blocks—the program, financing, results, and institutions. Risk assessment and mitigating measures will be embedded in all these aspects. In each of these building blocks, ADB will carry out assessments and assist the borrower in risk identification and mitigation, capacity building, implementation support, and M&E. These key building blocks are depicted in Figure 2.

Figure 2. Building Blocks of Results-Based Financing Programs



B. Suitability and Identification

1. Suitability

65. Several factors will be conducive for designing and implementing RBF programs.

66. *Development constraint.* RBF is suitable for supporting delivery of results and strengthening of institutions in a sector program. By comparison, a policy-based lending operation is suitable if the major constraints are pervasive policy weaknesses, and a project-based operation should be considered if the major constraint is the weakness in infrastructure or facilities.

67. *Strong government interest and ownership.* Government commitment is critical to a RBF program. Such commitment can be articulated in a government sector strategy, government’s own resource allocation, and willingness to improve the overall systems by engaging with development partners.

68. *Established engagement with development agencies.* In sectors or programs where there is a long-standing engagement between the government and development agencies through policy-based or project based-lending, it may be appropriate to use the RBF approach to translate the policy reforms and discrete projects into sector results and to deepen sector engagement.

69. *Knowledge and learning opportunities.* ADB's knowledge of sector constraints and opportunities will be useful in selecting a program. However, the learning opportunity provided to ADB and the government by the program will also be valuable. Government's willingness to collaborate with development partners in learning will also support the program.

70. *The strength of institutional capacity.* The institutional capacity should enable the efficient and effective implementation of a program, or the weaknesses can be addressed or mitigated. Both 'stock' and 'flow' perspectives need to be considered. The 'stock' perspective will look at the current institutional strength, while the 'flow' perspective will look at how fast and how soon the capacity can be improved, and how the improvement can be sustained.

71. Experience has shown that RBF programs can be implemented in DMCs with different income levels. For example, a sub-national government may be able to implement a RBF program even if a country is not ready. Sectors of RBF operations have become increasingly diverse. Thus, for piloting the RBF programs, ADB will not limit the sector or country selections. This will enable ADB to monitor what will emerge as the main areas using the RBF programs and learn a diverse range of lessons.

2. Identification

72. A potential RBF program will be identified as a part of the CPS, country operations and business plan, or policy dialogue process, similar to other ADB operations. The DMC and ADB will assess the nature of development constraints, country needs, and determine the most suitable modality, which will be confirmed later through further work.

73. A sector analysis or similar government strategic document will form the basis for the preliminary identification of a RBF program. Typically, a sector analysis should cover diagnosis of the constraints facing the sector; assessment of policy issues, institutional capacity issues, economic and financial issues, social and environmental issues; and the roles of the public and private sectors. A sector analysis will also establish the preliminary benchmark data and identify the gaps in these. The sector analysis should be a government document. ADB will assess the government's sector strategy and the medium terms objectives for the sector; identify the need for the RBF program, assess the suitability to use the RBF program modality, and understand other development partners' support.

C. General Approaches for Preparing Results-Based Financing Programs

74. Each proposed RBF program will undergo a rigorous assessment process. The assessment will cover all the four key building blocks (Figure 2), namely:

- (i) *The program.* This will include the rationale, scope, and soundness of the program.
- (ii) *Financing.* This will include the expenditure framework and financing plan for the program.
- (iii) *Results.* These will include the results frameworks and DLIs.

- (iv) *Institutions.* These will include M&E, governance institutions (financial management, procurement, and anti-corruption systems), and safeguard institutions.

75. There are five critical dimensions of such assessments:

- (i) *Rules and regulations:* reviewing the relevant policy, laws, rules, regulations, and/or procedures.
- (ii) *Functions:* assessing organizational arrangements and their functions, for example, agencies, capacities, and resources. For programs involving multiple agencies, ADB will assess the capacity of the EA, or agencies that have a major role in procurement, or a sample of agencies.
- (iii) *Performance:* reviewing the actual practice and performance of the executing and key or sample implementing agencies concerned.
- (iv) *Risks:* identifying risks and mitigating measures for the various facets of a program.
- (v) *Improvements required:* ADB and the borrower agree on the improvements required in various aspects for the program.

76. The assessment will identify the weaknesses and strengths of program systems, and inform the risk mitigating measures and capacity development needed. Through rigorous assessment and capacity development, RBF programs will seek to ensure that program results are achieved, that program systems are strengthened, and that fiduciary and safeguard risks are adequately addressed. Program assessments and related measures and assistance will be tailored to suit different operations. For example, for a CCT program, the main focus will be placed on the integrity of fund flows and the required behavior linked to the conditions. For a program that involves a large number of infrastructure activities, such as a rural road program, procurement and safeguard will be especially important.

77. The design and implementation of a RBF program will be guided by several considerations.

- (i) *Focusing on systems.* It will not be feasible for a government or a development agency to direct and monitor each transaction in a program. The geographic coverage, the volume of inputs and activities, and the number of agencies involved, will make it difficult to manage transactions. Thus, in RBF programs, ADB financing will not be linked to specific transactions and expenditures. To ensure that the program is carried out effectively and efficiently, it is critical to ensure that the systems supporting the program are adequate, especially over time.
- (ii) *Guided by principles.* The assessment and improvement of the program systems will be guided by commonly accepted principles. Development financing is likely to be moderate in the overall program financing.²⁵ Further, a government program may have been in place before ADB's involvement, and involve multiple development agencies. The transaction costs of transferring all agencies' procedures and system to the whole program is likely to be prohibitive. Using the commonly accepted principles to guide system assessments and improvement will help program systems to converge to these principles.
- (iii) *Covering the whole program.* ADB's assessment and related work will cover the whole program, not just the ADB financing. Helping to improve the systems to manage all resources—domestic as well as external, will provides a productive development assistance route.

²⁵ This is highlighted by operations to date. For example, the Bangladesh Education Program has development financing of \$1 billion from 10 development partners for a government program consisting of \$8 billion in total. The Indian Rural Road Program was for \$40 billion in total, for which the World Bank financing is \$1 billion.

- (iv) *Avoiding prohibitive processing costs and setting overly ambitious targets.* Bringing about incremental positive and sustainable changes will be more beneficial than setting up unachievable targets which stretch government and ADB capacity, demand large resources; and achieve little. The incremental changes will yield material improvements in the medium to long run.
- (v) *Development coordination.* ADB will actively coordinate with other development partners in carrying out the assessment and other related work.

D. Program Rationale and Soundness

78. ADB's support for the program can come at any time in a program's duration, from the conceptualization to an ongoing program. For a new program, ADB will support the borrower in designing the program. For an ongoing program, ADB will assist the borrower in improving program design as appropriate.

79. A program should be underpinned by a sector strategy which defines the sector objectives and strategies to achieve them. The sector strategy will be underpinned by sound sector analysis. The sector strategy will not be a rigid blueprint. It will establish basic principles, objectives, and strategies for the sector. Accordingly, there should be a defined process for updating the strategy. A transparent process will help to establish a cycle that strikes a balance between planning and implementation.²⁶

80. ADB will assess the program.

- (i) **Program Rationale.** ADB will ascertain that the program is underpinned by a sound sector strategy. ADB will further determine that the program's objectives are relevant and important. ADB will seek to ascertain the justification for the intended public interventions in supporting provision of public goods, addressing externalities, or addressing social and poverty concerns. Conditional upon the determination of the justification of public interventions, ADB will assess whether the public intervention should take the form of regulation, financing, or public provisions. In view of limited public resources and efficiency issues, the program needs to explore the role of the private sector in contributing to the development results, including through public and private partnerships (PPPs). Ensuring that public financing has a sound justification is a major step towards efficient public expenditure.
- (ii) **Program Effectiveness.** Effectiveness refers to the extent to which the program will achieve its intended results and meet its development objectives. ADB will determine that the program design is sound and can be expected to improve the sector performance and outcomes. It will assess whether the program approaches address the right problems with the right instruments in that the program activities and expenditures are appropriate for the program objectives.
- (iii) **Program efficiency and economy.** ADB will seek to determine that the program is designed and will be implemented efficiently. It will also look into whether the intervention gets the incentives right, whether the program is likely to generate

²⁶ OECD-DAC. 2006. *Harmonising Donor Practices for Effective Aid Delivery* - Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management. *DAC Guidelines and Reference Series*. Paris, France.

distortions, and whether the program will crowd-in or crowd-out private sector participation.

- (iv) **Policy considerations.** ADB will analyze the policy, legal, and regulatory framework governing the program. If there are major policy deficiencies in the sector, a policy-based lending approach may be needed.
- (v) **Institutional considerations.** ADB will assess the key institutions that will be responsible for implementing the program, including their roles, functions, human resources, inter-agency relations, and capacities. If there are major deficiencies in the institutions, capacity development will be required as a part of the program.

81. ADB will work with the borrower (and other development partners, as appropriate) to strengthen the program design and implementation arrangements as necessary.

E. Financing

1. Expenditure Program

82. The expenditure framework makes a program operational. It ensures that the program has been costed, and prioritized against realistic resource estimation. The expenditure framework is sometimes supported by a medium-term expenditure framework (MTEF). ADB will assess the adequacy, sustainability, efficiency and economy, transparency, and effectiveness of the whole expenditure program.

- (i) *Efficiency and economy* require that the public finance is used in an optimal manner. The efficiency and economy aspect will assess whether the expenditure covered under the program reflects efficiency in utilizing resources. It will assess whether certain aspects are best shouldered by the private sector or through PPP. The RBF program will strive to bring about incremental efficiency gains where possible.²⁷
- (ii) *Effectiveness* requires the public expenditures address the right problems with the right instruments, and achieves the development objectives. The effectiveness aspect will assess whether the expenditure program is likely to achieve the program results, and ascertain whether there are mismatches between expenditure and the problems on the ground.²⁸
- (iii) The adequacy aspect will review whether the expenditure is sufficient for the program objectives, and whether the allocation across components reflects the resources required to generate the results.
- (iv) *Sustainability* requires that a program has a long-lasting impact rather than short-lived and easily reversible results. The sustainability aspect will review whether the program can be sustained in the mid-term to achieve its objectives.
- (v) The transparency aspect will assess whether the budget and reporting systems provide timely and sufficient information on program expenditures.

²⁷ In the World Bank's Punjab Education Project, for example, the dismantling of the public sector text book production monopoly helped to improve the efficiency. See World Bank. 2009. *Project Appraisal Document on a Proposed Credit in the Amount of SDR 234.1 Million (US\$350 Million Equivalent) to the Islamic Republic of Pakistan Punjab Education Sector Project*. Washington, D.C.

²⁸ For example, an education sector program focusing on building schools and recruiting teachers may not be optimal when the main issue is teacher's absenteeism and the prevalence of 'ghost' schools.

2. Financing Plan

83. ADB will assess the adequacy and sustainability of the financing plan for the program. ADB will examine whether the financing plan is sufficient for the expenditure program. It will assess the government's medium fiscal projections, and ascertaining whether the underlying assumptions are realistic. ADB will analyze whether there have been significant discrepancies between budget allocation and budget execution. The assessment will also gauge whether there is a risk of faltering commitments for the program. ADB will seek assurances from the government of their continued commitment to fund the program.

84. ADB financing will constitute a part of the overall financing plan. The size of the ADB financing will be determined by the program's overall expenditure needs, ADB's lending in the country, the strength of the program, and the government and ADB's priorities. The ADB financing will be used to achieve program objectives, such as delivering results and improving program institutions. The specific share of the ADB financing in the program will be determined on a case-by-case basis. ADB financing will be pooled with the borrower's own resources and financing from other sources, if any.

F. Results and Disbursement

1. The Results Framework

85. A clear definition of results and strong emphasis on achieving those are defining features of RBF programs. The results of the ADB RBF programs are the results of government programs. Program results will be summarized in a results framework. If the results frameworks are not well defined, ADB will work with the borrower to develop or refine them.

86. ADB will assess the results framework of the program, seeking to ensure that they are concrete, measureable, transparent, and within the capacity of the program to deliver. The specific indicators will depend on the nature of a program, and may include development outcomes or supporting indicators such as outputs, institutional development indicators, and financing indicators.²⁹

87. ADB will analyze the result chains to establish the links between intermediate and final results, namely the program outcomes. For example, if the program outcome is to increase the number of students graduating from primary schools, outputs can include decreases in the drop-out rates and student and teacher absenteeism; and increases in enrolments. It is important to ensure that the causal relationships in the results chain are well established. ADB will assess the suitability of the result indicators in the results frameworks to ensure that they are well defined.³⁰ It is also important to select the right mix of different types of results.

88. The linkage between results and payments creates a powerful incentive for achieving results. It is thus critical to get the results "right". Outputs are the most important results in a RBF program. This is because outputs are directly within the program's control. It is the means

²⁹ For definitions of outcome, outputs, and other result definitions, see ADB. 2007. Manila; and, OECD-DAC. 2002. *Glossary of Key Terms in Evaluation and Results Based Management*. Paris, France. There is a need to review the applicability of ADB's design and monitoring framework (DMF) to ensure that it fits the design parameters of RBF operations. As ADB will disburse against results, there will no longer be need for ADB to approve activity plans. These and other necessary changes to the DMF need to be reviewed and introduced.

³⁰ For example, improved life expectancy generally cannot be used as a result indicator for a health sector program as it is influenced by many other factors. In addition, the time required to measure increases in life expectancy would exceed the loan period, rendering it ineffective as a program indicator.

through which the program achieves its outcomes, and it is the driving force in deciding how inputs should be selected and used.

89. In defining program outputs, RBF programs will stress that the outputs should be defined from the perspective of program beneficiaries. Outputs that are relevant to program beneficiaries may be significantly different from those for a government, a development agency, or a service provider. For example, school building and teachers' training are common output indicators in development projects. However, these may not be sufficiently relevant outputs for parents. For them, school buildings and trained teachers are only inputs for their children's education. The enrollment, retention, and children passing certain standards of tests are more relevant outputs for parents. Similarly, water pipes are commonly used output indicators for projects. However, for households, a stable supply of quality water is the crucial and relevant output, and water pipes are merely one input for delivering the water. Likewise, a road alone may not be a sufficient output for users, while well maintained and accessible roads (with connection roads and located in the right places) are more relevant. One key aspect in RBF programs is to select results that are relevant and meeting the needs of end-users—the program beneficiaries.

90. RBF programs will outputs be defined from the perspectives of program beneficiaries. Defined this way, outputs will be more likely to lead to outcomes as the results chain between outputs and outcome will be shorter than would otherwise have been the case.³¹ Such outputs will also better guide the determination of inputs and activities. End-users' perspectives are therefore a key point shaping the definition of RBF program results. ADB will assess whether the program results indicators, especially outputs, are sufficiently relevant to program beneficiaries and meet their needs.

91. DMCs should be provided with flexibility to choose the best means to achieve the results. Thus ADB should also assess whether the program approach embodies sufficient flexibility and motivates innovations.

2. Disbursement-Linked Indicators

92. DLIs will be a critical component for RBF programs as they are basis for disbursing ADB financing.³² DLIs will generally be a subset of results indicators carved out from the government's results framework. DLIs may, if necessary, exceed the government's result framework. For example, if critical institutional indicators are not included in the governments' result framework, they can still form a part of DLIs. The DLIs may be modified from the program's results framework if program results indicators are too broad or detailed. Ideally, however, DLIs should be the same as those in the program results framework to ensure synergy, government ownership, and integration between the government and ADB assistance. The DLIs will be agreed to between the ADB and the borrower.

93. Selection of DLIs can consider several factors

- (i) DLIs should be priority result indicators from the results framework carefully selected to catalyze the achievements of the program results;
- (ii) DLIs should reflect a balance between outcome, outputs, process, institutional, financing or other appropriate indicators that are necessary to achieve results. DLIs

³¹ For example, stable and quality supply of water is more likely to lead to improved health indicators than just water pipes.

³² Under a RBF program, ADB financing will not be paying the costs of achieving DLIs. DLIs are a part of the program results which will be achieved through using all the resources available for the program.

can include policy actions, but these should be limited to what is critical to achieve sector results. If policy indicators dominate, a policy based lending modality may be more appropriate;

- (iii) DLIs will be driven by the program outcomes and outputs, and linked with these through a clear results chain;
- (iv) DLIs should fully consider the perspective of the program beneficiaries to ensure that they are relevant and meet their needs;
- (v) DLIs should also consider the government's financing needs and fund flows to help the government's macroeconomic and fiscal management;
- (vi) DLIs may be progressively advanced during the program period. A program in the initial stages may have DLIs that are more focused on basic institutional capacity-building actions, while programs that are more advanced may have more output and outcome indicators;
- (vii) Determination of DLIs should consider the practical aspects of measuring, monitoring, and verifying results. DLIs should be concrete, measurable, transparent, and verifiable;
- (viii) DLIs should be realistic and achievable and under the control of the responsible agencies;
- (ix) DLIs (and the overall program result indicators), should be limited in number, reflecting only those crucial to the program to ensure the focus of a program.

94. Each DLI will be accompanied by a clear verification protocol that will define how it will be measured; how it will be the verified, who will be responsible for achieving the results, and who will verify the results. This credible and realistic verification mechanism will be agreed upon between ADB and the borrower.

3. Verifying Results

95. ADB's disbursement is conditional upon credible verification of achieving DLIs. The verification will depend on the nature of the DLI, the program, and country context, and can be conducted by different public, private, semiautonomous, or civil society entities, as appropriate. The key is to ensure the credibility and objectivity of the verification. It will be important to provide program beneficiaries with a role in verifying the results where appropriate.

4. Linking Results with Disbursement

96. **Disbursement.** RBF program proceeds will be disbursed to the relevant account of the borrower, following the achievement and verification of the agreed upon DLIs. Disbursements will not depend on expenditure or transactions. The disbursement schedule and amount will be defined and agreed during the RBF program preparation, following a fixed (e.g. yearly or semi-annually) and/or a floating schedule (e.g. when DLIs are met) within a time-bound program completion date. For results achieved prior to the closing dates of the program, ADB will allow for verification of the results and the disbursement up to six months after the closing date. Any extension of this timeframe will be approved by the relevant country or sector director.

