



Policy Paper

February 2013

Piloting Results-Based Lending for Programs

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Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CCT	–	conditional cash transfer
COD	–	cash on delivery
CAPE	–	country assistance program evaluation
DFID	–	Department for International Development of the United Kingdom
DLI	–	disbursement-linked indicator
DMC	–	developing member country
EC	–	European Commission
EU	–	European Union
FSS	–	franchise shipping scheme
GAVI	–	Global Alliance for Vaccines and Immunization
IDB	–	Inter-American Development Bank
ISS	–	immunization services support
M&E	–	monitoring and evaluation
MCC	–	Millennium Challenge Corporation
MDB	–	multilateral development bank
OBA	–	output-based aid
OCR	–	ordinary capital resources
OECD-DAC	–	Organisation for Economic Co-operation and Development–Development Assistance Committee
PBC	–	performance-based contract
PDL	–	performance-driven loan
PMGSY	–	Pradhan Mantri Gram Sadak Yojana
PNG	–	Papua New Guinea
RBF	–	results-based financing
RBL	–	results-based lending
RBPSM	–	results-based public sector management
SAI	–	supreme audit institution
SWAP	–	sector-wide approach
TA	–	technical assistance
UK	–	United Kingdom
US	–	United States

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

This paper proposes that the Asian Development Bank (ADB) introduce a results-based lending (RBL) modality for programs. This modality will support government-owned sector programs, and link disbursements directly to the achievement of program results. The design and implementation of programs supported by RBL will include ex ante assessments of the program and its systems, ex post results verification, and systematic institutional development. The objectives of RBL are to increase accountability and incentives for delivering and sustaining results, improve the effectiveness and efficiency of government-owned sector programs, promote institutional development, and enhance development effectiveness.

RBL will have the following key features:

- (i) **Supporting government sector programs.** RBL will support government-owned sector programs and finance the program's expenditure framework.
- (ii) **Linking disbursements directly to results.** Disbursements will be directly linked to the achievements of program results as measured by disbursement-linked indicators.
- (iii) **Supporting institutional development.** Institutional development will be an important motivation and objective of RBL. RBL will seek to strengthen key program systems, including monitoring and evaluation, fiduciary (financial management, procurement, and anticorruption measures), and safeguards. Institutional development will also include organizational and behavioral changes that strengthen accountability and incentives for results. The aim of institutional development will be achieving and sustaining sector results.
- (iv) **Managing risks adequately.** RBL will include rigorous assessments of the systems to implement the program, follow-up capacity development measures, and implementation support. ADB and the developing member country will agree on measures to improve the program and its systems to ensure that (a) the program achieves its development results, (b) funds are used for the program's expenditures with due consideration for economy and efficiency, and (c) potential environmental and social impacts are adequately addressed.
- (v) **Fostering partnerships.** When more than one development agency is involved in a program, RBL will support development partnerships by sharing a common government-owned results framework, using common systems, and financing a common expenditure framework.

The achievement of results and institutional development will be the centerpieces of RBL. Guided by commonly accepted good practice principles, ADB will assess a program and its financing, results, and systems and institutions. The assessments will cover the whole program to be supported—not just the ADB financing—and will be used to identify risks and mitigating measures, capacity development needs, and implementation support required.

To enable learning-by-doing, ADB will pilot the RBL for programs for 6 years. This is the minimum time frame required to yield sufficient information for a subsequent review of both the design and implementation of RBL. During the pilot, ADB will put in place measures for dissemination, consultation, training, and learning within ADB and in developing member countries. ADB will also learn from and exchange experiences with other development agencies. Management will carry out an implementation review of the RBL experience around 3 years after the modality has become effective to take stock of the experience and distill initial lessons. Near the end of the pilot, the Independent Evaluation Department will carry out its own

evaluation. The experiences derived from the pilot will inform the future policy direction of RBL for programs.

To mitigate risks during the pilot, RBL for programs will exclude activities that would (i) be classified as category A under ADB's Safeguard Policy Statement (2009); and (ii) involve procurement of works, goods, and services under contracts with estimated values that exceed specified monetary amounts (high-value contracts). ADB will limit the resource allocation for RBL for programs to 5% of the total ordinary capital resources and Asian Development Fund resources for the first 3 years from the date of policy effectiveness. Management may propose to the Board to lift this cap if justified by the implementation review.

RBL for programs is expected to deliver many benefits. It will complement ADB's existing lending modalities, help ADB better meet the needs of its developing member countries, support good governance, increase accountability and incentives for development results, and contribute to the aid effectiveness agenda.

I. INTRODUCTION

1. This paper proposes that the Asian Development Bank (ADB) introduce a results-based lending (RBL) modality for programs. RBL will support government-owned sector programs and link disbursements directly with the achievement of program results.¹ The design and implementation of programs supported by RBL will include ex ante assessments of the program and its systems, ex post results verification, and systematic institutional development. The objectives of RBL are to increase accountability and incentives to deliver and sustain results, improve the effectiveness and efficiency of government-owned sector programs, promote institutional development, and enhance development effectiveness. When more than one development agency is involved in a program, RBL will also support development coordination and harmonization.

2. The proposed modality is in line with the broad results-based financing (RBF) approach, which has been identified by the development community as a means of improving development effectiveness. This paper highlights the defining feature of the RBF approach in linking payments with results. In light of recent experience with RBF in multilateral development banks (MDBs), the paper identifies the need for an RBL modality for programs in ADB, and describes the modality.

II. WHAT IS RESULTS-BASED FINANCING?

3. All development operations seek to deliver results. A defining feature of results-based financing (RBF) is that it directly links payments with results. This differs from operations that link payments with evidence of expenditures for inputs, thereby establishing only an indirect relationship between payments and results.

4. While RBF approaches have been described in varying terms, they all essentially involve a financier making payments to a recipient based on results delivered through pre-agreed funding relationships. RBF relationships can be defined in legally binding contracts, memorandums of understanding, or partnership arrangements.²

5. RBF relationships can be between a development agency and a developing member country (DMC) government, between a government and a ministry, or between a national and a subnational government. The results under RBF operations can be outcomes, outputs, and institutional changes that address sector performance bottlenecks. Many RBF operations use a combination of results at different levels. The design of RBF operations also stresses the importance of identifying the “right” results. Results should be defined from the standpoint of the beneficiaries to ensure that they are relevant and meet beneficiaries’ needs.

III. WHY RESULTS-BASED FINANCING?

A. The Quest for Development Results

6. **Incentives and accountability for results.** RBF aims to strengthen incentives and accountability for results. Payments are based on what is delivered, rather than on evidence of expenses incurred. Essentially, the achievement of results is directly financed, not the inputs by an implementing entity to achieve the results. As a lack of results can mean reduced, delayed,

¹ Para. 56 elaborates on what a government program refers to.

² S. Klingebiel. 2011. Results Based Aid: Limitations of New Approaches. *Briefing Paper*. No. 17. Bonn, Germany: German Development Institute.

or no payments to those responsible for delivering results, RBF helps to strengthen accountability for results and align the incentives of people responsible for delivering results with those who will benefit from the results.

7. There is an increasing demand worldwide for governments and development agencies to deliver measurable results. Better results are essential for fiscal sustainability, economic growth, human development, and poverty reduction. These increasing demands have driven a wide range of public sector reforms since the 1980s. Many innovative instruments have emerged, in particular results-based public sector management (RBPSM).

8. RBPSM is especially relevant to development agencies because it shifts emphasis from inputs and activities to accountability for results through strategic planning, optimal allocation of resources, systematic implementation, effective use of resources, performance measurement, and monitoring and evaluation (M&E).³ Many countries in the Organisation for Economic Co-operation and Development (OECD) have implemented RBPSM. Some governments in the Asia and Pacific region have also adopted RBPSM. For example, Malaysia's RBPSM reforms have given the heads of line departments greater autonomy 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 DMCs such as India, where the government of Andhra Pradesh instituted the Performance Accountability Act in 2003.

9. RBPSM and similar public sector reforms can have profound implications for the operations of development agencies. With the growing demand to demonstrate accountability for results, more and more DMCs are expected to adopt RBPSM. Development agencies are stepping up their efforts to lead or keep pace with these developments. Managing for development results has been adopted as a key component of the Paris Declaration on Aid Effectiveness.

10. **Institutional development.** Institutional development is the second objective driving the emergence of the RBF approach. Development effectiveness not only depends on the availability of resources, but also the soundness of DMC institutions to develop and implement policies, and manage public resources. RBF approaches stress the importance of public institutions as cornerstones for achieving and sustaining development results. RBF supports building sound institutions and delivering development results. Under RBF, these are two complementary elements of sustainable development.

B. A New Development Paradigm

11. The quest for results and institutional development has significantly shaped development financing since the 1990s.⁴ A consensus has emerged through successive development forums, including the Monterrey Consensus in 2002, the Rome Declaration on Harmonisation in 2003, the Marrakesh Roundtable on Managing for Development 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 Co-operation in 2011. The international community, including MDBs, has committed through these forums to measuring development effectiveness by achieving results, supporting institutional development, strengthening partnerships, enhancing country ownership, and harmonizing development initiatives.

³ 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.

⁴ For example: OECD-Development Assistance Committee Working Party on Aid Effectiveness. 2005. *Harmonisation, Alignment, Results: Report on Progress, Challenges and Opportunities*. Paris.

IV. RESULTS-BASED FINANCING IN MULTILATERAL DEVELOPMENT BANKS

12. While bilateral development agencies have spearheaded the use of the RBF approach, MDBs have also pursued this approach in recent years. The Inter-American Development Bank (IDB) introduced performance-driven loans (PDLs) in 2003. The World Bank added an RBF instrument to its tool kit with the approval of the Program-for-Results financing policy in January 2012.⁵ Appendix 1 provides examples of RBF schemes. Appendix 2 summarizes the operations with RBF features of MDBs and other development agencies.

A. World Bank

13. **Program-for-Results financing.** The World Bank approved the Program-for-Results financing instrument in January 2012. It supports government development programs, uses results as the basis for disbursements, and promotes institutional development.

14. Under Program-for-Results financing, the World Bank aligns its assistance with government programs and helps countries improve the design and implementation of their programs. Program-for-Results financing funds government program expenditures. It focuses directly on systemic improvement and capacity development. The World Bank expects this instrument to increase the development impact and sustainability of the operations it finances.

15. **Operations.** While Program-for-Results financing is a relatively new instrument, many operations at the World Bank have incorporated features of RBF since the late 1990s.⁶ Most of these were processed as investment lending operations. These projects disbursed funds to eligible expenditure programs based on the achievement of disbursement-linked indicators (DLIs), which include outcomes, outputs, and institutional change indicators. The number of these operations has increased since the 1990s because of strong demand from governments. The World Bank's review of these operations indicates that their performance compares favorably with the overall investment lending portfolio. In particular, the World Bank found that links between disbursements and results strengthened incentives for governments to deliver results.

16. **Learning lessons and developing the Program-for-Results financing policy.** Although some operations had incorporated RBF features, the World Bank found that the absence of a dedicated policy framework created problems, necessitating the development of a dedicated instrument: Program-for-Results financing.

17. The World Bank's review concluded that RBF operations had been "squeezed" into investment lending frameworks. This had several drawbacks (footnote 5):

- (i) **High transaction costs.** A double layer of controls was often required to ensure that the operations complied 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

⁵ World Bank. 2011. *A New Instrument to Advance Development Effectiveness: Program-for-Results Financing*. Washington, DC.

⁶ Examples of projects with RBF features include the Punjab Education Project in Pakistan, the Sindh Education Project in Pakistan, the Rural Health Improvement Project in Brazil, the Decentralized Infrastructure Development Project in Mexico, the Bolsa Familia Program in Brazil, the School Operational Assistance (BOS) Knowledge Improvement for Transparency and Accountability Project in Indonesia, the Private Housing Finance Markets Strengthening Project in Mexico, the Protection of Basic Services Project in Ethiopia, and the Pradhan Mantri Gram Sadak Yojana (PMGSY) Rural Roads Project in India.

- attention away from substantive matters.
- (ii) **Inconsistency.** The absence of clear policies and guidance led to confusion and inconsistent applications, as staff had to revisit the same sets of issues for each project.
 - (iii) **Missed opportunities to improve government programs.** Squeezing RBF operations into the investment lending framework resulted in missed opportunities. First, it led to operation designs biased towards activities that were easier to accommodate within investment lending procedures rather than those driven by delivering results. This limited World Bank's ability to partner with a country to improve the effectiveness and efficiency of the entire program. Second, because RBF operations had to be designed to comply with investment lending frameworks, many potential RBF operations were designed as conventional investment lending to avoid the high transaction costs. This approach deprived the World Bank of the opportunity to help governments improve their programs.
 - (iv) **Missed opportunities to address institutional issues.** Because of concerns about applying World Bank rules to country programs, more attention was given to procedural compliance than to institutional issues. This led to missed opportunities to address institutional weaknesses.
 - (v) **High risks.** Uncertainty about how best to apply World Bank policies and procedures under these operations heightened risks for both borrowing countries and the World Bank.

18. The World Bank's Pradhan Mantri Gram Sadak Yojana (PMGSY) Rural Roads Project in India highlights these problems.⁷ Although the World Bank accepted modified government procedures for procurement and safeguards, the project still encountered several problems. First, ongoing contracts were excluded at project effectiveness, reducing the World Bank's ability to influence these contracts positively. Second, much of the project preparation resources of both the government and World Bank were used to find 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 included more than 7,000 contracts spread across about one-third of India. This has made project management difficult, inefficient, and risky for the World Bank and the government.

19. The development of Program-for-Results financing benefited from the World Bank's experience with investment lending operations that incorporated RBF features. After a careful review of the lessons learned, the World Bank concluded that a dedicated policy was needed to provide an enabling policy framework for RBF operations to (i) lower transaction costs, (ii) reduce inconsistencies and confusion, and (iii) reduce missed opportunities to influence positively the entirety of government programs and improve program institutions.

20. The World Bank has tentatively identified 14 operations that are likely to use Program-for-Results financing in the first year after policy approval in January 2012. These operations cover a wide range of country incomes, program types, and sectors, including health, education, transport, rural infrastructure, and public sector management. By January 2013, the World Bank

⁷ 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 Loan in the Amount of US\$500 Million to the Republic of India for the PMGSY Rural Roads Project*. Washington, DC. PMGSY is the Prime Minister's rural road program.

had approved five programs under Program-for-Results financing,⁸ and nine more programs were being processed.

B. Inter-American Development Bank

21. **Policy.** IDB adopted its policy on PDLs in 2003.⁹ The main features of PDLs include (i) disbursement based on meeting results targets, except for advance payment, which can be up to 20% of IDB financing; (ii) results defined by outcomes; (iii) results audited by independent performance reviewers; and (iv) use of country systems for procurement.

22. **Operations.** PDLs were used in infrastructure and social sectors. A health sector PDL operation in Colombia played an important role in delivering vaccinations to disadvantaged people.¹⁰ A solid waste management operation in Chile added flexibility in supporting a large number of investment activities on residential waste management.¹¹ An agricultural operation in Paraguay helped farmers gain access to inputs and technological support.¹² In Nicaragua, a PDL enabled the Maternal and Child Health Program to promote greater participation by national, regional, and local public health agencies in meeting the Millennium Development Goals on reducing maternal and child mortality.

23. **Lessons.** The demand for PDLs had been moderate—17 operations from 2003 to 2009—for two main reasons. First, PDLs require the direct attribution of specific results to IDB financing. This is difficult as results are achieved through resources from various sources; IDB financing is only one of the sources. Second, PDLs require ex post performance, as well as expenditure verification, to achieve results. Effectively, PDLs have placed double requirements on the governments and IDB staff by adding the result requirements on top of investment lending. This increased transaction costs and contributed to significant delays in disbursements. More importantly, the PDLs' combination of results- and transaction-based approaches was not optimal for project design and implementation. Consequently, instead of focusing on development results and strengthening national systems to achieve the results, IDB and the governments spent an excessive amount of time and energy on controlling expenditures.

C. Asian Development Bank

24. **Strategic transformation.** Strategy 2020 is transforming ADB's core business model, guided by a set of corporate values including responsiveness to DMC needs, recognition of

⁸ World Bank. 2012. *Program Appraisal Document on a Proposed Credit in the Amount SDR 38.7 Million (US\$60.0 Million) to Nepal for a Bridges Improvement and Maintenance Program*. Washington, DC; World Bank. 2012. *Program Appraisal Document on a Proposed Loan in the Amount of Euro 227 Million (US\$300 Million Equivalent) to the Kingdom of Morocco for a National Initiative for Human Development 2 Program*. Washington, DC; World Bank. 2012. *Program Appraisal Document on a Proposed Credit in the Amount of SDR 67.6 Million (US\$255 Million Equivalent) to the United Republic of Tanzania for an Urban Local Government Strengthening Program*. Washington, DC; World Bank. 2012. *Program Appraisal Document on a Proposed Loan in the Amount of US\$66 Million to the Oriental Republic of Uruguay for a Road Rehabilitation and Maintenance Program*. Washington, DC; and World Bank. 2012. *Program Appraisal Document on a Proposed Credit in the Amount of SDR 131.5 Million (US\$200 Million Equivalent) to the Socialist Republic of Vietnam for the Results-Based Rural Water Supply and Sanitation under the National Target Program*. Washington, DC.

⁹ IDB. 2003. *Proposal for a Pilot Program for Performance-Driven Loans*. Washington, DC.

¹⁰ IDB. 2005. *Colombia: Strengthening the Expanded Program on Immunization (EPI) 2005–2008 (CO-L1002) – Loan Proposal*. Washington, DC.

¹¹ IDB. 2008. *Chile: Integrated Solid Waste Management (CH-L1026) – Loan Proposal*. Washington, DC.

¹² IDB. 2006. *Paraguay: Modernization of Agricultural Support Management (PR-L1001) – Loan Proposal*. Washington, DC.

country ownership, commitment to development partnerships, and accountability and focus on results.¹³

25. ADB has defined an ambitious reform agenda to make the organization more effective, responsive, relevant, and results-focused. It has adopted a results framework with four results areas: (i) regional outcomes, (ii) contribution to country development outcomes, (iii) operational effectiveness, and (iv) organizational effectiveness. ADB's Development Effectiveness Review, started in 2008, annually tracks ADB's achievements in meeting its results targets. Recent reviews have found both successes and opportunities for improvement in ADB operations, especially in delivering outcomes. Developing new financing modalities and improving operational efficiency constitute a major part of ADB reforms to increase development effectiveness.

26. **Operations.** Even without a dedicated modality, RBF features have been included in some recent ADB operations, such as the Third Primary Education Development Project in Bangladesh.¹⁴ This project uses the sector-wide approach. It is supported by 10 development partners, with ADB financing linked with clearly defined DLIs. The project relies on the government's treasury system for financial management, thereby increasing development coordination and reducing transaction costs. The RBF features are in line with the development partners' commitment to (i) delivering results, (ii) reducing transaction costs, and (iii) enhancing government ownership and leadership. In addition to the sector-wide approach, ADB operations have also incorporated RBF features through the use of conditional cash transfers, output-based aid, performance-based contracts, and RBF for health. Appendix 3 provides examples of ADB operations with RBF features.

27. **Lessons.** ADB's experience has yielded lessons similar to those of the World Bank (paras 15–19). For example, the absence of an enabling policy framework has led to high transaction costs and missed opportunities. Without a dedicated and clear policy and a dedicated set of operational procedures, teams often need to search and reinvent ways to process these operations for each project. Disbursements are linked with both results and expenditures for inputs when these operations are processed as investment projects. Lengthy and complex procedures limit ADB's impacts and timely contribution to government programs. Adopting an RBL modality in line with the broad RBF approach will address these problems. ADB's experience also indicates that flexibility in program design and implementation is needed to promote continual improvements in programs.

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

28. The adoption of an RBL modality for programs, based on the concept of RBF, will fill a gap in ADB's existing lending modalities and generate many benefits.

A. Existing ADB Modalities

29. ADB's existing lending modalities can be broadly categorized as investment lending and policy-based lending.¹⁵

¹³ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

¹⁴ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Third Primary Education Development Project*. Manila. (Loan 2761-BAN, \$320 million, Asian Development Fund, approved on 5 July 2011).

¹⁵ In this paper, an "instrument" (or "product") for ADB operations refers to the generic means of providing or facilitating financing—debt (mostly loans), equity, guarantees, or grants. A "modality" involves the specific

30. **Investment lending.** Investment lending finances expenditures for inputs in discrete investment projects, such as works, goods, and services. Investment lending focuses on transactions and disburses funds incrementally based on evidence of expenditures for inputs.¹⁶ These operations are generally implemented by setting up project management units that follow ADB rules and procedures—a practice commonly referred to as ring-fencing.¹⁷ By ring-fencing project implementation arrangements, projects are generally implemented under parallel arrangements. In investment lending, procuring and using inputs are often key challenges to achieving results. Therefore, risk management focuses on procuring and using inputs to ensure, for example, that the appropriate construction materials and technology are in place. By using ADB rules, controlling the processes for procuring and using the inputs, and monitoring transactions, investment lending seeks to ensure that the right inputs are in place and the operation is implemented as planned. Investment lending is suitable for discrete investment operations in which ADB monitors the transactions.

