ADB

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Piloting a Results-Based Financing for Programs Modality

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
CPS	–	country partnership strategy
DFID	–	Department for International Development (UK)
DLI	–	disbursement-linked indicator
DMC	–	developing member country
EC	–	European Commission
EPC	–	Electric Power Corporation
EU	–	European Union
FSS	–	franchise shipping scheme
GACAP	–	governance and anticorruption action plan
GAVI	–	Global Alliance for Vaccines and Immunization
HSDP	–	health sector development program
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	–	Development Assistance Committee of the Organisation for Economic Co-operation and Development
PBC	–	performance-based contract
PDL	–	performance-driven loan
PNG	–	Papua New Guinea
PPP	–	public–private partnership
RBF	–	results-based financing
RBPSM	–	results-based public sector management
SAI	–	supreme audit institution
SPSP	–	social protection support project
SWAP	–	sector-wide approach
TA	–	technical assistance
UK	–	United Kingdom
US	–	United States

NOTE

In this report, “$” refers to US dollars.

CONTENTS

APPENDIXES

EXECUTIVE SUMMARY

This working paper proposes that the Asian Development Bank (ADB) introduce a results-based financing (RBF) for programs modality. The RBF for programs will support government-owned sector programs, linking disbursements directly with the achievement of program results. The design and implementation of RBF for programs operations will be based on *ex ante* assessments and supported by *ex post* results verification, and will be underpinned by systematic institutional development. The objectives of RBF for programs are to increase accountability and incentives to deliver results, improve the effectiveness and efficiency of government-owned sector programs, promote institutional development, support development coordination and harmonization, and enhance development effectiveness.

RBF for programs operations will have the following key features:

(i) **Supporting government sector programs**. These operations will support government-owned sector programs, and finance the program's expenditure framework.

(ii) **Linking disbursements to results**. Disbursements will be linked to the achievements of the program results—the disbursement-linked indicators (DLIs). The DLIs can be sector outcomes, outputs, and other related results.

(iii) **Strengthening institutional development**. Institutional development is a key motivation and objective of the RBF for programs. The RBF for programs operations will focus on key program systems, including monitoring and evaluation, governance or fiduciary (financial management, procurement, and anticorruption measures), and safeguards. Institutional development will also include organizational and behavioral changes that strengthen the accountability and incentives for results. The aim of institutional development will be achieving and sustaining sector results. The close integration and feedback between institutional development and results will be designed to promote government ownership of institutional development.

(iv) **Managing risks adequately.** RBF for programs operations will include rigorous assessments of the systems to implement the program, follow-up capacity development measures, and implementation support. ADB and the borrower 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**. RBF for programs operations will support development partnerships by sharing a common government-owned results framework, using common systems, and financing common expenditure frameworks.

The achievement of results and institutional development will be the centerpieces of RBF for programs. ADB will assess a program, its financing, results, fiduciary systems, and safeguard systems, guided by commonly accepted good practice principles. The assessments will cover the whole program to be supported—not just the part financed by ADB—and will be used to identify risks and mitigating measures, the capacity development needed, and other implementation support required.

To enable learning-by-doing, it is proposed that ADB pilot the RBF for programs modality for 6 years. This is the minimum time frame required to yield sufficient information for a subsequent review of RBF for programs operations, including both their design and implementation aspects. During the pilot, ADB will put in place measures for training, dissemination, consultation, and learning. ADB will also learn from and exchange experiences with other development agencies. The experiences derived from the pilot will inform the future policy direction of the RBF for programs modality.

To mitigate risks during the piloting, RBF for programs operations 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).

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

I. PROPOSAL

1. This working paper proposes that the Asian Development Bank (ADB) introduce a results-based financing (RBF) for programs modality. The RBF for programs will support government-owned sector programs and link disbursements directly with the achievement of program results. The design and implementation of RBF for programs operations will be based on *ex ante* assessments and supported by *ex post* results verification, and will be underpinned by systematic institutional development. The objectives of the RBF for programs are to enhance the achievement and sustainability of development results from government-owned programs, promote institutional development in ADB's developing member countries (DMCs), foster development coordination, and strengthen development effectiveness.

II. WHAT IS RESULTS-BASED FINANCING?

2. All development operations share the same objective of delivering results. What distinguishes RBF is that it directly links disbursements with results. This differs from modalities that link disbursements with evidence of expenditures for inputs, and thus have an indirect relationship between disbursements and results.