97. **Partial disbursement.** RBF programs will allow partial disbursements if DLIs are partially met. The design of the partial disbursement will be program specific, for example, disbursing after a minimum number of DLIs have been met, including global DLIs that are particularly important and must be met before the disbursement, or having a percentage rule. DLIs may be 'priced' equally or differently depending on their purposes. Equal pricing has the advantage of simplicity. Differential 'pricing' can accentuate the importance of key indicators.

Disbursement can be deferred or take place ahead of the expected disbursement schedule depending on the achievement of DLIs.

98. Cant, Carter, and Lister (2008) have summarized the rationale for partial disbursements.³³

- (i) Deviations between expectations and actual implementation are always to be expected. Partial disbursement for partial performance is appropriate to recognize progress made;
- (ii) Partial payment helps avoid a “stop-go” pattern in disbursements by providing less potential disruption to the disbursement schedule. The “all or nothing” approach can be damaging to macroeconomic and budget management;
- (iii) Partial disbursement can also enhance credibility of disbursement conditions. Often because of the damaging “stop-go” effects, development agencies are tempted to overlook under-performance by granting waivers to enable the whole amount to be disbursed rather than being blocked. This can undermine the credibility of disbursement conditions. Partial disbursement for partial performance can help address this problem.

99. The determination of the disbursement schedule will also take into consideration the government’s budgetary timetables to increase the predictability of fund flows. By linking disbursements to intermediate results and other actions, it will be possible to phase the expected timing and level of disbursements in a way that supports results as well as reflects the need for a predictable fund flow. Partial disbursement will also facilitate the predictability of fund flows.

100. To reflect the program commitment and provide incentives for timely and effective implementation, the ADB commitment charge will be applied to the portion of ADB financing that was not disbursed against the planned disbursement schedule agreed at the program preparation stage.

101. **Advanced financing and financing prior actions.** The initial financing gap may create a burden for the borrower given the resources required to achieve DLIs for the first disbursement. Advanced financing may also be needed for institutional development. To address the start up financing requirements and help to achieve the initial DLIs, ADB will be able to provide advances up to 25% of the total ADB financing as the mobilization disbursement. The amount of the advance will be recovered from the amount to be disbursed subsequently. Further advances can be made once an advance has been recovered or partially recovered. Some results may also need to be achieved before a RBF program is approved, for example, setting up the M&E arrangements. In such cases, ADB will be able to disburse against DLIs achieved between the date of the Program Concept Review and the program approval. The total amount for financing the prior actions should not exceed 10% of the ADB financing.

G. Institutions

1. Monitoring and Evaluation

102. Ensuring the reliability and soundness of the program’s M&E system is critical for the success of a RBF program. M&E will promote learning and better decision making. It will also generate reports on results achieved, including on the DLIs. In recent years, M&E systems have

³³ See J. Cant, R. Carter and S. Lister. 2008. *Stocktake on Donor Approaches to Managing Risk when Using Country Systems*. A report prepared for OECD-DAC Joint Venture on Public Financial Management.

been moving away from being implementation process-based to results-based. There is a strong synergy between the results-based M&E system and RBF programs.

103. RBF programs will require the program M&E systems to enable transparent and objective assessments of program performance and facilitate timely remedies when problems occur. M&E systems depend on careful definition of objectives, identification of indicators, and availability of data. One lesson to emerge has been the need to use existing government systems for M&E, rather than to duplicate as weaknesses in government systems provide an opportunity to strengthen them.³⁴

104. Under RBF programs, a strong M&E system is a necessity, not a choice. The feedback loop between results and financing will be internalized and institutionalized through linking results with disbursement. Through working with and using the borrower's M&E system, a RBF program will serve as a vehicle to strengthen the DMC M&E systems. Setting up an acceptable M&E system can be part of the DLIs.

105. ADB will assess the adequacy of the borrower's M&E system to generate reliable, timely, and adequate information on results, and produce credible and sound reports on the program. ADB will assess the institutional arrangements of M&E for the program, M&E capacity including staffing and resources, M&E experience and performance, M&E plans, availability and quality of data, capacity to generate adequate and reliable reports, information sharing and disclosure, and capacity development needs. M&E systems may include multifaceted approaches, for example, information systems, third party evaluation, beneficiary group feedback, and civil society oversight, as appropriate. ADB will discuss the methods of M&E with EAs and the key IAs.

106. ADB and the borrower will agree on measures to improve the M&E system. ADB and the borrower should avoid relying on cumbersome process-oriented oversight mechanisms to assess performance. The M&E system will be strengthened throughout the program cycle.

2. Governance Institutions for Results and Fiduciary Management

107. Strong governance institutions, including financial management, procurement, and anticorruption serve two important purposes. They support the efficient and effective implementation of the program to achieve the program's development objectives. A RBF program's governance systems, through capacity development and implementation support, also seek to provide reasonable assurance that the program financing will be used for intended purposes (with due attention to economy and efficiency) to achieve the program's fiduciary objectives.

108. ADB will assess the strengths and weaknesses of the governance institutions for the program as a whole. Based on the assessment, an action plan will be developed to address the weaknesses. ADB will assist the borrower in identifying the weaknesses and building capacity.

109. The specific scope of the fiduciary systems assessment will depend on the nature and scope of the program. The governance assessment may require more depth and focus than the application of transaction specific ADB rules and procedures used in ADB projects. This may mean that sufficient lead time needed for processing RBF programs to allow for robust and comprehensive system assessments.

³⁴ OECD. 2008. *2008 Survey on Monitoring the Paris Declaration Making Aid More Effective By 2010*. Paris, France.

110. Under RBF programs, capacity development will be closely linked with achieving program results. Results will not only be defined as improvements in sector outputs and outcomes, but also in improvements in systems. Learning from the lessons (Appendix 5), RBF programs will not just focus on transferring skills and technology. RBF programs will support incentive and institutional changes that will change behavior of organizations and individuals.

a. Financial Management

111. Most ADB financed projects have utilized DMC financial management practices in such areas as accounting, auditing, and financial reporting. A recent ADB analysis shows that 94% of ADB financed operations used DMC financial management systems in 2010, exceeding the Paris Declaration target of 78%.³⁵ RBF programs will build on ADB's experience in using DMC financial management systems by tackling weakness at the program level.

112. ADB's assessment of the financial management system will determine the degree to which the planning, budgeting, accounting, internal controls, fund flows, financial reporting, and auditing arrangements lead to effective and efficient program design and implementation, and provide a reasonable assurance of the appropriate use of program funds.

- (i) **Budgeting and planning.** The budgeting and planning system of the program should ensure that the resource allocation for the program is realistic, and there are no significant discrepancies between budget allocation and execution. Linking the sector strategy to the budget is the transmission chain between strategic priorities and results on the ground. The link from strategies to annual budgets will be facilitated by the preparation of a sector-specific MTEF.³⁶ In the absence of MTEFs, annual expenditure plans should be linked in with strategies. The budget and planning should ensure a realistic cost estimates for the program and a clear view of the resource envelope.
- (ii) **Internal controls.** ADB will establish whether reasonable internal controls are in place to safeguard program resources and give due consideration to economy and efficiency. It will identify gaps or weaknesses that may create opportunities for leakages and fraud, corruption, and other prohibited activities, and will identify areas for improvement to strengthen prevention and enforcement.
- (iii) **Funds flow.** ADB will assess the fund flow arrangement, seeking to ensure that there is adequate clarity, checks and balances (with due consideration to economy and efficiency), and measures to prevent leakages.
- (iv) **Accounting.** ADB will assess whether the borrower will maintain adequate program records and accounts.
- (v) **Financial reporting.** Based on the records and accounts, the program should generate timely and adequate financial statements. ADB will assess the scope, form, content, and frequency of financial statements.
- (vi) **External audit.** The program financial statements should be subject to independent audit. ADB will assess whether the form, content, and frequent of the program financial statements are acceptable to ADB. ADB will require the auditor to be independent, and to have the capacity to provide audit reports and opinions on the quality required by ADB.

³⁵ ADB. 2011. *Aid Effectiveness Report 2011: Overall achievements on Paris Declaration Commitments*. Manila.

³⁶ World Bank. 2007. *Results-Based National Development Strategies: Assessment and Challenges Ahead*. Washington, D.C..

b. Procurement

113. Procurement assessment will be guided by sound procurement principles, namely, competition, economy and efficiency, transparency, and fairness and equal opportunity.

- (i) *Competition*. Open competition is the default approach, and conditions for all other methods are clearly described.³⁷
- (ii) *Economy and efficiency*. The procurement processes are efficient and lead to optimal results in terms of time, costs, and quality.
- (iii) *Transparency*. The procurement processes are governed by clear rules that are easily accessible and consistently applied. Contract opportunities are advertised widely.
- (iv) *Fairness and equal opportunity*. All eligible bidders have an equal and fair opportunity. Procurement processes avoid preferential or discriminatory measures that might favor or affect certain participants.

114. Under the systemic approach of RBF programs, A RBF program would rely on program systems and arrangements for its implementation, including for procurement of goods, works and services.³⁸ ADB's Procurement and Consulting Guidelines, which are designed for transaction-based projects, will not apply. Rather, ADB's assessment will seek to determine the degree of the program procurement system, through capacity building and implementation support, provides reasonable assurance that program financing will be used economically and efficiently and for its intended purposes based on the same principles embodied in ADB's Guidelines. The procurement assessment will be conducted for the whole program.

115. The scope of the procurement assessment may cover the critical stages of the procurement cycle on whether there are reasonably:

- (i) sound arrangements for planning and budgeting;
- (ii) clear and accessible bidding rules;
- (iii) open and transparent the bidding process;
- (iv) consistent and transparent evaluation and award criteria;
- (v) strong contract award and contract management capacity;
- (vi) robust oversight and control systems; and
- (vii) strong complaint systems and dispute resolution mechanisms.

116. The assessment will be used to develop a baseline to help monitor procurement performance during implementation. ADB and the borrower will also identify key risks and prepare mitigating measures. Where weaknesses are identified, ADB will work with the borrower to prepare an action plan. The actions undertaken should aim to integrate sound procurement principles with the existing government procurement system of the program. ADB will support the borrower in implementing and refining the plan during the implementation; and monitor the program.

c. Anti-Corruption

117. RBF programs provide an additional opportunity for ADB to assist DMCs to fight fraud and corruption. RBF programs will have built-in mechanisms to mitigate fraud and corruption

³⁷ The degree of optimal competition depends on the size and nature of the procurement. Competitive processes take time and can require extensive capacity building. Underbidding during the tender process is a risk, followed by financial problems later. For small-scale projects, over-sophisticated systems with a wide array of checks and balances may prove costly and cumbersome and lead to inaction. These costs should be weighed against the many advantages of competition to drive down costs.

³⁸ Procurement also includes consulting services.

risks. First, linking ADB financing to verifiable results will help ensure that funds are used appropriately. Second, confronting systemic weaknesses and fostering institutional development in financial management and procurement will help address corruption risks. Third, RBF programs will include targeted measures to specifically address corruption risks.

118. Identifying the likely leakage points, weak links, and opportunities for corruption will constitute a key aspect of ADB's assessment and subsequent assistance. ADB will assess the degree to which program systems prevent and deal with the risk of fraud and corruption. The program's approach to and enforcement of its anticorruption policies will be included in this assessment, remedies to strengthen weak areas will be applied, and progress will be monitored.

119. ADB's GACAP II (2006) introduced a risk-based approach to managing governance and corruption risks.³⁹ RBF programs will benefit from the existing work on fiduciary risk management stipulated by GACAP II. However, RBF programs will require probing analysis to identify the risks of fraud and corruption at the program level, and determine the degree to which the program's governance systems provide reasonable assurances that financing for the whole program will be used for its intended purposes, with attention economy and efficiency. The fiduciary systems assessment will also provide a reference for monitoring the system performance and improvements during program implementation.

120. To enable the borrower to improve anticorruption systems, ADB will provide opportunity for the borrower to address the problem at hand, and implement measures to reduce its reoccurrence. ADB will expect that borrowers will take appropriate and timely measures to prevent, detect, and respond to allegations of fraud, corruption and other prohibited activities in RBF programs as presented in the Guidelines specifically designed for RBF programs (Appendix 6). ADB and the borrower should share information with each other about any relevant issues in a timely manner. As needed, a program may include specific arrangements to implement the anticorruption guidelines.

121. Based on the findings of the assessment, ADB and the borrower will agree on measures to mitigate risks of corruption. A reporting and complaint mechanism for allegations of fraud, corruption, and other prohibited activities will be developed and applied. Where remedial actions are identified, ADB will provide the borrower with appropriate assistance to strengthen institutions and the enforcement environment.⁴⁰

122. While RBF programs will encourage and support borrowers to tackle fraud and corruption risks, ADB will have the right to carry out investigations of the alleged fraud, corruption, and other prohibited activities related to the program that ADB deems necessary, and to sanction entities that are found to have engaged in fraud, corruption, or other prohibited activities. The ADB's sanction list will apply to RBF programs. The borrower will ensure that entities debarred and suspended by ADB do not participate in contracts awarded during implementation of the program or during the periods of debarment or suspension. ADB's standard remedies will enable ADB to sufficiently respond when issues of fraud and corruption are not satisfactorily addressed by the borrower.

³⁹ ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

⁴⁰ There are already several fiduciary risks assessments and capacity building programs designed by different departments, focusing on different segments of overall fiduciary system. However, these are not coordinated and are not based on an integrated fiduciary assessment mechanism.

3. Managing Safeguard Risks

123. ADB's Safeguard Policy Statement (SPS) will apply to RBF programs. RBF programs will uphold the policy objectives and policy principles of the SPS.

124. The distinct nature of RBF programs requires that the programs rely on the programs' safeguard systems. RBF programs thus will provide opportunities to strengthen the programs' safeguard systems. ADB will carry out diagnostic assessments of a program's safeguard system, guided by the SPS policy principles. ADB will examine the program's potential safeguards impacts, and the degree to which the program's safeguard system managing and mitigating the environmental and social impacts of the overall program.

125. ADB will further assess the degree to which the borrower has the adequate implementation practice, capacity, and commitment to plan, implement, monitor, and report on the safeguard measures for the program. ADB will review the program's arrangements and quality for early screening of safeguards effects; consultations with stakeholders; grievance redress procedures; and information disclosure mechanisms.

126. The assessment will inform measures to improve the program's safeguard system and capacity. Such actions should be commensurate to the nature and scope of the program. ADB will agree with the borrower on measures to strengthen the system. During implementation, the borrower will monitor and report on the performance of the program's safeguard system. ADB will monitor the implementation of the agreed actions.

127. ADB will disclose the draft environmental and social system assessment on the ADB website. Upon completion, ADB will disclose the final assessment on the ADB website.

H. Integrated Risk Assessments and Mitigation Measures

128. The program, finance, results, and institutional assessments will reveal the program's strengths, weaknesses, and risks. ADB and the borrower will integrate the findings from the various assessments to determine the overall soundness of the program, the program systems, risks and mitigating measures, and improvements required. ADB and the borrower will prepare an integrated risk assessment and mitigation plan.

129. This plan will include the risks specifically pertaining to the program, as well as risks relating to the operating environment. These risks can be broadly classified into six inter-linked categories:

- (i) *Program risks*: risks that can undermine the achievements of the program's results and development objectives. These risks further relate to the program's rationale, design, and government commitment.
- (ii) *Results risks*: risks relating to the definition and selection of results, DLIs, measurement, verification mechanisms, M&E, and sustainability.
- (iii) *Financing risks*: risks associated with the adequacy and sustainability of the program financing.
- (iv) *Fiduciary risks*: risks that the program finances will not be used for the intended purposes. These risks relates to financial management, procurement, and anti-corruption aspects.
- (v) *Safeguard risks*: risks that are associated with the potential adverse safeguard impacts of the program.

- (vi) *Operating environment risks*: risks that relate to the country's macroeconomic conditions, political conditions, and fiscal conditions.

130. Similar to other operations, ADB will first prepare a preliminary risk assessment during the program concept stage which will form the basis for the program's risk categorization. During program processing, more detailed assessments will be carried out and risk mitigation action plans will be agreed with the borrower. The risk assessment and mitigation will be a dynamic process, continue to be updated throughout the program preparation and implementation process.

131. In cases where weaknesses are identified, a robust capacity development and risk mitigation action plan will be drawn up and committed to by the borrower. This will require sustained political commitment by the borrower to implement the actions. If the assessment concludes that the program systems have major material weaknesses that cannot be effectively addressed through the program, ADB and the borrower may decide not to pursue the RBF program. In this case, ADB can still work with the borrower on institutional strengthening to prepare it for eventually meeting RBF program requirements.

I. Capacity Development and Other Required Actions

132. The assessments will inform the scope and intensity for capacity development and other required actions. ADB and the borrower will agree on an action plan to be implemented and monitored during implementation. Capacity development plans can include actions to improve the program's design and implementation, the program's institutions in governance, M&E, and other aspects, and actions to mitigate risks. Critical actions will be translated into DLIs. The action plan will be a living document, and will be continuously refined, improved, and updated. ADB can support the borrower through loans, grants, and technical assistance.

133. Capacity development and other actions will be driven by the objective of achieving the program's results. The design of the action plan should balance the considerations of best using the opportunities to improve institutions and results; and be realistic and feasible. Through RBF programs, ADB should aim to assist the borrower in achieving positive and sustainable changes. Incremental and continued progress is more beneficial than overly ambitious, short-lived changes.

J. Development Coordination

134. RBF programs will enhance ADB's ability to work in partnership with governments, development partners, and other stakeholders. RBF programs will support government ownership and leadership. The program will be owned by the government, the implementation will use the program systems, ADB disbursement will be based on indicators from government's results frameworks, and capacity development will be geared towards enhancing the government's ability to deliver results.

135. RBF programs will support development partner coordination and harmonization as they can share the common systems and results. Development partners can coordinate to assist the government in improving the program design, conduct assessments, identify risks, mitigate risks, coordinate in capacity development, and undertake joint learning. Such coordination and harmonization will help to avoid duplication and fragmentation of development assistance. The programs will be ideal for co-financing, including for technical assistance.

