Applying COD Aid to primary education: funding and implementation

The previous chapter described many aspects of a Cash on Delivery Aid (COD Aid) agreement for increasing primary school completion. This chapter addresses the issues that are apt to arise regarding funding and implementing such a program. We discuss the possible financial arrangements for a COD Aid agreement, ways to help funders fulfill long-term COD Aid commitments, and provisions to ensure that COD Aid is additional to other forms of foreign aid. We then turn to potential institutional structures for COD Aid and explore how the many different actors—bilateral aid agencies, multilateral banks, private foundations—could be involved.

Funding a COD Aid Agreement

Who are the possible funders of COD Aid programs? One of the attractive aspects of COD Aid is that many different types of funders may be interested in and capable of participating: private foundations, national and international nongovernmental organizations, as well as official bilateral and multilateral agencies. It should be underscored that in a COD Aid agreement, a funder can be distinguished from an implementing agency, where the latter might be a separate entity with responsibility for negotiating the contract, arranging the audit, and disbursing funds. For example, a private foundation might wish to join in funding an ongoing COD Aid program while delegating all implementation functions to a governmental aid agency with in-country negotiating experience and fiduciary capacity.

Financial arrangements and long-term commitments

One of the problems funders face, especially public funders, is that their budget cycles often preclude long term commitments like the one envisioned

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for COD Aid. Arranging a binding commitment to provide a variable amount of funding over five years can be a daunting challenge for funding bureaucracies. But it can be done. For example, the United States has established five-year compacts with recipients of Millennium Challenge Account funds through an arrangement with Congress that allows money to be spent outside the fiscal year in which it is allocated. The U.K. Department for International Development also has 10-year partnership agreements with recipients. These provide greater certainty about long-term funding. Given the high cost to recipients of the unpredictability of aid, longer term arrangements for aid are sorely needed. The bureaucratic problems are worth solving to make aid work better.[1]

For COD Aid, other solutions to bureaucratic rigidities are available. For example, funds could be placed in escrow based on projected disbursements and modified as experience with the program unfolds. The rules for the escrow fund could specify that unused money would remain in escrow for future years if it appears that the recipient will make progress on the shared goal. Rules for the escrow account could also establish the conditions for releasing funds to other recipients joining the COD Aid program. They might also provide explicit steps for transferring funds to other development purposes, or to global public goods such as agricultural or health research, when recipients fail to make progress on agreed goals.

Another approach would treat the COD Aid funds as prize money to be completely disbursed each year. In this case, the per-student amount would vary depending on the total number of additional assessed completers in a pool of participating countries. Thus, countries would be implicitly competing to perform better than their peers and thereby receive a larger share of the prize money (see box 2.2).

Additionality: giving with one hand and taking with the other?

A concern frequently expressed in our consultations is that COD Aid could displace other forms of foreign aid. This would occur if funders were to decide unilaterally after an agreement is signed to reduce funding to the country's education sector for each dollar of COD Aid disbursed. Indeed, there is no way to absolutely guarantee that a funder will not use the existence of COD Aid as an excuse to reduce other forms of foreign aid. We believe this is not a grave concern for two reasons. First, as we explained above, the last decade has seen a tremendous interest in scaling up foreign aid. With the recent international economic downturn, the likelihood of near-term increases in aid has declined. Even so, the broad secular decline that occurred in the 1990s after the end of the Cold War is unlikely, if only because foreign aid is more readily seen as a strategic and security tool in an age of interdependence. Second, funders are showing more interest in rewarding well performing countries. To reduce foreign aid programs to a country accelerating progress in education would be contrary to this increasingly important tenet of foreign aid.

Although it is not possible to guarantee that COD Aid would be additional to existing foreign aid, it is possible to include an explicit contract provision that funders at least abide by all existing foreign aid commitments to the recipients. This would be an enforceable provision with real consequences because canceling of previously approved education grants would violate other contractual commitments. While the contract could also commit the funder to make COD Aid additional to future programmed assistance or expectations about future educational programs, any provisions for the future would be enforceable only through moral suasion and the court of public opinion.