3. 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. The results financing relationships can be defined in legally binding contracts, memorandums of understanding, or partnership arrangements.[1]

4. The results-based relationships can be between various agencies, for example between a development agency and a 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 system improvements 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. Therefore, the results should be defined from the standpoint of the ultimate beneficiaries to ensure that results are relevant and meet their needs.

III. WHY RESULTS-BASED FINANCING?

A. The Quest for Development Results

5. **Incentives and accountability for achieving results**. RBF aims to strengthen incentives and accountability for achieving results. Payments are based on what is delivered, rather than on evidence of expenses incurred. As lack of results can mean reduced, delayed, or no payments, RBF helps align incentives of those who are responsible for delivering the results with the beneficiaries of the results.

6. Worldwide, demands are growing 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).

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

7. 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).[2] Many countries in the Organisation for Economic Cooperation and Development (OECD) have implemented RBPSM. RBPSM has also gradually been adopted in Asian countries. For example, Malaysia's RBPSM reforms have provided greater autonomy to the heads of line departments to manage their budget appropriations—under a philosophy of letting the managers manage and holding them accountable for results. These efforts have been echoed by other DMC governments. For example, the government of Andhra Pradesh in India instituted the Performance Accountability Act in 2003.

8. RBPSM and similar public sector reforms have profound implications for the operations of development agencies. With the growing demand to demonstrate accountability and 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.

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

B. A New Development Paradigm

10. The quest for results and institutional development has significantly shaped development financing since the 1990s.[3] A consensus emerged through successive development forums, including the Monterrey Consensus in 2002, the Rome Declaration on Harmonization in 2003, the Marrakesh Roundtable on Results in 2004, the Paris Declaration on Aid Effectiveness in 2005, the Accra Agenda for Action in 2008, and the Busan Partnership for Effective Development and Cooperation in 2011. The international community, including multilateral development banks (MDBs), committed through these forums to measuring development effectiveness by achieving results, supporting institutional development, strengthening partnerships, enhancing country ownership, and harmonizing development initiatives.

IV. RESULTS-BASED FINANCING IN MULTILATERAL DEVELOPMENT BANKS

11. While bilateral agencies have spearheaded the use of the RBF approach, MDBs have also been pursuing 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.[4] Appendix 1 summarizes the operations with RBF features by MDBs and other development agencies.

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[2] 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.

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

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

A. World Bank

12. **Program-for-results financing**. The World Bank's board of executive directors approved a new program-for-results financing instrument in January 2012. Program-for-results financing supports government development programs, uses results as the basis for disbursements, and promotes institutional development.

13. 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 finances 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.

14. **Operations.** While program-for-results financing is a new instrument, many operations at the World Bank have incorporated features of RBF since the late 1990s.[5] Most of these were processed as investment lending operations (Appendix 1). These projects disburse against 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 borrowers. 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 borrowers to deliver results.

15. **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, the program-for-results financing, to mainstream these operations.

16. The World Bank's review concluded that RBF operations had been "squeezed" into investment lending frameworks. This had several drawbacks (footnote 4):

(i) **High transaction costs**. A double layer of controls was often required to ensure the operations complied with both government and World Bank requirements, imposing additional transaction costs without additional value. Staff reported that internal processing costs were excessive and diverted time and attention away from substantive matters.

(ii) **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 the overall 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 the investment lending procedures rather than those driven by delivering results. This limited the 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 operations were designed as conventional investment lending to

[5] 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 - Knowledge Improvement for Transparency and Accountability Project (BOS-KITA) 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.

avoid the high transaction costs. This approach deprived the World Bank of the opportunity to help borrowers improve their program systems.

(iv) **Missed opportunities to address institutional issues**. Because of concerns about applying the World Bank rules to country programs, more attention was given to procedural compliance than to institutional issues. This created missed opportunities to address institutional issues.

(v) **High risks**. Uncertainty about the World Bank policies and procedures heightened risks for both borrowing countries and the World Bank.

17. The World Bank's PMGSY Rural Roads Project in India highlights these problems.[6] 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 the government and the 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 had more than 7,000 contracts spread across about one-third of India. This has made project management difficult and risky for the World Bank and the government.

