

## **A solution: Cash on Delivery Aid**

Cash on Delivery Aid (COD Aid) is a funding mechanism designed to address and overcome the drawbacks of foreign aid identified in the preceding chapter. While many previous efforts to reform foreign aid have pursued limited improvements, COD Aid is meant to be a more thorough approach to altering funder-recipient relationships, providing new means to ensure accountability and achieve shared goals.

The core of COD Aid is a contract for funders and recipients to agree on a mutually desired outcome and a fixed payment for each unit of confirmed progress (box 2.1). This chapter delineates the key features of COD Aid and the basic steps in fulfilling the contract. It next explores the advantages of COD Aid, both in correcting the evident shortcomings of earlier aid and in achieving the newly articulated goals for future aid. As a substantial departure from previous aid practices, COD Aid naturally raises legitimate reservations and concerns. This chapter responds to the concerns that were raised in our extensive consultations. The chapter then compares COD Aid and other results-based approaches to aid, clarifying how it is distinguished from and builds on these other approaches.

The COD Aid principles can be used for transfers between a variety of actors, such as between private philanthropic foundations and governments or between central and lower levels of government (chapter 6). The basic design can also be applied in any sector where an appropriate outcome measure can be identified. In chapter 3, we provide extensive details on its application to universal primary schooling. Further examples are discussed in chapter 7, including preventing the spread of HIV/AIDS, increasing household consumption of potable water, reducing carbon emissions, improving domestic statistical systems, and increasing citizen use of public data as a way to promote transparency and democracy.

## BOX 2.1

**Basics of COD Aid****Key features**

- Payment for outcomes, not inputs
- Hands-off funders, responsible recipients
- Independent verification
- Transparency through public dissemination
- Complementarity with other aid programs

**Basic steps**

- Two parties negotiate and sign a medium-term (for example, five-year) contract
- Recipient government pursues its own strategy
- Recipient government collects and reports data (for example, annually)
- Funder arranges independent audit (for example, annually)

- Funder makes payment for confirmed results (for example, annually)
- Third party finances research (optional)

**Advantages**

- Accountability
- Local ownership and institutions
- Learning by doing
- Workable in most low-income developing countries
- Opportunities to attract private funders
- Progress toward the 2005 Paris Declaration

**Risks and concerns**

- Displacement of other aid programs
- Too little, too late
- Unintended consequences
- Waste and corruption
- Difficulty measuring outcomes
- No progress means no payment

Although COD Aid is conceived as a substantial and fundamental change in the way some foreign aid programs are conducted, it is not intended to supplant all other forms of foreign assistance. Instead, we see COD Aid as complementing many existing foreign aid programs. Indeed, when its mechanisms for measuring progress, providing incentives, and clarifying responsibilities become established, we believe COD Aid will help funders and recipients make much more efficient use of existing resources across a spectrum of aid programs.

**Key features and basic steps**

COD Aid enables funders and recipients to pursue mutually desired outcomes through a contract that specifies the results that recipients will achieve and the fixed payments that funders will provide. A financial aid mechanism can be considered to be COD Aid if it has five key features.

First and most fundamental, the funder makes payments for outcomes, not inputs. The outcome (or outcomes) must be agreed between the funder and recipient. It must also be measurable and continuous (such as, number of children enrolled), making it possible to reward incremental progress. At no point does the funder specify or monitor inputs. There are no required policies, training programs, or outside consultancies; no agreed contracts for building, renovating, or maintaining bricks and mortar; no specified forms of management, reforms, or decisions.

Second, the funder embraces a hands-off approach, emphasizing the power of incentives rather than guidance or interference, even with good ideas. The funder not only does not pay for inputs, but indeed entirely eschews designing or demanding any particular set of inputs. A funder may make available or help obtain other resources for technical assistance, ideally in a pooled fund. But it is up to the recipient to choose whether to contract for technical help and advice from any party, including that from funders.<sup>1</sup>

Conversely, where the funder is hands-off, the recipient has complete discretion and responsibility. This extends from the initial design and planning right through to the implementation of strategies. All decisions and plans, including whether to have a plan, are up to the recipient government. Further, the funds a recipient receives after making progress can be used in any way, determined by the recipient: to reduce the fiscal deficit, pay off debt, build roads, finance increased health services—or in education to train teachers, subsidize school meals, pay cash to households that keep their children in school, provide prize grants to districts whose schools perform well or compensation grants to poorer districts. In short, without funder-imposed conditions or restrictions on the use of funds, COD Aid permits and requires recipients to assume full responsibility for progressing toward agreed goals.

Third, progress toward the agreed outcome is independently verified by a third party (neither funder nor recipient). Progress is the trigger for COD Aid payments. So, both funder and recipient must have confidence in the way progress is measured. Independent verification should take the form of a financial and performance audit, with no restrictions on the nationality or other characteristics of the auditing firm. Audits are paid for by the funder (see chapter 4 for more on audits). Once progress is verified, the funder pays for the improved outcomes. The information about outcomes is a further significant benefit of COD Aid.

Fourth is transparency, achieved by publicly disseminating the content of the COD Aid contract itself, the amount of progress, and the payment for each increment of progress. To encourage public scrutiny and understanding, the indicator or measure of progress should be as simple as possible. Simplicity and transparency increase the credibility of the arrangement, help ensure that the parties fulfill their commitments, improve accountability to the public, and encourage broader social engagement in aspects of progress beyond the specific object of the contract. In the education example in chapter 3, we note that the results of any testing should also be publicly disseminated.

Fifth, COD Aid complements other aid programs. We believe that COD Aid can and should be introduced as additional to current aid flows in a particular recipient country without disrupting ongoing programs. Indeed, we argue that COD Aid would create healthy incentives for more efficient use of existing resources by both funders and recipients.

**COD Aid enables funders and recipients to pursue mutually desired outcomes**

After confirming outcomes, the funder pays the agreed amount per unit of progress

How would these five features be implemented? In practical terms, in a COD Aid project funders and recipients would take the following steps:

The first is for the funder and recipient to negotiate and sign a contract. Elements of the contract to be negotiated include the measure of progress, the amount of payment for progress, the length of the agreement's term and a list of mutually agreed auditors (a sample funder-recipient contract is in the appendix). We suggest a minimum contract period of five years.

This would give the recipient time to plan, execute, evaluate, and adjust the strategy for making progress. Adjustments here are understood to comprise not merely adding or switching inputs but also engaging in political and institutional change.

The second step is for the recipient to take action to progress toward the agreed goal. Because COD Aid follows a hands-off approach, the recipient has full discretion over how to achieve progress. The funder may make technical assistance available, directly or through a pooled fund, but has no further involvement in design, strategy, inputs, or implementation. The recipient defines and pursues the route to progress.