136. RBF programs will also aid ADB to partner with the private sector, civil society, and other stakeholders. Stakeholders' feedback will help define and refine the program scope, results, M&E, verification, and risk mitigations. There may be opportunities for these stakeholders in to assist in implementing the programs.

K. Roles and Responsibilities

137. The borrower is responsible for designing, implementing, and monitoring a RBF program, and for maintaining the agreed-upon implementation arrangements, for example, the M&E arrangements, governance and fiduciary arrangements, and safeguard systems. The borrower is also responsible for dealing with problems at the individual or systemic level in the program in a timely and effective manner.

138. ADB will assess the program. ADB will also support the government in identifying and designing measures to improve the program's efficiency, effectiveness, systems, and risk mitigating measures. ADB, working with other development partners as appropriate, will support the borrower to implement the improvement measures, monitor program performance and risks, and help resolve emerging issues. ADB's review and support will include the achievement of the results and DLIs, system performance and progress, and management of risks.

139. RBF programs will be characterized by continuous capacity building to strengthen the program, results, institutions, and risk management throughout the program cycle. The very purpose of using the program systems is to raise standards for the whole program. Capacity building will be an important aspect of ADB support. ADB will work closely with other development partners as appropriate.⁴¹

140. The ADB program teams will be responsible for standard monitoring and supervision functions. The system based nature of the RBF programs requires that ADB teams continuously update their sector knowledge, and dialogue with the government and other development partners. As in any other operations, the RBF program implementation will be a joint problem solving process between the borrower, ADB, and other development partners.

L. Application and Approval

141. **Application.** Given that RBF programs support government owned programs, they will be applied to sovereign operations. In a similar manner to other existing modalities, there will be no *a priori* determination of the country, sector, or type of programs which may use this modality. Each RBF program will be evaluated on a case by case basis. A RBF program can be adapted to a wide range of specific applications (see Appendix 1 for examples). While the proposed RBF program modality focuses on program based operations, project based RBF such as OBA can form a part of a RBF operation, for example as a government subsidy program for connecting the poor with services. While a RBF program is a government program, it is well suited to take advantage of PPP, which are emerging as a major vehicle to augment resources and harness efficiency. RBF programs should actively explore opportunities to increase resources and efficiency for a government program. RBF programs can also be combined with other ADB modalities.

142. **Approval and Documentation.** Processing and approval of RBF programs will follow standard ADB procedures. Through the various review and oversight mechanisms embedded in

⁴¹ Recent analytical work and diagnostic assessments by other development partners, updated as required, can be used. Joint assessments with other development partners will be encouraged.

standard ADB procedures, ADB will assess the risks and benefits of engagement in a RBF program. ADB will consider the scope and quality of a program, the expenditure and financing arrangements, the strengths and weakness of its systems, the risks, the borrower's commitment and potential to make improvements, the challenges to make the improvements, and ADB's value added.

143. ADB will form a considered view on whether to proceed with a RBF program and how best to do so. The identification of the program should conclude that the program has a strong rationale, and confirm that sector results and system improvements, and other expected benefits will exceed the program costs. It will also confirm that ADB can contribute positively in such areas as in refining the program, increasing the likelihood for results, institutional development, and learning for ADB.

144. Concept papers for RBF programs operations will be cleared in accordance with ADB's prevailing business processes and may include preliminary analysis of the program, financing, results, institutions, and risks. The concept paper will outline assessments required and provide justification for selecting the RBF program modality. The concept paper will also provide the categorization of the RBF program as "high risk" or "low risk". The Report and Recommendation of the President will outline the rationale for the program and ADB assistance to be provided, describe the objective and scope of the RBF program, and report key findings of the assessments. It will describe the financing to be provided by the government and other financiers. The Office of the General Counsel will prepare the legal documents.

M. Financing Related Issues

145. ADB finance can come from various sources, for example the ordinary capital resources, Asian Development Fund (loan and/or grants), grants, or cofinancing. Financing related aspects are outlined below.

- (i) **Cofinancing.** RBF programs will provide a good platform for coordinating external financing in a sector. RBF programs should actively explore the scope for cofinancing. If cofinancing materializes after the ADB RBF program is approved, Management will approve such cofinancing and report to the Board for information as part of the annual report on cofinancing.
- (ii) **Additional financing.** RBF programs can apply additional financing following the additional financing policy and procedures.
- (iii) **Project design facility.** RBF program can use ADB's project design facility.
- (iv) **Technical assistance.** ADB can provide technical assistance to RBF programs, either as a part of the program or as separate operations.
- (v) **Use of proceeds.** The proceeds from the RBF program will be used to support recurrent and/or capital expenditures for achieving the program results, improving the program institutions, and providing other needed support to the program objectives. To satisfy the Charter requirement that ADB financing should be used only for procurement from member countries (Article 14.ix), the total program cost estimates excluding international procurement and consulting services from non-member countries should equal or exceed the amount of ADB financing.
- (vi) **Loan cancellation.** Loan cancellations will follow the same rules and procedures used for projects.

N. Implementation Related Issues

1. Financial Auditing and Results Verification

146. **Financial auditing.** ADB and the borrower will agree on the approach for financial auditing, to be carried out by auditors with independence, experience, and capacity acceptable to ADB, and under terms of reference acceptable to ADB, taking into consideration the program nature, country context, and risk assessment. The borrower will submit annual audited program financial statements to ADB after the close of the borrower's financial year. In DMCs, statutory requirements may specify the use of the country supreme audit institutions (SAIs) for a development program.⁴² If the audit reports from the SAI cover multiple programs and do not provide sufficient details for the program or are issued with delays, ADB will discuss and reach agreement with the EA and the SAI on acceptable terms of reference to ensure that the audit of annual program financial statements is conducted in a timely and acceptable manner. If the SAI is unable or unwilling to audit the program, ADB and the borrower may agree on alternative audit arrangements for the program. The borrower and ADB will monitor how the EA and IAs implement the findings and recommendations of the audit report on a sample basis as appropriate. ADB may also provide capacity building for audit arrangements related to the program.

147. **Results verification.** ADB or the borrower will arrange the appropriate results verification mechanisms, such as engaging technical experts, third parties, or seeking feedback from program beneficiaries. ADB program teams will review the verification report and/or other evidence to confirm the achievements of DLIs.

2. Change of Scope and Implementation Arrangements

148. As in other operations, RBF programs may require change of scope of implementation arrangement for example to improve a program's performance or respond to changed circumstances. Changes of scope and implementation arrangements will follow standard ADB procedures.

3. Addressing Performance Problems

149. If performance problems arise, ADB's responses will depend on the nature and severity of the problems and the responses of the borrower. ADB will promptly bring the problems to the attention of the EA and will ask the EA to take timely and appropriate actions. It will also support the borrower to address the problems. ADB will follow up on the borrower's actions and results in addressing performance problems.

150. Depending on the nature, scale, frequency, and a borrower's response to problems, ADB will adopt appropriate measures to deal with problems. Because RBF programs focus on systems instead of transactions, individual transactional non-compliance that is not considered unreasonable given the historical performance of such systems will be treated differently from systematic problems. Reasonable assurances in using program systems are premised on recognition that even robust systems have varying quality of transactions. Thus ADB's action will distinguish between systematic issues from ad hoc variation, and between government's own action and a lack of it in addressing performance problems. However, a borrower's failure to take corrective actions promptly for reasons under the borrower's control in addressing systematic performance problems may result in ADB having to apply its standard remedies.

⁴² SAIs are an important budget oversight institution. They take different forms in different countries, reporting to the Parliament, the Supreme Court, or an Audit Board. They audit government accounts to ensure: (i) the proper and effective use of public funds; (ii) the proper execution of administrative activities; (iii) the development of sound financial management; and (iv) the communication of information to public authorities and the general public through the publication of objective reports.

4. ADB Policies, Procedures, and Corporate Oversight Functions

151. Unless modified in this paper and/or the related Operations Manual, processing and implementation of RBF programs will follow standard ADB policies and operational procedures.

152. RBF programs will be subject to the oversight of the Independent Evaluation Department, Accountability Mechanism, and the Office of Integrity and Anticorruption.

153. **Independent Evaluation.** The RBF program policy and any RBF programs will be subject to independent evaluation as deemed appropriate by the Independent Evaluation Department.

154. **Accountability Mechanism.** A RBF program will be subject to the Accountability Mechanism policy.⁴³

155. **Anticorruption.** The RBF program policy will include anticorruption guidelines for borrowers and ADB to prevent and combat fraud and corruption in the programs (Appendix 5). Other anticorruption related measures are described in paras. 117-122.

5. Reporting Results

156. ADB will finance a portion of the program expenditures and the DLIs will generally come from the overall program results framework to be realized by all resources. ADB will apply a proxy to report its contribution to the program results. This may involve using *pro rata* allocation based on financing or other reasonable means.

6. Operations Manual and Guidelines

157. Conditional upon the Board's approval of the policy, ADB will prepare an operations manual for RBF programs. ADB may also prepare staff instructions or guidelines to support the design and implementation of RBF programs.

VIII. CHALLENGES AND WAYS FORWARD

A. Risks and Mitigating Measures

158. The introduction of the RBF program modality may involve several risks which can affect ADB and the borrower. However, none of these appear to pose major difficulties.

1. Definition and Verification of Results

159. Making results the basis for disbursements will present several challenges. Defining the results at the appropriate levels and ascertaining their causal relationships with sector outcomes will not always be straightforward. There is a risk of results being defined as too easy or overly ambitious. To address these challenges, ADB will support the borrower to develop or refine its results framework. Credible results verification and feedback from program beneficiaries will improve the definition, achievements, and verification of results. Defining results, especially outputs, from the perspectives of program beneficiaries will also guide the proper selection of relevant and appropriate result indicators.

⁴³ ADB. 2012. *Review of ADB's Accountability Mechanism Policy*. Manila.

160. For a borrower, linking results with disbursement may expose it to the risk that results may be not achieved and ADB financing may not be disbursed. Allowing partial disbursement will reduce this financing risk. Design of RBF programs should take into consideration both the importance of producing results and the need for predictability of fund flows. It is also important to bear in mind that the very purpose of the RBF programs is to ensure that results are delivered, and recognize achievements through disbursement. In this sense, it is a risk that is worth taking for increased prospects of achieving results. Countries seriously concerned about their ability to deliver identified results in a program may opt not to use the RBF program modality.

2. Institutional Development

161. Institutional development will promote sustainable development, but it can be resource intensive, time consuming, and difficult. ADB should work with the borrower to develop and implement realistic action plans to bring about incremental, positive, and sustainable changes, and should also join hands with other development partners to assist the government in institutional development. The close integration and feedback between systems and results will also make the institutional development focused, evolving, and with a higher likelihood of government buy-in.

3. High Transactions Costs

162. There is a risk that the various assessments conducted for a RBF program will be excessively complex, time-intensive, and costly; and the assessments too detailed and prescriptive. ADB should ensure that appropriate resources are available for the upstream assessments and downstream supervision. Over time, though, it should be possible to prepare RBF programs with lower transaction costs as necessary analytic work and knowledge are accumulated. Transactions costs can also be partly offset by the reduction in the costs to establish and maintaining parallel systems.

163. To reduce transaction costs, ADB should actively learn from its own experiences, and that of other development agencies. ADB should also actively explore efficient ways to more efficiently produce the assessment, for example, by collaborating with other development partners and sharing the assessments. The RBF programs should build on and advance many sector analyses that are already taking place.

164. It should also be recognized that while initial system assessment and capacity building may require more time and resources, the benefits from sharper result focus, improved sector knowledge, better institutions systems, and more sustainable programs can generate large pay-offs in the long run.

4. Fiduciary and Safeguards Risks

165. RBF programs will seek to ensure that all public finance for the program, including finance from ADB, is used appropriately and that fiduciary and safeguards risks are adequately addressed. However, improving systems and risk mitigation is a demanding task for governments and development agencies. To address the risks, ADB will carry out careful assessments of the governance and safeguard systems, assist the borrower in preparing an action plan to address the weaknesses, and support capacity building. Increased accountability for results as a built-in feature of the RBF will also mitigate fiduciary and safeguard risks. Systematic M&E will track achievements of results, performance of institutions, and allow the

lessons learned to be incorporated in the programs. The use of credible result verification mechanisms will also help to increase accountability and reduce risks. Finally, improving government systems, while difficult, is ultimately the only sustainable measure to address fiduciary and safeguard risks.

5. Risk of a Program Being Captured

166. RBF programs will provide a platform for ADB to work with the borrower to sharpen the result focus and enhance institutions, but there is also a risk of capture of the program in two senses. First, a program can become ADB driven, detached from the ownership and institutions of the DMC. Second, strong departments or groups in a DMC may dominate the dialogue and risk the program being captured by vested interests. To address these risks, ADB should assist the government in improving the local capacity, and making all the efforts to avoid an ADB driven agenda. ADB and the government should develop an effective consultation mechanism involving a wide range of stakeholders, including the program beneficiaries.

B. Advancing the Results-Based Agenda

167. Decades of development experience have emphatically illustrated that governments as well as development agencies should sharpen the results focus of their operations. Public finance must deliver results more effectively, and sustain results through bringing about systematic changes in institutions. Supporting the convergence between program systems and good practice principles will be a rewarding development journey for governments and development agencies. The huge potential benefits embodied in the RBF approach strongly argue for advancing the results-based agenda (paras. 45-57).

168. Many operations with the RBF features have already emerged in ADB and other development agencies in recent years. Experience on the operations show promising results, and demonstrates that RBF programs poses no greater risk than other projects.⁴⁴ The various risk mitigating measures embedded in RBF programs will also provide a solid foundation for managing risks. The risks of introducing the RBF programs are outweighed by the benefits of having a lending instrument that focuses on achieving program results and institutional development.

C. Piloting the Results Based Financing Programs

169. It is proposed that ADB adopt a learning-by-doing approach by piloting the RBF programs. The pilot time is proposed to be for six years which is the minimum timeframe required to process and implement RBF programs to yield sufficient information for the subsequent review and evaluation.

170. To support the piloting of the RBF programs, ADB should put in place a program for training, dissemination, consultation, and learning. As the programs are rolled out, a bank-wide advisory team including experienced mission leaders should be set up to support other program teams. ADB will proactively learn from its own experiences, and exchange experiences with other development agencies, especially the World Bank. After the pilot, ADB will review the implementation experience to guide the future direction on the RBF program modality.

⁴⁴ J. Cant, R. Carter and S. Lister. 2008. *Stocktake on Donor Approaches to Managing Risk when Using Country Systems*. A report prepared for OECD-DAC Joint Venture on Public Financial Management.

D. Resource Implications

171. RBF programs will require proficient staff to carry out the various assessments, assist the borrowers in improving program design and implementation, monitor the progress and initiate timely course of corrections. Recent stocktaking on ADB's financial management highlights capacity constraints of ADB in this area.⁴⁵ For system-related due diligence, the procurement skill sets will also be different compared to transaction based projects.

172. It is proposed that ADB strengthen the financial management and procurement capacity for implementing the RBF programs. This will not only benefit RBF programs, but ADB's operations as a whole. Assuming on average 2 programs from each subregion are developed annually, this could result in about 10 programs each year.⁴⁶ It is suggested that each subregion has at least one well qualified financial management specialist, and there is at least one specialist in a central department. This could result in the incremental costs of about \$0.8 million per year for about 6 international financial management specialists. The situation with procurement is less constrained. However, regional departments would benefit from having at least one procurement specialist with skills for system assessment. This could result in about \$0.7 million in additional salary costs per year. Overall the initial total implementation costs are estimated to be about \$1.5 million annually. These additional staff will not only help in design and implementing RBF programs, but also help to carry out training, develop good practice materials, and assist DMCs. Training should be carried out to better equip all staff.

173. Resource requirements should be balanced against the expected benefits from RBF programs. RBF programs will help ADB to consolidate its institutional work, accumulate knowledge and expertise in important areas of financial management, procurement, safeguards, and M&E. To better use resources, ADB should also actively cooperate with other development agencies and stakeholders to conduct assessments, build capacity, and generate knowledge products that will serve as 'public goods'.

IX. PUBLIC CONSULTATION

174. ADB seeks stakeholder and public comments and suggestions on the proposed piloting of the results-based financing programs. ADB will carefully consider all the points received in revising and finalizing the policy paper.

⁴⁵ ADB. 2011. *Strengthening ADB's Approach to Financial Management to Optimize Development Effectiveness (Draft, 16 August 2011)*. Manila.

⁴⁶ The number of programs will not be evenly distributed across the piloting years, with the numbers expected to pick up as staff becomes more familiar with the modality.

SUMMARY OF RESULTS-BASED FINANCING APPROACHES

1. Over the past decade, multilateral development banks (MDBs) and other agencies have carried out a large number of operations utilizing elements of results-based financing (RBF).¹ A broad array of RBF mechanisms has emerged. These include the World Bank's program-for-results financing, sector wide approaches (SWAPs), results-based financing in health (RBFH), conditional cash transfers (CCT), cash on delivery, performance-based contracting (PBC), output-based aid (OBA), the Global Fund to Fight AIDS, Tuberculosis and Malaria, the Millennium Challenge Corporation (MCC), the GAVI Alliance (formerly known as the Global Alliance for Vaccines and Immunizations), and performance-driven loans (PDLs).²

2. These initiatives either cover programs or projects.³ All share the common feature that the disbursement is made upon delivering results. This Appendix summarizes the key features of some mechanisms.

1. World Bank's Program-for-Results Financing

3. The World Bank's Program-for-Results Financing is a new instrument approved in January 2012.⁴ It was designed to enable the World Bank to better respond to changing development needs, meet demand from client countries, and enhance development effectiveness. It links disbursements to achievement of results. By directly supporting government programs, Program-for-Results aims to help countries strengthen institutions, build capacity, and enhance partnerships with stakeholders. Program-for-Results also aims enable the World Bank to leverage its own financing and partner with other development organizations in supporting country programs.