31. **Policy-based lending.** Policy-based lending is used to support reforms and improve policies.¹⁸ It provides budget support to governments to address development financing needs. ADB disburses funds based on evidence of the fulfillment of policy actions. ADB does not usually track or monitor the specific transactions supported by its financing, which is disbursed into the government's general account. Policy actions such as enacting new regulations or adopting new policy frameworks aim to create an enabling environment for public and private sector operations, leading to improved growth prospects and economic efficiency.

32. Appendix 4 provides more details on ADB's lending modalities.

B. The Need for Results-Based Lending for Programs

33. ADB's investment lending and policy-based lending modalities have a track record of supporting investment projects and policy reforms. However, ADB does not have a dedicated modality to support government-owned sector programs in delivering results, building program institutions, and financing clearly defined expenditure frameworks.

34. Despite the lack of a dedicated policy, ADB and other development agencies have implemented operations with RBF features in recent years (paras. 12–27). However, in the absence of a dedicated policy framework, these operations often have had to be squeezed into the investment lending modalities. This is not the optimal approach as it leads to high transaction costs and requires teams to search for suitable policies and procedures in each operation. More importantly, the absence of a dedicated policy framework reduces the opportunities for ADB to (i) influence positively the design and implementation of entire government programs, (ii) support governments' incentives and accountability for results, (iii) improve program systems and institutions, and (iv) engage more effectively with development partners in a results-based and programmatic setting.

application of these instruments within a defined legal, policy, and operational structure, such as policy-based lending. Lending or loans includes grants and other financing, and borrowers (also referred to as DMCs in ADB) include recipients of grants and other financing.

¹⁶ Investment lending operations are also called projects or investment projects.

¹⁷ While investment lending operations are implemented using ADB rules and procedures, projects are implemented by agencies from the borrowing countries. Thus, ring-fencing is normally only partial.

¹⁸ Policy-based lending was referred to as program lending until the Board approved the revision of the program lending policy in July 2011. ADB. 2011. *Review of ADB's Policy-Based Lending*. Manila.

35. The proposed RBL modality for programs seeks to fill this gap. It is well suited to be positioned between ADB's investment and policy-based lending modalities. It will help ADB address sector-wide challenges more effectively, and provide ADB and DMCs with more choices in selecting the most suitable modality for different development challenges.

36. As the World Bank noted in its Program-for-Results financing policy paper (footnote 5), many of the development challenges DMCs face today cannot be addressed just through discrete policy actions or investment projects. Improving the delivery of services (e.g., better maintained roads, functioning schools and health clinics, and 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). In many cases, however, 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 not be maintained despite the existence of contracts. To address these challenges, operations must emphasize results that meet beneficiaries' needs. It also requires (i) sharpening results-orientation in public sector management; (ii) improving the governance of program institutions and systems; and (iii) changing incentives and behavior of the government, service providers, and users. RBL for programs will be designed to better address such development challenges, and improve the quality of government programs and their accompanying systems.

37. Feedback from staff indicates that RBL will be well suited to both infrastructure and social sectors. RBL can help integrate multiple interventions in some sectors, such as in the education sector. It is also suitable for some new sectors and themes. For example, climate change and carbon finance interventions are usually results-based through disbursements for carbon emission reductions, energy efficiency improvements, or increased use of renewable energy. As international negotiations on climate change focus more on measurable, reportable, and verifiable results, the adoption of RBL in climate change mitigation operations will be increasingly relevant.

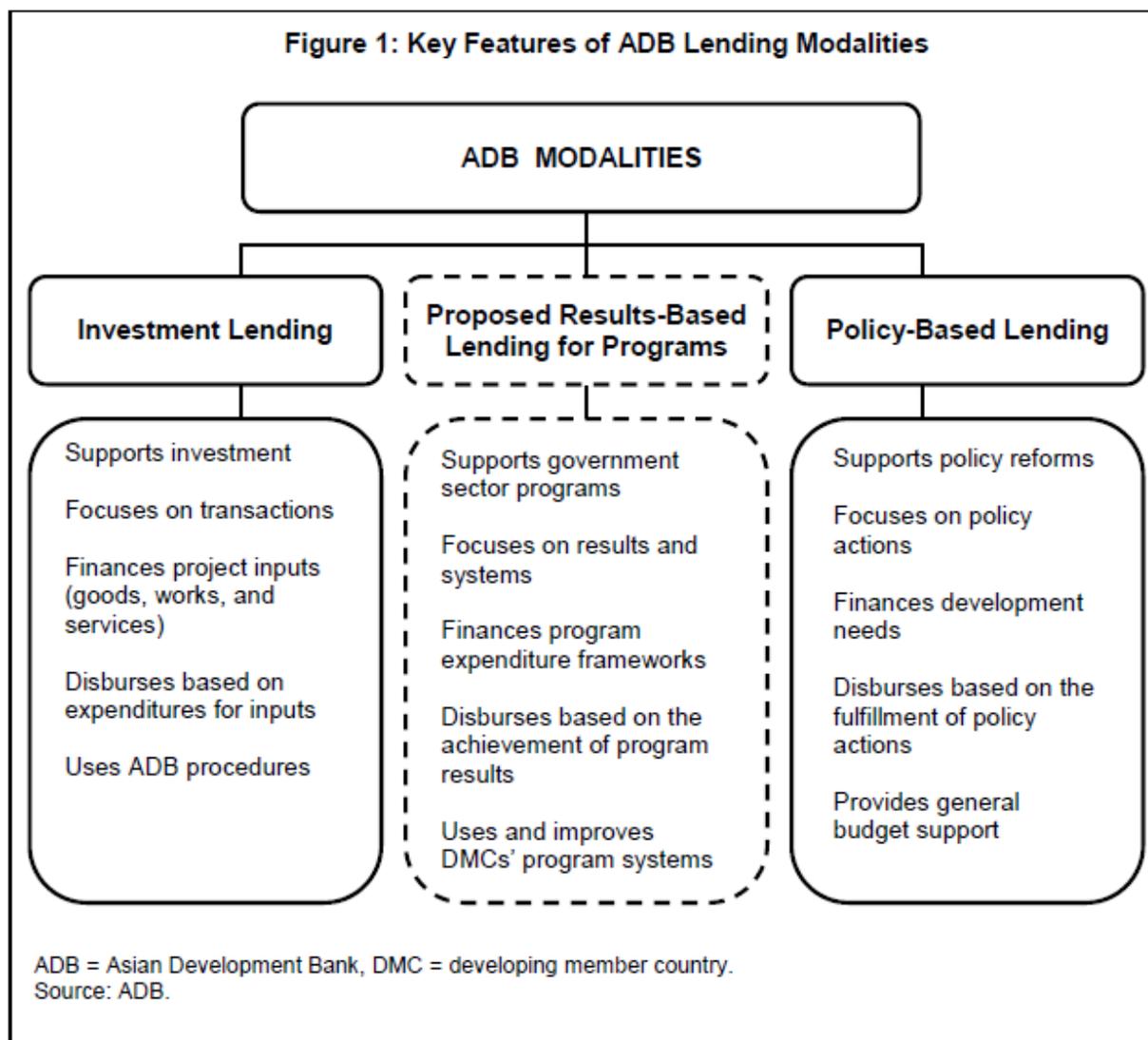
C. Results-Based Lending for Programs as a New Modality

38. The distinct nature of RBL for programs requires a dedicated policy and associated processes and procedures. Accordingly, it is appropriate that these programs be governed by a dedicated policy (paras. 56–169) and accompanying dedicated processes and procedures.¹⁹ If adopted, RBL for programs would be a new lending modality positioned between the policy-based and investment lending modalities. The modality would complement, not replace, policy-based lending and investment lending modalities.

39. RBL will be suitable for supporting the delivery of results in a sector program, and using and improving the program's institutions and systems to bring about the behavioral and institutional changes necessary for delivering and sustaining results. A program will require expenditures to deliver results, which ADB financing will support. RBL will disburse ADB financing based on the achievement of results. Development financing and engagement will help positively shape the government program and its systems. The achievement of results and institutional development will be the centerpieces of RBL. RBL will be a practical choice when (i) the objective of an operation is to support the performance of a government program using the DMC's program systems, (ii) the results require expenditures, and (iii) the major risks to achieving the program's results relate to the capacity and performance of the program systems.

¹⁹ The processes and procedures for the piloting stage of the RBL will be included in a guidance document adopted after the Board's approval of the dedicated policy articulated in this paper.

40. Figure 1 summarizes the key features of the policy-based lending, investment lending, and RBL for programs modalities. More details on the features of RBL are in para. 58.



D. Expected Benefits from Results-Based Lending for Programs

41. The adoption of RBL will be a step forward in the evolution of a new development financing paradigm. It is expected to deliver many benefits.

1. Meeting Developing Member Country Needs

42. RBL can assist DMCs in improving sector performance and results. Projects with RBF features have shown that DMCs are implementing holistic and comprehensive programs to improve the delivery of services and sector results. DMCs want their development partners to adopt a results-based approach that is integrated, focuses on results and system performance, and addresses system weaknesses. They need financing and expertise from their development partners to assist them in implementing and improving these programs. During consultations on

the proposed RBL modality, DMCs expressed a strong desire for ADB to put in place such a modality.²⁰ The experience of other MDBs, especially World Bank, confirms strong demand from DMCs.

2. Contributing to Aid Effectiveness

43. RBL will contribute to achieving the goals of the aid effectiveness agenda.

44. **Sharpening the results focus.** RBL will make achieving clearly defined results the basis for receiving ADB financing, thereby strengthening incentives for DMCs to deliver the intended results. The adoption of RBL is in line with the development community's broader emphasis on strengthening the link between disbursements and results. It will also provide DMCs with greater latitude to develop their own strategies and plans, and to use their own results frameworks. RBL will provide flexibility for DMCs to manage processes, fostering country ownership and creating opportunities to discover new and better ways to achieve the desired results. ADB can add further value in assisting DMCs by devoting more resources to program design, problem solving, and capacity development.

45. **Strengthening program institutions.** Institutional development and the achievement of results go hand in hand in RBL. Institutional development serves as both a means to achieve results and as a vehicle for risk mitigation. Closely linking institutional development with development results helps ensure that institutional development remains focused, purposeful, and owned by DMCs. Stronger institutions will make results more attainable and sustainable. RBL will directly confront institutional weaknesses and bring about incremental, positive, and sustainable changes. Organizational learning is an intrinsic part of RBL. Through the Paris Declaration on Aid Effectiveness and other related declarations since 2002 (para. 11), the international development community has reached a consensus that using and strengthening country systems is an important part of the development agenda. By using and improving the DMCs' program systems and institutions, RBL will contribute to improvements in those systems and institutions.

46. **Increasing alignment and harmonization.** Under RBL, development assistance will be aligned through shared results-frameworks and common systems. RBL will be a natural platform for pooling resources and capacity development. In many development operations funded by multiple agencies, DMCs have to comply with the requirements of each agency, resulting in dual or multiple implementation arrangements and procedures. This stretches DMC administrative capacity and causes delays. Using DMCs' systems will save resources and reduce transaction costs for DMCs, especially in the long run. RBL will help institutionalize the scrutinizing and strengthening of DMC systems. This will enable development agencies' assistance to be mainstreamed into existing DMC implementation arrangements.

3. Promoting Good Governance and Supporting Results-Based Public Sector Management

47. By focusing on results and institutional development, RBL will provide an added opportunity for ADB to mainstream good governance and improve public sector management across an entire government-owned program. Accountability will increase as public funding is

²⁰ ADB carried out missions to several DMCs to gauge their demand for RBL. DMCs stated that such a modality from their development partners is overdue. Further, ADB surveyed all of its DMCs and received 51 responses. All expressed support for RBL except one respondent, who stated that prefinancing by the government could be a constraint for the government.

linked to the delivery of verified results. The disclosure of results and system-related information to the public will increase transparency. RBL will cover the key components of governance: financial management, procurement, and anticorruption measures. Through rigorous assessments, capacity development, and fiduciary risk management, RBL will support DMCs in developing adequate systems, as well as reducing the opportunities for fraud, corruption, and other prohibited activities in the programs. Delivering results will provide further assurance that funds are being used for their intended purposes.

4. Enhancing ADB Operations

48. **Supporting results-based reforms.** ADB's development assistance has evolved to become more country-owned and results-focused. ADB's country partnership strategies are fully aligned with DMCs' strategies. At the operations level, ADB's lending modalities are becoming increasingly flexible and responsive. Adopting RBL will enhance ADB operations and advance ADB's results-driven reform agenda.

49. **Increasing ADB's development impact.** RBL will enhance ADB's leverage in expanding the development impact of its operations. As DMCs grow, development financing as a share of their total public finance has become smaller. Development agencies are shifting from being primary providers of funds to being catalysts for development. RBL will provide an opportunity for ADB to finance a portion of a government program, while being able to influence the whole program positively. This engagement will generate a multiplier effect, increasing ADB's leverage and development impact. RBL can also enhance the quality of dialogue between ADB and DMCs on sector reforms. ADB's assistance will help DMC systems converge with internationally accepted good practices, which can have far-reaching implications for sustaining results.

50. **Mutual learning.** RBL will provide an added vehicle to deepen links between ADB's knowledge and lending products. By creating an additional opportunity for ADB to understand DMC sectors and systems, RBL will help integrate ADB's finance, knowledge, and expertise into a sector perspective. The emphasis will shift from knowledge transfer to DMCs based on training and equipment to mutual learning-by-doing by ADB and its DMCs.

51. For these reasons, RBL has great potential to increase development effectiveness.

VI. CONSULTATION AND LEARNING LESSONS FOR RESULTS-BASED LENDING FOR PROGRAMS

52. ADB has carried out extensive internal and external consultations on the proposed RBL modality. An interdepartmental team was established, which has provided an effective forum for exchanging experiences and developing ideas. An informal Board seminar was held in November 2011. ADB surveyed all of its DMCs to gauge their demand for RBL and to get their feedback on the proposal. ADB also fielded missions to selected DMCs in different subregions. Broad web-based public consultations were conducted. All stakeholders and the public were invited to submit comments and suggestions on the draft policy paper. ADB also used social media sites (Facebook and Twitter) to announce the consultation in order to increase outreach to the public and stakeholders.

53. ADB has consulted its development partners, especially World Bank and IDB, both of which have rich experience in RBF operations and policies. During the development and implementation of the World Bank's Program-for-Results financing policy, two World Bank

missions visited ADB for consultation and dissemination of information. ADB has also carefully studied the stakeholder feedback on the World Bank's consultations on the Program-for-Results financing and reflected stakeholder comments in the design of RBL for programs.

54. Stakeholder feedback indicates broad support for developing an RBL modality in ADB. Most stakeholders appreciated the potential of this proposed modality for focusing on results, strengthening institutions, enhancing DMC ownership, and facilitating development coordination. Stakeholders also provided many constructive comments and suggestions, and asked many useful questions. Questions were raised about how to (i) define results, (ii) monitor results, (iii) carry out effective capacity development, (iv) mitigate fiduciary risks, (v) manage potential environmental and social impacts, and (vi) reduce transactions costs. Appendix 5 summarizes major questions received and ADB's responses. All comments, suggestions, and questions were carefully considered in designing the modality.

55. In addition to learning lessons from its own operations, ADB has carefully studied the lessons from implementing operations with RBF features in other MDBs (paras. 16, 17, 23, and 27). It also surveyed numerous publications on development effectiveness, especially by OECD's Development Assistance Committee (OECD-DAC). The practical experiences and analytical work point to numerous lessons that should be considered in designing RBL for programs (Appendix 6).

VII. PREPARING AND IMPLEMENTING RESULTS-BASED LENDING FOR PROGRAMS

A. Definitions, Objectives, Key Features, and Building Blocks

56. The proposed RBL modality will support government-owned sector programs and disburse ADB financing based on program results. A government program can cover the whole, part, or a time slice of a sector with the aim of improving sector performance; and it can be new or ongoing.²¹ The term "sector" can mean a sector, a subsector, multi-sectors, or a cross-sectoral theme such as environmental protection, poverty reduction, gender equity, public financial management, community development, and private sector development. The government can be national or subnational.

57. The objectives of RBL are to increase accountability and incentives for delivering and sustaining results, improve the effectiveness and efficiency of government-owned sector programs, promote institutional development, and enhance development effectiveness. RBL will also support development coordination and harmonization when more than one development agency is involved in a program.

58. RBL will have the following key features:

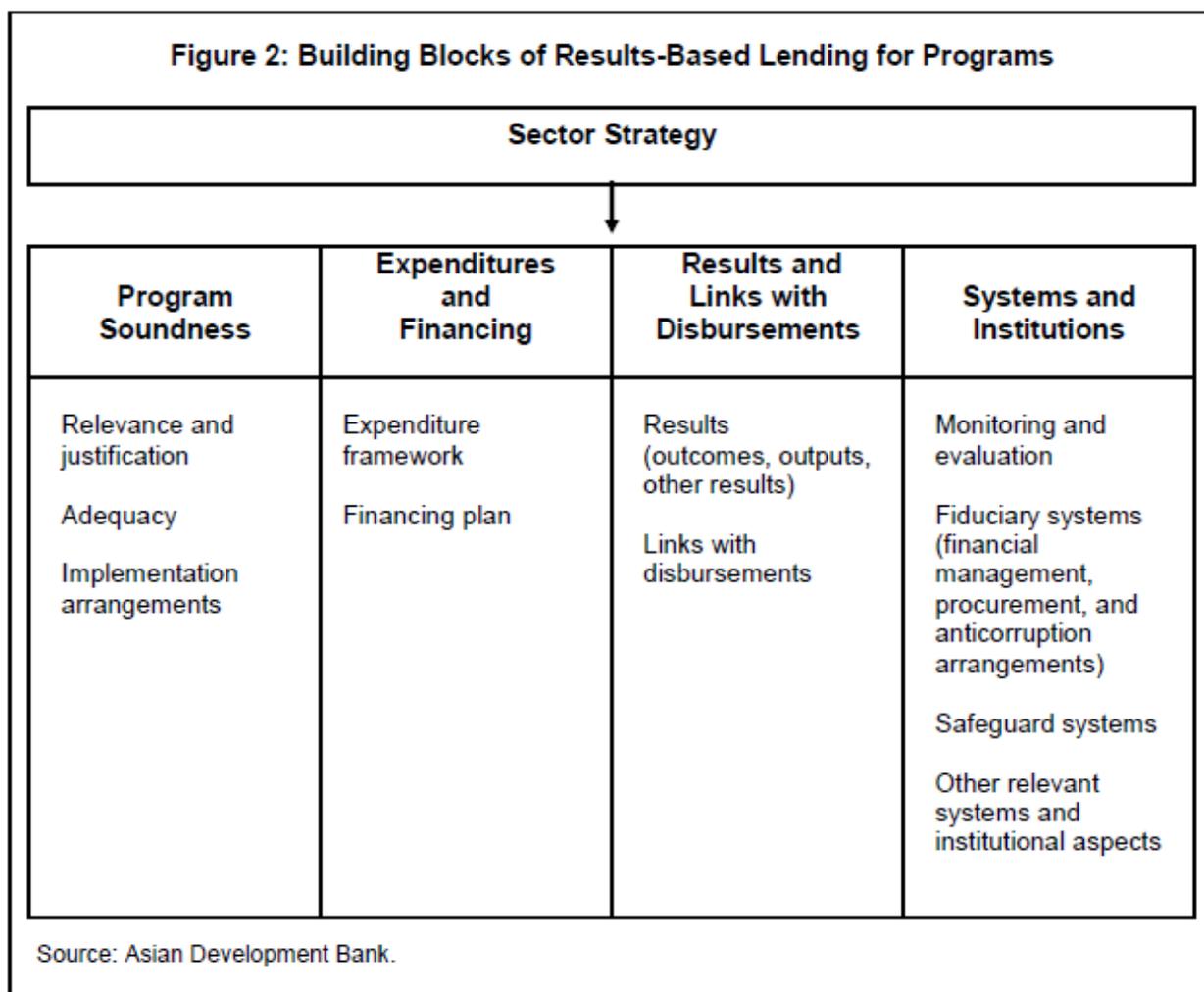
- (i) **Supporting government sector programs.** RBL will support government-owned sector programs and finance the program's expenditure framework.
- (ii) **Linking disbursements directly to results.** Disbursements will be directly linked to the achievements of program results as measured by DLIs.
- (iii) **Supporting institutional development.** Institutional development will be an important motivation and objective of RBL. RBL will seek to strengthen key program systems, including M&E, fiduciary (financial management, procurement, and anticorruption measures), and safeguards. Institutional development will also

²¹ ADB may support a part (or a slice) of a government program or the entire government program through RBL. The program or the part that is supported by the RBL, or the RBL operation, will need to be clearly defined. The term "program" in this policy refers to the RBL operation as defined unless otherwise specified.

include organizational and behavioral changes that strengthen accountability and incentives for results. The aim of institutional development will be achieving and sustaining sector results.

- (iv) **Managing risks adequately.** RBL will include rigorous assessments of the systems to implement the program, follow-up capacity development measures, and implementation support. ADB and the developing member country will agree on measures to improve the program and its systems to ensure that (a) the program achieves its development results, (b) funds are used for the program's expenditures with due consideration for economy and efficiency, and (c) potential environmental and social impacts are adequately addressed.
- (v) **Fostering partnerships.** When more than one development agency is involved in a program, RBL will support development partnerships by sharing a common government-owned results framework, using common systems, and financing a common expenditure framework.