18. The program-for-results financing instrument benefitted 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 required to (i) provide an enabling policy framework for RBF operations, (ii) lower transaction costs, (iii) reduce inconsistencies and confusion, and (iv) reduce missed opportunities to influence positively the entirety of government programs and improve program institutions. The World Bank has tentatively identified 13 operations that are likely to use program-for-results financing in the first year after policy approval. These operations cover a wide range of country incomes, program types, and sectors, including health, education, transport, rural infrastructure, and public sector management. In June 2012, the World Bank approved two programs under program-for-results financing.[7]

B. Inter-American Development Bank

19. **Policy.** The IDB adopted its policy on performance-driven loans (PDLs) in 2003.[8] The main features of PDLs include (i) disbursement based on meeting results targets, except for advance payment, which can be up to 20% of the IDB financing; (ii) results defined by outcomes; (iii) results audited by independent performance reviewers; and (iv) use of country systems for procurement.

20. **Operations**. PDLs were used in many infrastructure and social sectors. A health sector PDL operation in Colombia played an important role in delivering vaccinations to many

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[6] World Bank. 2010. *Project Appraisal Document on a Proposed Credit in the Amount of SDR 636.3 million (US$1,000 Million Equivalent) and a Proposed Loans in the Amount of US$500 Million to the Republic of India for the PMGSY Rural Roads Project.* Washington, DC. Pradhan Mantri Gram Sadak Yojana (PMGSY) is the Prime Minister's Rural Road Program.

[7] 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; and 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.

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

disadvantaged people.[9] A solid waste management operation in Chile added flexibility in supporting a large number of subprojects.[10] An agricultural operation in Paraguay helped farmers gain access to inputs and technological support.[11]

21. **Lessons.** The demand for PDLs had been moderate—17 operations from 2003 to 2009—for two main reasons. First, PDLs require the delivery of outcomes that often take longer to achieve. One lesson that can be derived from this experience is that while outcomes should drive RBF operations, basing disbursements largely on outcome can be problematic. Second, it is difficult to attribute outcomes directly to IDB financing, as these are achieved through financing from various sources. IDB assistance is only one of the financing sources contributing to the results. Third, PDLs require *ex post* performance as well as verification of expenditures to achieve results. Borrowers and project teams consider this burdensome as investment lending projects are generally only subject to financial accounting and reporting. Effectively, PDLs have added the result requirements on top of investment lending, which has increased transaction costs.

C. Asian Development Bank

22. **Strategic transformation.** Strategy 2020 is transforming ADB's core business model, guided by a set of core corporate values including responsiveness to DMCs' needs, recognition of country ownership, commitment to partnerships with DMCs and other development partners, and accountability for results.[12]

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

24. The Development Effectiveness Review, started in 2008, annually tracks ADB's achievements in meeting results targets. Recent Development Effectiveness Reviews have shown 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 the ADB reforms to increase development effectiveness.

25. **Operations.** Even without a dedicated RBF modality, RBF features have been included in some recent ADB operations, such as the Third Primary Education Development Project in Bangladesh.[13] This project is supported by 10 development partners, with ADB financing linked with clearly defined DLIs. The project uses the government's treasury system for financial management, thereby increasing development coordination and reducing transaction costs. The RBF features are in line with development partners' commitment to (i) results, (ii) a reduction in transaction costs, and (iii) enhanced government ownership and leadership. ADB has also been

[9] IDB. 2005. *Colombia: Strengthening the Expanded Program on Immunization (EPI) 2005–2008 (CO-L1002) – Loan Proposal.* Washington, DC.
[10] IDB. 2008. *Chile: Integrated Solid Waste Management (CH-L1026) – Loan Proposal.* Washington, DC.
[11] IDB. 2006. *Paraguay: Modernization of Agricultural Support Management (PR-L1001) – Loan Proposal.* Washington, DC.
[12] ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank*, *2008–2020*. Manila.
[13] 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).

involved in other sector-wide approach (SWAP) operations, including the Health Sector Development Program in the Philippines, approved in 2004;[14] and the Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project in Indonesia, approved in 2011.[15]

26. **Lessons**. ADB's implementation of operations with RBF features has yielded similar lessons with those of the World Bank. For example, a lack of an enabling policy framework has led to high transaction costs and missed opportunities. Without a dedicated and clear policy and procedures, teams often had to search and reinvent ways to process these operations. Further, operations with RBF features are often provided as investment projects under governments programs, which means spending more time in setting up parallel implementation arrangements that would simultaneously meet both government and ADB policy and procedural requirements. It also means that disbursements in these operations are linked with both results and inputs. Lengthy and complex procedures limit ADB's impacts and timely contribution to government programs. Adopting an RBF for programs modality will address these problems. ADB's experience also indicates that flexibility in design and implementation is needed to promote continual improvements in a program.