4. Program-for-Results has have the following features:

- (i) **Finances and supports borrowers' programs.** These programs, comprising expenditures and activities, can be ongoing or new, sectoral or sub-sectoral, and national or sub-national programs, as well as community development programs.
- (ii) **Disburses upon achievement of program results.** Disbursements will be determined by the achievement of monitorable and verifiable indicators, rather than by inputs. Together with funds from other sources, the World Bank disbursements will finance the borrower's expenditure program rather than being linked to individual transactions.
- (iii) **Focuses on strengthening the institutional capacity needed for programs to achieve their desired results.** A priority area for both preparation and implementation support will be to strengthen the capacity of the institutions to implement the program, thereby enhancing development impact and sustainability.
- (iv) **Provides assurance that World Bank financing is used appropriately and that the environmental and social impacts of the program are adequately addressed.** The World Bank will assess the program's fiduciary and environmental and social management systems. It will agree with the borrower on the additional measures needed to provide assurance that the loan proceeds are used for program expenditures, that these expenditures are incurred with economy and

¹ Lending includes grant and other financing, borrowers include grant and other financing recipient.

² This section draws from the published information of various organizations, for example information in the websites of various organizations.

³ Most MDBs processed these operations as investment projects due to the lack of a dedicated instrument.

⁴ World Bank. 2011. *A New Instrument to Advance Development Effectiveness: Program-for-Results Financing*. Washington, D.C.

efficiency, and that potential impacts to the environment and affected people are adequately addressed.

- (v) **Program Monitoring.** Disbursement linked indicators (DLIs) will require a credible verification process that is acceptable to the World Bank and is agreed at the time of appraisal. The verification process would also include independent or third party monitoring, where appropriate. Program-for-Results documents will be available to the public, giving stakeholders access to information about the performance of the public institutions and programs.

5. For each Program-for-Results operation, the World Bank will carry out a process of identification, preparation and assessment, appraisal, and implementation support. A central focus of preparation will be the identification of DLIs. Appraisal of each operation will be informed by rigorous assessments in three main areas that will be applied to the overall program and its expenditures. The *technical assessment* focuses on the strategic relevance and technical soundness of the program and its expenditure framework, the results framework, and the M&E arrangements. The *fiduciary assessment*, covering the procurement and financial management arrangements, seeks to make sure that program funds are used appropriately. The *environmental and social systems assessment* seeks to make sure that the potential environmental and social impacts and risks are adequately addressed. These assessments will identify measures to enhance performance, build capacity, and mitigate key risks, and will be reflected in an *integrated risk assessment*.

6. Program-for-Results focuses on the behavioral and institutional changes that are required to achieve results and manage associated risks. Hence it is expected that many Program-for-Results operations will require some level of capacity-building activities, which will be informed by the technical, fiduciary, and environmental and social systems assessments. Capacity building support will be provided through different modalities, from direct technical assistance and training to specific actions or DLIs to strengthen performance.

7. During implementation, the World Bank will monitor the overall progress of the program, associated expenditures, and the achievement of results. It will monitor progress in implementing the action plan, changes in the program's risks, and compliance with the provisions of the legal agreements. Technical support from the Bank team will focus on improving systems performance and resolving implementation issues. Program-for-Results will be subject to the same corporate oversight functions as other World Bank lending instruments, and the World Bank will retain the right to carry out investigations that it judges to be necessary and to sanction entities that are found to have engaged in fraud or corruption. The World Bank's debarment list will apply to Program-for-Results operations.

2. Sector-Wide Approaches

8. The SWAPs adopt a programmatic approach, many of which also have a result focus. The Organization for Economic Cooperation and Development-Development Assistance Committee (OECD-DAC) describes the SWAP as "a way of engaging in development cooperation based on the principles of coordinated support for a locally owned program of development". It includes four elements: leadership by the host country organization; a single program and budget framework; donor coordination and harmonization of procedures; and efforts to increase the use of local procedures over time with regard to program design and implementation, financial management, and monitoring

and evaluation.⁵ Development agency financing under SWAPs is typically channeled within a country-owned expenditure plan and budget in a sector or thematic area.

9. SWAPs represent an effort to address some problems in stand-alone projects, such as using parallel financial management systems which are not fully integrated into the government's budget. A SWAP is also intended to reduce transaction costs through increased coordination.

10. MDBs have carried out many SWAP operations since the mid-1990s. For example, ADB's The Bangladesh Third Primary Education Development Project.⁶ The World Bank estimated that their SWAP operations accounted for 20% of its disbursement in 2007 through 121 projects. SWAPs have been implemented mainly in the education and health sectors, but have expanded into many other sectors in recent years. The performance of these projects compare favorably with the overall World Bank lending portfolio. SWAPs have generally been processed as projects or investment lending operations. SWAP has also been used by many bilateral development agencies.

11. SWAPs have helped advance development assistance coordination among agencies, align development finance to country strategies, address sector wide problems, and support institutional reforms. The coordinated development partnership has produced better quality policy dialogue, enabling governments to make better use of technical resources and to spend less time focusing on individual donor concerns.

12. However, the implementation of SWAPs has encountered problems. The SWAP is an approach, not an instrument. The absence of clear policies and guidance on SWAPs has led to confusion and inconsistent applications. Transaction costs are high in many operations. Some borrowers see SWAPs as donor- rather than country-led. Harmonization has often taken place around donor-driven rules and templates. The focus on the SWAP processes itself rather than on the sector outcomes have sometimes resulted in 'SWAP fatigue'.

13. The implementation of SWAPs has provided valuable experience and lessons on results and programmatic based financing. It calls for development agencies to move this agenda forward by formally adopting a lending instrument to avoid confusion, inconsistent application, and high transaction costs.

3. European Commission Budget Support

14. Budget support is an important instrument in the comprehensive development policy of the European Union (EU) towards partner countries. It is a means of delivering better aid and achieving sustainable development objectives by fostering partner countries ownership of development policies and reforms. Budget support is disbursed only when the eligibility criteria and additional agreed conditions on results are met.⁷

15. To be eligible for budget support, countries must fulfill three mandatory conditions: (i) a well defined national policy and strategy is in place or under implementation, (ii) a stability-oriented macroeconomic policy is in place or under implementation, and (iii) a credible and

⁵ See Chapter 3 of OECD-DAC. 2006. *Harmonising Donor Practices for Effective Aid Delivery - Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management. DAC Guidelines and Reference Series.* Paris, France.

⁶ See Appendix 2 for examples of ADB operations with RBL features.

⁷ European Commission. 2011. *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: The Future Approach to EU Budget Support to Third Countries.* Brussels.

relevant program to improve public financial management is in place or under implementation.⁸ In 2011, the European Commission (EC) added a new criterion on public availability of most relevant budgetary information which is essential for promoting greater scrutiny of the budget.

16. Once the criteria are met, EC is involved in an ongoing dialogue with the partner government, addressing the government's priorities and strategies. Compliance with eligibility criteria and fulfillment of conditions is crucial in order to help safeguard the use of resources, mitigate risks, and create incentives for improved performance and results. This modality also aims to create incentives for partner countries to improve their governments systems.

17. EC focuses on sectors where policies and reforms are more promising to promote development and poverty alleviation, support the drivers of changes, and address the basic needs of populations (e.g. basic services such as health, education, and water and sanitation). EC intends to make more use of sector budget support to address sector constraints, promote reforms, and improve service delivery to populations.

18. The geographical coverage of the EC budget support has expanded over time to cover many countries with widely varying levels of wealth:

- (i) Africa, Caribbean, Pacific countries, signatories of the Cotonou Agreement (77 countries of Sub-Saharan Africa, the Caribbean and the Pacific). EC's total budget support to ACP countries increased from € 681 million per annum in 2002 to € 795 million in 2007.
- (ii) Countries benefiting from the Development Cooperation Instrument (47 developing countries in Latin America, Asia, Central Asia, and South Africa).

19. In providing funding, EC makes a broad qualitative assessment based on need and performance criteria:

- (i) Financing needs of the partner country assessed on the basis of its medium term fiscal framework and/or the national/sector development strategies.
- (ii) Commitment of the partner country to allocate national budget resources in line with development strategy and objectives.
- (iii) Effectiveness, value for money, and impact of the specific added value that budget support will bring in achieving the partner country's policy objectives.
- (iv) Track record and absorption capacity of past disbursements and how effectively agreed objectives were achieved with budget support operations.
- (v) Result orientation in the partner country's development strategy including a monitoring system.

20. EC has drawn several lessons from its budget support operations:

- (i) The growing success of budget support reflects efforts to improve the general effectiveness of aid. While traditional projects remain a useful and important tool, they are not always well suited to new development challenges, including the Millennium Development Goals.
- (ii) EU budget support should continue to ensure a high degree of predictability, to put strong emphasis on development strategies that are nationally owned and to use performance related tranches. EC remains committed to results-based budget support operations and intends to further strengthen the assessment of progress and monitoring of outcomes, including by using process and output indicators, so

⁸ European Commission. 2008. *Budget Support: The effective way to support development?* Brussels, Belgium.

as to better demonstrate and communicate the way EU budget support contributes to the development of partner countries.

- (iii) EC will refrain from establishing global targets for EU budget support to third countries. It considers that the appropriate mix between the different aid modalities is best decided as part of a portfolio approach that comprises several aid modalities in response to a partner country's specificities and agreed development objectives.
- (iv) EC will strengthen its risk management framework for EU budget support in line with the Court of Auditors' recommendations. This will include closely monitoring progress in the fight against corruption and fraud with a view to ensuring sustainable development benefits.

21. The 2007 Budget Support Guidelines are being revised to reflect the orientations set out in the 2011 Communication.

4. Results-based Financing for Health

22. RBFH aims to increase the impact of investments in health by providing financial or in-kind rewards conditional upon achievement of agreed performance goals. RBFH takes different forms, including provider payment incentives, vouchers, contracting linked to targets, and conditional cash payments and transfers to households.

23. RBFH is underpinned by the consideration that, while policy makers have always cared about results, governments and development agencies have typically financed inputs, such as salaries, medical equipment, hospitals, and health worker training. Improved health was assumed to follow, but this has not always happened. Health providers typically have not been required to guarantee that services are delivered. Instead, they have either received lump sum grants or been reimbursed for expenditures by governments and donors. This system encourages providers to devote energy to secure funds and justify inputs rather than to improve efficiency and the quality of services. RBFH aims to change this model fundamentally. RBFH start with the results, and let health service providers decide how to achieve them. This provides incentives and autonomy for service providers.

24. ADB incorporated the RBHF features in the Second Urban Primary Health Care Project in Bangladesh.⁹ RBFH has been supported by the World Bank through the Health Results Innovation Trust Fund, which is financing the implementation and evaluation of six pilot programs in Africa. In September 2009, members of the High-Level Taskforce on Innovative Health Financing committed a total of \$5.3 billion to accelerate progress towards the MDGs. The U.K. and Norway committed \$420 million to support results-based financing programs and buy-downs to improve maternal and child health. The Government of Australia committed AUD336 million over the next four years for performance-linked aid to help partner governments in Asia and the Pacific. This funding will boost the RBFH. In addition, the World Bank identified 40 projects with RBFH elements during FY95-FY08, mostly using investment lending modalities.¹⁰ The World Bank found that the RBHF has helped to disburse against results, establish M&E frameworks, and support capacity building.

⁹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Asian Development Fund Grant to the People's Republic of Bangladesh for the Second Urban Primary Health Care Project*. Manila. (Loan 2172-BAN, US\$40 million (ADF) and US\$25 million (UK) and US\$5 million (ATF), approved on 31 May 2005).

¹⁰ See World Bank. 2009. *Taking Stock: World Bank Experience With Results-Based Financing (RBF) For Health*. Washington, D.C.

25. There is evidence demonstrating that when poor patients or households have been offered financial or material rewards for adopting health-promoting practices, they respond positively and health indicators improve. Similarly, when health workers and facilities are given bonuses upon achieving targets, the health targets tend to be met¹¹. However, RBHF must overcome several hurdles to work well. The first is the difficulty in measuring performance quickly and accurately. The second is developing countries' lack of capacity to design, negotiate, and enforce performance contracts. The third is that investment for planning up front and setting the M&E system can be expensive. Avoiding these pitfalls requires that operations are carefully designed for each country's unique context, implemented with the necessary flexibility to adjust along the way, and diligently monitored and rigorously evaluated to draw lessons.

5. Global Fund to Fight AIDS, Tuberculosis and Malaria

26. The Global Fund to Fight AIDS, Tuberculosis and Malaria (the Global Fund) is a public-private partnership and international financing institution created to attract, manage, and disburse resources to fight three of the world's most devastating diseases.¹² Its approach is based on the concepts of country ownership and performance-based funding. People in countries implement their own programs based on their priorities, and the Global Fund provides financing on the condition that verifiable results are achieved. The Global Fund works in close collaboration with other bilateral and multilateral organizations. The Global Fund, together with the GAVI Alliance, the World Bank, and the World Health Organization (WHO), has developed a funding platform to harmonize support for health systems. Partnerships also bring together a diverse set of stakeholders including government, civil society, affected communities, and the private sector.

27. The Global Fund's system of performance-based funding is developed to:
- (i) Link funding to the achievement of country-owned objectives and targets.
 - (ii) Ensure that money is spent on delivering services for people in need.
 - (iii) Provide incentives for grantees to focus on programmatic results and timely implementation.
 - (iv) Encourage learning to strengthen capacities and improve program implementation.
 - (v) Invest in measurement systems and promote the use of evidence for decision-making.
 - (vi) Provide a tool for oversight and monitoring within countries and by the Global Fund Secretariat.
 - (vii) Free up committed resources from non-performing grants for re-allocation to programs where results can be achieved.

28. The Global Fund was created in 2002. By 2010, it has approved funding of \$21.7 billion for more than 600 programs in 150 countries. The Fund estimated that this funding has saved 6.5 million lives by providing AIDS treatment for 3 million people, anti-tuberculosis treatment for 7.7 million people and 160 million insecticide-treated nets for the prevention of malaria.¹³

29. Performance-based funding lies at the heart of the Global Fund's operating model by linking the provision of funding to the achievement of clear, measurable, and sustainable

¹¹ R. Eichler and R. Levine, *Performance Incentives for Health: Potentials and Pitfalls*. Washington, DC: Center for Global Development, 2009.

¹² <http://www.theglobalfund.org/en/about/>.

¹³ The treatment benefits mothers, children of aids infected mothers, and other dependents.

results. Performance-based funding ensures that funding decisions are based on a transparent assessment of results against time-bound targets. Global Fund provides initial funding based on the quality of the applications. To receive subsequent financing, they must demonstrate results against defined performance targets. These targets are proposed by the country for approval by the Global Fund to ensure that they are appropriate for the local context.

30. The Global Fund has found that focusing on performance by linking funding to the achievement of clear and measurable results requires investment in measurement systems. M&E is critical to performance-based funding and must be integrated throughout the operational life cycle. The Global Fund has also consolidated its grants in 2010 in a country into a single funding streams to facilitate a program based approach that is better aligned to national planning, reporting, and review cycles.

6. The Millennium Challenge Corporation

31. MCC is an U.S. foreign aid agency.¹⁴ Created by the U.S. Congress in January 2004 with strong bipartisan support, MCC aims to deliver smart U.S. foreign assistance by focusing on good policies, country ownership, and results. MCC forms partnerships with some of the world's poorest countries, but only those that are committed to good governance, economic freedom, and investments in their citizens.

32. MCC provides the well-performing countries with grants to fund country-led solutions for reducing poverty through sustainable economic growth. There are two primary types of MCC grants: compacts and threshold programs. Compacts are large, five-year grants for countries that pass MCC's eligibility criteria. Threshold programs are smaller grants to countries that come close to passing these criteria and are committed to improving their policy performance.

33. MCC looks at several elements in choosing indicators for a specific grant, including:

- (i) Development by a third party,
- (ii) Linkage to policies that the government can influence within a two to three year horizon,
- (iii) Linkage—theoretically or empirically—to economic growth and poverty reduction,
- (iv) Use of an analytically rigorous methodology and objective and high-quality data,
- (v) Broad country coverage and comparability across countries, and
- (vi) Consistency in results from year to year.

34. MCC places great emphasis on achieving and measuring results, concentrating on: (i) identifying activities that have the greatest promise of poverty reduction through growth, (ii) measuring progress during implementation, and (iii) learning from its experiences. MCC collaborates with a country to finalize benchmarks and to create a M&E Plan. Regular reporting of the achievements is done throughout a operation's lifecycle. MCC and their country partners hire independent organizations to conduct impact evaluations for their activities.

35. MCC has approved over \$7.4 billion in compact and threshold programs worldwide that support country-determined projects in such sectors as agriculture and irrigation, transportation (roads, bridges, and ports), water supply and sanitation, access to health, finance and enterprise development, anticorruption, land rights and access, and access to education. The support aims to promote growth opportunities, open markets, raise the standard of living, and create a more prosperous future for some of the world's poorest people.

¹⁴ <http://www.mcc.gov/pages/about>.

36. MCC's analytical framework focuses on results throughout the process of the program development and implementation. This focus on objectively measurable outcomes sharply reduces the ambiguity and sometimes conflicting objectives that can undermine development assistance. The collection and analysis of data play a critical role in every stage of a program, helping to identify problems, assess alternatives, track progress, and measure results.

7. GAVI Alliance

37. The GAVI Alliance (formerly known as the Global Alliance for Vaccines and Immunization), is a global partnership committed to saving children's lives and protecting people's health by increasing access to immunization in poor countries.¹⁵ It is a public-private partnership of governments, UNICEF, WHO, the World Bank, the Bill & Melinda Gates Foundation, civil society organizations, vaccine manufacturers, public health and research organizations, and other philanthropists.

38. The GAVI Alliance was launched in 2000, at a time when the distribution of vaccines to children in the poorest parts of the world began to falter. Nearly 30 million children born every year in developing countries were not fully immunized. With a \$750 million commitment from the Bill & Melinda Gates Foundation, the vision of GAVI Alliance is to deliver vaccines to these children.