59. A program will have four building blocks: (i) program soundness, (ii) expenditures and financing, (iii) results and links with disbursements, and (iv) systems and institutions (Figure 2).



B. Suitability and Identification

60. Several factors will be considered in identifying and designing a program supported by RBL.

61. **Definition of the program.** A program should have a defined scope, expected results, an expenditure framework, a financing plan, and accompanying institutions and systems.

62. **Development constraints.** RBL will support the delivery of sector results and strengthen program institutions through a system-based approach. The two key development constraints that RBL is well suited to address are (i) the need to strengthen incentives and accountability for results by directly linking disbursements with results; and (ii) the need to use and, as appropriate, improve program institutions and systems to deliver and sustain results through a system-based approach.

63. **Strong government interest and ownership.** Government commitment to delivering results and improving program systems is vital to RBL. This commitment can be articulated through a government's sector strategy, resource allocation, or willingness to improve overall systems by engaging with development partners.

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

65. **Institutional capacity.** The capacity of program institutions, as well as the risks associated with a program, should be rigorously assessed. Program institutions and systems, through capacity development, institutional strengthening, and implementation support, should provide reasonable assurance that a program can be efficiently and effectively implemented, results can be achieved, fiduciary risks can be addressed, and environmental and social impacts can be managed. Both "stock" and "flow" perspectives need to be considered. The stock perspective will look at current institutional strengths and weaknesses, while the flow perspective will look at whether and how capacity can be improved.

66. **Exclusion.** RBL for programs will exclude activities that would be classified as category A in the Safeguard Policy Statement (2009), and activities that would involve procurement of works, goods, and services under contracts whose estimated value exceeds specified monetary amounts (high-value contracts).²²

67. The experiences of MDBs and other development agencies have shown that RBL can be implemented in DMCs with different income levels, and in diverse sectors. Thus, ADB will not limit the sector or country selections in piloting RBL for programs. This will enable ADB to monitor what will emerge as the main sectors and countries for using RBL, and learn a diverse range of lessons. The recent World Bank Program-for-Results financing operations also demonstrate the flexibility and potential of RBL across different countries and sectors. These

²² The specified monetary amounts will be harmonized with the amount applied to the World Bank's Program-for-Results financing. This will increase development coordination and support program implementation. The amounts are currently \$50 million for works, turnkey and supply, and installation contracts; \$30 million for goods; \$20 million for information technology systems and non-consulting services; and \$15 million for consulting services. The amounts may be changed from time to time, and the thresholds for high-value contracts for RBL for programs will also be changed accordingly.

programs support countries with different income levels, and have been applied in various social and infrastructure sectors (footnote 8).

68. A government program should be underpinned by the government's sector strategy (or a similar document), which defines the sector objectives and strategies to achieve them.²³ The sector strategy will be supported by a sector analysis. Typically, a sector analysis should cover a diagnosis of the constraints facing the sector, an assessment of key issues, and the roles of the public and private sectors. The sector strategy will not be a rigid blueprint; it will instead establish basic objectives and strategies for the sector. Accordingly, a transparent process for updating the strategy should be defined, which will help establish a practice that strikes a balance between planning and implementation.²⁴

69. ADB will assess the quality of the sector analysis and strategy when preparing for a program, and will support required improvements where appropriate. ADB will identify the need for RBL in consultation with the DMC.

C. General Approaches and Considerations

70. Each proposed program will undergo a rigorous assessment covering the four building blocks (Figure 2):

- (i) The program soundness assessment will evaluate the program's relevance, justification, adequacy, and appropriateness of its implementation arrangement.
- (ii) The expenditure and financing assessment will review the efficiency, effectiveness, adequacy, and sustainability of the program's expenditure framework and financing.
- (iii) The results and links with disbursements assessment will examine the appropriateness of the results framework, select the DLIs, design the DLI verification protocol, and make disbursement arrangements.
- (iv) The institutional and system assessment will examine the M&E systems, the fiduciary systems, the environmental and social systems, and other institutional and system aspects, as relevant and appropriate to the program.

71. The assessment on the program soundness, expenditures and financing, and results and links with disbursements will seek to determine the degree to which the program will achieve its development results. The fiduciary systems assessment will seek to determine the degree to which the program systems provide reasonable assurance that the program financing will be used for intended purposes, with due consideration to economy and efficiency. The environmental and social systems assessment will seek to determine the degree to which the program systems manage and mitigate the environmental and social impacts.

72. The assessments will be tailored to suit different operations and be appropriate to the scope, nature, and circumstances of a specific program.²⁵ The assessments will identify the

²³ DMCs may use different terms to describe a sector strategy or other concepts referred to in this policy. ADB's assessments will focus on the substance of relevant documents or systems, not whether these have identical titles used in this paper. When the RBL supports a slice of a sector or government program, the government sector strategy may cover a broader scope than the RBL operation.

²⁴ 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.

²⁵ For example, for a conditional cash transfer program, the assessments will focus on the integrity of fund flows and the required beneficiary behavior linked to the conditions. For a program that involves a large number of

weaknesses and strengths of the program, inform the risk-mitigating measures, and identify the capacity development necessary for the program. To reduce duplication and improve efficiency, ADB will draw on or use existing assessments, documentation, analyses, and work by ADB, other development partners, and other relevant sources. ADB will work closely with the DMC, and coordinate with development partners where appropriate, to undertake or deepen these assessments. ADB will assist the DMC in strengthening the program systems as needed.

73. The design and implementation of a program will be guided by the following considerations:

- (i) **Focusing on results and systems.** It may not be feasible or appropriate for a government or a development agency to direct and monitor each transaction in a program because of the geographic coverage, the volume of inputs and activities, and/or the number of agencies involved. Thus, ADB financing in a program will not be linked to specific transactions and expenditures. To ensure that the program is carried out effectively and efficiently, a system-based and results-focused approach—rather than a transaction-based one—will be used.
- (ii) **Principle-based approach.** The assessments and improvement of the program systems will be guided by commonly accepted good practice principles.²⁶ The reason for this principle-based approach is that development financing may only account for a moderate share of total program financing.²⁷ Further, a government program may have been in place before ADB's participation and may involve multiple development agencies. Thus, it is appropriate for programs financed by RBL to use DMCs' own program systems, and for these systems to be assessed and improved using commonly accepted good practice principles. Accordingly, the implementation of programs supported by RBL will follow the same policy objectives and principles in the Safeguard Policy Statement, but not its policy delivery process and operational procedures. Similarly, the programs will follow the commonly accepted good practice principles embodied in ADB's Procurement Guidelines (2010, as amended from time to time) and Guidelines on the Use of Consultants (2010, as amended from time to time), but not the rules, processes, and procedures set out therein.²⁸ System assessments and improvements, guided by the commonly accepted good practice principles, will help DMC program systems to improve towards these principles, and allow adaptation of systems to the country context to ensure DMC ownership.
- (iii) **Covering the whole program.** ADB's assessments will cover the whole program supported by RBL. Improving the systems in order to effectively and efficiently manage all resources for a program—both domestic and external—will provide a productive development assistance route for expanded development impacts from ADB financing and assistance.
- (iv) **Setting appropriate targets.** Results should be relevant for delivering benefits to program beneficiaries. Similarly, bringing about incremental positive and

infrastructure activities, such as a rural road program, assessing fiduciary and safeguard systems will be especially relevant and important.

²⁶ The principles depend on the areas of assessments. The Safeguard Policy Statement lists policy principles for environmental and social management. ADB's procurement and consulting services guidelines provide the commonly accepted procurement principles: competition, efficiency and economy, transparency, and fairness and equal opportunity. The principles for financial management are efficiency and economy, effectiveness, adequacy, accountability, and transparency. Paras. 74-118 provide more details on the principles and assessments.

²⁷ For example, the Bangladesh Education Project has development financing of \$1 billion from 10 development partners for a government program totaling \$8 billion (footnote 14). The Indian Rural Road Program was for \$40 billion, of which World Bank financing was \$1 billion (footnote 7).

²⁸ The principles are listed in para. 103.

sustainable changes will be more beneficial than setting up unachievable targets that stretch DMC and ADB capacity, demand large resources, and in the end achieve little. RBL for programs will support positive, incremental, and sustainable changes that aim to yield material improvements in the medium to long run.

D. Assessing the Building Blocks

1. Program Soundness

74. ADB's support for a government sector program can be provided at any time in a program's duration—from the conceptualization to an existing program. For a new program, ADB will support the DMC in designing the program, as needed. For an existing program, ADB will assist the DMC in improving the program design, as necessary.

75. **Relevance and justification.** ADB will determine whether a program is strategically relevant and its outcomes are important. ADB will also assess the justification for the intended public interventions in supporting the provision of public goods, addressing externalities, or addressing social and poverty concerns. If a public intervention is determined to be justified, ADB will assess whether it should take the form of regulation, financing, or public provisions. In view of the limited public resources and efficiency considerations, the program should explore the role of the private sector in contributing to the development results, including through public–private partnerships. Ensuring that public financing has a sound justification is an important step towards efficient public expenditures.

76. **Adequacy.** An adequate program will sufficiently consider effectiveness, efficiency and economy, and sustainability dimensions. The effectiveness of a program is measured by how well it will achieve the intended results. ADB will determine whether the program scope and design can be expected to improve sector performance and outcomes. It will assess whether the program addresses the right problems with the right instruments, i.e., whether the program design is adequate and appropriate for the intended program results. To achieve efficiency and economy, ADB will assess whether the program uses resources optimally. ADB will assess whether the program will (i) use the appropriate incentives to induce the desired organizational and individual behaviors, (ii) be likely to generate distortions, and (iii) attract or crowd-out private sector participation.²⁹ RBL will strive to bring about incremental efficiency gains. Sustainability means that a program's results are not short-lived and easily reversible. The program's sustainability will be reviewed to determine whether it can be sustained in the medium term to achieve its outcomes.

77. **Implementation arrangements.** ADB will assess the roles, incentives, resources, capacities, and relations between the agencies responsible for program implementation.³⁰ ADB will work with the DMC (and other development partners, as appropriate) to strengthen program implementation arrangements as needed. ADB will also assess the commitment of the government to the program in delivering results and improving systems.

²⁹ In the World Bank's Punjab Education Project, for example, the dismantling of the public sector textbook production monopoly helped to improve efficiency. 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, DC.

³⁰ ADB may assess a sample of agencies, selected agencies, key agencies, or representative agencies by gathering first hand information or using existing information and analyses, as appropriate. Paras. 95–118 provide more details on the systems, institutions, and arrangements for implementing programs.

2. Expenditures and Financing

78. **Expenditure framework.** The expenditure framework will make a program operational, ensuring that the priorities and costs are realistic.³¹ ADB will assess the effectiveness, efficiency and economy, and adequacy of the entire program's expenditure framework, as follows:

- (i) Effectiveness requires that public expenditures address the right problems with the right instruments and achieve the program's development objectives. In assessing whether the expenditure framework is likely to achieve program results, ADB will try to identify any mismatches between expenditures and the problems they intend to address.³²
- (ii) Efficiency and economy require the optimal use of limited public finance. ADB will assess whether the expenditures covered by the program are allocated efficiently and whether certain aspects would be best shouldered by the private sector or public-private partnerships.
- (iii) Adequacy requires that expenditures are sufficient for the program results. ADB will assess whether the allocation for the program and across its components reflects the resources required to generate the results.

79. **Financing plan.** ADB will assess the adequacy and sustainability of the financing plan for the program. It will examine whether the financing plan is sufficient for the program expenditure framework and whether the results can be achieved within the program's resource envelope. ADB will assess whether the financing is predictable and sustainable.

80. Planning and budgeting are essential in transforming strategic priorities into results. ADB will assess the DMC's annual planning and budgeting, as well as the medium-term fiscal projections, to determine whether (i) the underlying cost estimation, resource allocation, and assumptions for the program are realistic; and (ii) any significant discrepancies exist between the budget allocation and execution for the program.

81. ADB financing will constitute a part of the overall program financing plan. The share of ADB financing will be determined on a case-by-case basis based on the program's financing needs, ADB's lending in the country, the strength of the program, and the priorities of the DMC and ADB. ADB financing will be pooled with the DMC's resources and financing from other sources.

3. Results and Links with Disbursements

a. Results

82. A clear definition of the results and a strong emphasis on achieving them by linking results directly with disbursements are defining features of RBL. ADB will assess the existence and quality of the program's results framework, seeking to ensure that the indicators are concrete, measureable, transparent, achievable, and time-bound. ADB will assess the suitability of the results indicators in the results framework.³³ The indicators will depend on the nature of a

³¹ The expenditure framework is sometimes supported by a medium-term expenditure framework. The program's expenditure framework may be part of a sector expenditure framework.

³² For example, an education sector program focusing on building schools and recruiting teachers may not be optimal when the main issue is teacher absenteeism and the prevalence of ghost schools (schools that exist only on paper, or have physical structures but do not have students).

³³ For example, longer 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 inappropriate as a program result indicator.

program and may include development outcomes or supporting indicators such as outputs, institutional development, and financing indicators.³⁴ The right mix of indicators to achieve results needs to be selected. ADB will analyze the results chains to establish the causal links between intermediate and final results (the program outcomes).³⁵ While disbursements will be based on a selection of key results—the DLIs—a clear understanding of overall program results is essential to ensure the success of the program. If the results framework is not in place or well defined, ADB will work with the DMC to develop or refine it.³⁶

83. The achievement of desired outcomes is the main measure of success for programs supported by RBL. These achievements are directly linked to the benefits and welfare of program beneficiaries. The desired outcomes will drive the overall nature, scope, and design of the program. The emphasis on sector outcomes under RBL helps focus attention on what matters to program beneficiaries. By establishing direct links between results and disbursements, RBL will provide an added opportunity for DMCs and ADB to deliver outcomes and ensure that the intended benefits for program beneficiaries are achieved.

84. Outputs are important as they are the means of achieving outcomes. RBL will stress the importance of defining the outputs from the perspective of program beneficiaries and making them as close to outcomes as possible. Outputs that are relevant to program beneficiaries may be different from those for a government, a development agency, a service provider, or a contractor. For example, school buildings and teacher training are common output indicators in development projects. However, these may not be sufficiently relevant outputs for parents who view school buildings and trained teachers only as inputs for their children's education. Enrollment, retention, and passing credible 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 relevant output; water pipes are one input for delivering that output. Outputs that are defined from the perspectives of program beneficiaries and are close to outcomes will be more likely to lead to the desired outcomes because the results chain between the outputs and outcome will be shorter and more direct.³⁷ Such outputs will also better guide the determination of inputs and activities.

85. The perspectives of beneficiaries will help shape the definition of program results. ADB will assess whether the program results are relevant to program beneficiaries and meet their needs. ADB will assess whether the achievement of the intermediate results will lead to the achievement of the program outcomes. ADB will also assess the sustainability of the program results to ensure the program will have long-term impacts beyond the implementation period. Focusing on results, ADB will also assess whether the program approach embodies sufficient flexibility to motivate and support innovations by the DMC and its development partners.

³⁴ The applicability of ADB's design and monitoring framework needs to be reviewed to ensure that it fits the design parameters of RBL for programs operations. As funds will be disbursed based on results, ADB may no longer need to approve activity plans. These and other changes to the design and monitoring framework need to be reviewed and introduced.

³⁵ For example, if the program outcome is to increase the number of students graduating from primary schools, outputs can include decreases in the dropout rates and student and teacher absenteeism, and increases in enrollment.

³⁶ For example, a results framework may not have been adopted for a new program, and the results framework of an existing program may be implicitly included in a government strategy or other document.

³⁷ For example, a stable supply of quality water is more likely to improve health indicators than just water pipes.

b. Links with Disbursements

86. **Disbursement-linked indicators.** DLIs are the basis for disbursing ADB financing.³⁸ DLIs will generally be a subset of results indicators carved out from the program's results framework. If necessary, DLIs may exceed the program's results framework. For example, if essential institutional indicators are not included in the program's results framework, they can still form a part of the DLIs. The DLIs may be modified from the program's results framework if program results indicators are too broad or detailed. However, these DLIs that have been modified or expanded from the program's results framework should then be integrated with the program's results framework to ensure government ownership and synergy between the government-owned program and ADB assistance. ADB and the DMC will agree upon the DLIs.

87. DLIs will be critical indicators for measuring program results. DLIs can include outcomes, outputs, institutional indicators, and financing indicators. DLIs may also be actions or process results that are essential for strengthening program performance, such as actions to improve fiduciary risk management, social and environmental systems, and M&E. A program in the early stages of implementation may have DLIs that are more focused on basic institutional capacity development and intermediate results, while programs that are more advanced may have more DLIs that are outcome-oriented. DLIs should be set at the appropriate level, consistent with the program's implementation capacity and need to deliver results. DLIs should not be so ambitious such that they cannot be achieved; nor should they be so insignificant that they do not meaningfully contribute to the achievements of program outcomes. The selection of DLIs will be driven by the desired outcomes and outputs of the program, as well as by the desire to ensure that the program will have sustainable impacts beyond its implementation period.

88. **Verifying results.** ADB's disbursement of funds is conditioned upon verification that the DLIs have been achieved. Each DLI will be accompanied by a clear verification protocol that will define how achievements will be measured and verified. ADB and the DMC will agree upon a credible verification mechanism. The verification will depend on the nature of the DLI, the program, and the country context. Verification can be carried out by public, private, semiautonomous, or civil society entities, as appropriate, as long as the credibility of the verification is ensured. Results verification should seek feedback from program beneficiaries, where appropriate. To support timely results verification, ADB and the DMC will work together to plan and prepare the verification mechanism as early as possible.

89. **Partial disbursement.** RBL will allow partial disbursements if DLIs are partially met. How partial disbursements will be carried out will be program specific, for example, (i) disbursing after a minimum number of DLIs have been met, (ii) having global DLIs that are particularly important and must be met before the disbursement, or (iii) having a percentage rule for DLIs. The disbursement amount linked with different DLIs will depend on the purposes of individual DLIs. Using an equal amount for each DLI has the advantage of simplicity. Using different amounts can accentuate the importance of key indicators. Disbursements can be deferred or take place ahead of the planned schedule depending on the achievement of the DLIs.

³⁸ Under RBL, ADB financing will not pay for the costs of achieving the DLIs. DLIs are a part of the program results, which will be achieved by using all the resources available for the program.

90. The rationale for partial disbursements is summarized as follows:³⁹
- (i) Deviations between plans and actual implementation are to be expected. Partial disbursement for partial performance is appropriate to recognize progress made.
 - (ii) Partial disbursement helps avoid a stop-and-go pattern in disbursements, thereby providing less potential disruption to the disbursement schedule. An all-or-nothing approach can be damaging to macroeconomic and budget management.
 - (iii) Partial disbursement can also enhance the credibility of disbursement conditions. Often because of damaging stop-and-go effects, development agencies are tempted to overlook underperformance 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 can help address this problem.
91. **Advance financing.** To address the financing requirements and support the achievement of the DLIs, ADB can provide up to 25% of its financing as advance disbursement. The amount of the advances will be recovered from subsequent disbursements. Additional advances can be made once an earlier advance has been recovered or partially recovered, but the outstanding advance should not exceed the ceiling of 25% of ADB financing.
92. **Financing prior results.** Some results may need to be achieved before an RBL operation is approved, such as setting up the M&E arrangements. In such cases, ADB will be able to finance and disburse based on the DLIs achieved before the effectiveness of the operation. The total amount for such financing should not exceed 20% of the ADB financing. The time frame for such financing should generally be no earlier than 12 months before the signing of the legal agreement, unless a longer time frame is approved by the Board.
93. **Ceilings.** The combined outstanding balance of advance financing and amount for financing for prior results should not exceed 30% of total ADB financing, and the advance financing or financing for prior results should not exceed its respective ceiling defined in paras. 91 and 92. Higher amounts for these individual or combined ceilings may only be provided if approved by the Board.
94. **Disbursement arrangement.** Proceeds from RBL will be disbursed to the account of the DMC or of the appropriate entity. Except for advance financing, disbursement will be made following the achievement and verification of the agreed DLIs. Disbursements will not depend on evidence of expenditures or transactions. The disbursement schedule and amounts will be defined and agreed upon during the preparation of the RBL. For results achieved close to the program completion dates, verification of the results and the disbursement can be done up to 6 months after the program completion. The determination of the disbursement schedule will take into consideration the government's budgetary timetables to increase the predictability of fund flows. By linking disbursements to intermediate results, the expected timing and level of disbursements can be done in phases to support results as well as reflect the need for a predictable fund flow. Partial disbursement will also facilitate the predictability of fund flows.

³⁹ 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. London: Chartered Institute of Public Finance and Accountancy (CIPFA).

4. Systems and Institutions

a. Monitoring and Evaluation System

95. A reliable M&E system is essential for the success of a program. M&E will promote learning and better decision making. It will also generate reports on results achieved, including on the DLIs. M&E systems have been moving away from being process-based to becoming results-based. Results-based M&E and RBL have significant synergies. The program's M&E system should enable transparent and reliable monitoring of program performance, and support the implementation of timely remedies when problems occur. One lesson to emerge in recent years has been the need to use DMC systems for M&E, rather than to duplicate them among development partners.⁴⁰

96. Under RBL, a strong M&E system is a necessity. The feedback loop between results and financing will be internalized and institutionalized by linking results with disbursement. Working with and using the program's M&E system, RBL will strengthen the DMC's M&E systems. Setting up an acceptable M&E system can be part of the DLIs.