The third step is for the recipient to measure outcomes and make the collected data public. Relevant data to be collected will already have been determined in the initial contract negotiations. The direct costs of data collection, analysis, and publication may be covered by funders (such a provision is included in the model contract in the appendix).

The fourth crucial step in COD Aid is an independent audit. The funder hires an auditor from the preapproved list of mutually acceptable auditors. The auditor verifies the recipient's report of outcomes (see the sample funder-auditor contract in the appendix).

Only when the first four steps are completed does the fifth step, payment, occur. After confirming outcomes, the funder pays the agreed amount per unit of progress in line with any provisions in the contract for differences between the auditor's and recipient's reports. Payments are unconditional transfers to the recipient.

In a five-year contract, steps three, four, and five would be repeated annually.

A further optional step is systematic research on the response of both funders and recipients to implementing COD Aid in a particular setting. As outlined in chapter 5, the benefits of such research would accrue largely, but not only, to the funders and recipients directly involved. Others would also learn from and could exploit the documented experiences. This further research is a highly desirable but optional step, appropriately financed in part or in full by a third party. If this research is financed, the recipient government should be obligated in the initial funder-recipient contract to provide information and make staff and citizens available for surveys and other data collection.

**Advantages of COD Aid: why it could succeed where other approaches fail**

An aid program embodying these key features and steps would, we believe, bring many advantages to the global system of foreign aid. In designing COD Aid, we have studied the shortcomings of the traditional system, the limitations of previous efforts at reform, the unmet needs and disappointments of various stakeholders, and the goals articulated in the 2005 Paris Declaration. We have devised an approach that we believe will foster accountability, build local ownership, permit learning by doing, and work even in fragile states—while also attracting new private funders, enabling funder coordination, reducing administrative burdens, and facilitating the expansion of aid.

***Accountability among funders, recipients, and their constituents***

COD Aid could have a major impact on one of the most enduring problems of foreign aid transfers: accountability. As noted in chapter 1, aid as practiced does not instill accountability between the funder government and its citizens, the recipient government and its citizens, or between the funder and recipient governments. COD Aid—with its focus on outcomes, independent verification, transparency, and recipient discretion and responsibility—could generate an entirely different framework for the many actors in foreign aid to demand and ensure accountability to each other.

First, COD Aid makes funders more accountable to their citizens by linking foreign assistance to specific outcomes. Because cash is disbursed only after progress is achieved, funders can present information on outcomes to constituents, showing that foreign aid is effective. We believe that taxpayers want aid to buy results, and COD Aid helps funders make clear statements, such as “Our funds paid for 1,000 more children to finish school.” Particularly for funders who view general budget support to developing countries skeptically, COD Aid provides the explicit link to outcomes that may allow them, in exchange, to offer recipients more flexibility and autonomy in the use of funds.

Second, COD Aid makes recipient governments more accountable to their citizens. Because it requires transparency, particularly by requiring that outcome measures be publicly reported, citizens and civil society groups will have information on progress that is not available in most countries. For education, nongovernmental organizations (NGOs) might use this information to hold governments to account in many ways. Creating school report cards, for example, has increased civic engagement with schools and improved quality in many settings.<sup>2</sup> The funder’s financing commitment is also public, making it possible for citizens to better assess their government’s claims of financial constraints.

Third, COD Aid improves mutual accountability between funders and recipients because the contracts are less ambiguous—focusing on shared

**COD Aid provides recipients more flexibility and autonomy in the use of funds**

goals and measured outcomes rather than on differences over strategy or expenditure tracking. In this way, COD Aid avoids the too-frequent practice of renegotiating after the fact whether particular expenses were allowed, bidding procedures acceptable, or targets adequately met under sector programs. Less ambiguity also makes funding more predictable, a key concern regularly raised by recipient governments when they denounce unpredictable aid flows as a problem for planning and management. With COD Aid, payments are as predictable as the government's projections of its own likelihood of progress.

In one respect, COD Aid would seem to reduce accountability: funders do not monitor and control the way recipients spend COD Aid funds. Yet the traditional forms of micromanagement that track spending give only an illusion of control. They allow funders to count how many books or hours of training were purchased with their funds and from whom, but not whether the books were actually used or kept behind the teacher's desk to avoid damage, whether training was useful or quickly forgotten. Even when properly collected, such information is not genuinely useful for policy decisions. And it imposes a substantial administrative burden on recipients. In contrast, the data required in a COD Aid agreement focus on outcomes rather than inputs—central for both policymaking and accountability. That is why the first key feature of COD Aid, the focus on outcomes rather than inputs, is so important.

### ***Local ownership and institutions: recipient responsibility and discretion***

The 2005 Paris Declaration is only one of the more prominent public statements to affirm that aid is more effective when developing country governments have full responsibility for their own policies and programs—that is, local ownership. Traditional approaches to aid have had considerable difficulty in realizing this aim; recent efforts such as budget support and the contracts under the U.S. Millennium Challenge Account do somewhat better. COD Aid takes a further step toward promoting recipient responsibility and discretion. The payments through COD Aid are not restricted ex ante for any particular use (though with more accountability). They are not conditional on the country's economic policies or education policies (curricular reform). Nor are they tied to particular inputs (teacher training or textbooks) or intermediate outputs (number of schools built).

The payments go to the recipient and then to whatever institutions (public or private schools, school districts, NGOs, subnational governments, families) or other purposes (health, agriculture, deficit reduction) the recipient chooses. The funder does not specify that funds go to a particular ministry, special implementing unit, contracted consulting firm, or NGO, as is now common. COD Aid thus puts resources and responsibility in recipient hands. It gives recipients the flexibility and freedom to conduct their own diagnostic studies, develop their own strategies, seek

With COD Aid, payments are as predictable as the government's projections of its own likelihood of progress

technical support at their discretion, experiment with new approaches, take credit for successes, and assume responsibility for failures. This level of recipient responsibility generates five further benefits.

**COD Aid puts resources and responsibility in recipient hands**

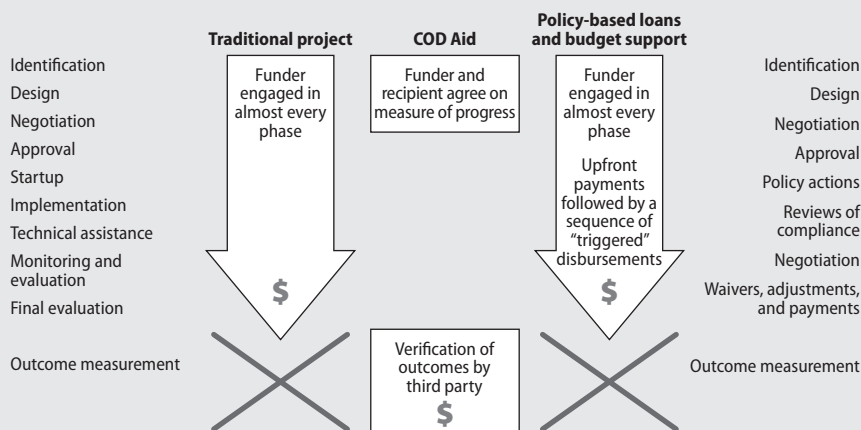
*COD Aid encourages institution-building.* In many countries, aid programs bypass normal government planning. Money may go to projects managed outside the government budget, unbeknownst to the finance, education, or other ministries. Aid programs are particularly apt to create such parallel mechanisms in countries with lower incomes or weaker institutions. The funder’s involvement in designing and implementing programs can thus undermine the government’s decisionmaking for allocating funds, a process central to democratic governance. And while the funder’s involvement in all stages of the program may ensure a degree of technical support and continuity, it also removes incentives and opportunities for the recipient to build its own capacities to design, implement, and manage programs in the long run (figure 2.1).