If COD Aid were tried and shown to be effective at promoting better development outcomes with low transaction costs, both funders and recipients might actually prefer to expand its role in foreign aid, and the concern about additionality would be irrelevant. Once funders (public and private, national and multilateral) and recipient countries have more experience with COD Aid, they will see its strengths and weaknesses and can judge whether it is more or less effective than other forms of foreign aid. Both parties can then also judge whether it works better as a complement to existing forms of aid or can stand on its own. They could then jointly make informed choices about the extent to which COD Aid should be additional to or replace other forms of aid.

Loans and grants

Thus far we have discussed COD Aid in its most direct form: a funder and recipient agree on a shared goal, the recipient makes progress, the progress is verified, and the funder pays for progress. Other arrangements are possible and could offer significant advantages and flexibility.

One variation on a COD Aid agreement would include the involvement of three parties: a lender (which could be a commercial bank or a multilateral development bank); the borrower-recipient; and a grantor (which could be a private foundation or other organization).[2]

In this variant, all three parties would be involved in negotiations and come to a shared agreement on the standard components of any COD Aid contract: a fixed payment per unit of progress, a way to measure progress, and a mechanism for third-party verification. In this variant, the three parties would also estimate the likely flow of COD Aid payments under mutually agreed future scenarios of progress. The borrower-recipient would then borrow funds from the lender in proportion to the anticipated COD Aid payments and use those funds to invest in activities that the borrower-recipient has chosen to achieve progress. As with progress measured and verified, the actual COD Aid payments would be calculated. The grantor would then make payments in that amount directly to the lender, paying back the loan.

It is possible to include an explicit contract provision that funders at least abide by all existing foreign aid commitments

If the borrower-recipient were to progress more swiftly than anticipated, the loan would be paid off more quickly, and all future payments under the agreement would go directly to the borrower-recipient. If the borrower-recipient were less successful than expected, the loan would be paid off more slowly. What if the borrower-recipient were to fail completely to make progress? This is an important risk and would leave the borrower-recipient in debt for funds it had applied ineffectually. While this is certainly not the most desirable outcome, it is no different from what happens whenever a country borrows money for development projects and fails to achieve its aims. For example, when a developing country government borrows money to implement a traditional primary education program, it has to repay that loan regardless of whether it succeeds in educating children. Pairing such a loan with a COD Aid grantor's promise to pay down the loan in proportion to success creates the opportunity to buy down that debt, a stronger incentive to succeed, and freer ability to use funds according to the borrower-recipient's own strategies.

This concept of buying down loans for successful programs is not unique to COD Aid. Indeed, something like it is already in operation. Under a program started in 2003, governments can borrow from the World Bank to implement polio eradication programs. These loans are channeled through the International Development Association (IDA), the World Bank's soft-loan arm for the poorest countries. If the polio eradication programs are implemented successfully, a partnership involving the Bill and Melinda Gates Foundation and Rotary International/United Nations Foundation will buy down the country's IDA loan. Because of the generous loan terms, each grant dollar unlocks \$2.50–\$3.00 for affected countries to fight polio. To fund the buy-downs, the partnership has established a trust fund with \$25 million from the Gates Foundation and \$25 million from Rotary International/UN Foundation. This \$50 million investment will buy down \$120–\$140 million in World Bank IDA loans. In this way, developing countries can mobilize what ultimately becomes grant funding to eradicate polio, and thus contribute beyond their national borders to the global campaign to eliminate polio transmission worldwide.

With this type of three-way agreement within a COD Aid project, it would have advantages for each of the three parties. The borrower-recipient would gain access to upfront funding for necessary investments to make progress while continuing to have complete discretion over how to use those funds (unlike standard loans or traditional development programs). If the borrower-recipient makes good progress, it would not pay the loan back, though it would bear the risk of failure if no progress were made. The lender would gain assurance that the loans would be used well and repaid, due to the distinctive features of COD Aid (focus on outcome, recipient responsibility, verification of progress, and transparency) as well as the involvement of the grantor. And the grantor would gain

The concept of buying down loans for successful programs is not unique to COD Aid

greater confidence that the borrower-recipient would have the up front resources to make progress, while also leveraging funding from large lending institutions.