97. ADB will assess whether the program's M&E system can generate reliable, timely, and adequate information on results. ADB will assess (i) the institutional arrangements for M&E; (ii) M&E capacity, including staffing and other resources; (iii) M&E experience in case of ongoing programs; and (iv) capacity development needs. ADB will also assess M&E plans, availability and quality of data, capacity to generate adequate and reliable reports, and information sharing and disclosure arrangements for the program. M&E systems may include multifaceted approaches, such as information systems and beneficiary group feedback, as appropriate.

98. M&E system assessments and capacity development actions will be designed to ensure that the status of a program's DLIs will be disclosed in a timely manner and made accessible to affected communities. This will allow those communities to monitor the indicators and provide feedback.

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

b. Fiduciary Systems

100. Strong fiduciary systems, including financial management, procurement, and anticorruption measures, serve two important purposes. First, they support the efficient and effective achievement of the program's results. Second, through capacity development and implementation support, they provide reasonable assurance that program financing will be used for the intended purposes (with due attention to economy and efficiency). ADB will assess the program's fiduciary risks and the ability of the program's fiduciary systems to manage and mitigate those risks. The scope of the assessment will depend on the nature and scope of the program. The assessments will include

- (i) applicable rules and procedures,
- (ii) the capacity of the relevant agencies,
- (iii) the agencies' practice and performance in case of ongoing programs, and
- (iv) required improvements.

⁴⁰ OECD. 2008. *2008 Survey on Monitoring the Paris Declaration Making Aid More Effective by 2010*. Paris.

101. **Financial management.** A recent ADB analysis found that 94% of ADB-financed operations in 2010 used DMC financial management systems in areas such as accounting, auditing, and financial reporting—exceeding the Paris Declaration target of 78%.⁴¹ RBL will build on ADB's experience in using DMC financial management systems by addressing system weaknesses at the program level.

102. ADB's assessment of the financial management system will determine the degree to which it manages fiduciary risks and provides a reasonable assurance that program funds will be used appropriately. The assessment will be guided by commonly accepted good practice principles.⁴² The fiduciary assessments of the financial management system will focus on accountability and transparency, and will cover the following aspects:

- (i) **Internal controls.** ADB will determine whether reasonable internal controls are in place to safeguard program finance and give due consideration to economy and efficiency. ADB will identify weaknesses that may create opportunities for leaks, fraud, corruption, and other prohibited activities, and will identify areas for improvement to strengthen prevention and enforcement measures, as appropriate.⁴³ ADB will also assess whether the internal controls are efficient.
- (ii) **Funds flow.** ADB will assess fund flow arrangements to ensure adequate clarity, checks and balances, and economy and efficiency.
- (iii) **Accounting.** ADB will assess whether the program will have adequate program accounts and records.
- (iv) **Financial reporting.** ADB will assess the adequacy of the scope, form, content, and frequency of the program's financial statements to ensure that they are acceptable.
- (v) **Independent audit.** The program's financial statements will be subject to independent audit. ADB will require the independent auditor to have the capacity to provide audit reports and opinions of the quality required by ADB.

103. **Procurement.** Procurement system assessment will be guided by the following sound procurement principles:⁴⁴

- (i) **Competition.** Open competition is the default approach, and conditions for other methods are clearly described.⁴⁵
- (ii) **Economy and efficiency.** The procurement processes are efficient and lead to optimal results in a balanced consideration of time, costs, and quality.
- (iii) **Transparency.** The procurement processes are governed by clear rules that are easily accessible and can be consistently applied. Contract opportunities are advertised widely.⁴⁶

⁴¹ ADB. 2011. *Aid Effectiveness Report 2011: Overall Achievements on Paris Declaration Commitments*. Manila.

⁴² Paras. 78–81 cover the principles on effectiveness, efficiency and economy, adequacy, and sustainability. For more information on financial management principles, see ADB. 2003. *Financial Management Systems, Financial Analysis, and Financial Performance Indicators. Operations Manual*. OM G2/BP. Manila; ADB. 2005. *Financial Management and Analysis of Projects*. Manila; and ADB. 2010. *Governance. Operations Manual*. OM C4/BP. Manila.

⁴³ Appendix 7 provides definitions of fraud, corruption, and other prohibited activities.

⁴⁴ For more information on procurement principles, see ADB. 2010. *Procurement Guidelines*. Manila; and ADB. 2010. *Guidelines on the Use of Consultants by Asian Development Bank and Its Borrowers*. Manila.

⁴⁵ The degree of optimal competition will depend on the size and nature of the procurement. Competitive processes take time and may require extensive capacity development. Underbidding during the tender process is a risk, followed by financial problems later. For small-scale projects, systems that are overly sophisticated 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.

- (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.

104. RBL implementation will rely on DMCs' program systems, including for procurement of goods, works, and services. ADB's assessment will determine the degree to which the program procurement system—through capacity development and implementation support—can provide reasonable assurance that program financing will be used economically, efficiently, and for its intended purposes, based on the commonly accepted good practice principles embodied in ADB's Procurement Guidelines and Guidelines on the Use of Consultants (para. 103). The procurement system assessment will be conducted for the whole program.

105. The scope of the procurement system assessment should cover the critical stages of the procurement cycle for the program to determine if it has reasonable

- (i) arrangements for procurement planning and budgeting,
- (ii) procurement rules that are accessible to the public,
- (iii) capacity for contract management and administration,
- (iv) oversight and control systems, and
- (v) complaint mechanisms.

106. Where weaknesses are identified, ADB and the DMC will agree upon the improvements required. The actions to be undertaken should aim to integrate sound procurement principles with the existing procurement system of the program in the DMC.

107. RBL will exclude activities that would involve procurement of works, goods, and services under contracts whose estimated value exceeds specified monetary amounts, i.e., high-value contracts (footnote 22).⁴⁷

108. **Anticorruption system.** Through its built-in mechanisms, RBL will provide an additional opportunity for ADB to assist DMCs in addressing fraud and corruption. First, linking ADB financing to verifiable results will help ensure that funds are used appropriately and for the intended purposes. Second, confronting systemic weaknesses and fostering institutional development in financial management and procurement systems will help build robust and transparent public management systems, and reduce opportunities for corruption. Third, RBL will include specific guidelines to address corruption risks (Appendix 7).

109. ADB's Second Governance and Anticorruption Action Plan (GACAP II) introduced a risk-based approach to managing governance and corruption risks in 2006.⁴⁸ RBL for programs will benefit from GACAP II's work on fiduciary risk management. Under RBL for programs, ADB will identify the risks of fraud and corruption at the program level, and assess how the program's fiduciary systems will deal with the risks. This system-based approach focuses on how the DMC manages all program resources, not only those provided by ADB. The findings will inform ADB and the DMC about the system improvements needed. ADB and the DMC will agree on measures to mitigate the risks of fraud and corruption. A reporting and complaint mechanism for allegations of fraud, corruption, and other prohibited activities will be developed and implemented. Where remedial actions are identified, ADB will provide the DMC with appropriate

⁴⁶ The specific advertisement arrangements and scope depend on the size and nature of the procurement, and program context.

⁴⁷ RBL operations will also exclude activities on ADB's prohibited investment activities list.

⁴⁸ ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

assistance to strengthen institutions and the enforcement environment, such as through implementation support and technical assistance (TA).

110. For detailed measures to deal with fraud and corruption cases, see paras. 139–143.

c. Safeguard Systems

111. ADB's Safeguard Policy Statement will apply to RBL for programs. Specifically, RBL for programs will be designed to achieve the policy objectives and adhere to the policy principles of the Safeguard Policy Statement.⁴⁹ Paras. 112–116 below provide the safeguard policy delivery process for RBL for programs.

112. The distinct nature of RBL for programs requires that programs rely on the program systems to address social and environmental issues. ADB will examine the program's potential safeguard impacts and, based on Safeguard Policy Statement principles, ADB will carry out a diagnostic assessment of applicable and relevant laws, regulations, rules, and procedures for managing and mitigating the environmental and social impacts of the overall program. This is to determine whether the program systems can manage and mitigate the environmental and social impacts of the overall program or have areas that need to be improved.

113. ADB will also assess whether the DMC has adequate implementation practice, capacity, and commitment to plan, implement, monitor, and report on the safeguard measures for the program. This assessment will include an evaluation of the program's arrangements and quality for (i) early screening and mitigation of environmental and social impacts, (ii) information disclosure mechanisms and consultations with stakeholders, and (iii) grievance redress procedures.

114. The assessments will be the basis for identifying measures to improve the safeguard systems and to build capacity in the program, if needed. The level of comprehensiveness, as well as the details of the assessments and measures, should be commensurate with the nature and scope of the program. ADB and the DMC will agree upon measures to strengthen the program safeguard systems and include these in an action plan. During implementation, the DMC will monitor and report on the safeguard aspects of program performance. ADB will monitor the implementation of the program and the agreed actions.

115. ADB will disclose the draft diagnostic assessment reports on the ADB website, including identified weaknesses and proposed measures to improve the safeguard systems of the program, and will undertake a public consultation on the draft assessment. Upon completion, the final assessment reports will also be disclosed on ADB's website.

116. RBL for programs will exclude activities that would be classified as category A in the Safeguard Policy Statement.

d. Other Relevant Systemic and Institutional Aspects

117. The strength of a program's systems and institutions hinges upon many organizational and individual factors. System and institutional development may entail changes in the organization, behaviors, and incentive structures. RBL can address a broad range of issues in these areas pertaining to the program. It may include regulatory issues for the sector, such as (i) barriers to entry, (ii) optimal division of responsibilities between the public and private sectors in

⁴⁹ Safeguard Policy Statement, pp.16–18.

financing and providing services, (iii) demand for and supply of services, (iv) organizational changes in public institutions for better delivery of results, (v) incentives of public and private sector agencies, and (vi) efficiency and accountability of service providers. The assessments of these systematic and institutional aspects will be driven by the need to deliver and sustain development results.

118. RBL will aim to generate institutional, organizational, and individual changes that can deliver and sustain results. Learning from the lessons of past operations (Appendix 6), RBL will support behavioral changes that improve performance and results by positively shaping incentives and increasing accountability. As the assessments will focus on the whole program, their findings can benefit the entire program. ADB and the DMC will agree on the measures to bring about the needed positive institutional changes to be carried out as part of the program implementation.

E. Integrated Risk Assessments and Mitigating Measures

119. The assessments will reveal the program's strengths, weaknesses, and risks. ADB and the DMC will integrate the findings from these assessments to determine the overall soundness of the program and its systems, the risks and mitigating measures, and the improvements required.

120. The program's risks may be broadly classified into five interlinked categories:

- (i) **Development.** These risks can impede the achievement of the program's results and development outcomes. They relate to the program's rationale, design, government commitment, definition and selection of results and DLIs, results measurement and verification mechanisms, M&E, implementation capacity, and sustainability.
- (ii) **Expenditures and financing.** These risks are associated with the efficiency and effectiveness of the expenditure framework, and the adequacy and sustainability of the program financing.
- (iii) **Fiduciary.** These pertain to the risks that program finances will not be used for the intended purposes. These risks relate to financial management, procurement, and anticorruption systems.
- (iv) **Safeguards.** These risks are associated with the safeguard systems' ability in managing potential adverse environmental and social impacts of the program.
- (v) **Operating environment.** These risks relate to such factors as the country's macroeconomic conditions, political factors, and fiscal conditions.

121. Risk assessment and mitigation will be a dynamic process that will be updated throughout program preparation and implementation. Where weaknesses are identified, ADB and the DMC will agree upon robust capacity development and risk mitigating measures. Implementation of the risk mitigating measures will require sustained government commitment. ADB will monitor the implementation of these measures in addition to the program's own M&E.

122. If the assessments conclude that the program systems have major material weaknesses that cannot be effectively addressed through the program, ADB and the DMC may decide not to pursue the RBL. In such cases, ADB can still work with the DMC on institutional strengthening and/or use another lending modality.

F. Program Action Plan and Capacity Development

123. The assessments will inform the appropriate scope, measures, and intensity for capacity development and implementation support. ADB and the DMC will agree on a program action plan to be executed and monitored during implementation. As appropriate, actions may include those to improve the program's design and implementation, strengthen the program's systems and institutions, increase agencies' capacity, and mitigate risks. The action plan will be refined, improved, and updated during implementation, as needed.

124. Under RBL, the achievement of program results will drive capacity development. Results will not be defined only as improvements in sector outputs and outcomes, but also in improvements in systems. The design of the action plan should be realistic and feasible, taking into consideration the best use of opportunities to improve institutions and results. Through RBL, ADB should aim to assist DMCs in achieving positive and sustainable changes.

125. In addition to the overall program-level support through RBL, ADB may also support capacity development through dedicated TA activities. TA may be provided as an integral part of RBL, as separate products in the operation, through parallel efforts financed by development partners, or through other appropriate arrangements.⁵⁰

VIII. APPROVING AND IMPLEMENTING RESULTS-BASED LENDING FOR PROGRAMS

A. Application and Approval

126. Since RBL supports government-owned programs, it will be applied to sovereign operations. As with other modalities, the country, sector, or type of programs that may use RBL will not be predetermined. Each program will be reviewed on a case-by-case basis. RBL can be adapted to a wide range of applications. Program implementation can be carried out by different public and/or private entities.

127. Processing and approval of programs will follow standard ADB procedures. Through the review and oversight mechanisms embedded in these procedures, ADB will form an overall conclusion on whether to proceed with the RBL and how best to do so.

128. To strengthen Management oversight, Management Review Meetings will be held for all programs processed within 2 years after the approval of the policy. After 2 years, whether a Management Review Meeting or a Staff Review Meeting is required will depend on the complexity of a program.

B. Financing-Related Issues

129. ADB financing for RBL can come from various sources, including ordinary capital resources, the Asian Development Fund (loans and/or grants), grants, and/or cofinancing. Financing-related aspects are outlined below:

- (i) **Cofinancing.** RBL can provide a strong platform for coordinating external financing in a sector. RBL will support DMCs and development partners to explore the scope for cofinancing and joint financing of government-owned

⁵⁰ The implementation of operations with RBF features demonstrates the great need for separate TA in such areas as (i) support to meet the DLIs, (ii) DLI reporting, (iii) DLI achievement verification, and (iv) fiduciary oversight. See ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Third Primary Education Development Project*. Manila.

programs. If cofinancing materializes after ADB approves a program, Management will approve such cofinancing and report it to the Board for information as part of the annual report on cofinancing.

- (ii) **Additional financing.** RBL for programs can apply for additional financing following ADB's additional financing procedures.⁵¹
- (iii) **Technical assistance.** ADB can provide TA to RBL, as a part of the program or as separate products or operations.
- (iv) **Loan terms.** RBL financing terms will be the same as those for investment projects.

130. **Use of proceeds and procurement.** Proceeds from RBL will be used to finance program expenditures aimed at achieving program results, improving program institutions, and providing needed support for achieving program objectives. ADB financing under RBL is not linked to specific transactions, but is an integral part of program financing as a whole, which may include financing from the DMC's own resources and cofinanciers.

131. To satisfy the Agreement Establishing the Asian Development Bank (the Charter),⁵² RBL for programs will require the adoption and implementation of mechanisms and procedures relating to the mandated country procurement eligibility requirement. Such mechanisms and procedures will provide reasonable assurance that the aggregate amount of ADB disbursement proceeds does not exceed the amount of the total program expenditures on goods, works, and services from ADB member countries, including from the borrowing country. Conversely, the total program expenditures excluding the procurement from non-member countries should be at least equal to, or exceed, the amount of ADB financing.

132. At the processing stage, as part of the procurement and financial management system assessments, ADB will take measures to ensure that those systems will provide for competitive and transparent procurement with due consideration for economy and efficiency, and can adequately track and record awards to foreign bidders, particularly those from non-member countries. During implementation, ADB will require the DMC to reflect the aggregate procurement value from ADB's non-member countries in the program's audited financial statements. This data will need to confirm that the amount of total program expenditures on goods, works, and services from ADB member countries (including the borrowing country) is at least equal to, or exceeds, the amount of the ADB RBL disbursements during the relevant reporting period.⁵³ ADB will reserve the right to audit compliance with this requirement. In certain cases, ADB may, where necessary, also support the DMC in establishing an adequate procurement bidder award recording and reporting system.

C. Implementation-Related Issues

1. Auditing and Reviews

133. **Financial auditing.** ADB and the DMC will agree on the approach for financial auditing. The audits will be conducted by auditors with independence, experience, and capacity acceptable to ADB, and under terms of reference acceptable to ADB, taking into consideration

⁵¹ ADB. 2010. *Additional Financing: Enhancing Development Effectiveness*. Manila. For additional financing funded by cofinancing, refer to the approval process described in para. 129(i), which further simplifies the process as provided in the additional financing policy.

⁵² ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

⁵³ This means that the total program expenditures, excluding procurement from non-member countries, is equal to or greater than the amount of ADB financing. In cases where cofinanciers also have procurement country eligibility requirements, the program expenditures should satisfy ADB's requirements as well as those of the cofinanciers.

the program nature, country context, and risk assessment. The DMC will submit annual audited financial statements of the program to ADB within the agreed time frame after the close of the DMC's financial year. In DMCs, statutory requirements may specify the use of the country's supreme audit institutions (SAIs) for a development program.⁵⁴ There may be cases in which the audit reports from the SAI cover multiple projects or programs and do not provide sufficient details for the program, or are issued with significant delays. In such cases, during the processing of the operation, ADB will discuss and reach agreement with the DMC 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 DMC may agree on alternative audit arrangements for the program.

134. **Results verification and disbursement.** During the implementation of a program, ADB will review the progress toward the achievement of the DLIs. Achievements of DLIs will be verified by the appropriate verification mechanisms agreed upon by ADB and the DMC. ADB's disbursement will be based on achievements of DLIs, not evidence of transactions or expenditures. ADB will disburse the agreed amount based on the agreed disbursement arrangements.

135. **Other reviews or audits.** ADB and the DMC may agree on and arrange other reviews or audits as necessary. These may include reviews of the performance of environmental and social impacts management system, procurement system, grievance redress mechanisms, and/or complaint-handling mechanisms.

2. Changes in Scope and Implementation Arrangements

136. As in projects, programs supported by RBL may require changes in scope and/or implementation arrangements. These changes may be needed to improve a program's performance, reflect changes in a DMC's priorities and needs, modify the DLIs, revise program financing arrangements, or respond to changed circumstances. Changes in scope and/or implementation arrangements will follow ADB's prevailing rules and procedures on change in scope for projects.

3. Risk Monitoring and Addressing Performance Problems

137. ADB and the DMC will monitor risks during program implementation, identify emerging issues, and make adjustments on risk management measures as necessary. ADB and the DMC will notify each other when they become aware of performance problems. The DMC will be expected to take timely and appropriate actions to address such problems. ADB will support the DMC in addressing the problems.

138. Depending on the nature, scale, and frequency of performance problems—and the DMC's response to problems—ADB will adopt appropriate measures to address them. Reasonable assurances in using program systems are premised on the recognition that even robust systems have varying quality of transactions. Thus, ADB's actions will distinguish between systematic issues and ad hoc variations, and between a DMC's actions and inaction in addressing performance problems. However, a DMC's failure to take corrective actions promptly for reasons under the DMC's control to address systematic performance problems may result in ADB applying corrective remedies agreed to in the legal agreement.

⁵⁴ SAIs are important budget oversight institutions. They take different forms in different countries, reporting to the parliament, the supreme court, or an audit board.

4. Dealing with Fraud and Corruption Cases

139. Consistent with the RBL approach of using and strengthening DMC program fiduciary systems, RBL will support DMC efforts to address and manage risks associated with fraud and corruption in a program, and to investigate incidences of fraud and corruption when they arise. To improve DMCs' anticorruption systems for programs, DMCs should have opportunities to address identified problems and implement measures to avoid the reoccurrence of the problems. A DMC will be expected to take appropriate and timely measures to prevent, detect, and respond to allegations of fraud, corruption, and other prohibited activities in a program supported by RBL, in accordance with the Guidelines to Prevent or Mitigate Fraud, Corruption, and Other Prohibited Activities in Results-Based Lending for Programs (Appendix 7). The RBL anticorruption guidelines take into account that, in the context of RBL, ADB will not fund specific transactions, i.e., ADB funds will not be linked to specific expenditures within a program.

140. While RBL will support DMCs as they tackle fraud and corruption, ADB has a fiduciary responsibility to ensure that its loans and other forms of financing are used only for the purposes for which they were granted. To that end, ADB will have the right to investigate allegations of violations that arise in RBL and to sanction entities that are found to have engaged in fraud or corruption. ADB will exercise the right as the circumstances require (e.g., the nature of the case, frequency of occurrence, and action or capacity of the DMC) when it believes it necessary to do so. The definitions of these violations and actions required from DMCs and ADB are presented in the RBL anticorruption guidelines (Appendix 7).