Aid programs with extensive funder involvement can also divert government attention from the need for institutional development and toward managing foreign aid. In some cases, funder micromanagement might effectively buy AIDS drugs or train teachers but do little to ensure that recipients will have the capacity to deliver health care or education in the long run. So, even in the world’s most fragile states, COD Aid could make a particularly positive contribution.

To build local capacity, funders have agreed that recipient governments should be more involved in deciding how aid funds are spent and that more aid should flow through recipient country budget systems.<sup>3</sup> Progress in making these two aims a reality has been mixed. COD Aid would make both happen automatically.

FIGURE 2.1

**COD Aid changes the roles of funders and recipients**



Recipients are free to test strategies and choose the most effective ones

*COD Aid gives recipients more discretion to address binding constraints in whatever sector.* Since payments are not tied to particular inputs, recipients are free to test strategies and choose the most effective ones, regardless of sector. For example, if COD Aid were applied to a primary education initiative, the funds would not necessarily have to be used by the ministry of education. Instead, funds might increase demand through conditional cash transfers or school feeding programs. If the recipient views labor relations as a key issue, funds could be used to change the dynamics of negotiations with unions—for example, financing incentives for teachers to work in rural areas or establishing programs to encourage early retirement of unqualified teachers. Funds might even fix impassable roads in districts where transportation problems limit attendance—or speed disbursements to purchase teaching supplies.

*Technical assistance is demand-driven.* In traditional aid programs, funders often provide technical assistance for designing and implementing programs regardless of whether they have the most relevant expertise. This is particularly problematic when funders push ideas that are fashionable in international debates but that may not be relevant to a particular setting.<sup>4</sup> With COD Aid, recipients can use local knowledge of problems to assess which kinds of technical assistance from which sources will be most relevant. Such demand-driven technical assistance has a greater chance of being useful to recipients, and because they selected it, they are more likely to apply it.

*Recipient responsibility also fosters local involvement and accountability.* Over time, both funders and recipients have become dissatisfied with approaches that treat beneficiaries as objects rather than subjects of their own development. While progress has been made through greater consultation (surveys and focus groups) and participation (community meetings, design workshops, and demand-driven programs), these processes were largely instigated by the funder's agenda (developing a poverty reduction strategy).<sup>5</sup> With COD Aid, recipients can develop their strategies through local debate and existing channels for accountability to citizens. With the public fully informed of the amount of COD Aid at stake, accountability can be strengthened in ways that fit domestic political dynamics.

*Increased discretion gives recipients the freedom to engage with private and nonprofit initiatives.* Once the funder cedes responsibility to the recipient, it is easier to include nontraditional actors. The COD Aid agreement gives the recipient an incentive to achieve goals by any means, including collaborations, partnerships, or contracts with private or nonprofit organizations. For example, national leaders might respond to a COD Aid agreement that seeks to increase primary school completion by simplifying regulatory restrictions on private schools or by establishing a voucher program. Under



an agreement to reduce the prevalence of tuberculosis, national leaders might contract with private healthcare providers or pharmacies.<sup>6</sup> This flexibility would be particularly welcome where nonprofit and even commercial firms provide a significant share of services used by the poor.<sup>7</sup>

***Learning by doing: COD Aid fosters experimentation and assessment***

Without information about whether goals are being met, it is difficult to determine whether programs are successful. Yet current aid provides weak incentives to get reliable information about outcomes. With COD Aid, those incentives are strong.

*Both funders and recipients have strong incentives to invest in collecting good data on outcomes.* Recipients want information on outcomes because it triggers aid payments; funders want the information to be assured that they are paying for real progress. In traditional aid, recipients are rewarded mostly for documenting their expenditures and reporting on procurement, while funders consider their funds well spent if they can show how many inputs were purchased.

*COD Aid encourages learning by doing.* Collecting information on outcomes is not an end in itself. By measuring progress, COD Aid establishes ideal conditions for learning by doing. It gives recipients discretion, permitting experimentation and innovation, and requires measurement of outcomes, making it possible to assess which of those experiments and innovations are most promising. In this way, funders and recipients learn about the effectiveness of a range of policies and programs and build knowledge about which ones work and which ones don't. (Chapter 5 discusses in detail how a research program could complement a government's own accumulation of learning.)

***COD Aid can work in most low-income developing countries—even in fragile states***

Another advantage of COD Aid is that it can work almost anywhere. The challenges of implementation and the likelihood of success will vary with context. The main characteristic of a country where COD Aid could make a big difference is one where the promise of additional unconstrained funds could facilitate effective action to achieve shared development goals. Other contextual factors—the amount of money, the potential gains, the information systems, the institutional capacity—only make the likelihood of success greater or smaller.

At least 40 countries receive more than 10 percent of their GDP in aid,<sup>8</sup> many of them viewed as fragile states.<sup>9</sup> In fragile states, encouraging development through foreign aid is extremely difficult, regardless of its form. The key challenges to implementing COD Aid in such countries are:

- Establishing a baseline for measuring progress.

**COD Aid can  
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anywhere**

- Verifying progress when information systems are weak.
- Relying on the government to design new strategies and articulate demand for technical assistance.
- Relying on the government to implement its program with a weak institutional base.
- Expecting the political system to respond coherently to the externally generated incentives.

COD Aid might be more successful in fragile states than traditional forms of aid for three reasons. First, because COD Aid requires verified progress to trigger payment, it requires serious efforts to gather data and establish information systems, which can make a large difference for subsequent policymaking. All too often, this core requirement of good governance is addressed only after meeting more immediate needs, even when it is unclear whether ongoing actions are making any difference. Second, while it may be risky to rely on governments in fragile states to design and implement their own programs, traditional approaches that substitute foreign for domestic institutional capacity only maintain dependence and compromise sustainability. Third, fragile states may have more flexibility to respond to COD Aid's incentives with innovative approaches because vested interests are weaker and government bureaucracies less entrenched and less resistant to innovations.