39. GAVI Alliance seeks to ensure that its support has the maximum impact through a transparent, accountable, and results-oriented approach. It uses the principles set out in the Paris Declaration on Aid Effectiveness to guide its work. These principles are enshrined in the four core areas of GAVI Alliance's work: (i) country-driven programs, (ii) predictable funding, (iii) results-based support, and (iv) harmonized aid.

40. GAVI Alliance encourages countries to go beyond their original immunization targets by offering cash rewards if additional children are immunized. Countries are then allowed to spend the reward money on improving health care delivery services, thereby facilitating even wider vaccination coverage.

41. GAVI Alliance's Immunization Services Support (ISS) is a performance-based funding mechanism that provides funding to immunization programs conditional upon improved performance. This strategy allows countries and governments to spend ISS funds in any manner they deem appropriate, but funding in later years is based on increases in the number of immunized children. While ISS was not the first time performance-based funding had been used to improve health, it represented innovative design given its large scale (with 59 eligible countries), combined with an emphasis on country-led programming and a single result indicator.

42. The evaluation of ISS in 2007 found that ISS had a statistically significant positive effect on diphtheria-tetanus-pertussis (DTP3) coverage in recipient countries. The flexibility of the GAVI Alliance funding was a unique characteristic allowing National Immunization Programs (NIP) unprecedented ability to pursue country specific priorities. Evidence from case study countries found that the flexibility of funding may have been an important factor affecting its impact.

¹⁵ GAVI Alliance websites <http://www.gavialliance.org/>

43. In GAVI Alliance's first decade, 288 million children have been immunized against life threatening diseases, and more than 5 million future deaths have been prevented (2010 WHO estimation). However, with 20% of children unvaccinated, GAVI Alliance's mission is far from accomplished.

44. In November 2010, the GAVI Alliance Board agreed to pilot incentives for routine immunization strengthening (IRIS), a performance-based program targeting countries with less than 70% coverage for three doses of DTP3. It is designed to increase accountability for results and value for money, while minimizing the reporting and management burden imposed on countries. Countries will receive an annual fixed payment to help strengthen their immunization coverage, and additional payments based on their performance against targets. A key feature of IRIS is to support countries for improving data quality, and ensure that payments are based on verified results.

45. GAVI Alliance aims to ensure predictable and stable funding to enable developing countries to plan and sustain their immunization program. It considers that steady, multi-year donor contributions and innovative finance mechanisms as a fundamental condition to long-term sustainability of the immunization initiative. Mobilization of development agency resources is at the forefront of GAVI's priorities. Total funding to GAVI Alliance amounted to US\$ 696 million in 2010, an increase of US\$ 28 million compared with 2009 levels. Cumulative funds received for 2000–2010 totaled US\$ 5.2 billion. GAVI Alliance's unique funding model draws heavily on private sector strength to overcome the historic limitations of development funding for immunization.

8. Conditional Cash Transfers

46. CCTs transfer cash to poor households conditional upon certain household behaviors, generally in the areas of parents ensuring investment in education or health of their children.¹⁶ CCTs have dual objectives. First, they seek to provide poor households with a minimum consumption floor for immediate poverty reduction. Second, for long term poverty reduction, they seek to encourage the accumulation of human capital and to break a vicious cycle whereby poverty is transmitted across generations. CCTs use demand-side interventions to directly support beneficiaries, departing from traditional supply-side mechanisms such as subsidies or investments in schools and health centers.

47. First used in Latin America, CCTs have become popular in developing countries since the 1990s. Recent reviews estimate that at least 29 developing countries have CCTs in place.¹⁷ In some countries, the CCT is the largest social assistance program, covering millions of households. In 2007, Brazil's Bolsa Escola covered 4.8 million families, Mexico's Oportunidades covered 5 million households, while Brazil's Bolsa Família covers 11 million families, or around 46 million people—almost a quarter of the population. Examples of CCTs in Asia include the Bangladesh Food for Education Program and the Cambodia Education Sector Support Program and Scholarship Program. CCTs range from covering 40% of the population in Ecuador, to about 20% Brazil and Mexico, to 1% in Cambodia.

¹⁶ For example, children between 6 and 14 years of age remain enrolled and actually in attendance at school.

¹⁷ See D. Filmer and N. Schady. 2009. Are There Diminishing Returns to Transfer Size in Conditional Cash Transfers? *Policy Research Working Paper 4999. Impact Evaluation Series*. No. 35. Washington, D.C. World Bank; J. Das, Q. Do and B. Ozler. 2004. Conditional Cash Transfers and the Equity-Efficiency Debate. *Working Paper Series*. No. 3280. Washington, D.C.: World Bank.

48. CCTs have been considered as a way of reducing inequality, promoting health and schooling for children; helping households break out of a vicious poverty cycle being transmitted from one generation to another; and helping countries meet the MDGs. Evidence from many countries indicate positive results of CCTs on school enrollment of children in recipient households. Filmer and Schady (2009) estimate that the CCT in Cambodia which transfers cash to parents conditional on them keeping teenage girls enrolled in school raised enrollment rates by between 20 and 30 percentage points. Jacoby (2002) finds that the Philippines School Feeding Program raised children's caloric intake by 80% compared to the caloric redistribution value from the school feeding program.¹⁸ In Cambodia, the JFPR program eliminated sharp socioeconomic gradients in enrollment among eligible households. CCTs have helped to reduce the education gender gap in Bangladesh and Pakistan, where school enrollment rates among girls are lower than among boys. CCTs also have a strong evaluation culture, well beyond traditional practice in social policy; and this culture is spreading from one CCT to another, as well as to other programs in the same country.

49. The evidence on improvements in final outcomes in health and education is more mixed. To maximize the potential benefits on the accumulation of human capital, CCTs need to be combined with programs to improve the quality of the supply of health and education services. Further, some of these programs have become large and costly. This raises the issue of sustainability, potential politicizing of CCTs, and fostering a culture of dependence.¹⁹

9. Performance-Driven Loans

50. The Inter-American Development Bank (IDB) adopted PDLs in 2003 in response to borrowers' demands.²⁰ The PDL was to be piloted for six years. In 2006, IDB reviewed the progress of the PDLs implementation. The review indicated that there was a growing interest in PDLs from the borrowing member countries and decided to continue the piloting.

51. The PDL has the following features:
- (i) It is an investment lending instrument.
 - (ii) Disbursements are conditional on the achievement of results and verification of expenditures—recipients are required to track eligible expenditure directly related to the outputs and outcomes in addition to achieving results.²¹
 - (iii) Results are defined by outcomes—the effects from outputs delivered by a project. For example, increased school enrollment and achievement (outcomes) attributed to the construction of a new school and training of teachers (outputs).
 - (iv) Results are audited by independent performance reviewers—usually consultants hired by IDB or the borrower.
 - (v) Use of the borrowing country systems in procurements—country systems must, however, comply with commonly accepted principles of competition, economy, transparency, equity, publicity and due process.

¹⁸ H. Jacoby. 2002. Is There an Intra-household 'Flypaper Effect'? Evidence from a School Feeding Programme. *The Economic Journal*. 112 (January). pp. 196-221.

¹⁹ B. de la Brière and L. Rawlings. 2006. Examining Conditional Cash Transfer Programs: A Role for Increased Social Inclusion? *Social Safety Net Primer Series*. Washington, D.C.: World Bank; Fizbein and N. Schady. 2009. Conditional Cash Transfers – Reducing Present and Future Poverty. *World Bank Policy Research Report Series*. Washington, D.C.

²⁰ Inter-American Development Bank. 2003. *Proposal for a Pilot Program for Performance-Driven Loans*. Washington, D.C.

²¹ Advance payments of up to 20% of the IDB financing are allowed, and have been used in PDL projects to help finance upfront costs

52. Demand of PDL operations has been moderate. From 2003 to 2009, IDB has approved 17 PDL projects. IDB indicated that the moderate demand was mainly due to two reasons. First, the results are defined as development outcomes which can take a long time to achieve and can be outside the control of a project. Second, PDLs operations are in the form of investment lending. It requires achievements of results as well as fulfilling of many investment lending requirements. In particular, The PDLs are required to track eligible expenditure directly related to the outputs and outcomes established in the results matrix. Establishing a direct relationship between expenditure and performance outcomes is challenging, and may not be feasible, particularly in sectors where the IDB, governments, and other multiple donors are supporting a national development goal.

53. In the health sector, for example, outputs such as training of health professionals can be costed-out, but the final outcome of reducing mortality rates for children under five years of age is actually achieved through financing a combination of activities and many outputs. Given that the accountability rests with the executing agency to select the most cost-effective input-output mix for achieving the performance targets, the task of costing activities and outputs loses relevance. The fact that PDLs, as investment loans, are required to track eligible expenditures directly related to the outputs and outcomes established in the results matrix constitutes a burden for both the borrower and IDB staff, since PDLs carry the same accounting and reporting requirements as regular investment loans, and added the results requirements on top of it. Borrowers and project teams find the requirements went beyond the investment lending and have created high transaction costs.

54. However, projects in several sectors have shown promising results. The health sector PDL project in Colombia played an important role in delivering vaccinations to a large number of disadvantaged people. Similarly, the solid waste management project in Chile added flexibility in supporting a large number of sub-projects. An agricultural project in Paraguay also helped a large number of farmers to get access to input and technological support. The PDL piloting phase expired in 2009. The IDB is expected to evaluate its implementation experience soon and make a decision on the way forward.

10. Output-Based Aid

55. OBA uses performance-based subsidies to deliver basic services to poor households.²² Basic services supported by OBA include water supply, sanitation, electricity, transport, telecommunications, education, and health care. OBA finances the funding gap between the cost of service delivery and the beneficiaries' ability and willingness to pay for the service.

56. The OBA concept was introduced in 2003 through the launch of the Global Partnership on Output-Based Aid (GPOBA) as a World Bank-administered and donor-funded pilot program by the Department for International Development (UK) and the World Bank. Since then many development partners have joined the program, including the AusAID (Australia), the Directorate-General for International Cooperation (Netherlands), the Swedish International Development Cooperation Agency (Sweden), and the IFC. The mandate of the GPOBA is to fund, design, demonstrate, and document OBA approaches to improving the delivery of basic infrastructure and social services to the poor in developing countries.

²² Y. Mumssen, L. Johannes, and G. Kumar. 2011. *Output-Based Aid: Lessons Learned and Best Practices*. Washington, D.C.: The World Bank.

57. OBA's key features include:
- (i) Uses of performance-based subsidies to deliver services—with the aim of improving the affordability of consumption of basic services by low-income populations;
 - (ii) Finances the 'funding gap' between the cost of service delivery and the beneficiaries' ability to pay for the service—with the aim of facilitating the transition to cost-recovery tariffs; and
 - (iii) Contracts out services to a third-party service provider—with the aim of improving the efficient delivery of services that exhibit positive externalities.

58. The World Bank remains the primary source of OBA projects, with a portfolio of OBA subsidies of about US\$4 billion. The World Bank estimated that its use of OBA grew from 32 projects in 2003 to over 200 in 2009. A World Bank review of the piloting phase of GPOBA rated it a success.²³ Implementation Completion Reports provide evidence that the OBA projects have been more effective in achieving development outcomes than traditional projects. For example, in a Mongolian ICT project, the OBA approach enabled 28% savings in the total subsidy required. The savings were then used to expand the project to 1,000 more beneficiaries. In a Sri Lankan rural electrification project, a service provider introduced 15% price discounting and its own consumer financing, seeking to capture the market share. The competitive bidding process for the OBA scheme in Water Supply in Uganda's Small Towns and Rural Growth Centers resulted in an average efficiency gain in 10 towns of about 20%. The World Bank expects its OBA projects to date to benefit at least 60 million poor people. In recent years, ADB has also started to implement the OBA schemes through the joint efforts of the Office of Cofinancing Operations and operations departments (Appendix 2).

59. OBA is based on a procurement processes that would result in a contractual relationship where payments are made to service providers for measured outputs. Accordingly OBA allows for linking disbursement for specific outputs, but remains focused on the specific transactions.

60. Under OBAs, services are contracted out to a third party (service provider) either through a competitive process, or a single source selection process. OBA schemes normally apply performance-based subsidies in three ways: one-off subsidies such as connection subsidies, transitional tariff subsidies that taper off as user contributions increase, or ongoing subsidies. A competitive process to choose a service provider generally involves seeking (i) the lowest subsidy required for the pre-determined outputs; (ii) the greatest coverage per fixed offered subsidy; or (iii) the least connection cost per fixed offered subsidy. In the case of an incumbent service provider, where the subsidy level is not determined through a competitive procurement process, subsidy levels are determined through establishing standard costs or an agreement on a unit cost schedule, verified by independent consultants during project preparation.

61. OBA contrast with projects which finances inputs such as books and medicines. OBA links the payment to service providers to their delivery of "outputs" that meet beneficiaries' needs. It addresses the weak incentives for efficiency and innovation, low accountability for performance, and limited opportunities for leveraging scarce public resources through private financing. A defining feature of OBA is the shift of performance risks to service providers.

62. The main challenge for mainstreaming OBA approaches lies in reconciling the investment lending's "expenditure-based" approach with the "performance-based" nature of OBA. Engaging

²³ The World Bank's project ratings include highly satisfactory; satisfactory; moderately satisfactory; moderately unsatisfactory; unsatisfactory; and highly unsatisfactory.

incumbent service providers also poses difficulties. The development procurement approaches and customized reporting documentation in the World Bank's procurement and financial management guidelines have helped to overcome these challenges.²⁴

11. Performance-Based Contracts

63. PBCs began in 1990s and use results-based approaches at the project level. PBCs move the government's role in contracting processes from spelling out every detail of how it wanted goals to be achieved, to defining the problems that need to be solved and results to be delivered.²⁵ This in turn allows contactors to deliver the results by maximizing innovation and efficiency, and rewarding them for doing so.²⁶ The objectives of PBCs are to reduce costs, improve quality, and reduce risks. OECD countries have spearheaded the use of PBCs.

64. PBCs structure contracts around the purpose of the work desired as opposed to the manner by which the work is to be performed. An important prerequisite for PBCs is a well defined and clearly written statement of work which defines the quantity, quality, and measurement of work. To the maximum extent possible, a PBC describes the work in terms of what is to be the required output rather than how the work is to be accomplished. Contractors shoulder the responsibility of assuring quality performance. The contractor's compensation is tied to the achievement of the prescribed results. PBCs often include incentives to motivate contractors to meet and exceed the performance standards, and to save time and costs.

65. To facilitate PBC, ADB has developed guidelines on PBC as a part of the Project Administration Instructions (PAI 3.05 Section G). ADB used PBCs in projects such as the PRC Yunnan Integrated Road Network Development Project²⁷ and Second Heilongjiang Road Network Development Project (Appendix 2).²⁸

²⁴ Update. World Bank. 2007. Implementing Output Based Disbursement Mechanism for Investment Operations. *Operation/Technical Guidance Note to Staff*. Washington, D.C. The guidance note "Structuring OBA Approaches" November 17, 2005, describes an approach that applies to specified infrastructure service contracts awarded to private sector or third party service providers.

²⁵ For example, under a traditional road maintenance contract, the private sector maintains an existing road based on input indicators, such as labor used, tons of pothole patch material used, number of linear meters of pipe culverts replaced, and number of square meters of cracks sealed. Under a PBC contract, the private sector maintains an existing road on the basis of customer-based performance indicators, such as riding and strength quality (smoothness), safety features, and aesthetics and attractiveness of roadside.

²⁶ U.S. Office of Management and Budget. 1998. *A Guide to Best Practices for Performance-Based Service Contracting*. Washington, D.C.

²⁷ ADB. 2010. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan People's Republic of China: Yunnan Integrated Road Network Development Project*. Manila. (Loan 2709-PRC, US\$250 million (OCR) and US\$0.2 million (TASF), approved on 2 Dec 2010)

²⁸ ADB. 2010. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan Second Heilongjiang Road Network Development Project (People's Republic of China)*. Manila. (Loan 2631-PRC, US\$200 million (OCR), approved on 20 April 2010)

EXAMPLES OF ADB OPERATIONS WITH RESULTS-BASED FINANCING FEATURES

1. Although ADB does not yet have a dedicated results-based financing (RBF) instrument, operations with RBF features have already emerged in recent years. This experience is similar to that of the World Bank.

2. As part of the process to develop the RBF program modality, the Strategy and Policy Department carried out a stocktaking exercise on ADB operations with RBF features. The exercise revealed that operations with RBF features in ADB have mainly taken the following forms:

- (i) **Sector wide approaches (SWAP)** in which one or more development agencies support a government owned program.
- (ii) **Conditional cash transfers (CCTs)** which transfer cash to poor households conditional upon certain household behaviors, generally relating to these households investing in the education or health of their children.
- (iii) **Results-based Financing for Health (RBFH)** which aims to improve health outcomes by providing a financial or in-kind reward to service providers conditional upon their delivering of agreed performance goals.
- (iv) **Output-based aid (OBA)** which uses explicit performance-based subsidies to deliver basic services to poor households. Services are contracted out to a third party service provider and the payment to whom occurs when the outputs are delivered (for example, connection of households to water supply).
- (v) **Performance based contracts (PBCs)** which structure contracts around the purpose of the work desired as opposed to the manner by which the work is to be performed.

3. There are two types of RBF operations: (i) disbursement from ADB to the borrower against results, or (ii) payments from the borrower to the contractor based on results.¹ Operations satisfying one of these two aspects are considered to be with RBF features. This Appendix provides some examples of ADB operations with such features.

1. Sector-Wide Approaches

4. SWAPs have mainly been used in the health and education sectors, but have been extended into other sectors in recent years. Some SWAP examples are listed below.

5. **The Bangladesh: Third Primary Education Development Project.**² The Bangladesh Primary Education Program (PEDP III) was prepared in consultation with stakeholders through a Government-led participatory process. It incorporates lessons from an in-depth evaluation of the first and second Primary Education Development Program, as well as lessons learned from other SWAPs in Bangladesh and the region.