141. If allegations of fraud, corruption, or other prohibited activities arise regarding a program, the RBL anticorruption guidelines require that ADB and the DMC communicate the allegations to each other in a timely manner. This will lead to consultation on appropriate actions. The findings by the responsible investigative unit and proposed actions will be shared with ADB and, as appropriate, ADB and the DMC will consult on the corrective measures warranted.

142. Entities debarred by ADB are ineligible to participate in the programs throughout the duration of their sanctions. The DMC will be expected to ensure that entities debarred and suspended by ADB do not participate in program activities during their periods of debarment or suspension. This debarment may be subject to recognition by other MDBs if provisions of the Agreement for Mutual Enforcement of Debarment Actions between ADB and other MDBs are met.

143. ADB's standard remedies under the loan regulations and loan agreements (e.g., suspension of loans, cancellation of loans, or acceleration of maturity for funds already provided) provide sufficient scope for ADB to respond when issues of fraud and corruption are not being satisfactorily addressed.

5. ADB's Key Corporate Functions

144. **Independent evaluation.** RBL operations will be subject to independent evaluation if deemed appropriate by the Independent Evaluation Department.

145. **Accountability Mechanism.** RBL operations will be subject to the Accountability Mechanism policy.⁵⁵

⁵⁵ ADB. 2012. *Review of the Accountability Mechanism Policy*. Manila.

146. **Consultation and transparency.** RBL operations will include stakeholder consultation on the indicative DLIs, draft fiduciary system assessments, and draft environmental and social systems assessment. Information disclosure on RBL will comply with the ADB's Public Communications Policy (2011). Disclosure requirements for RBL for programs will be consistent with other operations. The report and recommendation of the President for an operation—including the DLIs, DLI verification protocols, and assessments—will be disclosed. During implementation, the project data sheet will be disclosed. The draft and final environmental and social systems assessment will also be disclosed.

147. **Anticorruption measures.** ADB will have the right to investigate allegations of fraud and corruption related to an RBL operation. Anticorruption related measures are described in paras. 108–109 and paras. 139–143, and dedicated anticorruption guidelines for RBL are included in Appendix 7.

IX. RESPONSIBILITIES AND PARTNERSHIP

A. Roles and Responsibilities

148. The DMC will be responsible for designing, implementing, and monitoring a program supported by RBL. The DMC will also maintain the agreed implementation arrangements, including the M&E systems, fiduciary systems, and safeguard systems. Individual and systemic problems in the program will be expected to be addressed by the DMC in a timely and effective manner.

149. ADB will assess the program in coordination with the DMC. ADB will also support the DMC in identifying and designing measures to improve the program, its systems, and risk mitigating measures. Working with other development partners as appropriate, ADB will support the DMC in implementing improvement measures, monitoring program performance and risks, and helping to resolve emerging issues.⁵⁶

150. RBL will be characterized by capacity development to strengthen the program, results, institutions, and risk management throughout the program cycle. The very reason for using the program systems of DMCs is to support results and sustainability, and improve performance of the whole program. Capacity development will be an important aspect of support from ADB, which will work closely with other development partners, as appropriate.⁵⁷

B. Development Partnership

151. RBL will support government ownership and leadership. The program will be owned by the DMC, and implemented by using and improving DMCs' own program systems. ADB's disbursement will be based on the DLIs, which are derived from the DMC's results framework. Capacity development will be geared towards improving the DMC's ability to deliver and sustain results. Through assessing, using, and improving DMCs' program systems, RBL will support joint learning by DMCs and ADB.

152. When a program is supported by two or multiple development agencies, RBL will foster development partnerships by sharing a common DMC-owned results framework, using common

⁵⁶ For programs that cover wide geographical areas, ADB's monitoring may need to use a sample of or selected agencies.

⁵⁷ Analytical work and diagnostic assessments by other development partners can be used or updated as required. Joint assessments with other development partners, as appropriate, will be encouraged.

program systems, and financing a common expenditure framework among the DMC and development partners. Development partners can coordinate their assistance to the DMC to improve program design, conduct assessments, identify risks, mitigate risks, coordinate capacity development, and undertake joint learning. Development coordination and harmonization will be carried out to improve the efficiency of the program design and implementation, and to avoid duplication and fragmentation of development assistance. RBL will be ideal for cofinancing and/or joint financing for a government-owned program between DMCs, ADB, and other development partners.

X. CHALLENGES AND WAYS FORWARD

A. Risks and Mitigating Measures

153. The introduction of RBL for programs may involve several risks that could affect ADB and DMCs. However, all the risks can be sufficiently mitigated or managed.

1. Definition and Verification of Results

154. 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. The definition of results may be overly ambitious and unrealistic. Conversely, the results indicators may be defined below the achievements needed to make them sufficiently relevant. To address these challenges, ADB will support the DMC in developing or refining its results framework. Credible results verification and feedback from program beneficiaries will improve the definition and achievement of results. Defining results from the perspectives of program beneficiaries will also guide the proper selection of relevant and appropriate results indicators.

155. Linking results with disbursements may expose a DMC to the risk that ADB financing will not be disbursed if results are not achieved. However, allowing partial disbursement will reduce this financing risk. While focusing on delivering results, the design of operations should take into consideration the need for predictability of fund flows. However, the primary purpose of RBL is to support achievements of results, and to recognize achievements through disbursement. Therefore, it is a risk worth taking to increase the prospect of achieving results. DMCs concerned about their ability to deliver identified program results may choose not to use the RBL modality.

2. Institutional Development

156. Institutional development can be resource intensive, time consuming, and difficult. ADB will work with the DMC to develop and implement realistic action plans to bring about incremental, positive, and sustainable changes over time. ADB should also join with other development partners in assisting DMCs with institutional development, where possible. The close integration of systems and results—and the positive feedback it generates—will also increase the likelihood that the DMC will embrace institutional development.

3. Potential High Transactions Costs

157. The assessments conducted for the programs may be excessively complex, time intensive, and costly; or too detailed and prescriptive. ADB should ensure that appropriate assessments are carried out depending on the nature and context of a program. ADB should

ensure that appropriate resources are available for upstream assessments and downstream support and supervision. However, as analytic work and knowledge are accumulated, it should be possible to prepare RBL with lower transaction costs. Transaction costs will also be partly offset by avoiding establishing and maintaining parallel systems, and by reducing procedural requirements.⁵⁸

158. To reduce the potential transaction costs, ADB should incorporate learning from its own experiences and those of other development agencies. ADB should also explore ways to produce the assessments more efficiently, for example, using existing assessments by ADB or other agencies, conducting common assessments (where appropriate) at the sector level that can be used by all programs in the sector, and collaborating with other development agencies and sharing the assessments. RBL should use or build on the many sector and other analyses that have already been completed by ADB and others.

159. System assessments and capacity development may initially require more time and resources. However, the benefits from a sharper focus on results, better sector knowledge, stronger systems and institutions, and more sustainable programs will promote development effectiveness and can generate large benefits. There will also be resource savings for both ADB and DMCs by reducing the staff time required for supervising a large number of individual contracts and setting up parallel implementation arrangements. RBL may also be able to achieve more than what a single project can by leveraging ADB's impact to positively influence a large government program through limited ADB financing.

4. Fiduciary and Safeguard Risks

160. RBL will incorporate measures to ensure that all program financing, including financing from ADB, is used appropriately and that fiduciary and safeguard risks are adequately addressed. However, improving systems and mitigating risks are demanding tasks for DMCs and development agencies. To address these risks, ADB will undertake careful assessments of the fiduciary and safeguard systems, assist DMCs in preparing program action plans to address weaknesses, and support capacity development. More accountability for results—a built-in feature of RBL—will also mitigate fiduciary and safeguard risks. Systematic M&E will track the achievement of results and the performance of systems, and will allow the lessons learned to be incorporated into the program. Credible results verification mechanisms will also help to increase accountability and reduce risks. While improving DMC systems is difficult, it is the only sustainable way to address fiduciary and safeguard risks. Excluding activities involving high-value contracts and activities that would be classified as category A under the Safeguard Policy Statement will also reduce these risks.

5. Risk of an ADB-Driven Agenda

161. RBL will provide an added platform for ADB to work with DMCs to sharpen the results focus and strengthen institutions. However, there is a risk that a program could become driven by ADB, detached from the ownership and institutions of the DMC. To address these risks, ADB should assist the DMC in improving local capacity, support government ownership, and avoid an ADB-driven agenda.

⁵⁸ Fewer withdrawal applications will be processed for a program with, e.g., a semiannual disbursement schedule, compared with investment operations.

B. Advancing the Results-Based Agenda

162. Decades of development experience have shown that governments, as well as development agencies, need to sharpen the results focus of their operations. Public finance must deliver results more efficiently and effectively—and sustain them by making systematic changes in a DMC's systems and institutions. The huge expected benefits of RBL strongly suggest it will advance the results-based development agenda (paras. 41–51). These expected benefits highlight the need for ADB to adopt the RBL modality that focuses on achieving program results and institutional development by using and improving DMCs' program systems.

C. Piloting Results-Based Lending for Programs

163. This paper proposes that ADB adopt a learning-by-doing approach by piloting the RBL modality for 6 years. This is the minimum time frame required to process and implement RBL in order to yield sufficient information for the subsequent review and evaluation, on both the design and implementation dimensions. It is also proposed that ADB limit the resource allocation for RBL for programs to 5% of the total ordinary capital resources and Asian Development Fund resource allocation for the first 3 years from the effective date of this policy. Setting the ceiling at 5% of the total resource allocation for 3 years, without specifying the exact annual limit, is appropriate. This will provide the needed flexibility for ADB to build the RBL pipeline gradually, without rushing to meet annual limits. Management may propose to the Board to lift this cap if justified by a review of RBL implementation.

164. To support the piloting, ADB will put in place measures for dissemination, consultation, and learning. Training will be carried out to better equip staff and raise awareness of DMCs. ADB will develop a guidance document to support staff and DMCs in designing and implementing programs supported by RBL. ADB will, as necessary, set up an ADB-wide support team comprising members from relevant departments (including experienced mission leaders) to assist program teams. ADB will update or modify relevant documents as necessary. For example, changes that may be necessary or desirable to give effect to the recommendation in the policy will be made to the Ordinary Operations Loan Regulations Applicable to LIBOR-Based Loans Made from ADB's Ordinary Capital Resources (dated 1 July 2001), the Special Operations Loan Regulations Applicable to Loans Made by ADB from its Special Funds Resources (dated 1 January 2006), and the Regulations of the Asian Development Fund (dated 27 April 2009).

165. ADB will learn from its own experiences and exchange experiences with other development agencies, especially the World Bank. Around 3 years of implementation, Management will carry out a review to take stock of the experiences with RBL. The review will examine aspects such as the demand for this modality, the sector and country distribution of the operations, ways of managing fiduciary and safeguard risks, approaches to capacity development, transaction costs by ADB and the DMCs, emerging issues, and lessons. The review will also look into whether there are areas to fine-tune the modality based on the initial experience, and if so, will make recommendations for the improvements needed. The Independent Evaluation Department of ADB will assess the implementation experience of RBL. ADB will consider and decide on the future direction of the modality in light of the Independent Evaluation Department's findings.⁵⁹

⁵⁹ The Independent Evaluation Department review should be scheduled to provide sufficient time for ADB to decide on the future of the RBL modality and, if necessary, prepare and adopt a policy document. Therefore, it may be appropriate for the review to be completed 1–2 years before the completion of the pilot.

D. Effective Date and Transitional Period

166. The policy on piloting RBL for programs will become effective 3 months after the date of approval by the Board of Directors.

E. Resource Implications

167. RBL will require ADB staff to carry out the assessments, assist DMCs in improving program design and implementation, monitor the progress, and initiate timely corrections. ADB has strengthened staff capacity in financial management through the addition of new positions during 2010–2012 and redeployment of existing staff. ADB's procurement capacity has also been strengthened through the Procurement Accreditation Skills Scheme. Stronger staff capacity will aid the implementation of RBL.

168. RBL may require additional resources to carry out the assessments and develop capacity. However, resource savings for both ADB and DMCs should come from reduced staff time for supervising a large number of individual contracts and setting up parallel implementation arrangements. Thus, there is no clear indication that RBL will require more resources to design and implement. Recent experience with investment lending projects with RBF features at ADB and the World Bank suggests that a lack of a dedicated policy framework has increased transaction costs. However, excluding these, the processing and implementation costs for these operations were within the norm for investment lending projects. The resources required for each RBL operation will depend on many factors, such as previous engagement in the sector and with the institutions that will implement the program, the capacity of the implementing agencies, and the involvement of other development agencies. The piloting of RBL will yield more information on the resource implications. ADB should monitor the resource needs during the pilot period and make adjustment as necessary.

169. Any future resource requirements should be balanced against the expected benefits from RBL. RBL will help ADB consolidate its institutional work and accumulate knowledge and expertise in financial management, procurement, safeguards, and M&E systems. To better use resources, ADB should cooperate with other development agencies and stakeholders in conducting assessments, developing capacity, and generating knowledge products that will serve as public goods.

XI. RECOMMENDATION

170. The President recommends that the Board approve the Piloting Results-Based Lending for Programs policy as set out in sections VII, VIII, IX, and X of this paper.

EXAMPLES OF RESULTS-BASED FINANCING SCHEMES

Title	Description
Cash on Delivery Aid	A concept for making payments to a government in return for achievement of specific results (e.g., increase in primary school enrollment).
Conditional Cash Transfers	Payment made to targeted beneficiary in return for using specified services.
European Commission Millennium Development Goal Contracts	Payment made to a government in return for its commitment to good governance and satisfactory progress in poverty reduction. Variable tranche payments are used to reward partial achievements and increase flexibility.
GAVI Alliance Immunisation Services Support	Initial investment based on (self-reported) number of children expected to be vaccinated in first year. Subsequent reward payments of \$20 per child vaccinated are provided above this baseline.
Global Fund to Fight AIDS, Tuberculosis and Malaria	Funding for years 3–5 dependent on overall performance achieved during first 2 years of grant implementation.
Global Partnership for Output-Based Aid	Multi-donor partnership and trust fund established to (i) fund and facilitate the preparation of output-based aid projects in which payment is made to an implementing agent (usually private sector organizations and usually in the utilities sector) for each unit of output supplied, and (ii) document and disseminate lessons learned.
Health Results Innovation Trust Fund	Vehicle for supporting results-based financing approaches. The trust fund also focuses on raising resources and knowledge generation.
IDB's Performance-Driven Loans	The performance-driven loan is an investment loan that disburses once a project's developmental results or outcomes are achieved.
Millennium Challenge Account	Payment made to a government in return for a demonstrable commitment to democracy, good governance, economic freedom, and pro-poor public services.
Performance-Based Contracts	A type of contracting with a clear set of objectives and indicators. Contractors are rewarded or sanctioned based on the delivery of desired work.
Poverty Reduction Budget Support	Payment made to a government in return for a commitment to good governance and satisfactory progress in poverty reduction. Variable or performance-related tranche payments are provided to increase flexibility.
Sector-Wide Approach	Project funds contribute directly to a sector-specific umbrella and are tied to a defined sector policy under a government authority.
UK Payment by Results	Fixed payment (based on national average unit costs) paid to hospitals in the UK for delivering a specific health output.
UK Quality and Outcomes Framework	Payment made based on the performance by general practitioners in the UK against more than 100 quality-based indicators.

Title	Description
US Pay-for-Performance	Payment made to providers with the amount based on performance against quality-based output indicators.
Vouchers	Reimbursement made to accredited providers based on the services delivered to voucher recipients.
World Bank's Program-for-Results Financing	Finances government programs with disbursement of loan proceeds linked to the achievement of results that are tangible, transparent, and verifiable.

GAVI = Global Alliance for Vaccines and Immunisation, IDB = Inter-American Development Bank, UK = United Kingdom, US = United States.

Sources: Asian Development Bank; IDB. 2003. *Proposal for a Pilot Program for Performance-Driven Loans*. Washington, DC; M. Pearson. 2011. *Results based aid and results based financing: What are they? Have they delivered results?* London: Health and Life Sciences Partnership (HLSP) Institute; and World Bank. 2011. *A New Instrument to Advance Development Effectiveness: Program-for-Results Financing*. Washington, DC.

SUMMARY OF RESULTS-BASED FINANCING APPROACHES

1. Multilateral development banks (MDBs) and other agencies have carried out many operations utilizing elements of results-based financing (RBF) since the late 1990s.¹ A broad array of RBF mechanisms has emerged, including cash on delivery (COD) aid; conditional cash transfers (CCTs); European Commission Budget Support; output-based aid (OBA); performance-based contracts (PBCs); RBF in health; sector-wide approaches (SWAPs); the GAVI Alliance (formerly the Global Alliance for Vaccines and Immunizations); the Global Fund to Fight AIDS, Tuberculosis and Malaria; the Millennium Challenge Corporation (MCC); the Inter-American Development Bank's performance-driven loans (PDLs), and the World Bank's Program-for-Results financing.²

2. These initiatives share the common feature that disbursements are made upon delivering results. Some approaches have been used by many organizations, while others are specific to individual organizations.

A. General Approaches on Results-Based Financing

1. Cash on Delivery Aid

3. Developed by the Center for Global Development, COD aid aims to increase country ownership and payment for results.³ It is designed to strengthen the accountability of recipient governments to their citizens, funders to recipient governments, and recipient governments to funders. Financing is contingent upon transparent and measurable incremental progress on specific agreed goals. COD aid has five basic features: (i) disbursements for outcomes, (ii) hands-off implementation, (iii) independent verification of progress, (iv) transparency through public dissemination, and (v) complementarity with other aid programs.

4. Under this approach, development partners pay for measurable progress on specific results that were agreed upon in advance with recipient governments. COD aid builds on existing initiatives that strive to disburse aid based on results, but it takes the idea further by linking disbursements more directly to a single specific result. This gives the recipient country more authority to achieve progress however it sees fit, while ensuring that the country's progress is transparent to its citizens.

5. The COD approach can be applied to any sector in which governments and their development partners are committed to making progress on shared, measurable results. Governments can also apply it to their own fiscal transfers to subnational governments. Once a result indicator has been identified and the basic contract has been negotiated, any number of development partners—public or private—can pool funds without creating additional reporting requirements or changing the structure of the aid arrangement. Most importantly, recipient countries can focus on what they need to do to achieve development results instead of spending time documenting expenditures or developing strategies to satisfy funders' prerequisites.

¹ Lending includes grants and other financing; borrowers include recipients of grants and other financing.

² This appendix draws from the published information of various organizations, such as information on the websites of those organizations.

³ Center for Global Development. 2012. *Cash on Delivery: A New Approach to Foreign Aid*. http://www.cgdev.org/section/initiatives/_active/codaid/the_approach/

6. The United Kingdom (UK) and Ethiopia were the first countries to apply the COD approach. In a nationwide pilot in 2011, the Department for International Development (DFID) of the UK made grant disbursements to the Ministry of Education of Ethiopia to increase the number of students who sit for or pass the national grade 10 examination.⁴ A maximum of £10 million will be disbursed each year during 2012–2014.

7. The Government of Ethiopia maintains education examination and management information systems which will be the basis for its reports on the results. DFID has contracted an independent agency to verify the government reports. DFID will also visit a sample of schools in each region to verify that the nationally reported results are accurate. Once results are verified, DFID will disburse for additional students above the baseline that sit for the exam and a further payment for additional students who pass the exam. The Ministry of Education will have full discretion on how funds received are allocated, but DFID staff, upon requests from the government, provides technical advice on allocating funds to regions and secondary schools.

8. The following lessons have been learned:

- (i) Although the key interlocutor for the government is the Ministry of Education, education officials found that the interest of the Ministry of Finance in planning and designing the project has also increased.
- (ii) The project provides a good example of how the COD approach complements other aid financing.
- (iii) Despite involving little funding, the program has drawn significant attention to tracking progress on secondary schooling and its quality.
- (iv) Setting up the pilot as a 3-year program with a total size of £30 million through a memorandum of understanding is appropriate. The program has no annual disbursements limit. This has given the government incentives to make progress as quickly as possible, and not limit the program by holding back in a given year to facilitate reaching a full payout in the following year. It also assures the government that if it took initiatives in the first year that yield benefits only in later years, it could still reap the full benefits of those investments.
- (v) The structure of a COD agreement, compared with a traditional project, increases the government's accountability to its citizens. For citizens to hold their governments accountable, they need information about the agreement and its implementation.

9. The Center for Global Development is designing more COD pilots in collaboration with technical experts, potential official and private development partners, and partner countries. In addition to other education-related pilot activities, the application of COD in the health sector is also being explored to improve maternal health, reduce child mortality, and prevent HIV/AIDS. COD's application to development goals in other sectors is also being analyzed.