COD Aid may be particularly relevant for fragile states with new and effective leaders. Currently, such countries may not have access to aid that requires demonstrations of good governance. For example, a country that has recently emerged from a civil war may not be eligible for budget support if its public financial management is poor. Yet it could sign a forward-looking COD Aid agreement and begin to reap the benefits of its success in achieving social goals in a fairly short time.

At the other end of the spectrum, COD Aid may seem irrelevant to large countries with strong domestic capacity for public policy. But COD Aid funds are additional and unconstrained. So, even if the amounts are small, COD Aid might offer these governments a new resource or lever for introducing change in contexts where there are strong vested interests and entrenched bureaucracies that might hamper experimentation. Or, national governments might be interested in using the COD Aid to encourage progress in worse off regions, particularly if they have a federal political structure.

In general, the benefits of COD Aid are probably greatest in poorer and more aid-dependent countries. COD Aid might be easier to implement in a country with better data and a more organized and capable government bureaucracy, but the gains might be greatest where data are poor (because COD Aid generates incentives for government to establish management information systems) and where bureaucracies are hide-bound and inflexible (because COD Aid provides incentives that might unlock creative solutions even in a difficult environment).

**COD Aid might be more successful in fragile states than traditional forms of aid**

***COD Aid creates opportunities to attract private funders***

Attracting private funders to foreign aid is another major advantage. Some private funders—whether corporations, foundations, privately funded NGOs, or individuals—continue to finance traditional projects. But many have become aware that their efforts are small relative to the gains that could be made if public policy were to improve. In addition, as the scale of private philanthropy has increased, many of the same issues facing public donors have arisen. One school might be built without coordinating with the government, but not a hundred. Sometimes private funders are too small to engage in meaningful sectorwide policy discussions. And in many cases, private funders are cautious about moving into broader sector debates because they cannot envision grants for such intangibles as policy reform.

COD Aid makes it easy to reach out and include such funders in two ways: it reduces the administrative costs of engaging in coordinated funder action, and it links payments to specific measurable outcomes. The funder's ability to report on the outcomes it has paid for is particularly useful in relating to its constituents (shareholders, managers, members, or contributors).

***The 2005 Paris Declaration and aid effectiveness: from rhetoric to real reform***

Another advantage is that COD Aid will help funders fulfill the commitments made in the 2005 Paris Declaration—for local ownership, coordination, harmonization, outcome focus, and accountability by establishing an explicit and publicly visible contractual arrangement. COD Aid ensures that funds flow to pursue the shared goal (more students completing school) while aligning with the recipient's own policies, programs, and strategies.

COD Aid also provides useful discipline for funders. Once the contract is signed, the funder cannot indulge the temptation to direct funds toward parallel executing units and pet projects, toward its own preferred form of technical assistance and suppliers, or even to alternative or changing objectives (such as geopolitical aims or pleasing particular domestic constituencies). The potential of COD Aid for aid effectiveness as envisioned in the 2005 Paris Declaration has several parts.

*COD Aid coordinates actions of official funders.* Once a COD Aid agreement is in place, any number of funders can join the program without increasing administrative or coordination costs. The goal is explicit and shared; the reporting requirements and outcome measures are uniform; a single mechanism exists for auditing and verifying reported progress. Additional funds can be added either to increase the size of the incentive for each unit of progress (additional child who completes primary school) or to extend the agreement to additional countries, without increasing the program's

**COD Aid will help funders fulfill the commitments in the 2005 Paris Declaration**

complexity. COD Aid is also perfectly suited to disbursing a pool of funds through a single payment mechanism, though that is not necessary. This would go even further in ensuring funder coordination and reducing the administrative burden on recipient countries (box 2.2). And it would facilitate contributions from private philanthropies.

If such a pooled fund were created through a global compact, the price list or fixed payment for each measure of progress could be the same for all countries. The payments would then be correspondingly more valuable in less developed countries, where wages and costs are typically lower. And because it is generally easier and cheaper to improve from a low base than from a higher one (expanding primary completion when the baseline is only 60 percent compared with 90 percent), the payment would

#### BOX 2.2

### **Should COD Aid be negotiated for each country or established as a global compact?**

In developing the concept for COD Aid, we debated whether COD Aid should be tailored to each country or negotiated as a global compact for countries to join voluntarily.

In the first case, one or more funders would negotiate COD Aid contracts with a recipient country. This approach allows funders and recipients to adjust agreements to different goals, measures, and forms of verification. The deliberative process of choosing a measure of progress might be, in itself, beneficial to public policy formation.

But, we conclude that a global compact offers substantial benefits to funders and recipients that a country-by-country approach cannot match.<sup>1</sup> With a global compact, a group of funders and recipient countries would collectively design a COD Aid agreement. Once it became operational, funders would commit funds according to the agreement, and eligible recipient countries would choose whether to take advantage of the agreement.

Administrative costs would be substantially reduced by collectively negotiating the COD Aid agreement just once. With the COD Aid compact in place, funders of any kind (public or private, large or small) could

commit funds to a common pool or to specific recipients but always according to the same criteria. For education, this would mean the agreements would all use the same definition of completion, the same process for approving tests, the same process and agents for verifying and auditing outcomes. A single global compact would ensure harmonization and coordination among funders and limit opportunities for manipulating agreements to favor the interests of a particular funder or recipient.

A standard contract would also promote fairness and transparency. By setting a uniform payment, it would ensure that lives and beneficiaries are not valued more in one country than another. Such uniformity would also assist civil society and others in interpreting whether the agreements are being implemented and whether their countries are performing well relative to others.

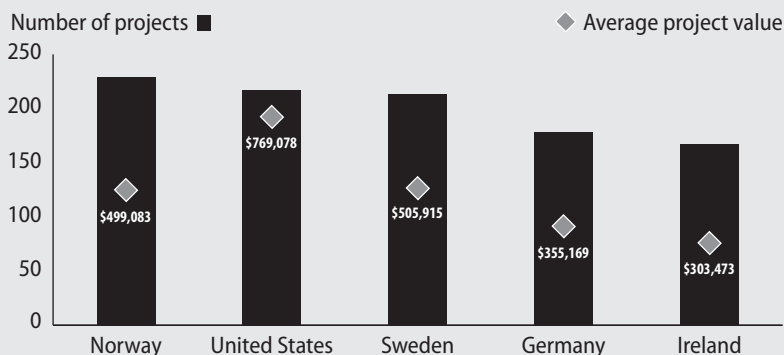
Some practical issues would arise in establishing a global compact, but they are manageable. For example, it may be necessary for the compact to specify eligibility standards (such as the country's income or governance score) or to offer a limited set of progress measures that would be feasible in different contexts.