6. The Board of Directors of ADB approved the PEDP III on 5 July 2011. The Project has three key features. First, the PEDP III focuses on results. Disbursement is linked to achieving nine output level disbursement linked indicators (DLI) every year. Second, funds are channeled to the government's treasury (budget) system. Third, the government and nine development

¹ Policy-based lending operations have not been considered as the RBL for the stocktaking exercises, unless there are unique features such as using CCT. This is to distinguish between RBL and policy-based lending instruments.

² ADB. 2011. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan to the People's Republic Bangladesh Third Primary Education Development Project*. Manila. (Loan 2671-BAN, \$320 million ADF, approved on 5 July 2011).

partners have signed a joint financing arrangement to further enhance alignment and increase harmonization in line with the Paris Declaration.

7. Led by the ADB, several bilateral agencies and the World Bank provided support for primary education through a SWAP, using Bangladesh's newly upgraded procurement system for 85% of this work. The SWAP replaces the previous primary education operation, under which 13 donors supported over 27 different projects through approximately 30 different accounts, with separate donor arrangements for procurement and financial arrangements.

8. **Bangladesh: Public-Private Infrastructure Development Facility.**³ In this project, ADB financing is channeled through the Government to the Infrastructure Development Company Limited (a government owned financial institution) which offers loans to participating organizations, which then provide customers in rural areas to finance up to 80% of the cost of a solar home system, solar irrigation pumps, and other initiatives. Creative financing mechanisms have been explored to finance large infrastructure projects, primarily in the energy sector. Several projects have been awarded by the Government of Bangladesh to private sector sponsors. The Infrastructure Development Company Limited expects to extend financing for a term of up to 20 years. One component of this project uses a SWAP in which ADB and other development agencies (World Bank, GIZ, KfW, and Islamic Development Bank) support the Government's renewable energy program, which targets rural populations in off-grid areas in providing them with access to environment-friendly electricity.

9. **Philippines: Health Sector Development Program (HSDP).**⁴ The HSDP was implemented under the Sector Development Approach for Health (SDAH), which used a SWAP approach to support implementation of the Government's Health Sector Reform Agenda (HSRA). The HSDP was approved by ADB in December 2004 and became effective in January 2005. It consists of a program loan of \$200 million and a project loan of \$13 million. The second tranche of the program loan was approved in November 2006, and the project loan is ongoing.

10. The HSDP systemically addresses sector constraints to improve decentralized health services. Together with development partners, it helped to pioneer the use of provincial expenditure reviews in participating provinces (carried out with European Union assistance) as the basis for improving local expenditure efficiency. The program has taken steps to introduce performance-based funding approaches and rationalize health service delivery systems. The technical assistance attached to the program has helped to develop capacity for the key reform policies at national as well as local levels.

11. The 2007 Philippines CAPE undertaken by the Independent Evaluation Department found that the program has helped to improve the health care service infrastructure, and was relevant and generally "effective."⁵ Strong government support and ownership was a major positive feature of the HSDP. However, the implementation of reforms at local level or localization of reform in a devolved setting faced significant challenges and delays (e.g., weak national and local government coordination; insufficient health human resources; inadequate encouragement

³ ADB. 2008. *Report and Recommendation of the President to the Board of Directors on the Proposed Loans and Technical Assistance Grant People's Republic of Bangladesh: Public-Private Infrastructure Development Facility*. Manila. (Loan 2453.2454-BAN, US\$83 million (ADF) and US\$82 (OCR), 2 Oct 2008).

⁴ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on the Proposed Loans to the Republic of the Philippines for the Health Sector Development Program*. Manila. (Loan 2136/2137-PH, \$213 million (OCR), approved 15 December 2004).

⁵ ADB. 2008. *Country Assistance Program Evaluation for the Philippines: Increasing Strategic Focus for Better Results*. Manila.

from local government leadership; lack of local resources; weak public finance management of LGUs). Despite the challenges, the CAPE found that the SWAP is a 'good practice' to provide a supportive environment for a sector development program.

2. Output-Based Aid

12. In the Pacific, ADB used OBAs to improve shipping services to remote areas that are considered commercially unviable in the Solomon Islands and Papua New Guinea. In Nepal, the ADB's Second Small Towns Water Supply and Sanitation Sector Project used the OBA approach to provide services to target water supply and sanitation to the poor in 12 small urban towns.

13. **Solomon Islands: Domestic Maritime Support Project.** This grant became effective on 10 February 2009 and is scheduled to close on 31 December 2018.⁶ The project aims to reduce economic disadvantage in remote rural areas by providing interisland shipping services that are regular, reliable, affordable, and safe.

14. The project has two components: (i) improvement of rural infrastructure, including about 12 wharves and jetties for rehabilitation or reconstruction; and (ii) the establishment of a franchise shipping scheme (FSS) providing shipping services to remote areas that are considered commercially unviable. The second component uses OBA to provide efficient subsidies to private sector operators through a minimum-subsidy tender process. The objective is to promote increased shipping services to otherwise commercially unviable routes. Subsidies are tied to performance, including vessel suitability (dimensions, capacity, and safety certifications), franchise areas and routes, call locations and frequency, substantiation of calls and submission of voyage data, and flexibility of force majeure.

15. Competitive bidding in the operation of marine transport in Solomon Islands had never taken place in the past. Seven FSS routes were initially identified as commercially unviable. The government analyzed the voyage data and the financial losses on some routes. To ensure that routes become commercially viable over time, the government has redesigned the six routes. In redesigning each route, it has considered additional call locations to increase the revenue, recalculated the operating costs, and split one route into two routes, thus allowing flexibility in the voyage time and frequency of the voyages. The government has invited rebidding for seven of the eight revised routes.

16. The first route is already profitable. For the first three voyages, revenue generated from passenger and cargo fares and the subsidy were sufficient to offset direct costs. Every inbound voyage from this originally commercially unviable route has increased cargo and passengers, thus increasing confidence of the rural population that more reliable and safe maritime services are being put in place.

17. Observations from the profitable FSS route have been encouraging. In addressing economic disadvantages in remote rural areas, the first outgoing voyage to the rural destination transported empty fuel barrels which are used to build copra drying structures. Subsequently, the direct income of the third voyage was about twice the amount of the first two voyages, attributed to high volumes of freight, predominantly copra from the rural communities. The

⁶ ADB. 2008. *Report and Recommendation of the President to the Board of Directors on the Proposed Asian Development Fund Grant and Administration of Grant Solomon Islands: Domestic Maritime Support (Sector) Project*. Manila. (Grant 0127-SOL, US\$14 million (ADF) and US\$1.0 million (TASF) and US\$5.25 million (EC), approved on 28 Nov 2008).

voyages have been scheduled on a monthly basis, which has also enabled government staff from the Ministries of Health and Education to visit these rural areas more regularly.

18. A national firm has been engaged to manage the FSS voyages and analyze the voyage data. The firm provides capacity building to the vessel owners and operators in the financial management of their business. It has also helped one operator obtain a loan from the commercial bank to buy a ship.

19. To complement the project, ADB provided technical assistance to establish the Solomon Islands Maritime Safety Administration. The Maritime Safety Administration Act was passed by parliament in 2009, along with regulatory reform to improve maritime administration and marine safety. In addition, the project provides a loan of safety equipment to ship operators to ensure that safety regulation requirements are met.

20. The project design considered and reflected local conditions. Due to the limited capacity of private sector operators in Solomon Islands, it was important to simplify the bid documents and conduct pre-bid meetings to ensure that the scope of shipping services was fully understood. In addition, while the procurement of services was through national competitive bidding procedures, a longer bid period of eight weeks was provided to allow the operators sufficient time to prepare bids. Extensive capacity development of private sector operators resulted in successful tenders.

21. The project is a good example of an OBA to deliver basic shipping services to remote areas where people lack access to basic socioeconomic services. The shipping services are contracted out to shipping operators and the payments are linked to the services. Payment for the services is conditional upon verification by a national firm. To deliver the services, the government and ADB have developed sector capacity, institutions, and an enabling policy environment. The core principles of the FSS are accountability for results, incentives for efficiency, opportunities for innovation, and minimization of fiduciary and safeguards risks. The project needs to further improve the design of shipping routes, accuracy of cost estimates and required subsidy level, and the maritime transport sector's capacity to reach the targeted principles. In doing so, ADB will continue to assist the government and private sector in monitoring and evaluating current status, developing an action plan, and providing required resources.

22. **Papua New Guinea: Community Water Transport Project.**⁷ The Community Water Transport Project aimed at providing water transport to remote areas and reforming the maritime sector in Papua New Guinea (PNG). One of the project components finances subsidized shipping franchises on non-commercially viable routes. There are two OBA features in this arrangement: (i) the franchised shipper only receives the subsidy if the shipping services are actually provided; and (ii) the franchise agreement allows the shipper to retain any profits it makes in addition to the franchise payment, thus encouraging performance over and above the minimum prescribed service. To date, two out of four franchises are operating successfully. Improved shipping services are being maintained with the prospect of becoming financially self-sustaining in the medium term.

⁷ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan to Papua New Guinea for the Community Water Transport Project*. Manila. (Loan 2079-PNG, US\$19 million (ADF), approved on 25 Nov 2004).

23. **Second Small Towns Water Supply and Sanitation Sector Project.** This project provides subsidies to water users and sanitation committees upon confirmation of agreed output.⁸ ADB approved the project in 2009 to provide improved water supply and sanitation services to about 240,000 people in 20 small towns in Nepal. To address weaknesses in the first project, ADB has introduced the OBA approach to 12 small towns. The targeting of small urban towns, coupled with the fact that it is ADB's first OBA in Nepal, makes this initiative a potentially rich source of lessons for future projects.

3. Conditional Cash Transfers

24. **Papua New Guinea: Pilot Border Trade and Investment Development Project.** This project aims to improve the business environment in areas of the West Sepik Province of PNG.⁹ One project component finances activities to improve human development in health and education in the border villages. CCT are used for (i) heads of households connecting to electricity on a cost sharing basis, (ii) heads of households constructing standard septic tanks and toilets, (iii) pregnant women obtaining doctor certificates on specified maternal health visits, and (iv) heads of households enrolling disadvantaged children in school.

25. **Philippines: Social Protection Support Project.** ADB approved the Social Protection Support Project (SPSP) to support the Government of Philippines's CCT program, the *Pantawid Pamilyang Pilipino Program* (formerly abbreviated as "4Ps" and now as *Pantawid Pamilya*), which provides cash grants to targeted poor families who comply with health and education conditions.¹⁰

26. In close dialogue with World Bank, the Governments of Australia and Japan, and other development partners, ADB supported social protection policy dialogue and provided budgetary support for the initial scale-up of 4Ps in 2008 and 2009. Subsequently, ADB responded to the Government's request for project-based support, approving a \$400 million loan for the SPSP in September 2010, and the project became effective on 12 January 2011. The Project directly supports the government's CCT program, with the loan funding about one third of grants to the first 1 million beneficiary households.¹¹ The Government and a loan from World Bank each funds one third of the CCT program. ADB is also providing three technical assistance projects totaling \$2.5 million, covering capacity development, gender mainstreaming, and support for broader rationalization the social protection sector programs.¹²

27. The progress of SPSP to date has been encouraging. Emerging evidence for *Pantawid Pamilya* (including portions supported by ADB) appears promising. This is due to factors

⁸ ADB. 2009. *Report and Recommendation of the President to the Board of Directors on the Proposed Asian Development Fund Grant Nepal: Second Small Towns Water Supply and Sanitation Sector Project*. Manila. (Grant 0157-NEP, US\$45.1 million (ADF), approved on 17 Sept 2009).

⁹ ADB. 2009. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Technical Assistance Papua New Guinea: Pilot Border Trade and Investment Development Project*. Manila. (Loan 2591-PNG, US\$0.9 million (TASF) and US\$25 million, approved on 27 Nov 2009).

¹⁰ Compliant households can receive (i) health grants of P500/month for meeting Department of Health protocols—including for pre- and post-natal visits, infant and child weighing and nutrition counseling, child immunization and deworming—as well as parental participation in family development sessions; and (ii) education grants of P300 per school month per child (up to 3 children) for maintaining at least 85% attendance. Program details are available on DSWD's website at <http://pantawid.dswd.gov.ph/>

¹¹ The Project directly funds a portion of grants in "Set 2" and "Set 3" localities, covering about 582,000 households in 436 municipalities and 37 cities in 53 provinces.

¹² Information on ADB support is available online at <http://www.adb.org/projects/project.asp?id=43407> and <http://www.adb.org/projects/project.asp?id=43263>

ranging from the government's commitment to *Pantawid Pamilya* to the program's ability to directly address demand-side constraints, which appear to be one of the most important barrier to utilization of education and health services among the poor. ADB's role is widely recognized and has been commended by the government, as reflected in a Certificate of Appreciation that was provided to ADB by President Aquino and DSWD's Secretary Soliman in January 2011.

28. SPSP faces three sets of challenges. First, within ADB, CCTs remain a new area of operations, which implies a sharp learning curve. Existing ADB procedures and mechanisms have posed challenges. A second set of challenges relate to the aggressive pace that the Government of Philippines is seeking to scale up *Pantawid Pamilya*, which targets reaching 2.3 million households by end of 2011, more than double the initial 1.0 million target. The imperative to rapidly expand beneficiary households has put additionally heavy pressure on DSWD capacities and related systems. Third, the SPSP's dual nature in providing project-based support to a government program has posed difficulties in simultaneously meeting both government and ADB procedural requirements.

29. International evidence on CCTs as well as early implementation experience suggests that ADB should continue to consider support for CCT in the region. Experiences with CCT have shown it to be an effective means to directly contribute to poverty reduction and promoting the inclusiveness of growth in the short-term through as a social safety net, and promote long term poverty reduction through increased investments in children's human capital. To the extent that ADB assists a growing number of DMCs that are exploring introduction of CCT programs, it will be important for ADB to have more up-front involvement at the technical level, and to coordinate closely with other development partners. ADB also needs to strengthen its own capacity for designing and implementing CCTs.

4. Results-Based Financing for Health

30. **Bangladesh: Second Urban Primary Health Care Project.** This project contracts out primary health care services to nongovernment organizations (NGOs) through partnership agreements.¹³ The project is being implemented in Dhaka, Chittagong, Khulna, Rajshahi, Sylhet, Barisal City Corporation and Comilla, Bogra, Sirajgonj, Madhabdi and Savar municipalities.

31. Under the UPHCP-II, 24 partnership agreements with NGOs have been established, covering 200,000–300,000 people per area. Each partnership agreement area consists of one comprehensive reproductive health care center (CRHCC), at least one primary health care center per 30,000–50,000 people, and at least one satellite or mini-clinic per 10,000 people. Primary health care centers provide a full range of basic and essential services, and CRHCCs provide comprehensive emergency obstetric care, newborn care, and other related services. Routine data on service delivery shows a continued general upward trend in volume services uptake. Patient inflow has increased 3.78 times since 2005, with the coverage reaching 82.6% of the targeted population of 9.41 million to be served under the project. Nearly 80% of patients are female.

¹³ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Asian Development Fund Grant to the People's Republic of Bangladesh for the Second Urban Primary Health Care Project*. Manila. (Loan 2172-BAN, US\$40 million (ADF) and US\$25 million (UK) and US\$5 million (ATF), approved on 31 May 2005).

5. Performance-Based Contracts

32. **Papua New Guinea: Highlands Region Road Improvement Investment Program – Multi-Tranche Financing Facility.**¹⁴ The Highlands Region Road Improvement Investment Program aims to improve accessibility and reduce transport costs in the Highlands Region of PNG. One component involves road rehabilitation and maintenance with the works being undertaken by civil work contractors. Contractors are required to maintain the roads they rehabilitate for up to 5 to 10 years. The maintenance components of the contracts are performance-based, and payments are made to contractors only upon the achievement of prescribed road condition indicators. This arrangement encourages contractors to achieve high standards of road rehabilitation.

33. **People’s Republic of China: Yunnan Integrated Road Network Development Project.**¹⁵ This project supports the improvement on the road transport system in Yunnan to promote sustainable economic and social development. One output is to enhance performance by selecting road agencies and road maintenance groups through PBC to decrease the administrative burden and promote efficient use of maintenance funds. PBC has been applied whereby monthly work plans have been defined by the rural road maintenance divisions of the county communication bureaus. The plans indicate the road sections to be maintained by the maintenance groups. Inspections are based on the achievement of predefined performance indicators indicated in the work plan. Payments are based on the quantity and quality of the output (performance), and not on the input. ADB has assisted the prefecture and county communication bureaus in implementing the PBC and in capacity building for the county communication bureaus and the community maintenance groups.

34. **People’s Republic of China: Second Heilongjiang Road Network Development Project.**¹⁶ This project aims to improve the transport capacity of the Heilongjiang Province’s East–West corridor. In addition to road construction, the project helps the province establish an improved road asset management system for selecting maintenance works on the basis of their expected economic returns. It supports the institutionalizing of this system by financing a program of priority maintenance works. The project introduces on a pilot basis the use of PBC for road maintenance to improve the quality of works and develop private sector capacity for bidding and execution of maintenance works. It also assists the provincial government’s capacity in prioritizing and budgeting maintenance works.

6. Other Operations with RBF Features

35. There are various other ADB projects which incorporate RBF features in ADB.

36. **Bangladesh power sector program.** An example of result-based programmatic sector support is the Bangladesh power sector program.¹⁷ In addition to using traditional ADB products

¹⁴ ADB. 2008. *Report and Recommendation of the President to the Board of Directors on the Proposed Multitranche Financing Facility Papua New Guinea: Highlands Region Road Improvement Investment Program*. Manila. (Loan 2496/2497-PNG, US\$30 million (ADF), approved on 22 Dec 2008).

¹⁵ ADB. 2010. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan People’s Republic of China: Yunnan Integrated Road Network Development Project*. Manila. (Loan 2709-PRC, US\$250 million (OCR) and US\$0.2 million (TASF), approved on 2 Dec 2010).

¹⁶ ADB. 2010. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan Second Heilongjiang Road Network Development Project (People’s Republic of China)*. Manila. (Loan 2631-PRC, US\$200 million (OCR), approved on 20 April 2010).