2. Conditional Cash Transfers

10. CCTs provide cash grants to poor households based on desirable household behavior, generally involving parents ensuring investment in the education or health of their children.⁵ CCTs have dual objectives. First, they seek to raise living standards of poor households for immediate poverty reduction. Second, for long-term poverty reduction, they seek to encourage

⁴ N. Birdsall and R. Perakis. 2012. *Cash on Delivery Aid: Implementation of a Pilot in Ethiopia*. http://www.cgdev.org/doc/Initiatives/Ethiopia_RBA_pilot_report.pdf

⁵ For example, children between 6 and 14 years old remain enrolled and attend school.

the accumulation of human capital in order to stop the transmission of poverty 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.⁶

11. First used in Latin America, CCTs have been popular in developing countries since the 1990s. Recent reviews estimate that at least 29 developing countries have CCT programs in place.⁷ In some countries, the CCT program is the largest social assistance program, covering millions of households. In 2007, for example, Brazil's Bolsa Escola covered 4.8 million families; Mexico's Oportunidades covered 5 million households; and Brazil's Bolsa Família covered 11 million families or about 46 million people—almost a quarter of the population. Examples of CCTs in Asia include the Food for Education Program in Bangladesh and the World Bank's Education Sector Support Project in Cambodia. The coverage of CCTs vary widely—from about 40% of the population in Ecuador to about 20% in Brazil and Mexico to 1% in Cambodia.

12. CCTs have been used as vehicles to (i) reduce inequality, and promote health and schooling for children; (ii) help households break out of the vicious cycle that transmits poverty from one generation to another; and (iii) help countries meet the Millennium Development Goals (MDGs). Evidence from many countries indicates positive results of CCTs on school enrollment of children in recipient households. A 2009 study estimated that the CCT program in Cambodia, which transfers cash to parents if they keep their teenage girls enrolled in school, raised enrollment rates by 20–30 percentage points. A 2002 study found that the School Feeding Program in the Philippines raised children's caloric intake by 80% compared with the caloric redistribution value from the school feeding program.⁸ In Cambodia, a program financed by the Japan Fund for Poverty Reduction significantly reduced socioeconomic gradients in enrollment among girls from eligible households.⁹ CCTs have helped to reduce the education gender gap in Bangladesh and Pakistan. Most CCT programs used excellent monitoring and evaluation (M&E) systems and demonstrated high degree of transparency in documentation and information. This strong evaluation culture has gone beyond traditional practice in social policy, and is spreading from one CCT to another, as well as to other programs in the same country.¹⁰

13. 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 the CCT programs have become large and costly, which raises the issues of sustainability, potential politicizing of CCTs, and fostering of a culture of dependence.¹¹

⁶ A. Fiszbein and N. Schady. 2009. *Conditional cash transfers: reducing present and future poverty*. A World Bank Policy Research Report. Washington, DC: World Bank.

⁷ D. Filmer and N. Schady. 2009. Are there Diminishing Returns to Transfer Size in Conditional Cash Transfers? *Policy Research Working Paper*. No. 4999. Washington, DC: World Bank; and J. Das, Q. Do, and B. Ozler. 2004. Conditional Cash Transfers and the Equity-Efficiency Debate. *Working Paper Series*. No. 3280. Washington, DC: World Bank.

⁸ H. Jacoby. 2002. Is there an Intra-Household 'Flypaper Effect'? Evidence from a School Feeding Programme. *The Economic Journal*. 112 (January). pp. 196–221.

⁹ D. Filmer and N. Schady. 2006. *Cambodia - Getting Girls Into School*. Washington, DC: World Bank.

¹⁰ A. Fiszbein and N. Schady. 2009. Conditional Cash Transfers - Reducing Present and Future Poverty. *World Bank Policy Research Report*. Washington, DC: World Bank.

¹¹ 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, DC: World Bank; A. Fiszbein and N. Schady. 2009. Conditional Cash Transfers – Reducing Present and Future Poverty. *World Bank Policy Research Report Series*. Washington, DC.

3. Output-Based Aid

14. OBA uses performance-based subsidies to deliver basic services to poor households.¹² Basic services supported by OBA include water supply, sanitation, electricity, transport, telecommunications, education, and healthcare. OBA fills the funding gap between the cost of service delivery and the beneficiaries' ability and willingness to pay for the service.

15. The OBA concept was introduced in 2003 through the launch of the Global Partnership on Output-Based Aid (GPOBA) by the World Bank and DFID. Since then other development partners have joined the program, including the Australian Agency for International Development, the Directorate-General for International Cooperation of the Netherlands, the Swedish International Development Cooperation Agency, and the International Finance Corporation. The mandate of this partnership is to fund, design, demonstrate, and document OBA approaches to improve the delivery of basic infrastructure and social services to the poor in developing countries.

16. The OBA approach

- (i) uses performance-based subsidies to deliver services—to improve the affordability of basic services used by low-income populations;
- (ii) finances the funding gap between the cost of service delivery and the beneficiaries' ability and willingness to pay for the service—with the aim of facilitating the transition to cost-recovery tariffs; and
- (iii) contracts out services to third-party providers—to improve the efficient delivery of services that exhibit positive externalities.

17. The GPOBA remains the primary source of OBA projects, with a portfolio of OBA subsidies totaling about \$4 billion. The GPOBA estimated that its use of OBA grew from 32 projects in 2003 to more than 200 in 2009. A World Bank review of the piloting phase of the GPOBA rated it a success.¹³ Implementation completion reports provide evidence that OBA projects have been more effective in achieving development outcomes than traditional projects. For example, the OBA approach in a Mongolian information and communication technology project enabled 28% savings in the total subsidy required. The savings were then used to expand the project to 1,000 more beneficiaries. In a rural electrification project in Sri Lanka a service provider introduced a 15% price discount and its own consumer financing, seeking to capture market share. The competitive bidding process for the OBA scheme in a project to improve access to water supply in small towns and rural growth centers in Uganda resulted in an average efficiency gain of about 20%. GPOBA estimates its OBA projects have benefited at least 60 million poor people. ADB has also started to implement OBA schemes through the joint efforts of the Office of Cofinancing Operations and operations departments (Appendix 3).

18. OBA schemes normally apply performance-based subsidies in three ways: one-off subsidies such as connection subsidies, transitional tariff subsidies that decrease as user contributions increase, or ongoing subsidies. Under OBA, services are contracted out to a third party (service provider) either through a competitive process or a single source selection process. A competitive process to choose a service provider generally involves seeking (i) the lowest subsidy required for the predetermined outputs, (ii) the greatest coverage per fixed

¹² Y. Mumssen, L. Johannes, and G. Kumar. 2011. *Output-Based Aid: Lessons Learned and Best Practices*. Washington, DC: World Bank.

¹³ The World Bank's project ratings include highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, and highly unsatisfactory.

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 by establishing standard costs or an agreement on a unit cost schedule, verified by independent consultants during project preparation.

19. The OBA approach differs from projects that finance inputs such as books and medicines. OBA makes disbursements to service providers based on 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.

20. The main challenge in mainstreaming OBA is reconciling investment lending's expenditure-based approach with the performance-based nature of OBA. Engaging 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.¹⁴

4. Performance-Based Contracts

21. PBCs began in 1990s and use results-based approaches in projects. PBCs move the government's role in the contracting process from describing how it wants results to be achieved to defining what results it wants to be delivered.¹⁵ This allows contractors to deliver the results by maximizing innovation and efficiency, and rewards them for doing so.¹⁶ The objectives of PBCs are to improve performance of service providers, achieve desired results, improve quality of results, reduce costs, and reduce risks. Organisation for Economic Co-operation and Development (OECD) countries have spearheaded the use of PBCs.

22. PBCs structure contracts around the work desired as opposed to how the work is to be performed. An important prerequisite for PBCs is a well-defined and clearly written statement of work, which describes the quantity, quality, and measurement of work. Contractors shoulder the responsibility for quality performance. The contractor's compensation is tied to the achievement of the prescribed results. PBCs often include incentives to motivate contractors to meet or exceed the performance standards, and to save time and costs.¹⁷

23. ADB has developed guidelines to facilitate PBCs.¹⁸ Project teams have used PBCs in projects such as the Yunnan Integrated Road Network Development Project¹⁹ and the Second

¹⁴ World Bank. 2007. Implementing Output Based Disbursement Mechanism for Investment Operations. *Operation/Technical Guidance Note to Staff*. Washington, DC. Update. The guidance note "Structuring OBA Approaches" dated 17 November 2005, describes an approach that applies to specific infrastructure service contracts awarded to private sector or third party service providers.

¹⁵ 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, 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 the roadside.

¹⁶ Government of the United States, Office of Management and Budget. 1998. *A Guide to Best Practices for Performance-Based Service Contracting*. Washington, DC.

¹⁷ U.S. Department of Energy. 1998. *Performance-Based Contracting – Guide*. Washington, DC.

¹⁸ ADB. 2007. Other Forms of Procurement. *Project Administration Instructions*. PAI 3.05. Manila (para. 16); ADB. 2010. *Procurement Guidelines*. Manila (paras. 3.14-3.15).

Heilongjiang Road Network Development Project (Appendix 3),²⁰ both in the People's Republic of China.

5. Results-Based Financing in Health

24. RBF in health aims to increase the impact of public spending in health by providing financial or in-kind rewards conditioned upon achievement of agreed performance goals. RBF in health takes different forms, including provider payment incentives, vouchers, contracting linked to targets, and conditional cash disbursements and transfers to households.

25. While policymakers care about results, governments and development agencies have typically financed inputs, such as salaries for doctors, medical equipment, constructions of hospitals, and health worker training. Better 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 received from governments and development agencies either lump sum grants or reimbursements for expenditures. This system encourages providers to devote energy to secure funds and justify inputs rather than to improve the efficiency and quality of services. RBF in health aims to change this model fundamentally by starting with the results and allowing health service providers to decide how to achieve them. This provides incentives and autonomy for service providers.

26. ADB incorporated features of the RBF in health approach in the Second Urban Primary Healthcare Project in Bangladesh (Appendix 3).²¹ The World Bank has supported RBF in health 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 International Financing for Health Systems committed \$5.3 billion to accelerate progress towards the MDGs. The UK and Norway committed \$420 million to support RBF programs and buy-downs to improve maternal and child health. The Government of Australia committed A\$336 million over 4 years for performance-linked aid to help partner governments in Asia and the Pacific. In addition, the World Bank identified 40 projects with elements of the RBF in health approach during FY1995–FY2008, mostly using investment lending modalities.²² The World Bank found that RBF in health has helped in disbursing based on results, establishing M&E frameworks, and supporting capacity development.

27. Evidence demonstrates that when poor patients or households are 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, health targets tend to be met.²³ However, RBF in health must overcome some

¹⁹ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of China for the Yunnan Integrated Road Network Development Project*. Manila. (Loan 2709-PRC, \$250 million [OCR], and \$0.2 million [Technical Assistance Special Fund], approved on 2 December 2010).

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

²¹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Asian Development Fund Grant to the People's Republic of Bangladesh for the Second Urban Primary Healthcare Project*. Manila. (Loan 2172-BAN, \$40 million [Asian Development Fund], \$25 million [United Kingdom], and \$5 million [Swedish International Development Cooperation Agency], approved on 31 May 2005).

²² World Bank. 2009. *Taking Stock: World Bank Experience With Results-Based Financing (RBF) For Health*. Washington, DC.

²³ R. Eichler and R. Levine. 2009. *Performance Incentives for Health: Potentials and Pitfalls*. Washington, DC: Center for Global Development.

hurdles to work well: (i) the difficulty in measuring performance quickly and accurately; (ii) the lack of capacity in developing countries to design, negotiate, and enforce results- and performance-based contracts; and (iii) the sometimes high cost of planning and setting up the M&E system. Avoiding these pitfalls requires that operations be carefully designed for each country's unique context, implemented with the flexibility to make adjustments along the way, and diligently monitored and rigorously evaluated to draw lessons.

6. Sector-Wide Approaches

28. SWAPs adopt programmatic approaches, many of which also focused on results. The Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC) describes a programmatic or program-based approach 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 organizations; 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.”²⁴ Financing by development agencies under SWAPs is typically channeled into a country-owned expenditure plan and budget in a sector or thematic area. SWAPs aim to address problems in stand-alone projects, such as using parallel financial management systems that are not fully integrated into the government's budget. A SWAP is also intended to reduce transaction costs through increased coordination.

29. MDBs have carried out many SWAP operations since the mid-1990s, such as the Bangladesh Third Primary Education Development Project financed by the Asian Development Bank (ADB).²⁵ The World Bank estimated that their SWAP operations accounted for 20% of its disbursements 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. SWAP operations have generally been processed as projects or investment lending operations. Many bilateral development agencies have also used SWAPs.

30. SWAPs have helped to (i) improve the coordination of development assistance among agencies, (ii) align development finance with country strategies, (iii) address sector-wide problems, and (iv) support institutional reforms. The coordinated development partnership has produced higher-quality policy dialogue and enabled governments to make better use of technical resources and reduce the time spent on the preferences of individual development agencies.

31. However, the implementation of SWAPs has also 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 led by development agencies rather than by countries. Harmonization has often been based on rules and templates of the development agencies, rather than on principles. The focus on SWAP processes, which is time- and energy-consuming, rather than on sector outcomes has sometimes resulted in SWAP fatigue.²⁶

²⁴ OECD-DAC. 2006. *Harmonizing Donor Practices for Effective Aid Delivery - Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management (Chapter 3). DAC Guidelines and Reference Series*. Paris.

²⁵ Appendix 3 provides more examples of ADB operations with RBF features.

²⁶ The Global Mechanism. 2007. *Sector-wide approaches - Implications for sustainable land management and United Nations Convention to Combat Desertification (UNCCD) financing arrangements*. Rome.

32. The implementation of SWAPs has provided valuable experience and lessons on results- and programmatic-based financing. The experience suggests that development agencies should adopt a lending instrument to avoid confusion, inconsistent application, and high transaction costs.

B. Results-Based Financing by Different Organizations

1. European Commission Budget Support

33. Budget support is an important instrument in the comprehensive development policy of the European Union (EU) towards partner countries. It aims to effectively deliver aid and achieve sustainable development objectives by fostering country ownership of development policies and reforms. Budget support is disbursed only when the eligibility criteria and conditions on results are met.²⁷

34. To be eligible for budget support, countries must fulfill three conditions: (i) a well-defined national policy and strategy in place or being implemented, (ii) a stability-oriented macroeconomic policy in place or being implemented, and (iii) a credible and relevant program to improve public financial management in place or being implemented.²⁸ In 2011, the European Commission (EC) added a new criterion requiring public availability of most relevant budgetary information, which is essential for promoting greater scrutiny of the budget.

35. Once the criteria are met, the EC engages in an ongoing dialogue with the partner government, addressing its priorities and strategies. Compliance with eligibility criteria and fulfillment of conditions is crucial to safeguard the use of resources, mitigate risks, and create incentives for better performance and results. This modality also aims to create incentives for partner countries to improve their government systems.

36. The EC focuses on sectors where policies and reforms are more promising to (i) promote development and reduce poverty; (ii) support the drivers of changes; and (iii) address the basic needs of the population (e.g., health, education, and water and sanitation services). The EC intends to use sector budget support to address sector constraints, promote reforms, and improve the delivery of services.

37. The geographical coverage of EC budget support has been expanded to many countries. The EC's total budget support to countries in Africa, the Caribbean, and the Pacific—the 77 signatories to the Cotonou Agreement—increased from €681 million per year in 2002 to €795 million in 2007. In addition, 47 developing countries in Latin America, Asia, Central Asia, and South Africa have benefited from the development cooperation instrument (footnote 28).

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

- (i) the financing needs of the partner country assessed on the basis of its medium-term fiscal framework and/or the national or sector development strategies;

²⁷ 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.

²⁸ European Commission. 2008. *Budget Support: The Effective Way to Finance Development?* Brussels.

- (ii) the commitment of the partner country to allocate national budget resources in line with its development strategy and objectives;
 - (iii) the 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) the track record and absorption capacity of past disbursements, and how effectively objectives were achieved with budget support operations; and
 - (v) the results orientation in the partner country's development strategy including a monitoring system.
39. The EC has drawn the following 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.
 - (ii) EC budget support should continue to ensure a high degree of predictability in order to support development strategies that are nationally owned and to use performance-related tranches. The EC remains committed to results-based budget support operations and intends to strengthen the assessment of progress and monitoring of outcomes. This will include the use of process and output indicators to better demonstrate and communicate the way EC budget support contributes to the development of partner country systems.
 - (iii) The EC will refrain from establishing global targets for its budget support to third countries. According to the EC, the decision regarding the appropriate mix between the different aid modalities is best made as part of a portfolio approach that comprises several modalities in response to a country's specificities and development objectives.
 - (iv) The EC will strengthen its risk management framework for its budget support in line with the Court of Auditors' recommendations.²⁹ This will include closely monitoring progress in the fight against corruption and fraud to ensure sustainable development benefits.
40. The 2007 budget support guidelines have been revised to reflect the orientations set out in the 2011 communication.³⁰

2. GAVI Alliance

41. The GAVI Alliance (formerly 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.³¹ It is a public-private partnership of governments, the United Nations Children's Fund (UNICEF), the World Health Organization, the World Bank, the Bill & Melinda Gates Foundation, civil society organizations, vaccine manufacturers, public health and research organizations, and other philanthropists.

42. 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 22 million children born every year in developing countries were not fully immunized. The GAVI alliance has supported

²⁹ A special report by the European Court of Auditors (No. 2/2005) made several recommendations on public financial management and budget support. Source: European Commission. 2007. *Guidelines on the Programming, Design & Management of General Budget Support*. Brussels.

³⁰ European Commission. How the Commission provides budget support. http://ec.europa.eu/europeaid/how/delivering-aid/budget-support/index_en.htm

³¹ GAVI Alliance. GAVI's mission. <http://www.gavialliance.org/about/mission>

developing countries in making significant progress in introducing live-saving vaccines. For example, hepatitis B vaccine coverage has risen from 17% in 2000 to 74% in low-income countries, totaling 296 million children immunized; 1.9 million children received rotavirus vaccine, and 3.6 million children received pneumococcal vaccine.

43. The GAVI Alliance seeks maximum impact from its support 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 the GAVI Alliance's work: (i) country-driven programs, (ii) predictable funding, (iii) results-based support, and (iv) harmonized aid.

44. The 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 healthcare delivery services, thereby facilitating even wider vaccination coverage.

45. The GAVI Alliance's immunization services support (ISS) provides funding to immunization programs based on improvement in performance. This approach 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 performance-based funding mechanism used to improve health, it offered an innovative design given its large scale (59 eligible countries), combined with an emphasis on country-led programming and a single result indicator.

46. A 2007 evaluation found that ISS had a statistically significant positive effect on diphtheria-tetanus-pertussis coverage in recipient countries. The flexibility of the GAVI Alliance funding was a unique characteristic, allowing national immunization programs unprecedented ability to pursue country-specific priorities. Country case studies found that the flexibility of ISS funding may have been an important factor affecting its impact.

47. In November 2010, the GAVI Alliance Board agreed to pilot incentives for routine immunization strengthening, a performance-based program targeting countries with less than 70% coverage for three doses of the diphtheria-tetanus-pertussis vaccine. 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 disbursements based on their performance against targets. A key feature of this program is its support for countries to improve data quality and ensure that disbursements are based on verified results.

48. The GAVI Alliance aims to ensure predictable and stable funding to enable developing countries to plan and sustain their immunization programs. It views steady, multiyear contributions and innovative financing mechanisms as fundamental conditions for long-term sustainability of the immunization initiative. Mobilization of development agency resources is at the forefront of GAVI's priorities. Funding to the GAVI Alliance totaled \$696 million in 2010, an increase of \$28 million from 2009. Cumulative funds received for 2000–2010 totaled \$5.2 billion. The GAVI Alliance's unique funding model relies heavily on the private sector to overcome the historic limitations of development funding for immunization.

3. Global Fund to Fight AIDS, Tuberculosis and Malaria

49. The Global Fund to Fight AIDS, Tuberculosis and Malaria is a public–private partnership and international financing institution created in 2002 to attract, manage, and disburse resources to fight three of the world's most devastating diseases.³² Its approach is based on the concepts of country ownership and performance-based funding. Countries implement programs based on their priorities, and the Global Fund provides financing on the condition that verifiable results are achieved. The Global Fund works closely with other bilateral and multilateral organizations. Together with the GAVI Alliance, the World Bank, and the World Health Organization, the Global Fund 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.

50. The Global Fund's performance-based funding aims to

- (i) link funding to the achievement of country-owned objectives and targets;
- (ii) ensure that money is spent on delivering services to people in need;
- (iii) provide incentives for grantees to focus on program results and timely implementation;
- (iv) encourage learning to strengthen capacity 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; and
- (vii) free up committed resources from nonperforming grants for reallocation to programs where results can be achieved.

51. By 2010, the Global Fund had approved funding of \$21.7 billion for more than 600 programs in 150 countries. It estimated that this funding has saved 6.5 million lives by providing AIDS treatment to 3 million people, anti-tuberculosis treatment to 7.7 million people, and 160 million insecticide-treated nets to prevent malaria.³³

52. Performance-based funding is at the heart of the Global Fund's operating model, which links the provision of funding to the achievement of clear, measurable, and sustainable results. This ensures that funding decisions are based on a transparent assessment of results against time-bound targets. The Global Fund provides initial funding based on the quality of the proposals. Eligibility for subsequent financing requires recipients to demonstrate results based on performance targets. These targets are proposed by the country to ensure that they are appropriate for the local context.

53. The Global Fund has found that emphasizing results requires investment in measurement systems. M&E is essential to performance-based funding and must be integrated throughout the operational life cycle. In 2010, the Global Fund also consolidated its grants in a country into a single funding stream to facilitate a program-based approach that is better aligned with national planning, reporting, and review cycles.