#### **Note**

1. Barder and Birdsall's (2006) original description of COD Aid (as "payments for progress") was as a single offer by one or more funders to any partner (recipient) country.

FIGURE 2.2

### Large numbers of funders and projects can burden recipient countries: Tanzania



Source: OECD Stat Extracts.

be more valuable for countries that are currently further behind. Governments that find ways to provide services at lower cost would benefit from the resulting surplus, acting as an incentive to use public funds efficiently.

*COD Aid reduces the administrative burden on recipient governments—and on funders too.* When dozens of funders operate in the same country, they create large administrative costs (figure 2.2). Funders that take the 2005 Paris Declaration seriously need to spend much time and effort to coordinate among themselves. Recipient governments are also burdened with meetings and managing independent arrangements with many foreign agencies. In fact, officials' time in aid-dependent countries is often occupied extensively by meeting and coordinating with funders (see box 1.1). By reducing the burden of administration, COD Aid might be even more appropriate for weak and fragile states, which could focus on executing their own programs and measuring outcomes.

*COD aid complements budget support, project aid, and traditional technical assistance.* COD Aid creates incentives for the recipient government to maximize, however it can, the effectiveness of its programs and of its support from funders. Indeed, with COD Aid, governments need not spend more money; they have an incentive to do more with resources they have. Most governments are well within the frontier that defines effective use of resources for public services.

*COD Aid facilitates scaling up foreign aid.* In the last decades, funders have harnessed political support to obtain substantial funds for foreign aid. Yet negotiating traditional

aid projects is labor intensive, and arranging for the expansion of sector programs takes time. By contrast, negotiating new COD Aid programs is fairly quick and can channel as much funding as can be mobilized. Once COD Aid agreements are in place, funders could apply additional funds by increasing the size of the incentives or expanding the number of countries that are eligible, with minimal demands on technical or administrative staff.

### **Concerns and risks—and how to manage them**

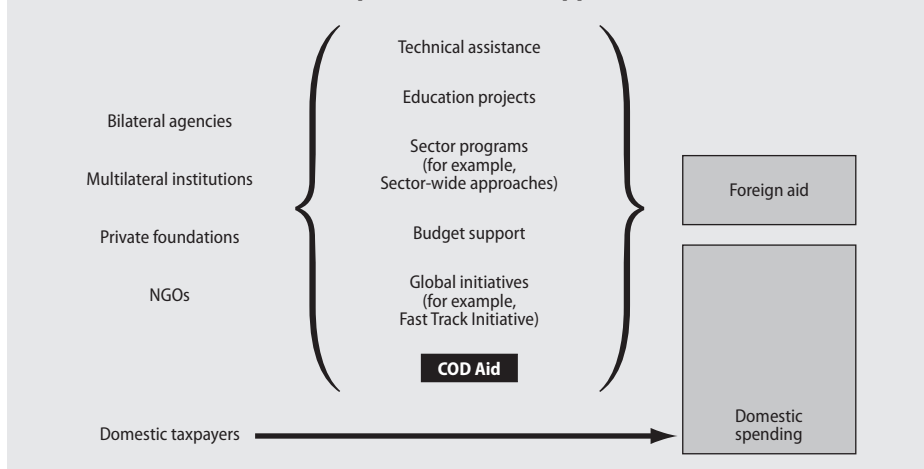
COD Aims to fundamentally change the way foreign aid operates, in the funder-recipient relationship and in the assignment of accountability, responsibility, and focus of aid programs. Its key features—payment for outcome, hands-off funders and responsible recipients, independent verification, transparency, and complementarity—chart a new path for foreign assistance. We have laid out the manifold advantages we believe this new approach to foreign aid will provide. We also know the risks in embarking on this new path. Indeed, careful attention to the legitimate and reasonable concerns expressed in various consultations and meetings have influenced the design and enabled us to refine and improve the COD Aid proposal.

Some risks specific to COD Aid can be contained during negotiations by carefully defining the agreed measure of progress, explicitly specifying financial arrangements (such as escrow accounts), or providing for third-party verification. Other risks, such as diversions of funds, are common to all forms of aid. In most cases, these common risks may actually be better managed through the structure of a COD Aid agreement. The most serious and frequently raised concerns about COD Aid are shared and responded to here.

#### ***Displacement of other aid programs?***

In our consultations, representatives from funding agencies and recipient governments were concerned that COD Aid would substitute for existing foreign aid approaches. While this is possible, it is neither likely nor advisable in the short to medium term. Displacing other aid programs is unlikely because agencies and governments already have contractual arrangements in place for multiyear programs. Since COD Aid is not paid until progress is achieved, the funding through existing aid channels may be an important resource that would permit recipients to respond effectively to the COD Aid incentive. Furthermore, it would be inadvisable to replace existing aid modalities with COD Aid until the new approach is tried and tested. For these reasons, we propose (and discuss in chapter 4) that funders commit to making COD Aid additional to their current and projected commitments. This commitment would apply, at a minimum, through the term of the contract, which we propose to be five years, with the possibility of a five-year extension.

FIGURE 2.3

**COD Aid for education complements other approaches*****Too little, too late?***

COD Aid is paid when recipients achieve outcomes, not when a government initiates reforms or new programs. In our consultations, participants expressed the concern that countries will not be able to reach the initiative's goals without funds for initial investments. By definition, COD Aid cannot provide this support upfront without undercutting its emphasis on outcomes. But this does not mean that countries will be without resources for meeting goals. COD Aid would be only one source within the envelope of foreign aid and domestic spending (for education, see figure 2.3). In countries heavily dependent on outside resources, existing aid flows are likely to matter for any efforts to accelerate progress under a COD Aid agreement at least in the first year before the COD Aid begins to flow. This is true for real investments (building schools, distributing textbooks, reforming curricula) and for technical assistance that a recipient might request.

The question is whether COD Aid payments present a sufficient incentive to spur funders and recipients to search farther afield for efficiencies in the use of current resources. Because education outcomes in developing countries have only a weak relationship to public spending, we believe there is some scope for greater efficiency in some countries, if not all. Furthermore, existing aid flows and aid-financed programs (including budget support) are likely to be a good source of funding for a government to implement reforms or try pilot programs to increase enrollment and raise quality in education.

Governments with a COD Aid contract might be in a good position to raise matching private money or even to borrow against expected future

**COD Aid would be only one source within the envelope of foreign aid and domestic spending**

An inappropriate outcome measure could lead to unintended consequences

COD Aid payments to finance upfront investments.<sup>10</sup> Funders might also respond with financing innovations, as in health.<sup>11</sup> In short, we believe COD Aid will encourage better use of existing resources, public and private, domestic and foreign. We also want to underscore that COD Aid should be additional to existing aid. Indeed, at least for the initial five-year contract, this addition is critical.