The COD Aid agreement could be available as an open contract

Should financing stop if an exogenous adverse event blocks progress?
An important feature of the COD Aid agreement is to provide a firm incentive for the recipient to make progress, but outcomes depend on factors both in and outside the control of the recipient. Thus, the question arises: is it fair for a recipient to have to forgo an expected COD Aid payment because of a sharp reduction in national income due to adverse weather or a shift in international terms of trade reduces public expenditures or the ability of households to send their children to school?

While it is appropriate for other countries to provide additional assistance to countries facing such adverse shocks, the COD Aid agreement should not be modified to address this need. The COD Aid agreement does cover contingencies, but they should focus on factors that interfere with measuring progress. For example, it is appropriate for the contract to include provisions to address external factors (such as weather) that interfere with applying the annual test or collecting administrative data, so long as these factors are clearly beyond the recipient's control. In such cases, the contract could permit delays in applying tests or submitting reports. Similarly, the contract should include provisions for addressing any discrepancies between government reports of outcomes and the auditor's estimates. By contrast, the agreement should not include a provision that permits COD Aid payments to be based on anything other than verified progress in the number of children completing primary school. Any contingencies that weaken the link between payment for and delivery of the outcome also weaken the incentive that the COD Aid agreement is meant to create.

Implementation: who and how?

In the first COD Aid agreements, a small number of recipient countries is likely to be involved in negotiating the arrangement. Once funders and recipients have experience with this new modality, an institutional arrangement could be adopted that allows the COD Aid agreement to be available as an open contract. Funders and recipients would negotiate a single agreement that would become a standing offer for any eligible recipient to join. Funders, whether private or public, would put money forward for any country interested in participating.

An open contract is attractive for several reasons. First, it would reduce administrative costs, because further negotiations would be unnecessary. Second, it would increase transparency through simplicity and uniformity. And third, it would encourage self-selection of countries for which the terms would be most attractive (for example, a fixed payment of $200 per additional assessed completer would be of much

Before creating an additional independent initiative, it would be advisable to explore opportunities for working through existing institutions

greater interest to low-income than middle-income countries). An open contract would require, in addition, some provisions to limit the funders' exposure, either by restricting the contract to a specific number of countries or establishing a maximum payout.

While it is possible to develop a COD Aid agreement for reaching universal primary schooling as an independent initiative, the international community already has institutions and initiatives that could support or even administer a COD Aid arrangement. The United Nations Educational, Scientific, and Cultural Organization, the Fast Track Initiative for Education, multilateral development banks, bilateral aid agencies, and major private foundations engaged in efforts to expand primary schooling all have their own well established administrative and technical capacities. Before creating an additional independent initiative, it would be advisable to explore opportunities for working through existing institutions.

In our discussions, we identified at least three basic ways to implement a COD Aid agreement for primary education: one or more bilateral agencies participate both as funder and as implementing agency; a multilateral agency negotiates and manages the programs with its own or other resources; and an existing multilateral initiative that included the education sector incorporates COD Aid.

One or more bilateral agencies. One or more bilateral agencies could offer COD Aid as a pilot in multiple countries. For example, the European Commission could incorporate a COD Aid component into its Millennium Development Goal contracts. The Millennium Challenge Corporation could complement its threshold programs or compacts with COD Aid funding for countries that fail its education indicator.

A multilateral agency. A multilateral agency such as the World Bank or a regional development bank could provide the framework and logistical support for a COD Aid agreement. The agency would negotiate the contract with potential recipients, support the development of tests, contract and supervise the auditor, disburse funds, and contract an evaluation of the arrangement. Bilateral agencies, private foundations, and individual philanthropists could contribute to the fund managed by this agency.

A multilateral initiative in the education sector. COD Aid could be part of an existing multilateral initiative in the education sector. In particular, the Fast Track Initiative for Education is a promising institutional base for a COD Aid initiative. Established in 2002, it brings together bilateral and multilateral donors that have committed to provide funding to any country with a strong plan to scale up education. It works in two ways. First, it streamlines vetting of country policies, so funders do this once as a group instead of draining recipient and funder resources with duplicative processes.