³² The Global Fund to Fight AIDS, Tuberculosis and Malaria. <http://www.theglobalfund.org/en/about/whoweare/>

³³ The treatment benefits mothers, children of AIDS-infected mothers, and other dependents.

4. Inter-American Development Bank Performance-Driven Loans

54. The Inter-American Development Bank (IDB) introduced PDLs in 2003 in response to demands of borrowers.³⁴ The PDL was piloted for 6 years. In 2007, IDB reviewed the implementation progress of the PDLs. Findings of the review indicated that the interest in PDLs among borrowing member countries was growing.

55. 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 expenditures in addition to achieving results.³⁵
- (iii) Results are defined by outcomes—the effects from outputs delivered by a project.
- (iv) Results are audited by independent performance reviewers, usually consultants hired by IDB or the borrower.
- (v) Borrowing country systems are used for procurement. However, country systems must comply with commonly accepted principles of competition, economy, transparency, equity, publicity, and due process.

56. PDLs in several sectors have shown promising results. A health sector PDL project in Colombia played an important role in delivering vaccinations to many disadvantaged people. Similarly, a solid waste management project in Chile added flexibility in supporting a large number of subprojects. An agricultural project in Paraguay also helped many farmers to gain access to inputs and technological support.

57. The PDL instrument generated several benefits. First, it helped provide incentives for governments to work towards the achievement of results that directly impact the beneficiary population, while contributing significantly to the public sector M&E. In Nicaragua, the PDL instrument enabled the Maternal and Child Health Program to promote greater participation of health agencies in meeting the MDGs for maternal and child mortality reductions.³⁶ Second, it helped to better align, link, and coordinate the efforts of countries and the international community in working with a programmatic approach to achieve MDGs in the social sector. Third, it helped IDB and its borrowers to explore new operational areas to promote results-driven public sector management. In Bolivia, a PDL operation has opened new opportunities in government revenue collection, promoted a results-based management culture, and strengthened the government's planning, budgeting, monitoring, and evaluation processes.³⁷

58. However, despite the growing interest in the PDL and recognition of its benefits, the design weaknesses in the policy have limited its usefulness. The first problem is the policy's requirement to establish a direct relationship between expenditures and outcomes. This has been challenging, and in many cases unrealistic, particularly in sectors where IDB and other donors are supporting a national development goal. In the health sector, for example, the costs of the outputs such as training of health professionals can be determined, but the final outcome of reducing mortality rates for children under 5 years old is achieved through financing a

³⁴ IDB. 2003. *Proposal for a Pilot Program for Performance-Driven Loans*. Washington, DC.

³⁵ Advance disbursements of up to 20% of the IDB financing are allowed and have been used in PDL projects to help finance up-front costs.

³⁶ IDB. 2004. *Loan Proposal on Nicaragua: Maternal and Child Health Performance-Driven Loan (NI-L1001)*. Washington, DC.

³⁷ IDB. 2006. *Loan Proposal on Bolivia: Program to Consolidate Reforms in the Government Revenues Area (BO-L1007)*. Washington, DC.

combination of many activities and outputs. Since the executing agency is accountable for selecting the most cost-effective input–output mix to achieve the performance targets, the task of costing activities and outputs loses relevance.

59. The second problem is the requirement to verify expenditures. This constitutes a double burden for executing agencies, as proceeds from IDB loans are disbursed only upon attainment of the performance targets and verification of the expenditures made to attain the targets. This process made the PDL transaction costs higher than those of traditional investment loans. It also weakened the emphasis on results and reverted to an expenditure control practice. In Colombia, for example, verification of expenditures is complicated by the country's decentralized structure, in which social services such as healthcare are financed at the municipal level.³⁸ For the Health Ministry in Colombia, this requires arduous documentation gathering from all the municipalities involved in the program. For IDB, enormous resources were spent in controlling expenditures, diverting focusing on program results and performance of country systems to achieve those results.

60. Feedback from project teams and the borrowers shows support for the results orientation of the PDL. However, the design of the policy limited the benefits that an RBF driven instrument could provide. For these reasons, the demand for PDL operations has been moderate. From 2003 to 2009, the IDB approved only 17 PDL projects.

61. The PDL piloting phase expired in 2009. The IDB's Office of Evaluation and Oversight is expected to evaluate the PDL implementation experience and make a decision on the way forward. While the PDL implementation experience exposed its design weakness, it also provided valuable lessons for designing RBF modalities. The design of the World Bank's Program-for-Results-financing and ADB's RBL have both learned from the PDL experiences.

5. Millennium Challenge Corporation

62. MCC is a foreign aid agency of the United States (US) created by the US Congress on 2004.³⁹ It is mandated to reduce poverty by increasing incomes of program beneficiaries. MCC's operational model is based on the principles of development effectiveness on good governance, country ownership, and focus on results. MCC forms partnerships with some of the world's poorest countries which are committed to good governance, economic freedom, and investment in their citizens.

63. MCC provides well-performing countries with grants to finance their poverty reduction programs based on country priorities. It looks at several elements in choosing indicators for a specific grant, including

- (i) links to policies the government can influence in 2–3 years;
- (ii) links—theoretical or empirical—to economic growth and poverty reduction;
- (iii) use of an analytically rigorous methodology and objective, and high quality data;
- (iv) broad country coverage and comparability across countries; and
- (v) consistency of results from year to year.

64. MCC emphasizes achieving and measuring results, concentrating on (i) identifying activities that have the greatest potential to reduce poverty through growth, (ii) measuring

³⁸ IDB. 2005. *Loan Proposal on Colombia: Support to the Extended Vaccinations Program (CO-L1002)*. Washington, DC.

³⁹ Millennium Challenge Corporation of the United States of America. <http://www.mcc.gov/>.

progress during implementation, and (iii) learning from its experiences. MCC collaborates with a country to finalize benchmarks and to create an M&E plan. The achievements are reported regularly throughout an operation's life cycle. MCC and its country partners hire independent organizations to conduct impact evaluations of their activities.

65. In 2012 MCC has approved more than \$7.5 billion to support country-determined projects in different sectors, such as agriculture and irrigation, transportation (roads, bridges, and ports), water supply and sanitation, access to health, finance and enterprise development, combating corruption, 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.

66. MCC's analytical framework focuses on results throughout program development, implementation, and evaluation. This emphasis on results reduces the ambiguity and sometimes conflicting objectives that can undermine development assistance. The collection and analysis of data play a vital role in every stage of a program, helping to identify problems, assess alternatives, track progress, and measure results.

6. World Bank Program-for-Results Financing

67. The World Bank approved the Program-for-Results financing instrument in January 2012.⁴⁰ It was designed to enable the World Bank to respond better to changing development needs, meet demands from client countries, and increase development effectiveness. It links disbursements to the achievement of results. By directly supporting government programs, Program-for-Results financing aims to help countries strengthen institutions, build capacity, and enhance partnerships with stakeholders. It also aims to enable the World Bank to leverage its own financing by joining other development organizations in supporting country programs.

68. Program-for-Results financing has the following features:

- (i) **Finances and supports borrowers' programs.** These programs, comprising expenditures and activities, can be ongoing or new, sector- or subsector-focused, and national or subnational, as well as community development programs.
- (ii) **Disburses upon achievement of program results.** Disbursements will be determined by the achievement of results indicators that can be monitored and verified, rather than by inputs. Together with funds from other sources, World Bank disbursements will finance the borrower's expenditure framework rather than being linked to individual transactions.
- (iii) **Focuses on strengthening institutional capacity.** Strengthening the capacity of the institutions to implement the program and achieve the desired results is a priority for preparation and implementation support of Program-for-Results financing.
- (iv) **Provides assurance that World Bank financing is used appropriately.** The program's fiduciary, environmental, and social management systems will be assessed by the World Bank. It will agree with the borrower on the additional measures needed to ensure that (a) the loan proceeds are used for program expenditures, (b) these expenditures are incurred with economy and efficiency, and (c) potential impacts on the environment and people are adequately addressed.

⁴⁰ World Bank. 2011. *A New Instrument to Advance Development Effectiveness: Program-for-Results Financing*. Washington, DC.

- (v) **Monitors the program.** Disbursement-linked indicators (DLIs) will require a verification process that is acceptable to the World Bank and is agreed upon at the time of appraisal. Program-for-Results financing documents will be available to the public, giving stakeholders access to information about the performance of the public institutions and programs.

69. Appraisal of each operation will involve rigorous assessments in three main areas that will be applied to the overall program and its expenditures. The technical assessment evaluates 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 ensure that program funds are used appropriately. The environmental and social systems assessment seeks to ensure that the potential environmental and social impacts and risks are adequately addressed. These assessments will identify measures to enhance performance, build capacity, and mitigate major risks—and these will be reflected in an integrated risk assessment. Many Program-for-Results operations are expected to require capacity development, which will be informed by the technical, fiduciary, and environmental and social systems assessments. Capacity development support will be provided through different modalities—from direct technical assistance and training to specific actions or DLIs to strengthen performance.

70. During implementation of the program, the World Bank will monitor progress, associated expenditures, and the achievement of results. Technical support from the World Bank team will aim to improve systems performance and resolve implementation issues. Program-for-Results financing 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 financing operations. The World Bank has limited commitments to 5% of the total commitments by the International Bank for Reconstruction and Development and the International Development Association for the first 2 years from Board approval of Program-for-Results financing operations. Following a review of the implementation experience, World Bank management will propose to the Board to lift this cap if justified by implementation experience.

EXAMPLES OF ADB OPERATIONS WITH RESULTS-BASED FINANCING FEATURES

1. Although the Asian Development Bank (ADB) does not yet have a dedicated results-based financing (RBF) modality, some operations in recent years have incorporated RBF features. This experience has been similar to that of the World Bank.
2. A recent review by the Strategy and Policy Department found that ADB operations with RBF features have mainly taken the following forms:
 - (i) conditional cash transfers (CCTs), which provide cash to poor households based on certain desirable household behaviors, generally related to investing in the education or health of their children;
 - (ii) output-based aid (OBA), which uses explicit performance-based subsidies to a third party to deliver basic services to poor households (e.g., connection to a water supply);
 - (iii) performance-based contracts (PBCs), which are structured around the purpose of the work desired rather than the manner in which the work is done;
 - (iv) RBF for health, which aims to improve health outcomes by providing a financial or in-kind reward to service providers for delivering agreed upon performance goals; and
 - (v) sector-wide approaches (SWAPs) in which one or more development agency supports a government-owned program.
3. RBF operations may involve (i) disbursement from ADB to the borrower based on results, or (ii) disbursements from the borrower to a contractor based on results.

A. Conditional Cash Transfers

4. **Papua New Guinea: Pilot Border Trade and Investment Development Project.**¹ This project aims to improve the business environment in areas of the West Sepik Province. One project component finances activities to improve human development in health and education in the border villages. CCTs are provided to (i) heads of households for connecting to electricity on a cost-sharing basis, (ii) heads of households for constructing standard septic tanks and toilets, (iii) pregnant women for getting maternal healthcare, and (iv) heads of households for enrolling disadvantaged children in school.

5. **Philippines: Social Protection Support Project.**² This project supports the government's CCT program—the Pantawid Pamilyang Pilipino Program (Building Bridges for the Filipino Family Program). The government CCP program has an estimated cost of \$1.29 billion. It provides cash grants to targeted poor families that comply with health and education conditions.³

¹ ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance to Papua New Guinea for the Pilot Border Trade and Investment Development Project*. Manila. (Loan 2591-PNG, \$0.9 million from TASF and \$25 million, approved on 27 November 2009).

² ADB. 2010. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan, Technical Assistance Grant, and Administration of Technical Assistance Grant to the Republic of the Philippines: Social Protection Support Project*. Manila.

³ The project directly funds a portion of grants in localities covering about 582,000 households in 436 municipalities and 37 cities in 53 provinces. Eligible households can receive (i) health grants of P500 per 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;

6. In cooperation with the World Bank, the governments of Australia and Japan, and other development partners, ADB supported social protection policy dialogue and provided budgetary support to scale up the CCT program in 2008 and 2009. Subsequently, ADB responded to the government's request for project-based support, approving a \$400 million loan for the project in September 2010. The government CCT program initially aimed to reach 1 million beneficiary households. Funding from the government and a loan from the World Bank each funds one-third of the CCT program. ADB is also providing three technical assistance (TA) projects totaling \$2.5 million, covering capacity development, gender mainstreaming, and support for broader rationalization of social protection sector programs.

7. The emerging evidence for Pantawid Pamilya (including the portions supported by ADB) is promising. This is the result of factors including (i) the government's commitment to the program, and (ii) the program's ability to address demand-side constraints directly, which appear to be one of the most important barriers to the 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 provided to ADB in January 2011.

8. The project faces three sets of challenges. First, CCTs remain a new area of operations within ADB, which implies a sharp learning curve. ADB procedures and mechanisms have presented difficulties. Second, following the approval of ADB's loan and TA support, the government scaled up Pantawid Pamilya aggressively, covering 2.3 million households by the end of 2011—more than double the initial 1.0 million target. The imperative to rapidly increase beneficiary households has put additional pressure on the government's capacity and systems. Third, the project's dual nature in providing project-based support to a government program has posed difficulties in simultaneously meeting both government and ADB procedural requirements.

B. Output-Based Aid

9. **Solomon Islands: Domestic Maritime Support Sector Project.**⁴ This project aims to reduce economic disadvantages in remote rural areas by providing interisland shipping services that are regular, reliable, affordable, and safe. This grant became effective on 10 February 2009 and is scheduled to close on 31 December 2018.

10. The project has two components: (i) improvement of rural infrastructure, including rehabilitation or reconstruction of 12 wharves and jetties; and (ii) the establishment of a franchise shipping scheme (FSS) providing shipping services to remote areas that are not considered commercially viable. The second component uses OBA to provide efficient subsidies to private sector operators through a minimum-subsidy tender process. The objective is to promote more shipping services on routes that otherwise would not be commercially viable. 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.

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: <http://pantawid.dswd.gov.ph/>.

⁴ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant and Administration of Grant to Solomon Islands for the Domestic Maritime Support (Sector) Project*. Manila. (Grant 0127-SOL, \$14 million [ADF], \$1.0 million Technical Assistance Special Fund [TASF], and \$5.25 million from European Commission, approved on 28 November 2008).

11. Solomon Islands had never employed competitive bidding in the operation of marine transport before the project. Seven FSS routes were initially identified as commercially unviable, and the government invited rebidding for these routes. The first route is already profitable. In the first three voyages, revenue generated from passenger and cargo fares plus the subsidy were sufficient to offset direct costs. Cargo and passengers have increased on every inbound voyage from this originally commercially unviable route, thus boosting the confidence of the rural population that more reliable and safe maritime services are being put in place.

12. The project is a good example of an OBA that delivered shipping services to remote areas where people lack access to basic services. The shipping services are contracted out to shipping operators and the disbursements are linked to the services. Payment for the services is conditioned on verification by a national firm. To deliver the services, the government and ADB 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 safeguard risks. The project needs to improve the design of shipping routes, the accuracy of cost estimates and the required subsidy level, and the maritime transport sector's capacity to reach the targeted principles. ADB will continue to assist the government and private sector in monitoring and evaluating the status, developing an action plan, and providing required resources.

13. **Papua New Guinea: Community Water Transport Project.**⁵ The project aims to provide water transport to remote areas and reform the maritime sector in Papua New Guinea (PNG). One of the project components finances subsidized shipping franchises on routes that are not commercially viable. This arrangement includes two OBA features: (i) the franchised shipper only receives the subsidy if the shipping services are provided; and (ii) the franchise agreement allows the shipper to retain any profits it makes in addition to the franchise payment, thus encouraging performance exceeding the minimum prescribed service. Two of the four franchises are operating successfully. Improved shipping services are being maintained with the prospect of becoming financially self-sustaining in the medium term.

14. **Nepal: Second Small Towns Water Supply and Sanitation Sector Project.**⁶ The project provides subsidies to water users and sanitation committees upon confirmation of agreed output. ADB approved the project in 2009 to improve water supply and sanitation services to about 240,000 people in 20 small towns in Nepal. To address weaknesses in the first project, ADB introduced the OBA approach to 12 small towns. The targeting of small urban towns, coupled with ADB's first use of the OBA in Nepal, makes this initiative a potentially rich source of lessons for future projects.

C. Performance-Based Contracts

15. **Papua New Guinea: Highlands Region Road Improvement Investment Program.**⁷ The program, financed by a multitranche financing facility, aims to improve accessibility and

⁵ ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Papua New Guinea for the Community Water Transport Project*. Manila. (Loan 2079-PNG, \$19 million from ADF, approved on 25 November 2004).

⁶ ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant to Nepal for the Second Small Towns Water Supply and Sanitation Sector Project*. Manila. (Grant 0157-NEP, \$45.1 million from ADF, approved on 17 September 2009).

⁷ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to Papua New Guinea for the Highlands Region Road Improvement Investment Program*. Manila. (Loan 2496/2497-PNG, \$30 million [ADF], approved on 22 December 2008).

reduce transport costs in the Highlands Region of PNG. One component involves civil works contractors undertaking road rehabilitation and maintenance. The contractors are required to maintain the roads they rehabilitate for up to 10 years. The maintenance components of the contracts are performance-based, and disbursements are made to contractors only upon the achievement of prescribed road condition indicators. This arrangement encourages contractors to achieve high standards of road rehabilitation. The government finances the performance-based maintenance part of the civil works contracts.

16. People's Republic of China: Yunnan Integrated Road Network Development Project.⁸ The project supports improvement of the road transport system in Yunnan Province to promote sustainable economic and social development. One output is enhanced performance by engaging road agencies and road maintenance groups through PBCs to decrease the administrative burden and promote efficient use of maintenance funds. Under the PBCs, 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 in the work plan. Disbursements are based on the quantity and quality of the output (performance), not on the input.

17. People's Republic of China: Second Heilongjiang Road Network Development Project.⁹ The 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 a better road asset management system for selecting maintenance works on the basis of their expected economic returns. Further, the project supports the institutionalization of this system by financing a program of priority maintenance works. The project introduces on a pilot basis the use of PBCs for road maintenance to improve the quality of works and develop private sector capacity for bidding and execution of maintenance works. It also develops the provincial government's capacity in prioritizing and budgeting maintenance works.

D. Results-Based Financing for Health

18. Bangladesh: Second Urban Primary Healthcare Project.¹⁰ The project contracts out primary healthcare services to nongovernment organizations through partnership agreements. The project is being implemented in the following municipalities: Dhaka, Chittagong, Khulna, Rajshahi, Sylhet, Barisal City Corporation and Comilla, Bogra, Sirajgonj, Madhabdi, and Savar.

19. The project has established 24 partnership agreements with nongovernment organizations, covering 200,000–300,000 people per area. Each area consists of one comprehensive reproductive healthcare center, at least one primary healthcare center per 30,000–50,000 people, and at least one satellite or mini-clinic per 10,000 people. Primary healthcare centers provide a full range of basic and essential services, and comprehensive reproductive healthcare centers provide emergency obstetric care, newborn care, and other

⁸ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of China for the Yunnan Integrated Road Network Development Project*. Manila. (Loan 2709-PRC, \$250 million [OCR]. \$0.2 million [TASF], approved on 2 December 2010).

⁹ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of China for the Second Heilongjiang Road Network Development Project*. Manila. (Loan 2631-PRC, \$200 million [OCR], approved on 20 April 2010).

¹⁰ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Asian Development Fund Grant to the People's Republic of Bangladesh for the Second Urban Primary Healthcare Project*. Manila. (Loan 2172-BAN, \$40 million [ADF] and \$25 million [UK] and \$5 million [Swedish Development Cooperation Agency], approved on 31 May 2005).

related services. Routine data on service delivery show an upward trend in the uptake of services. 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.

E. Sector-Wide Approaches

20. SWAPs have mainly been used in the health and education sectors, but have been extended into other sectors in recent years.

21. **Bangladesh: Third Primary Education Development Project.**¹¹ The project 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 projects, as well as lessons learned from other SWAPs in Bangladesh and the region.

22. The project, approved by ADB on 5 July 2011, has three key features. First, it focuses on results. Disbursements are linked to achieving nine disbursement-linked indicators (DLIs), each year. Second, ADB funds are channeled to the government's treasury (budget) system. Third, the government and 10 development partners have signed a joint financing arrangement to increase alignment and harmonization in line with the Paris Declaration on Aid Effectiveness.

23. Led by the ADB, several bilateral agencies and the World Bank provided support for primary education through this SWAP, using Bangladesh's newly upgraded procurement system for 85% of this work. The SWAP replaces the previous primary education operation, which involved 13 development partners supporting more than 27 projects through about 30 different accounts, with separate procurement and financial arrangements with each development partner.

24. **Philippines: Health Sector Development Program.**¹² The program used a SWAP to support the implementation of the government's health sector reform agenda. ADB approved the program in December 2004 and it became effective in January 2005. It consists of a program loan of \$200 million and a project loan of \$13 million. ADB approved the second tranche of the program loan in November 2006. The project is ongoing.

25. The program systemically addresses sector constraints to improve decentralized health services. With the support of ADB and other development partners, it helped to pioneer the use of provincial expenditure reviews (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 and pilot test new insurance schemes and community-based re-insurance.