A single exception exists to COD Aid's exclusion of upfront funding: reimbursement for the cost of creating a system to gather reliable information on outcomes. For example, for an agreement in which funders commit to pay a fixed sum for each additional student who takes a test in the final year of primary school, the initial costs for developing and applying the test could be financed by funders (see chapter 3 and the appendix for more details).

### *Unintended consequences?*

One hazard of COD Aid is that an inappropriate outcome measure could lead to unintended consequences. Domestic resources might be diverted to one sector and away from others. For example, if the COD Aid agreement pays for expanding primary completion, funds might be diverted from other priorities such as improving health or rural infrastructure, although the overall social return might be higher in these sectors.

This concern can be mitigated to some extent by the size of the payment. If the payment is large enough to cover the cost of progress (such as the marginal cost of ensuring an additional child completes primary school), funding for other priorities would not be affected. With a smaller payment, diversion of resources is an issue that funders and recipient countries would have to consider seriously. If the COD Aid approach were successful in one area, funders could offer a range of contracts to cover the spectrum of development objectives that they share with developing countries.

For education, an immediate concern is that a country that is paid for the quantity of children who complete school might expand enrollment at the expense of schooling quality. One response to this risk is to identify a measure of progress that closely approximates the shared goal and minimizes such foreseeable problems. This could involve finding an outcome measure that relates to learning and not just school attendance. Another response is to mobilize social groups that can monitor aspects of the program that are not easily measured. Again, for education, this might include providing parents, political parties, and civic organizations with access to school information such as the results of student literacy tests, school budgets, and test results.

In our consultations, we also heard concerns that recipients might direct funding to better-off areas where it is easier to make progress or to better-off groups who are easier to reach, perhaps ignoring children who are socially excluded, from ethnic minorities, or living with disabilities. The tradeoffs in choosing where to expand public services



and for whom cannot be avoided. For social services, some countries have expansion plans that seek to maximize the number of beneficiaries as fast as possible within their limited resources. In such cases, resources may go to relatively better-off areas where it is easier to make progress. Other countries have chosen expansion plans that seek to ensure that gains are more widely spread across geographic, gender, income, and ethnic differences, though this may come at the cost of reaching more beneficiaries. These are tradeoffs that even the richest countries face and that ultimately are resolved only through the political process, with national public debate.

### *Waste and corruption?*

COD Aid maximizes the recipient's discretion in using funds, making it virtually impossible for funders to ensure that COD Aid payments are used only for legitimate public purposes. But this is fundamentally true of all foreign aid. Even the most detailed monitoring of spending on traditional development projects cannot guarantee that the recipient country is not taking advantage of the increased resources to release other funds for inappropriate uses. The risk that COD Aid might encourage waste and corruption can be mitigated by establishing standards for public financial accountability as a condition of eligibility. Or, funders can accept the risk and rely on the improved assurance that, regardless how the money is spent, progress has been achieved.

Some funders already provide aid that is delinked from specific inputs, as through budget support. These funders address corruption and financial controls through conditions for good policies or improving public financial management—or through reviews such as the World Bank's Public Expenditure Reviews and Public Expenditure and Financial Accountability reports.<sup>12</sup> These approaches are likely to be more helpful than the intense attention paid to tracking aid dollars and rooting out corruption just in those projects for which aid is spent. More to the point, COD funds are no more likely to be subject to corruption than other aid channeled through recipient budgets or than money freed up when funders finance specific programs or projects.

Under COD Aid, recipients receive payments for each unit of progress regardless of how it is achieved. So, another way that funds could be wasted is by rewarding recipients for progress even when success is due to other causes. The only way to avoid this would be to use elaborate, expensive, and possibly intrusive methods for attributing success to specific actions by the recipient. We are not concerned with such apparent windfall payments, however, for at least three reasons. First, the transparency and improvement of data quality to make the COD Aid agreement work are important objectives in themselves. Second, paying recipients with successful public programs is much like giving budget support to a country that is generally a high performer—something many funders already do. Contrast this with the large number of projects that fully disburse their funds without achieving their goals, implying much more

**COD funds are no more likely to be subject to corruption than other aid**

waste. Third, in most of the cases considered here (such as schools, health services, water), public policies generally contribute in some way to success, if only through supporting the basic administrative infrastructure necessary for service systems to function. So, in most of the cases we are discussing, it is very unlikely that progress could be achieved without some significant contribution from the public sector.

### *Difficulty measuring outcomes?*

Identifying a relevant, credible, and feasible outcome measure is essential to the COD Aid approach, and there is no inherent reason that such measures cannot be designed. Meeting this challenge is a practical issue that, in many cases, can be resolved by convening experts and encouraging creative problem-solving. Our proposal in chapter 3 to measure progress toward universal primary education by testing students in their final year of primary school is the result of such a deliberative process. Ultimately, setting correct outcome measures can be assessed only in the context of a specific goal in a specific country, and in collaboration with local and international experts.

#### BOX 2.3

#### **Fees or prizes?**

Governments and philanthropies have used a range of methods to induce innovation. Current examples include grants for basic research, advance market commitments,<sup>1</sup> and payments for outcomes (such as the Global Alliance for Vaccines and Immunisation), as well as prizes.

Masters and Delbecq (2008) propose a proportional-reward prize system to encourage higher agricultural productivity. The prize money would be fully disbursed at the end of the time period to participating farmers in proportion to the productivity gain each one achieves. That is, if all farmers increased their productivity by equal amounts, each would get an equal share of the prize money. If some farmers raised productivity dramatically more than their neighbors, they would get a proportionately larger share.

Incorporating this idea in a COD Aid agreement is possible if the agreement involves a number of countries competing

for the prize, and it is attractive for three reasons. First, it solves the problem facing funders over disbursement. With a prize, disbursement is guaranteed. Second, it complements the idea of a global compact that could be on offer to countries that wish to join (see box 2.2). Requirements for entering the contest would focus on establishing baseline data and third-party verification. Third, countries would be rewarded in relation to the difficulty of the task. If all countries easily accelerate student achievement, the average payment would be lower. But if the task is difficult, then only those countries that really put in the effort will be rewarded—and rewarded well.

A proportional-reward prize could be effective within countries too. For example, states could establish proportional-reward prizes for school districts or schools that choose to participate.

#### **Note**

1. Advance Market Commitment Working Group 2005.

***No progress means no payment: political risks and external shocks***

With the COD Aid approach, if the recipient makes no progress, the funder makes no payments. Funders take the risk that funds will not be disbursed, and recipients take the risk that any failures will be visibly and transparently revealed. This frequently expressed concern—viewing lack of disbursements as a risk—is somewhat strange in a broader perspective. If a contractor fails to construct a road, only the contractors are likely to be upset that the government refuses to pay them. If a recipient country fails to educate even one additional child, why would a funder want to pay it?