Second, it pools funding from many sources, to support countries in expanding primary education.

The members of the Fast Track Initiative could create a special Innovation Fund separate from the Education Program Development Fund and Catalytic Fund. Contributions to this new fund would be voluntary, and the use of its resources would be flexible enough to experiment with innovations like COD Aid.[3] The Fast Track Initiative and its members could then offer a COD Aid agreement to a number of recipients, relying on the initiative's existing contacts, reviews of education sector plans, and financial administration.

Public-private partnership for progress. In each of the cases above, agreements can be structured so that both public and private funders could contribute. Particularly in arrangements involving multilateral agencies and initiatives, it should be possible to establish funds for COD Aid into which private money could be contributed. Putting the institutional structure in place would allow private contributors to support progress in education without the administrative costs and commitment of establishing operations in each country. Private funders would also benefit from the low risk of this approach: if no progress is achieved, no funds are spent.

Audit and arbitration

The role of third parties in the COD Aid agreement is critical to its success, particularly auditing the reported progress measure and arbitrating any eventual disagreements over implementing the contract.

To verify the outcome measure, implementation of the COD Aid agreement requires that the funder and recipient agree on a pool of mutually acceptable agents (chapter 3). The funder then selects and hires one of those agents to conduct retests at a randomly selected sample of schools and to assess the validity of administrative reports from those schools.

The COD Aid agreement also requires a further set of independent agents to arbitrate when disagreements arise over the implementation of the contract. Disagreements can occur over any number of things—the technical quality of the recipient's reporting, the auditor's reports, the quality of the test, the calculation of payments, unanticipated changes in public education policy. Issues not foreseen cannot be incorporated in the COD Aid agreement and thus require some form of binding arbitration to resolve.

Agreements can be structured so that both public and private funders could contribute

To address this possibility, a COD Aid agreement could include a procedure to establish an arbitration committee. If a disagreement were to arise, the recipient and funder would agree on a group of people to serve on such a committee. It might comprise, say, five internationally respected individuals who are not citizens of the countries involved in the dispute and who have relevant expertise in law, education, finance, or the social sciences. Once the committee is empaneled, the funder and recipient would make their cases to the committee and be required to abide by its final decision. The contract would also specify a range of potential remedies available to the committee (such as maximum financial penalties, ability to dissolve the agreement). Recourse to the arbitration procedure should involve costs so that it is not frivolous; for example, the losing party might have to pay the costs of the arbitration.

Hands-off does not preclude engagement

While the COD Aid agreement explicitly delinks a funder's contribution of money from its contribution of expertise, this by no means prohibits the funder from engaging substantively with the recipient. The delinking means, however, that a funder's engagement with the recipient on discussions of strategy or policy is at the recipient's request. Whatever the technical assistance or policy dialogue, it will be more meaningful when clearly demand-driven. The value of any technical support will have to be evident to the recipient rather than merely attached as a condition for receiving funds.

In our consultations on applying COD Aid to the education sector, many education specialists within funding institutions were reluctant to embrace the new aid modality because it seemed to eliminate their engagement with recipients. Their views often changed when they understood that linking aid to outcomes would give them an opportunity to engage in discussions with recipient governments about the best way to educate students and solve problems rather than negotiate over the purchasing and monitoring of specific inputs.

In sum, the challenges of implementing and financing a COD Aid agreement are quite surmountable, and many of the challenges have already been addressed by other aid modalities. Several countries have found ways to make long-term financial aid commitments that exceed their internal budget cycles. Private foundations have established mechanisms for buying down development loans. And many international contracts contain provisions for independent arbitration. The model contract provided in the appendix incorporates these already established solutions to some of the challenges anticipated in implementing a COD Aid agreement.

Notes

1. Eifert and Gelb 2005; Kharas 2008.
2. The lender and grantor could be the same organization, but for exposition, it helps to think of them separately.
3. These ideas have been discussed with Fast Track Initiative staff, and in principle are consistent with the initiatives' system.