26. A 2007 country assistance program evaluation (CAPE) by ADB's Independent Evaluation Department found that the program helped to improve the healthcare service

¹¹ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Third Primary Education Development Project*. Manila. (Loan 2671-BAN, \$320 million [ADF], approved on 5 July 2011).

¹² ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Republic of the Philippines for the Health Sector Development Program*. Manila. (Loan 2136/2137-PHI, \$213 million [OCR], approved 15 December 2004).

infrastructure.¹³ Strong government support and ownership was a major positive feature of the program. However, the implementation of the reforms in a devolved setting faced significant challenges, including weak national and local government coordination, insufficient health human resources, inadequate encouragement from local government leadership, lack of local resources, and weak public financial management by local governments. Despite these challenges, the CAPE found that the SWAP is a good practice for providing a supportive environment for a sector development program.

F. Other Operations with Results-Based Financing Features

27. **Bangladesh: Power Sector Program.**¹⁴ The program is an example of results-based programmatic sector support. In addition to using traditional ADB products, including project investment loans and sector development programs, a pragmatic results-based approach was followed. This meant that key policy actions, such as financial settlements and unbundling of key government power sector entities into state-owned enterprises, were included as prior conditions and undertaken before loan approval. This flexible results-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 by the 2009 CAPE for Bangladesh, the 2009 sector assistance program evaluation,¹⁵ and the Asian Development Fund XI paper on development effectiveness.¹⁶

28. **Lao People's Democratic Republic: Northern and Central Regions Water Supply and Sanitation Sector Project.**¹⁷ The project aims to improve the accessibility, quality, reliability, and sustainability of water supply services, and improve environmental conditions in the project towns. It 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 the OPEC Fund for International Development, the Norwegian Agency for Development Cooperation, and the United Nations Human Settlements Programme. Sector coordination has been undertaken with these and other partners, including the World Bank's Water and Sanitation Program, SNV Netherlands Development Organization, United Nations Children's Fund (UNICEF), World Health Organization, GRET Professionals for Fair Development, and the Japan International Cooperation Agency.

29. The number of beneficiaries was expected to reach about 100,000 by the end of 2012 in 12 towns. Water supply systems have been completed in four towns with the following results: (i) about 35,400 people have access to improved water supply, (ii) close to 100% have

¹³ ADB. 2008. *Country Assistance Program Evaluation for the Philippines: Increasing Strategic Focus for Better Results*. Manila. (Project 2769-BAN).

¹⁴ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Power System Efficiency Improvement Project*. Manila. (Project no. 37113); ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Sector Development Program Loan to the People's Republic of Bangladesh for the Sustainable Power Sector Development Program*. Manila. (Project 2334-BAN); and ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the People's Republic of Bangladesh for the Power Sector Development Program*. Manila. (Project 2039/2038-BAN).

¹⁵ ADB. 2009. *Country Assistance Program Evaluation: Bangladesh*. Manila; and ADB. 2009. *Sector Assistance Program Evaluation: Bangladesh Energy Sector*. Manila.

¹⁶ ADB. 2011. *Delivering Results through the ADF*. Paper prepared for the first ADF XI replenishment meeting in Manila, Philippines, 8–9 September 2011.

¹⁷ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Supplementary Grant to the Lao People's Democratic Republic for the Northern and Central Regions Water Supply and Sanitation Sector Project*. Manila. (Grant 0016/0205-LAO, \$16.6 million [ADF], \$1.7 million [Norwegian Agency for Development Cooperation], approved on 25 August 2005 and 7 April 2010 (supplementary)).

improved their household sanitation facilities, and (iii) 318 poor households have received a sanitation grant. By the end of 2011, eight systems are expected to be completed, providing about 60,000 people with improved water supply, and sanitation to about 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.

30. 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 that required additional assistance in constructing latrines. The free connections were for a limited time, and the provision for installing connections was included in the contractor's contract.

31. **Indonesia: Urban Sanitation and Rural Infrastructure Support to PNPM Mandiri Project.**¹⁸ The project supports the government'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.

32. Block grants are provided to villages to upgrade basic infrastructure and improve sanitation services. This fixed sum of money granted by the national government is transferred in three tranches to a selected community that has met the criteria for the financing of construction of basic rural infrastructure or sanitation facilities in urban areas. A menu of investment opportunities is open for these communities with financing to be selected based on the guidelines of the project.

33. Financing is linked to the 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.

¹⁸ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the Republic of Indonesia for the Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project*. Manila. (Project no. 43255, Loan 2768-INO, approved on 5 August 2011, closing date on 31 December 2015, \$100 million [OCR]).

SUMMARY OF ADB'S LENDING MODALITIES

Modalities	Key Features
A. Investment Lending	
Sovereign project lending	<p>Finances specific stand-alone investment projects with sovereign guarantee.</p> <p>Consists of ordinary operations financed by OCR and special operations financed by Special Funds, including ADF loans and grants.</p> <p>Finances project costs subject to ADB rules.</p>
Nonsovereign project lending	<p>Finances project or corporate finance requirements (operating and/or capital expenses) without sovereign guarantee.</p> <p>Introduced under the Innovation and Efficiency Initiative in 2005. ADB directly assumes the credit risk of the borrower.</p> <p>Financial terms (pricing) are set on a commercial basis.</p>
Sector loans	<p>Finances a large number of subprojects in a sector or subsector. Investments are made in a geographic area (an area slice of a sector), and/or over a period of time (a time slice of a sector).</p> <p>“Subprojects” are numerous and comparatively small projects that make up a sector loan.</p>
Financial intermediary loans	<p>Finances eligible participating financial intermediaries for onlending, at the financial intermediary's credit risk, to final borrowers for eligible subprojects.</p> <p>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>Finances activities and inputs for capacity development, policy and advisory, research and development, and project preparation (e.g. engineering design).</p>
Disaster and emergency assistance	<p>Finances activities relating to emergency prevention and post-conflict reconstruction.</p> <p>Can be provided in different phases of disaster management: (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 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>

Modalities	Key Features
Multitranche financing facilities	<p>Enables ADB to provide assistance programmatically by aligning its financing with project readiness and the long-term needs of a DMC.</p> <p>Finances (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 (periodic financing requests).</p> <p>“Tranches” comprise loans, grants, guarantees, or ADB-administered cofinancing.</p>
Guarantees	<p>Includes (i) partial credit guarantees to cover partial repayment owed to lenders of ADB’s client, and (ii) political risk guarantees to cover repayment of amounts owed to lenders of ADB’s client when repayment fails because of political risk.</p> <p>Allows ADB to share a wide range of risks that are inherent in its operations.</p>
Equity investments	<p>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>
Syndications	<p>Enables 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 except those financed through policy-based lending.</p>
B. Policy-Based Lending	
Policy-based lending	<p>Supports reforms and disburses in tranches based on the fulfillment of agreed upon policy conditions.</p> <p>Provides budget support to address development financing needs. Can also support DMCs in addressing fiscal or balance-of-payments crises. The four types of policy-based lending are (i) stand-alone policy-based lending, (ii) the programmatic approach, (iii) special policy-based lending, and (iv) the countercyclical support facility.</p>
C. Sector Development Programs	
Sector development program loans	<p>Finances a reform program and specific projects linked to a sector and program.</p> <p>Is a combination of project lending and policy-based lending, not a separate modality.</p>

Modalities	Key Features
D. Financing Facilities	
Retroactive financing	<p>Finances expenditures incurred before the signing of the ADB loan, grant, or TA agreement.</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>
Local currency financing	<p>Provides loans in local currencies to reduce mismatches between income received in a domestic currency and debt repayments in a foreign currency.</p> <p>Can be attractive to private or 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>Provides quick-disbursing resources through PDAs to fund detailed engineering design and broader project preparation.</p> <p>Has shorter processing time than a TA loan. Helps in providing more realistic cost estimates, obviating the need for large contingencies and relieving resource constraints for project preparation.</p> <p>The ceiling for an individual PDA is \$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> <p>The facility is being piloted until 31 December 2013.</p>

ADB = Asian Development Bank, ADF = Asian Development Fund, DMC = developing member country, MFF = multitranches financing facility, OCR = ordinary capital resources, PDA = project design advance, PDF = project design facility, TA = technical assistance.

Note: Lending is a general term which includes grants.

Source: ADB.

SUMMARY OF CONSULTATIONS

A. Public Consultations

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

- (i) discussing draft RBL papers with each operations department and other relevant departments in ADB;
- (ii) establishing an interdepartmental team, which has provided an effective forum for exchanging ideas across many areas;
- (iii) briefing Management;
- (iv) holding an informal Board seminar in November 2011 to share preliminary thinking on the modality with the Board;
- (v) fielding missions to selected developing member countries (DMCs) in different subregions to obtain their feedback;
- (vi) conducting surveys in all DMCs with assistance from resident missions;
- (vii) exchanging experiences with development partners, especially the World Bank and the Inter-American Development Bank; and
- (viii) conducting broad web-based consultation with all the stakeholders and the public.

2. In the web-based public consultation, all stakeholders and the public were invited to submit comments and suggestions on the draft policy paper in June and July 2012.¹ ADB also used social media (Facebook and Twitter) to announce the consultation in order to expand outreach to stakeholders and the public. All comments and suggestions received were carefully considered in developing the policy paper.

B. Major Comments and Suggestions

3. The consultations suggest broad support for RBFPs. The direct links between disbursements and results, the emphasis on institutional development, the support for government ownership, the transparent identification and focused measures to mitigate risks, and the potential for enhanced development partnerships are considered positive features of RBL. Many stakeholders also see RBL as a tool for greater innovations and efficiency as it focuses on results. The prospect of using and improving DMCs' own program systems is considered a major potential advantage of RBL. Many stakeholders consider RBL well suited for contributing to the implementation of the Paris Declaration principles.

4. Survey results from DMCs suggest that a diverse range of sectors can be suitable for RBL, including agriculture and natural resources (e.g., livestock diseases diagnosis, treatment and prevention); 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 risk management; public sector management; and food security and distribution. DMCs expressed strong support for this modality.

¹ The consultation used the ADB's home page (<http://www.adb.org/>) as well as a dedicated web page (<http://www.adb.org/documents/piloting-results-based-financing-programs>).

5. Stakeholders consider that RBL will deliver many benefits, including:
 - (i) enhancing the achievement and sustainability of development results, especially outcomes;
 - (ii) supporting effective and efficient program selection, planning, implementation, monitoring and evaluation (M&E), results verification, and program management;
 - (iii) effectively and efficiently allocating and using scarce public resources (including healthy competition for funds among programs);
 - (iv) reducing procedural inefficiency;
 - (v) enhancing institutional development and capacity development in financial management, procurement, safeguards, M&E, achievement of targets, skills development, competence improvement, and performance budgeting;
 - (vi) mitigating risks;
 - (vii) reducing corruption;
 - (viii) improving country ownership;
 - (ix) establishing a platform for development agencies to coordinate more efficiently; and
 - (x) establishing a platform for stakeholder participation.

6. ADB has also received many constructive comments and suggestions, particularly the following:
 - (i) The sustainability of the programs is important. What happens after the external financing should be a major consideration for designing the modality.
 - (ii) M&E and credible verification are important. The defining, measuring, monitoring, and evaluation of results should not be overburdened by tedious and overly demanding data and procedural requirements. Instead it should be practical, feasible, and effective.
 - (iii) RBL should be governed by efficient procedures.
 - (iv) Results indicators should be concrete, measureable, and achievable by the program.
 - (v) Large amounts of up-front financing by the government may not be affordable for many countries. Advance financing should be provided to bridge the financing gap.
 - (vi) RBL should be strongly linked to the government's financing needs. Predictability of funds is important.
 - (vii) RBL should use existing program systems, and avoid undesirable and unworkable reengineering.
 - (viii) ADB should arrange participatory knowledge-sharing sessions with stakeholders to disseminate the approaches of RBL. Awareness-raising and rollout activities will be important when introducing the new modality.
 - (ix) Intensive and continual capacity development (e.g., improvements in systems and processes and aligning institutions with sound principles) will be essential.
 - (x) Capacity development in financial management, procurement, results-focused program design and management, and in M&E tools are critical.
 - (xi) Learning from experience and involvement of stakeholders will be important.

C. Major Questions

7. Stakeholders asked questions about the background of introducing RBL in ADB, as well as on results, systems, and risk management. Major questions and ADB's responses are summarized in paras. 8-17.

1. Why does ADB want to introduce the modality?

8. ADB is introducing RBL to provide more choices for DMCs and ADB operations, enhancing incentives and accountability for results, and strengthening program systems. RBL will disburse based on results, not expenditures. The program assessment will be system-based, not transaction-based. These features of the RBL will help deliver sustainable results.

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

9. Defining the results is a key aspect of designing RBL operations. 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.

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

10. 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 program results framework. They will be the results indicators that are critical to the success of the program.

11. Each DLI will have a transparent verification protocol. Verification will be carried by a credible mechanism 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.

4. What will be the role of institutional development?

12. Institutional strengthening will be a core component of RBL. RBL seeks to assess, improve, and work with the country's own program systems. Capacity development will be provided through technical assistance and other support. Important institutional indicators will be included as part of DLIs.

5. How will fraud and corruption be addressed?

13. Tackling systematic weaknesses is a key objective of RBL. RBL will include rigorous risk assessments, systematic capacity development, and solid risk management measures. One important aspect is the identification of points for leaks and opportunities for corruption, and to adopt measures accordingly. RBL will adopt specific anticorruption guidelines to support DMCs to deal with fraud and corruption. 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. RBL will exclude activities involving high-value procurement contracts.

6. How can fiduciary and safeguard risks be minimized?

14. One of the objectives of RBL is to raise the performance of the program systems in order to minimize risks, including development risks, fiduciary risks, and safeguard risks. Systematic improvement is the only sustainable way to mitigate these risks in the long run. Many measures will be built into RBL to minimize fiduciary and safeguard risks. ADB will assess the strengths and weaknesses of the program's fiduciary and safeguard systems, institutional capacity, practice,

and performance. Capacity development will be carried out and risk-mitigating measures will be incorporated. Exclusion of activities that would be classified as category A under the Safeguard Policy Statement (2009) and high-value procurement contracts will also help reduce risks.

7. Will the assessments be too demanding?

15. Rigorous assessments are a key input of RBL as they are necessary activities that ADB and DMCs must carry out. Sound assessments will require time and resources from both ADB and DMCs. Initial transaction costs may be high. However, those costs are expected to decline as more knowledge is accumulated. Coordination and joint efforts by development partners can also help reduce transaction costs.

8. What kind of support will ADB give to developing member countries?

16. Through RBL, ADB will support DMCs in the following ways:
- (i) refining the program design;
 - (ii) refining the program results frameworks;
 - (iii) assessing systems strengths and weaknesses;
 - (iv) identifying risks and mitigating measures;
 - (v) supporting capacity development;
 - (vi) providing implementation support;
 - (vii) assisting in design and implementation of M&E;
 - (viii) providing financing for the program, linked with achievements and verification of DLIs;
 - (ix) providing technical assistance; and
 - (x) offering other necessary support.

9. What are the roles of the civil society organizations?

17. As with all ADB operations, the participation of key stakeholders will be important in RBL operations. The degree and nature of such participation will be decided at the operational level. Civil society organizations could be involved in the implementation of the program, M&E, results verification, providing feedback, and providing other necessary support, as appropriate.

SUMMARY OF LESSONS RELATED TO RESULTS-BASED FINANCING OPERATIONS

1. The Asian Development Bank (ADB) carefully studied the operations with results-based financing (RBF) features both within ADB and in similar organizations. ADB also surveyed numerous publications on development effectiveness, especially those by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC). The practical experience and analytical work revealed lessons that should be considered in designing the results-based lending (RBL) for programs.

A. Policy and Operations

2. An enabling policy framework is needed. The absence of such a policy framework for RBL increases processing costs, diverts time and attention from substantive matters, causes inconsistencies, and creates missed development opportunities.

3. The initial transactions costs for designing and implementing RBL can be high because the institutional development and results verification mechanisms need to be assessed. However, transaction costs are likely to decline over time. The RBF approach can strengthen the quality of institutions over the long run.

B. Results

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

5. Disbursement-linked indicators should strike a balance between outcomes, outputs, and other related indicators. The emphasis on sector outcomes is helpful to focus attention on what matters to program beneficiaries. Outcomes should drive RBL. However, basing disbursements largely on outcomes can be problematic. The results indicators also depend on the maturity of the program, with the delivery of outcomes becoming more attainable as a program proceeds.

6. Because RBF may focus on the wrong results, a key lesson is to define the results from the standpoint of the beneficiaries to ensure that results are relevant and meet their needs.

C. Institutional and Capacity Development

7. A significant objective of RBL is to improve program systems. Decades of development assistance offer numerous lessons on institutional and capacity development.¹

8. **Government ownership.** Effective capacity development must be owned by a government.² External assistance can support capacity development, but it cannot be a

¹ 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. London: Chartered Institute of Public Finance and Accountancy (CIPFA).

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.

substitute for it. Capacity development is most likely to succeed when countries view it as serving their own interests. Supply-driven and fragmented assistance is not effective.

9. **Beyond skill transfers.** Capacity development goes beyond transferring skills. It can entail major changes in organizational, behavior, and incentive structures. Although 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 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. Similarly, adopting midterm expenditure frameworks proved too complex without first addressing basic system weaknesses in ensuring that the government is executing a 1-year budget reasonably well.³

10. **Incremental progress over time.** Strengthening capacity can rarely be accomplished quickly. It is not easy to change laws, regulations, institutions, practices, habits, and mindsets. Progress is often incremental, but gradual steps over time will make a difference. Capacity development thus requires a long-term perspective.

11. **Results.** Capacity needs to support results. A strengthened system is necessary—but not sufficient—for development impact. It needs to be linked to results and better service delivery.

12. **Flexibility.** Capacity development processes and approaches require flexibility. In a complex system, it is not possible to identify all the relevant capacity development needs from the outset. Hence, processes must be continually monitored and adjustments made if necessary. A formulated action plan should be clear in its objectives, but flexible in its approach and process to respond to unforeseen events.

13. **Harmonization.** A harmonized approach among development partners will be more efficient and effective. This could involve sharing information, sharing diagnostics, joint analysis, and harmonized assistance strategies. Harmonization can lower transaction costs.⁴

14. These lessons have been carefully considered in designing RBL.

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

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

PROPOSED GUIDELINES TO PREVENT OR MITIGATE FRAUD, CORRUPTION, AND OTHER PROHIBITED ACTIVITIES IN RESULTS-BASED LENDING FOR PROGRAMS

A. Purpose and General Principles

1. The developing member country (DMC) is responsible for the implementation of programs supported by results-based lending (RBL). The Asian Development Bank (ADB) has a fiduciary responsibility to ensure that its loans and other forms of financing are used only for the purposes for which they were granted, in accordance with the Agreement Establishing the Asian Development Bank (the Charter).¹ To uphold that obligation, ADB presents these guidelines to prevent or mitigate fraud, corruption, and other prohibited activities in RBL operations financed in whole or in part by ADB. These guidelines build upon the legal obligations presented in the loan agreement and apply to operations funded by the RBL (the programs).²
2. These guidelines do not limit any other rights, remedies, or obligations of ADB or the DMC under the loan agreement or any other agreement to which the ADB and the DMC are both parties.
3. All persons and entities participating in the programs must observe the highest ethical standards; take all appropriate measures to prevent or mitigate fraud, corruption, and other prohibited activities; and refrain from engaging in actions described in these guidelines in connection with such programs.

B. Definitions

4. These guidelines address the following practices as defined by ADB:
 - (i) A “corrupt practice” is the offering, giving, receiving, or soliciting, directly or indirectly, anything of value to influence improperly the actions of another party.
 - (ii) 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.³
 - (iii) 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.
 - (iv) 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:
 - (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, 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

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

² ADB may support a part (or a slice) of a government program or the entire government program through RBL. The program or the part that is supported by the RBL is the RBL operation. The term “program” in these guidelines refers to the RBL operation as defined unless otherwise specified.

³ 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. The inaccuracy of such information or impression, committed through negligence, is not enough to constitute a fraudulent practice.

persons and entities must be excluded from participating in relevant program activities.

- (ii) An “obstructive practice” includes deliberately destroying, falsifying, altering, or concealing 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.

C. Developing Member Country’s Actions to Prevent Fraud, Corruption, and Other Prohibited Activities in Results-Based Lending for Programs

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

- (i) ensure that the program is carried out in accordance with these guidelines;
- (ii) avoid conflicts of interest in the program;
- (iii) prevent fraud, corruption, and other prohibited activities from occurring in the program, including 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 that 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 program, and take all appropriate measures to ensure the full cooperation of relevant persons and entities subject to the DMC’s jurisdiction in such investigation, including, in each case, allowing ADB to meet with relevant persons and to inspect all of their relevant accounts, records and other documents and have them audited by or on behalf of ADB; and
- (viii) ensure that persons or entities sanctioned by ADB do not participate in RBL supported activities in violation of their sanction.

D. ADB’s Actions to Prevent Fraud, Corruption, and Other Prohibited Activities in Results-Based Lending for Programs

7. Unless otherwise agreed in writing by the DMC and ADB, ADB will

- (i) inform the DMC 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 DMC;

- (iii) inform the DMC 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; sanctions may result in that party's exclusion from participating in an RBL-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 begun before the date of the loan agreement.