Of course, the failure to disburse foreign aid can create political problems for government aid agencies. Failure to disburse foreign aid can lead to cuts in subsequent aid requests and to charges of political failure to fulfill pledges.<sup>13</sup> This risk can be mitigated by establishing contingencies for the use of funds for other public purposes or by pooling the risk across a number of recipients. Another alternative is to structure the payment as a “prize” whose actual value would be determined by the number of children educated among a group of competing countries (box 2.3).

Failure to make progress and receive payments is also problematic for recipients. Even the best-intentioned recipients, with the best of plans, may not succeed due to factors beyond their control. External shocks to terms of trade, major crop failures, or serious financial crises can interfere with a country’s progress on schooling in any one year. Fortunately, if the right policies and efforts are in place, there is likely to be catch-up progress in a subsequent year, with higher than expected payments compensating for the earlier lower payment. While it is tempting to protect countries from such delays, reducing the recipient’s ultimate responsibility and discretion is the only way to mitigate this risk. Well intentioned efforts to limit the recipient’s risk of failure weaken the COD Aid incentive. It changes COD Aid into an entitlement rather than a payment for achievement.

The one exception is to make explicit provision for factors beyond the recipient’s control that jeopardize their efforts to measure and report outcomes, such as a natural disaster that interferes with testing. If factors beyond the recipients’ control keep them from measuring progress in schools, provisions for extending deadlines may be required (chapter 4).

The official aid system, like other large systems, does not change rapidly. Enlightened staff of donor bureaucracies, well aware of the constraints to new products and modalities, have raised useful questions and concerns. In our view, most can be managed. Some are more like testable hypotheses (would governments respond to this kind of incentive?) and can be addressed only once COD Aid is tried. Our argument is not that COD Aid will solve all problems, but that its advantages make it well worth trying.

**If the recipient makes no progress, the funder makes no payments**

### **COD Aid builds on other results-based aid programs**

This chapter has discussed the essential features and basic steps of COD Aid. It has explored the many advantages and addressed concerns that this initiative raises. Before moving on to the detailed discussion in chapter 3, which applies COD Aid to education, we compare it with other results-based aid programs. Results-based programs implemented in recent years provide an experience base to learn from—and indeed have influenced our design of COD Aid. Drawing out comparisons with other results-based programs will allow us to further distinguish and introduce COD Aid, while making it clear how we have learned from and built on these earlier efforts.

#### ***Incremental payment***

The Global Alliance for Vaccines and Immunisation (GAVI) is an alliance of public and private funders that provides funds and incentives for countries to expand and improve their immunization programs.<sup>14</sup> Countries present a plan for increasing childhood immunization rates. If approved, they receive an initial payment and become eligible for ex post rewards based on progress. GAVI's measure of progress is the number of children who have obtained all three antigens for diphtheria, tetanus, and pertussis (DTP-3) through vaccination. GAVI pays \$20 per child, which was at one point estimated to be the cost of providing DTP-3 to a child in recipient countries.

The results element of GAVI is similar to the COD Aid proposal in that it provides an incremental payment for each unit of progress. GAVI also reduces the administrative burden on recipient countries by coordinating some funder support through a single mechanism and relying where possible on existing information systems.

GAVI differs from COD Aid, however, in that it provides a basic payment upfront and links only a part of funds to the outcome. In addition, the payment to recipient governments by GAVI is intended to help cover the costs of the immunization program, not to be used at the government's discretion in other sectors or programs. Another difference is that the GAVI arrangement relies on the country's reporting system to establish progress once that system has been vetted for reliability and accuracy, as opposed to COD Aid's independent audit. Although the country reporting systems are vetted ahead of time, problems have been discovered after the fact (see box 7.1 in chapter 7).

#### ***Output-based aid and other performance-based incentive programs***

Output-based aid is a World Bank program sponsored by the U.K. Department for International Development, among others. Its payments to providers are linked to their delivery of specific physical outputs, such as paying private contractors for each water connection installed. In the health sector, funders have sponsored payments to NGOs based at least in part on such outputs as the number of prenatal visits.<sup>15</sup> Performance

The results element of GAVI is similar to the COD Aid proposal

incentives have been paid to households as well. The best-known are conditional cash transfer programs under which, for example, mothers receive monthly cash payments conditional on their children attending school or making regular visits to health clinics.<sup>16</sup>

These programs differ from COD Aid in two ways. First, they pay not for an outcome (such as improved health or learning) but for an output—the number of water connections or consultations at a clinic, or the fact that children attended school. Second, these programs operate at the micro level of providers or consumers. In contrast, COD Aid operates at the macro level. It aims to provide a clear incentive for top officials (heads of state, ministers of finance) to focus on a key outcome. Of course, top officials have the option of using COD Aid funds to create micro incentives for local providers or households. This enhances COD Aid’s potential to make local providers and politicians accountable to their constituents.

**COD Aid aims to provide a clear incentive for top officials to focus on a key outcome**

### ***Budget support***

Budget support programs began in the 1990s as an effort to align aid with country priorities and systems, thus improving ownership. These programs also seek to reduce the administrative burden on recipients and to focus attention on shared objectives. To accomplish these aims, funders and recipients negotiate agreements that set objectives related to improving governance or public policies. The agreed objectives are specified in such inputs as minimum spending on poverty programs, such processes as streamlining public sector management, and such outputs as the number of schools built. Funds are then disbursed against periodic assessments of progress on this mix of inputs and processes, rather than disbursing funds against expenditures on specific activities. In practice, many budget support programs rely on other joint planning exercises such as Poverty Reduction Strategy Papers or Sector-Wide Approaches (SWAs).

A prominent evaluation of budget support programs was commissioned by funders. The report specifically endorsed the idea of linking payments to a broad range of indicators related to overall performance rather than linking them mechanically to specific outcomes. The report reasoned that conditions and indicators specified in budget support programs cannot focus on outcomes due to poor and infrequent data. The vagueness of indicators also gives different funders in any country the flexibility to apply their own judgments.<sup>17</sup>

Budget support programs provide a forum for funders and recipients to regularly discuss priorities and review performance in a number of dimensions. To the extent that performance is judged flexibly, it also makes disbursements more predictable. This is helpful to both funders and recipient governments for planning.

By its nature, however, budget support cannot be structured around a single clear outcome that is transparent to citizens and shared by the recipient government.

**COD Aid complements budget support by adding far greater accountability**

Indeed, recipient governments have sometimes seen the goals as onerous conditions. The multiple performance and progress measures of budget support and the different schedules of funder assistance make it less likely that recipient country citizens will understand what is occurring. Thus, recipient governments continue to be accountable primarily to their funders rather than their citizens. Budget support clearly cannot encourage and may even put at risk the responsiveness of government officials and politicians to their own citizens—on which the sustained growth and

development that funders want to support depends.