¹⁷ ADB. 2011. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan to the People’s Republic of Bangladesh: Power System Efficiency Improvement Project*. Manila.

including project investment loans, sector development programs, and an Independent Power Producer by the ADB's Private Sector Operations Department, a pragmatic result-based approach was followed. This meant that certain key policy actions, such as financial settlements and unbundling of key government power sector entities into state-owned enterprises, were included as processing conditions and undertaken before loan approval. This pragmatic and flexible result-based sector approach took into account the political economy and the local environment. It contributed to the achievement of sector results and successful project outcomes as documented the most recent Bangladesh Country Assistance Program Evaluation (CAPE) and Sector Assistance Program Evaluation (SAPE)¹⁸ and the Asian Development Fund XI paper on development effectiveness.¹⁹

37. Lao PDR: Northern and Central Regions Water Supply and Sanitation Sector. The Northern and Central Regions Water Supply and Sanitation Sector Project (NCRWSSP) in Lao PDR was approved in 2005 and a supplementary grant was approved in 2010.²⁰ The project aims to improve the accessibility, quality, reliability, and sustainability of water supply services, and improve environmental conditions in the project towns. The project is a sector investment project that is in line with government priorities and follows the Ministry of Public Works and Transport Sector Investment Plan and Policy Statement. Other project cofinanciers include OPEC Fund for International Development (OFID), Norwegian Agency for Development Cooperation (NORAD) (parallel basis), and United Nations Human Settlements Programme UN-HABITAT (parallel). Sector coordination has been undertaken with these and other partners, including the Water and Sanitation Program (WSP) of the World Bank, SNV Netherlands Development Organization, United Nations Children's Fund (UNICEF), World Health Organization (WHO), GRET Professionals for Fair Development, and Japan International Cooperation Agency (JICA).

38. The number of beneficiaries is expected to reach around 100,000 by the end of 2012 in 12 towns. Water supply systems have been completed in 4 towns: (i) an estimated 35,400 people have access to improved water supply. (ii) close to 100% have improved their household sanitation facilities, and (iii) 318 poor households have received a sanitation grant. By the end-2011, a total of 8 systems are expected to be completed providing around 60,000 people with improved water supply, and sanitation to around 90% of the total population (of which 4% will have received a sanitation grant). The project also supports the role of women through the development of a project-specific gender action plan.

39. These results were achieved by requiring households to have sanitation systems before connecting to the piped water supply system in urban areas. It supported this requirement by (i) promoting free water connections to those households with a latrine, and (ii) providing sanitation grants to poor households who required additional assistance in constructing latrines. The "free"

(Project no. 37113); ADB. 2007. *Report and Recommendation of the President to the Board of Directors on the Proposed Sector Development Program Loan to the People's Republic of Bangladesh: Sustainable Power Sector Development Program*. Manila. (Project no. 36107), and ADB. 2003. *Report and Recommendation of the President to the Board of Directors on the Proposed Loans to the People's Republic of Bangladesh for the Power Sector Development Program*. Manila. (Project no. 36205).

¹⁸ ADB. 2009. *Bangladesh Country Assistance Program Evaluation*. Manila; ADB. 2009. *Sector Assistance Program Evaluation: Bangladesh Energy Sector*. Manila.

¹⁹ ADB. 2011. *Delivering Results through the ADF*. Paper prepared for the first ADF XI replenishment meeting in Manila, Philippines, 8–9 September 2011.

²⁰ ADB. 2010. *Report and Recommendation of the President to the Board of Directors on the Proposed Supplementary Grant Lao People's Democratic Republic: Northern and Central Regions Water Supply and Sanitation Sector Project*. Manila. (Grant 0016/0205-LAO, US\$16.6 million (ADF) and US\$1.7 million (NADC), approved on 25 Aug 2005 and 7 April 2010 (supplementary).

connections were for a limited time, and the provision for installing connections was included in the contractor's contract.

40. **Indonesia: Urban Sanitation and Rural Infrastructure Support to PNPM Mandiri Project.**²¹ This project supports the Government of Indonesia's flagship poverty reduction program—the National Program for Community Empowerment (PNPM Mandiri). PNPM Mandiri adapts a community-driven approach and supports the poor rural and urban communities to improve essential social services and basic infrastructure. The project covers a geographic slice of the Government's PNPM Mandiri Program. It includes about 600 rural communities in four provinces; and 1,350 poor urban neighborhoods in 34 cities.

41. Block grants are provided to villages to upgrade basic infrastructure and improve sanitation services. This is a fixed sum of money granted by the national government, which is transferred in three tranches to a selected community that has met criteria for the financing of construction of (i) basic rural infrastructure, or (ii) sanitation facilities in urban areas. A cycle of block grant consists of at least three block grants to a selected community. A menu of investment opportunities for communities are open for financing to be selected based on the guidelines for the project.

42. Financing is linked to performance of the communities. After the completion of the first cycle of block grants, the executing agency, assisted by the district and provincial project implementation units, will conduct a village performance evaluation. Only villages that are evaluated as good performers will receive the second cycle of block grants. Poorly performing villages will be excluded for the second round of block grants and replaced by new villages.

²¹ ADB. 2011. *Report and Recommendation of the President to the Board of Directors on Proposed Loan and Administration of Technical Assistance Grant Republic of Indonesia: Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project*. Manila. Project no. 43255, Loan no. 2768, approved on 5 Aug 2011, closing date in on 31 Dec 2015, US\$100 million (OCR).

SUMMARY OF ADB'S LENDING MODALITIES

1. The existing lending instruments and modalities of the Asian Development Bank (ADB) can be broadly categorized under project-based lending and policy-based lending.

A. Project-Based Lending

2. ADB provides project lending to finance specific investments for sovereign and nonsovereign operations.¹ These operations disburse against specific transactions and expenditure; most of which are used for the purchase of works, goods, and services.

3. There are various forms of project-based lending. In addition to stand alone projects, for investments relating to a sector or subsector of a developing member country (DMC), ADB provides sector lending to finance multiple sub-projects in a DMC.² Disbursements for a sector loan are made in amounts requested against the costs of subprojects. Other types of project-based lending include financing of detailed engineering design through a technical assistance loan³, providing immediate short-term transitional assistance to help rebuild high-priority physical assets and restore economic, social, and governance activities after emergencies through emergency assistance loans,⁴ and providing loans to financial intermediaries to finance development projects whose individual financing requirements are not large enough to warrant the direct supervision of ADB through financial intermediary loans.⁵

4. Project-based lending generally supports a pre-determined design, or a "blueprint" capital investment project, such as construction of a road, dam, or bridge. Assessments of projects are based on their technical soundness, financial and economic viability and sustainability, governance, social and environment impacts, and poverty impacts. The projects are implemented following ADB's procurement guidelines and Safeguard Policy Statements (2009). Risks are managed through ring-fencing, and establishing parallel financial management and project implementation systems.

5. Project-based lending is suitable when the key to achieve the results is the procurement and use of inputs; and when the scope of the operation is a specific, discrete, activities (for example, the construction of an infrastructure project). In these projects, close attention to the details of how inputs are procured and used are keys to success. Project-based lending ring-fence ADB's funds from other sources of finance. By focusing on the implementation and risk mitigation of individual transactions, project-based lending seeks to ensure that right inputs and technology are in place and the projects are implemented as planned.

6. In recent years, ADB has introduced new modalities, all of which fall under the project lending category. These instruments expand the options available to DMCs, to include: (i) a multitranche financing facility,⁶ which allows ADB to finance a time slice of a long-term investment program organized in a series of funding blocks or tranches; (ii) a nonsovereign

¹ ADB. 2012. Lending Policies for Sovereign and Sovereign-Guaranteed Borrowers (Ordinary Capital Resources). *Operations Manual*. OM Section D1/BP. Manila; ADB. 2007. Lending and Grant Policies (Asian Development Fund). *Operations Manual*. OM Section D2/BP. Manila.

² ADB. 2003. Sector Lending. *Operations Manual*. OM Section D3/BP. Manila.

³ ADB. 2011. Technical Assistance. *Operations Manual*. OM Section D12/BP. Manila.

⁴ ADB. 2004. Disaster and Emergency Assistance. *Operations Manual*. OM Section D7/BP. Manila.

⁵ ADB. 2003. Financial Intermediation Loans. *Operations Manual*. OM Section D6/BP. Manila.

⁶ ADB. 2010. Multitranche Financing Facility. *Operations Manual*. OM Section D14/BP. Manila.

public sector financing facility,⁷ which provides loans and guarantees to selected nonsovereign public sector entities without a central government (sovereign) guarantee; (iii) Local currency financing,⁸ which allows ADB to offer loans denominated in a local currency to reduce the mismatch between income received in a domestic currency and debt repayments in a foreign currency; and (iv) new forms of cofinancing through active financial syndications and risk sharing with commercial financing partners. In addition, ADB also strengthened the role of supplementary financing and renamed it as additional financing,⁹ as a modality to enhance development effectiveness by providing additional financing to scale up ongoing projects that are performing well, finance charges in project scope, finance cost overruns, or finance a combination of these.

B. Policy-Based Loans

7. ADB's policy-based lending supports policy reforms.¹⁰ From earlier financing adjustment costs of reforms, policy-based lending now provides budget supports to meet development financing needs. The policy-based lending disburses in tranches against the achievements of policy conditions.

8. ADB has three modalities within the policy-based lending modality: standard policy-based loans, cluster policy-based loans, and special policy loans. A standard policy-based loan supports policy reforms in the short to medium term to improve the policy environment. A cluster approach extends the standard policy-based loan to address reforms over a longer time frame (typically between 4 to 7 years). A cluster policy-based loan can be designed as chronologically-sequenced policy reforms; vertical reforms involving several levels of governments; or horizontal reforms involving cross-sector policy goals. A special policy-based loan provides emergency lending to a DMC in times of crisis, for example, large reversals of capital flows and marked unexpected swings in relative prices.

9. The evolution of ADB's approach in policy-based lending has led to an expansion in its objectives. In the initial years, the primary objective of policy-based lending was to provide short-term financing (mainly for agricultural imports) and to improve utilization of existing capacity. The 1999 program lending policy review introduced the program cluster approach, which allows a broader and longer term perspective on reforms and capacity development. The 2011 review of the program loans removed the restriction on retroactive financing to support reforms undertaken before ADB financing is approved. The review also led to a departure from using the adjustment costs to determine the overall loan size to determination based on the development financing needs of a country. The review also renamed program lending as policy-based lending.

10. Policy-based lending is suitable for supporting reforms when policy actions are critical in creating an enabling policy environment, and for providing general budget support. Policy-based lending requires knowledge of the public financial management environment in the country and needs to be supported by up-to-date diagnostic work. Risk assessments are to be carried out at the country, priority sector, and program levels to evaluate public financial management,

⁷ ADB. 2011. *Mainstreaming Nonsovereign Public Sector Financing*.

⁸ ADB. 2012. *Lending Policies for Sovereign and Sovereign-Guaranteed Borrowers (Ordinary Capital Resources)*. *Operations Manual*. OM Section D1/BP. Manila.

⁹ ADB. 2011. *Additional Financing*. *Operations Manual*. OM Section H5/BP. Manila.

¹⁰ The policy-based lending was referred to as the program lending until the Board approved the most recent revision to the program lending policy in July 2011. ADB. 2011. *Policy-based Lending*. *Operations Manual*. OM Section D4/BP. Manila.

procurement, and integrity issues following the Second Governance and Anticorruption Action Plan (GACAP II).¹¹

C. Sector Development Programs

11. ADB also has an instrument that combines components of a stand-alone project (sector loan) and policy-based lending through the sector development program.¹² This modality came about through the 1996 review of program lending, which allowed both substantive policy reforms and large-scale investment to be included in one operation. This instrument finances a reform program as well as specific projects. It is disbursed in tranches against completion of policy conditions and against project costs. The sector development program is not a separate lending instrument, but represents a combination of policy-based and project-based lending.

12. Major ADB lending instruments and modalities are summarized in Table A3.1 below.

Table A3. 1: Summary of ADB's Lending Modalities

Modalities	Key Features
Project-Based Lending	
Sovereign project lending	<p>Finance specific stand-alone investment projects with sovereign guarantee.</p> <p>Consist of ordinary operations financed by OCR and special operations financed by special funds, including ADF loans and grants.</p> <p>Finance project costs subject to ADB rules.</p>
Nonsovereign project lending	<p>Finance project or corporate finance requirements (operating or capital expenses) without sovereign guarantee.</p> <p>Introduced under the Innovation and Efficiency Initiative (IEI) in 2005. ADB directly assumes the credit risk of the borrower. Financial terms (pricing) are set on a commercial basis, similar to that applied to ADB's private sector loans.</p>
Sector Loan	<p>Finance a large number of sub-projects in a sector. Investments are made in a geographic area (an area slice), or over a period of time (a time slice), or both.</p> <p>"Subprojects" refer to (numerous and comparatively small) projects that make up a sector loan.</p>
Financial Intermediary Loan	<p>Finance directed investments of financial intermediaries, usually as credit lines.</p> <p>Can be used in conjunction with ADB's guarantee products to enhance the availability of funds for financial intermediaries.</p>
Technical Assistance Loans or Grants	<p>Finance capacity building or engineering design of a project.</p>

¹¹ ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

¹² ADB. 2003. Sector Development Programs. *Operations Manual*. OM Section D5/BP. Manila.

Modalities	Key Features
Disaster and Emergency Assistance	<p>Provide immediate short-term transitional assistance to mitigate immediate losses to priority assets, capacity, or productivity.</p> <p>Can be provided in different phases of an emergency: (i) development or prevention phase (e.g. mitigation measures); (ii) emergency response or transition phase (e.g. rehabilitating high-priority physical and social infrastructure; revitalizing basic services, and jump-starting economic productivity); or (iii) recovery phase (based on joint damage and needs assessment with relevant partners).</p> <p>Can use (i) Portfolio restructuring or use of loans savings; (ii) Emergency assistance loans; (iii) normal development loans; (iv) additional financing, or (v) technical assistance.</p>
MFF	<p>Finance (i) multiple projects under an investment program in a sector or sectors; (ii) large stand-alone projects with substantial and related individual components; (iii) slices of large contract packages, and (iv) time slices of an investment program.</p> <p>“Facility” refers to the Board-approved maximum amount for the MFF. On the basis of the Board’s approval, Management converts the MFF amount into a series of tranches to finance eligible investments (termed periodic financing requirement).</p> <p>“Tranches” comprise loans, grants, guarantee, or ADB-administered cofinancing.</p>
Guarantees	<p>Include:</p> <ul style="list-style-type: none"> • Partial credit guarantees to cover partial repayment owed to lenders of ADB’s client. • Political risk guarantee to cover repayment of amounts owed to lenders of ADB’s client when repayment fails due to political risk.
Equity Investments	<p>Equality investment facilitates launching of new ventures or the privatization of state-owned enterprises. ADB can choose to invest directly, or through financial intermediaries. ADB seldom takes equity larger than 25% of total share capital.</p>
Syndication	<p>Syndications enable ADB to transfer some or all of the risks associated with its loans and guarantees to other financing partners. It includes B-loan or lender-of-record arrangements and guarantor-of-record arrangements.</p>
Additional Financing (previously Supplementary Financing)	<p>Can be used to: (i) scale up ongoing projects that are performing well, (ii) finance changes in project scope, (iii) meet cost overruns and financing gaps, or (iv) finance a combination of these.</p> <p>All forms of public and private sector projects can receive additional financing.</p>
Policy-Based Lending	
Policy-based loans (or grants)	<p>Support reforms and disburse in tranches against completion of agreed policy conditions.</p> <p>Provide budget support to address development financing needs. There are three types of policy-based lending:</p> <ul style="list-style-type: none"> • Standard policy-based loans. • Cluster policy base loans. • Special policy-based loan (for emergency situations). Only graduated DMCs

Modalities	Key Features
	(i.e. countries that are not ADF recipients) can avail to modality.
Sector Development Programs	
Sector Development Program lending	<p>Finance a reform program and specific projects linked to a sector and program.</p> <p>Is a combination of project lending and policy-based lending. It is thus not a separate modality.</p>
Financing Facilities	
Retroactive Financing	<p>Finance expenditure incurred before the ADB loan, grant, or TA becomes effective.</p> <p>Should not exceed 20% of the ADB financing, and should be incurred within 12 months before the effectiveness of the ADB financing.</p> <p>The 2011 review of policy-based lending eliminated the ceiling of retroactive financing for policy-based lending.</p>
Local Currency Financing	<p>Provide loans in local currencies to reduce mismatch between income received in a domestic currency and debt repayments in a foreign currency.</p> <p>Can be attractive to private, state-owned enterprises, local governments, as well as public services, utilities, and infrastructure projects that are subject to regulated tariff regimes.</p> <p>ADB can only offer local currency loans in selected DMCs where it has secured approvals to access the local capital market.</p>
Project Design Facility	<p>Provide quick-disbursing resources through PDAs to fund detailed engineering design and broader project preparation.</p> <p>PDF has shorter processing time compared with a TA loan. It helps in providing more realistic cost estimates, obviating the need for large contingencies and relieving resource constraints for project preparation.</p> <p>PDF is pilot implementation until 31 December 2013. The ceiling for an individual PDA is set at \$5 million or 1% of the estimated cost of the ensuing OCR or ADF loan, whichever is larger. One or more PDAs may be provided for an operation, up to the ceiling set for an individual PDA.</p>

ADB = Asian Development Bank, ADF = Asian Development Fund, DMC = developing member country, IEI = innovation and efficiency initiative, MFF = multitranches financing facility, OCR = ordinary capital resources, PDA = project design advances, PDF = Project Design Facility, TA = technical assistance

SUMMARY OF CONSULTATIONS

A. Public Consultations

1. The Asian Development Bank (ADB) has undertaken extensive internal and external consultations in preparing the results-based financing (RBF) program modality. Key consultation activities included:

- (i) discussing RBF paper drafts with each operations department and other relevant departments;
- (ii) establishing an inter-departmental team which has provided a forum for exchanging ideas across many areas;
- (iii) providing briefing sessions to Management;
- (iv) holding an informal board seminar in November 2011 to share the preliminary thinking with the Board;
- (v) fielding missions to developing member countries (DMCs) in different sub-regions to obtain their feedback,
- (vi) surveying all DMCs with assistance from resident missions; and
- (vii) exchanging experiences with development partners, especially the World Bank and the Inter-American Development Bank.