COD Aid complements budget support by adding a far greater element of accountability. Like budget support, COD Aid payments are made to the government without restriction on the use of funds and are disbursed after assessing progress toward pre-defined goals and indicators. But unlike budget support, COD Aid:

- Is focused on one or very few measures, thus strengthening the incentive effect and reducing ambiguity on achievements.
- Pays against incremental measures of progress (such as numbers of students who graduate), thus making calculation of disbursements a less high-stakes, pass-fail process.
- Is verified by an independent third party, increasing the credibility of the commitment to pay only for the amount of progress achieved, no more and no less.
- Is likely to be more predictable because it depends more on factors within the recipients' control (progress) than on factors in the funder country (budget pressures or changing geopolitical concerns).

### *EC performance-linked budget support*

The European Commission allocates budget support with a fixed and a variable tranche.<sup>18</sup> The variable tranche depends on whether the recipient has met mutually agreed targets for a range of public finance, health, and education indicators in the recipient government's Poverty Reduction Strategy Paper. To the extent that the variable tranche is linked to true outcome measures, it shares some aspects with COD Aid. The EC's budget support initiative differs from COD Aid, however, in that it contains a fairly large number of indicators, and most of the funds (more than 90 percent) are fixed, not linked to outcomes.

### **Time for a new approach**

We believe it is time to try a new approach to aid—not to replace existing modalities but to experiment with a new one—with funders paying “cash” only on “delivery” of the agreed unit of progress. After extensive research, consultation, and review, we have devised an approach that focuses on shared goals and payment for outcomes,

providing cash only on delivery of confirmed progress. The key features and basic steps outlined here, the advantages such a system could generate, the valid concerns that can be answered, and the improvements on other recent limited reforms encourage us to see COD Aid as the initiative now needed in foreign aid.

COD Aid will not be a panacea, but it will directly address many of the commitments in the 2005 Paris Declaration, against which little progress has been made thus far. Among other characteristics, COD Aid:

- Generates accountability for results by firmly linking payments to outcomes that represent measures of progress toward a shared goal.
- Involves full ownership by recipient governments who have complete flexibility to choose how to accomplish the goal, allowing for local self-discovery and institutional development;
- Improves learning about what works because the contract creates incentives for measuring outcomes rather than inputs, generating data on progress in addition to expenditures.
- Guarantees harmonization and alignment because it involves a single agreement with each country no matter how many funders are involved.
- Makes predictability of funding a function of recipient country planning and performance and less a function of funder politics and budgets.

Our COD Aid proposal cannot eliminate the political pressures and conflicts that undermine aid effectiveness. It does, however, create structures that confine those pressures to the initial contract negotiation phase. It also permits funders and recipients to focus on their joint objectives rather than their divergent interests. Once a funder and recipient have agreed to the terms of the COD Aid contract, it becomes difficult to divert attention from the shared goal.

Moving to COD Aid will not be simple. Both recipients and funders will have to relinquish a comfortable way of doing business for something untried. But if funders and recipients look openly at the tradeoffs, we believe they will see the value in trying this approach. The essential tradeoffs for each party can be characterized as follows:

- In return for accepting the public contract, funders will not be able to control design or determine inputs, and any engagement in implementation will depend on whether the recipient requests it. They will, however, be able to respond to demands for accountability in their own countries because of the simplicity and transparency of linking payments to progress. They will also benefit by sending foreign aid only to countries that have genuinely improved their development outcomes.
- In return for accepting the public contract, recipients will receive COD Aid payments only if they achieve agreed outcomes. In

**Both recipients and funders will have to relinquish a comfortable way of doing business**



return, however, they will have complete discretion and responsibility for their domestic programs, will choose whether and from whom to seek technical assistance, and will redirect their information gathering efforts away from input monitoring reports and toward outcome measurement and analysis.

It would be presumptuous to claim that this proposal is ensured of success or even that it will be more successful than other aid modalities. But our view is that COD Aid addresses the difficult problems of accountability in foreign aid more fully than existing modalities. In this sense, it represents an approach that is well worth trying, adapting, and assessing.

The next step in fully exploring COD Aid is to consider it in a particular context. The success of a COD Aid agreement will hinge on a number of important details: the likelihood of reaching agreement on shared goals, the exact character of the outcome measure to avoid undesirable side effects, the right fee schedule to ensure an adequate incentive, an effective and credible audit process to minimize incentives for the recipient country to manipulate data, contingencies to deal with unforeseen setbacks, provisions to ensure that the COD Aid is additional to existing funding, and mechanisms to make the funder's commitment credible. Chapter 3 is an opportunity to engage COD Aid at this level of detail, examining how COD Aid might be applied in education to achieve the goal of reaching universal primary completion in developing countries.

## Notes

1. This would not be unprecedented. The World Bank has arrangements with some member governments under which those governments buy technical advisory services from the Bank, just as they might from a private consultancy.
2. EQUIP2 n.d.-a, n.d.-b; Rajani 2005.
3. High Level Forum on Aid Effectiveness 2005, Development Assistance Committee 2008b.
4. In fact, sometimes the inputs chosen seem to be driven more by donor trends than anything else (Rodrik 2007).
5. For the limitations of current approaches to participation, see Birdsall (2008) and World Bank (2004).
6. See Eichler and Levine (2009) for case studies of such performance payments to a range of health care providers.
7. Harding 2009.
8. Birdsall (2007) lists 20 such countries.
9. For a definition of fragile states, see OECD (2006).
10. See Barder and Birdsall (2006).
11. A good example is the International Finance Facility for Immunizations, initially backed by the U.K. government and the Bill and Melinda Gates Foundation; see IFFIm (2008).
12. DFID and others 2004; World Bank n.d.; PEFA 2005.



13. The U.S. Millennium Challenge Account has struggled with this political challenge. Countries must compete for its funds and then design and implement its compacts. While this has advantages over other forms of aid, it can create a greater lag from commitment to disbursement; see Herrling and Rose (2007).
14. Chee and others 2004; Hsi and Fields 2004.
15. Eichler and Levine 2009.
16. On conditional cash transfers, see Morley and Coady (2003) and Eichler and Levine (2009), among others.
17. The International Development Department and Associates (2006) report was conducted as part of the Joint Evaluation of General Budget Support commissioned by a consortium of funding agencies and seven recipient governments under the auspices of the Development Assistance Committee Network on Development Evaluation. The report specifically endorsed the idea of linking payments to a broad range of indicators related to overall performance rather than linking them mechanically to specific outcomes. The report reasoned that conditions and indicators specified in budget support programs cannot focus on outcomes due to poor and infrequent data. For funders, the vagueness of indicators allows each the flexibility to apply its own judgment (see, in particular, pages 36, 68–69, and 98–99). The report noted that different funder decisions are inconsistent: they make their own decisions about disbursements based on common data but apply different rules and judgments.
18. European Commission 2005.