2. All comments and suggestions received have been carefully considered in drafting the RBF policy paper. In addition, ADB is planning to hold a broad web-based public consultation with all stakeholders and the public. Stakeholders' feedback will be carefully considered in revising the RBF program policy.

B. Major Comments and Suggestions

3. The consultations suggest that there is broad support for the RBF programs. The direct links between disbursement and results, focus on institutional development, support for government ownership, transparent identification and focused measures to mitigate risks, and the potential for enhanced development partnerships are all welcoming features of the RBF programs. Many stakeholders also see RBF as an instrument for greater innovations and efficiency, given that it focuses on results. The prospect of using and improving program systems is considered a major potential advantage of RBF programs.

4. Survey results from DMCs suggest that a diverse range of sectors can be suitable for RBF programs, for example, agriculture and natural resources (e.g. livestock, disease diagnosis, treatment and prevention), large numbers of smaller scale infrastructure projects across a large geographic area; renewable energy; rural development (e.g. rural roads), education, health, urban development, water supply and sanitation, environment, disaster management programs, public sector management, and food security and food distribution system. They expressed strong support for having such a modality. They see the programs as having many potential benefits:

- (i) Contributing to the operationalization of the Paris Declaration principles.
- (ii) Enhancing achievement and sustainability of development results, especially outcomes.
- (iii) Supporting effective and efficient program selection, planning, implementation, monitoring and evaluation (M&E), results verification, and better program management.
- (iv) Effective and efficient allocation and use of scarce public resources (including healthy competition for funds among programs).
- (v) Procedural efficiency.

- (vi) Institutional development and capacity building in areas of financial management, procurement, safeguards, M&E, achievement of targets, skills development, competence improvement, and performance-budgeting.
- (vii) Helpful for risk mitigation.
- (viii) Potential to reduce corruption
- (ix) Improving country ownership.
- (x) Platform for development agencies to better coordinate.
- (xi) Platform for stakeholder participation.

5. ADB has also received many constructive comments and suggestions. The major points are summarized below.

- (i) Sustainability of the programs is very important. What happens after the external financing is over should be a key consideration for designing the instrument.
- (ii) The defining, measuring, monitoring, and evaluation of results should not be overburdened by tedious and overly demanding data and procedural requirements, and instead should be practical, feasible, as well as effective. M&E and credible verification are important.
- (iii) Result indicators should be concrete, measureable, controlled by the program and attributable to the efforts made.
- (i) Large amounts of up-front financing by government may not be affordable for many countries. Advanced financing should be provided to bridge the financing gap.
- (ii) There should be a strong linkage between RBF programs and government's financing needs. Predictability of funds is important.
- (iii) RBF programs should carefully consider existing program systems first to avoid undesirable and unworkable re-engineering.
- (iv) Public and private partnerships should also include communities and nongovernmental organizations.
- (v) ADB should arrange participatory knowledge sharing sessions with the stakeholders to disseminate the approaches for RBF programs. Awareness-raising and rollout activities will be important for introducing the new modality.
- (vi) Intensive and continuous capacity development activities (e.g. proper guidance and follow-ups on changing of attitude for improvements in systems and processes and aligning institutions with sound principles) will be critical.
- (vii) Capacity building in operational aspects (such as financial management, procurement), in results-focused program design and management, and in M&E tools are critical. Training should be provided.
- (viii) Learning from experience and involvement of stakeholders will be important.
- (ix) RBF programs should be governed by efficient procedures. This will be consistent with the RBF approach.

C. Major Questions

6. Stakeholders asked questions about the background of introducing RBF programs in ADB, and on such aspects as results; systems, and risk management. Major questions and ADB's responses are summarized below.

7. *Why does ADB want to introduce the RBF program modality?*

8. ADB is considering introducing the RBF programs to provide more choices for DMCs and ADB operations, enhancing incentives and accountability for results, and strengthening program systems. RBF programs will disburse against results, not expenditures. The programs will be

system based, not transaction based. These features of RBF program will help deliver sustainable results. ADB has adopted a result based corporate performance system. ADB is also moving towards results based country strategies and its internally work plans that are closely linked with results. This new instrument will constitute a step in the results-based reforms in ADB.

9. *How will the results be defined, measured, and verified?*

10. Defining the results is a key aspect of designing the RBF programs. One important consideration is to define the results that are relevant to the end-users—the program beneficiaries. Results can be a combination of outcomes, outputs, processes, financing, and institutional indicators. Results will evolve with time as a program matures. Results will be measured based on clearly defined indicators, monitored by sound M&E systems, and verified through credible mechanisms.

11. *How will the disbursement linked indicators be decided and verified?*

12. The Disbursement Linked Indicators (DLIs) will be decided through dialogue between the government and ADB. DLIs will generally be a subset of indicators from the government's results framework. They will be the critical result indicators for the success of the program.

13. Each DLI will have a transparent verification protocol. Verification will be carried by a credible mechanism which will be tailored to suit the needs of each DLI. The specific verification process will differ based on the nature of the DLI, the country, and sector context.

14. *What will be the role of institutional development?*

15. Institutional strengthening will be a core component of RBF programs. RBF programs seek to assess, improve, and work with program systems. Capacity building will be provided through technical assistance and other support. Important institutional indicators will be included as part of DLIs.

16. *How will fraud and corruption be addressed?*

17. Tackling systematic weaknesses is a key motivation of RBF programs. RBF programs will include rigorous risk assessments, systematic capacity building, and solid risk management measures. One key aspect is to identify the leakage points and opportunities for corruption, and adopt measures accordingly. The RBF program will adopt specific anti-corruption guidelines to support DMCs to deal with fraud and corruption. ADB will support DMCs' efforts. At the same time, ADB reserves the right to investigate. ADB's standard remedies provide sufficient tools for ADB to deal with fraud and corruption.

18. *How can fiduciary and safeguard risks be minimized?*

19. One key objective of RBF programs is to raise the standard of the program systems, so that all the risks, including development risks, fiduciary risks, safeguard risks, as well as other risks can be minimized. Systematic improvement is the only sustainable way to mitigate these risks in the long run. Many measures will be built into RBF programs to minimize fiduciary and safeguard risks. ADB will assess the strengths and weaknesses of the program's fiduciary and safeguard systems, institutional capacity, and performance. Capacity building will be carried out and risk mitigating measures will be carried out.

20. *Will the assessments be too demanding?*

21. Rigorous assessments are a key input of RBF programs. It is a necessary step that ADB and DMCs must take. Sound assessments will require time and resources from both ADB and the borrowers. Initial transaction costs may be high. However, over time, this is expected to decline as more knowledge is accumulated. Coordination and joint efforts by development partners can also help reduce transaction costs.

22. *What kind of support will ADB give to DMCs?*

23. Through RBF programs, ADB will support DMCs in the following aspects:

- (i) Refining the program design.
- (ii) Refining the results frameworks.
- (iii) Assessing system strengths and weaknesses.
- (iv) Identify risks and mitigating measures.
- (v) Supporting capacity development.
- (vi) Providing implementation supports.
- (vii) Assist in M&E.
- (viii) Providing financing for the program, linked with achievements and verification of DLIs.
- (ix) Providing technical assistance.
- (x) Other necessary support.

24. *What are the roles of the civil society organizations?*

25. Civil society organizations can play important roles in RBF program design, implementation, and monitoring. They can

- (i) provide inputs into the design of the program;
- (ii) provide inputs into the design of the results framework;
- (iii) implement activities in the program as appropriate;
- (iv) help monitor the program implementation;
- (v) help to verify results;
- (vi) provide other feedbacks; and
- (vii) providing other supports.

SUMMARY OF LESSONS RELATED TO RESULTS-BASED FINANCING OPERATIONS

1. The Asian Development Bank (ADB) has carefully studied the experience on operations with RBF features both within ADB and in similar organizations, and surveyed numerous publications on development effectiveness especially by the Organisation for Economic Co-operation and Development-Development Assistance Committee. The practical experience and analytical work point to lessons that should be considered in designing a RBF program modality.

1. Policy and Operations

2. *Need for an enabling policy framework.* The absence of an enabling policy framework for RBF programs increases processing costs, diverts time and attention from substantive matters, cause inconsistencies, and create missed development opportunities.

3. *Initial transactions costs can be high.* Initial transactions costs for designing and implementing RBF programs can be high due to the need to assess the systems, institutional development, and results verification. Over time, however, transaction costs are likely to decline, and the RBF support structures can have long lasting positive impacts on the quality of institutions. Development agencies need to factor these costs in when allocating resources.

2. Results

4. *Adding result requirements on top of expenditure verification is counter-productive.* This double-layered requirement will contradict with the RBF approach and increase transaction costs. When development agency financing is pooled with government and other financing sources, it is also difficult to trace and single out results from a specific development agency's financing. It is more productive to focus on the entire program financing and systems.

5. *Disbursements indicators should strike a balance between outcomes, outputs, and other related indicators.* The emphasis on sector outcomes is helpful to focus all the attention on what matters for program beneficiaries. Outcomes should drive RBF programs. However, basing disbursement largely on outcome can be problematic. Results should be a mix of outcomes, outputs, and other indicators. The results indicators also depend on the maturity of the program, with the delivery outcomes being more attainable as a program proceeds.

6. *It is important to focus on the right results.* RBF may focus on the wrong results. For this reason, a key lesson is to define the results from the stand point of the ultimate beneficiaries to ensure that results are relevant and meet their needs.

7. *RBF programs involve payment for results rather than payment by results.* Development agency financing generally accounts for a moderate share of total program resources. It is therefore one of multiple inputs contributing to the program results. It will be difficult to single out the 'cost' of each result indicator. RBF programs thus involve payment for results rather than by results. Attention should be placed on results for the whole program and the financing needs for achieving all the results.

3. Institutional and Capacity Development

8. One key motivation of a RBF program is to improve program systems. There are numerous lessons from decades' of development assistance.¹

¹ See J. Cant, R. Carter and S. Lister. 2008. *Stocktake on Donor Approaches to Managing Risk when Using Country Systems*. A report prepared for OECD-DAC Joint Venture on Public Financial Management.

9. *Country ownership.* An overwhelming finding from many studies is that effective capacity development must be owned by a government.² External assistance can support capacity development, but it cannot be a substitute for it. Capacity development is most likely to succeed when countries view it as serving their own self interests. Supply-driven and fragmented assistance will not be effective.

10. *Capacity development goes much further than merely transferring skills.* Capacity development can entail major changes in organizational, behavior, and incentive structures. Though new equipment, training programs, and updated procedures all play a role, effective capacity development must take into account the political, institutional and organizational context. The most crucial and difficult part is changing behavior and organizational culture. Many capacity development programs have been weakened by giving too much attention to complex technical solutions and too little to existing constraints in capacity, incentives, and political-economy factors. Using high-technology solutions to address basic problems – for example, implementation of state-of-the-art Integrated Financial Management Information Systems to address weaknesses in accounting – has failed in many countries. Often, the technologies were too complex for the country's capacity and needs. Likewise, adopting mid-term expenditure frameworks proved too complex without first addressing basic systems weaknesses in ensuring that the government is executing a one-year budget reasonably well.³

11. *Capacity can rarely be strengthened with a “quick fix”.* It is not easy to change laws, regulations, institutions, practices, habits, and mindsets. Progress is often incremental, but continued steps will make a difference. Capacity development thus requires a long-term perspective.

12. *Capacity needs to support results.* A strengthened system is not an end in itself. It is necessary – but not sufficient – for development impact. It needs to be linked to results and improved service delivery.

13. *Capacity development requires flexibility.* In a complex system, it is not possible to identify all the relevant capacity building from the outset. Hence, it is necessary to continually monitor the processes, and to adjust them if necessary. A formulated action plan should be clear in its objectives, but flexible in its approach to respond to unforeseen events.

14. *A harmonized approach will be more efficient and effective.* Harmonized approaches among development partners could involve sharing information, sharing diagnostics, joint analysis, and harmonized assistance strategies. This could reduce transaction costs.⁴

15. The designing of a RBF program modality will keep abreast these lessons.

² For example, OECD-DAC. 2006. *Harmonising Donor Practices for Effective Aid Delivery - Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management. DAC Guidelines and Reference Series.* Paris, France.

³ World Bank. 2008. *Public Sector Reform: What Works and Why? An IEG Evaluation of World Bank Support.* Washington, D.C.

⁴ OECD-DAC Working Party on Aid Effectiveness. 2005. *Harmonisation, Alignment, Results: Report on Progress, Challenges and Opportunities.* Paris, France.

**PROPOSED GUIDELINES
TO PREVENT AND MITIGATE FRAUD, CORRUPTION, AND OTHER PROHIBITED
ACTIVITIES IN RESULTS-BASED FINANCING PROGRAMS**

1. Purpose and General Principles

1. The Asian Development Bank (ADB) has a fiduciary responsibility to ensure that ADB loans (and other forms of financing) is used only for the purposes for which a loan was granted, in accordance with its Charter.¹ To uphold that obligation, ADB presents Guidelines to prevent and mitigate fraud, corruption and other prohibited activities in programs financed in whole or in part through the results-based financing (RBF) program modality. These Guidelines build upon the legal obligations presented in the Loan Agreement and apply to programs funded by the RBF program modality (the Programs).

2. These Guidelines do not limit any other rights, remedies or obligations of ADB or the Borrower under the Loan Agreement or any other document to which the ADB and the Borrower are both parties.

3. All persons and entities participating in the Programs must observe the highest ethical standards, take all appropriate measures to prevent and mitigate fraud, corruption and other prohibited activities from occurring, and refrain from engaging in actions described in these Guidelines in connection with such programs.

2. Definitions

4. These Guidelines address the following practices as defined by ADB:

a.) A “corrupt practice” is the offering, giving, receiving or soliciting, directly or indirectly, anything of value to influence improperly the actions of another party.

(i) A “fraudulent practice” is any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation.²

(ii) A “collusive practice” is an arrangement between two or more parties designed to achieve an improper purpose, including to improperly influence the actions of another party.

(iii) A “coercive practice” is impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party.

5. In addition, ADB may investigate conflicts of interest, obstruction, and retaliation, as presented below:

(i) A “conflict of interest” is a situation in which a party has interests that could improperly influence a party’s performance of official duties or responsibilities,

¹ ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

² To act “knowingly or recklessly,” the fraudulent actor must either know that the information or impression being conveyed is false, or be recklessly indifferent as to whether it is true or false. Mere inaccuracy in such information or impression, committed through simple negligence, is not enough to constitute fraudulent practice.

contractual obligations, or compliance with applicable laws and regulations. To the extent that conflicts of interest may provide an unfair competitive advantage or compromise the integrity of financial and governance systems, conflicted persons and entities must be excluded from participating in relevant Program activities.

- (ii) An “obstructive practice” includes deliberately destroying, falsifying, altering or concealing of evidence material to an investigation; making false statements to investigators in order to materially impede an investigation; threatening, harassing, or intimidating any party to prevent it from disclosing its knowledge of matters relevant to the investigation or from pursuing the investigation, or materially impeding ADB’s contractual rights of audit or access to information.
- (iii) Retaliation against whistleblowers or witnesses is any detrimental act, direct or indirect, recommended, threatened or taken against a whistleblower or witness or person associated with a whistleblower or witness in a manner material to a complaint because of the report or cooperation with an investigation by the whistleblower or witness.³

3. Borrower’s Actions to Prevent Fraud, Corruption and Other Prohibited Activities In the Programs

6. Unless otherwise agreed in writing by the Borrower and ADB, the Borrower will take timely and appropriate measures to:

- (i) ensure that the Program is carried out in accordance with these Guidelines;
- (ii) avoid real or perceived conflicts of interest in the Programs;
- (iii) prevent fraud, corruption and other prohibited activities from occurring in the Programs, including (but not limited to) adopting, implementing and enforcing appropriate fiduciary and administrative practices and institutional arrangements to ensure that the proceeds of the Loan are used only for the purposes for which the Loan was granted;
- (iv) promptly inform ADB of allegations of fraud, corruption and other prohibited activities found or alleged related to a Program;
- (v) investigate allegations of fraud, corruption and other prohibited activities and report preliminary and final findings of investigations to ADB
- (vi) respond to, mitigate and remedy fraud, corruption or other prohibited activities which are found to have occurred in a Program and prevent its occurrence;
- (vii) cooperate fully with ADB in any ADB investigation into allegations of fraud, corruption and other prohibited activities related to the Programs; and
- (viii) ensure that persons or entities sanctioned by ADB do not participate in the Program supported activities in violation of their sanction.

³ ADB’s Whistleblower Protection Administrative Order can be found on ADB’s website, at <http://www.adb.org/employment/whistleblower-witness-protection.asp>. ADB. 2009. Whistleblower and Witness Protection. *Administrative Order*. AO 2.10. Manila.

4. ADB's Actions to Prevent Fraud, Corruption and other Prohibited Activities in the Programs

7. Unless otherwise agreed in writing by the Borrower and ADB, ADB will
- (i) inform the Borrower of credible and material allegations or other indications of fraud, corruption and other prohibited activities related to a Program, consistent with ADB's policies and procedures;
 - (ii) have the right to investigate allegations independently or in collaboration with the Borrower;
 - (iii) inform the Borrower of the outcome of any investigation, consistent with ADB policies and procedures;
 - (iv) have the right to sanction any individual or entity for engaging in practices defined above in accordance with ADB's prevailing sanctions policies and procedures. Sanction may result in that party's exclusion from participating in a Program financed activity indefinitely or for a stated period of time;⁴ and
 - (v) recognize sanctions determined by other multilateral development banks in accordance with the agreement for the mutual enforcement of debarment.

⁴ Participation does not include the performance under contracts entered into or other engagements began prior to the date of the Loan Agreement.