27. Appendix 2 provides examples of ADB operations with RBF features.

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

28. Adopting a RBF for programs modality is expected to 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 project-based and policy-based loans.[16]

30. **Project-based lending**. ADB has various modalities that fall within the project lending ambit. Project-based lending finances expenditures for inputs in discrete investment projects, such as works, goods, and services. Project-based lending focuses on transactions and disburses funds incrementally based on evidence of expenditure. 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 systems, projects are generally implemented under parallel systems. In project-based lending, technical design and implementation challenges in procuring and using inputs are generally critical bottlenecks to achieving results. Therefore risk management and controls are needed on the inputs side, for example to ensure that the appropriate construction materials

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[14] 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, ordinary capital resources, approved on 15 December 2004).

[15] 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. (Loan 2768-INO, $100 million, ordinary capital resources, approved on 5 August 2011). PNPM Mandiri refers to Program Nasional Pemberdayaan Masyarakat which means National Program for Community Empowerment.

[16] In this paper, "instrument" (or "product") refers to the generic means of providing or facilitating financing—debt (mostly loans), equity, guarantees, or grants. A "modality" involves the specific application of these instruments within a defined legal, policy, and operational structure, such as the multitranche financing facility and additional financing.

[17] While projects are implemented using ADB rules and procedures in certain areas, projects are implemented by agencies from the borrowing countries. Thus, the ring-fencing is only partial.

and technology are in place. By using ADB rules, controlling the processes for procuring and using the inputs, and monitoring transactions, project-based lending seeks to ensure that the right inputs are in place and the operation is implemented as planned. Project-based lending is therefore suitable for discrete investment operations in which ADB's attention should be focused on monitoring all the transactions. The scope of a project should also make it feasible for ADB to monitor all the transactions.

31. **Policy-based lending**. Policy-based lending is used to support reforms.[18] It usually provides budget support to governments to address development financing needs. ADB disburses funds based on evidence of the fulfillment of policy conditions. Country systems are used in policy-based lending. ADB does not track or monitor the specific transactions supported by its financing, which is disbursed into the government's general account. The utilization of country systems is based on the existence of a stable macroeconomic environment and knowledge of the financial management environment. Policy-based lending is suitable for improving policies and supporting reforms. Policy conditions such as enacting new regulations or adopting new policy frameworks aim to create an enabling environment for public and private sector operations, and improve growth prospects and economic efficiency.

32. **Sector development programs**. ADB's sector development program is not a separate lending modality. Rather, it combines project- and policy-based lending modalities. In a sector development program, the policy-based operations and investment operations follow the existing policy frameworks for these two modalities.[19]

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

B. The Need for a Results-Based Financing for Programs Modality

34. ADB's project-based lending and policy-based lending modalities have an established track record in 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. These programs are generally spread over large geographical areas and require a holistic package of measures to address sector-wide issues.

35. As the World Bank noted in its program-for-results financing policy paper (footnote 4), many of the development challenges DMCs face 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, 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 institutions and systems; and (iii) changing incentives and behavior by the government, service providers, and users. RBF for programs will be designed

[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.

[19] ADB. 2003. Sector Development Programs. *Operations Manual.* OM Section D5/BP. Manila. Policy-based lending can also finance balance of payments.

to better address such development challenges, and improve the quality of government programs and their accompanying systems.

36. Despite the lack of a dedicated policy, ADB and other development agencies have implemented operations with RBF features in recent years—a testimony of the demand for, and usefulness of RBF for programs. In a sense, practice has preceded policy development. However, in the absence of a dedicated policy framework, these operations often have had to be squeezed into the project 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) strengthen their incentives and accountability for results, (iii) improve the program systems and institutions, and (iv) engage more effectively in development partnerships in a results-based and programmatic setting.

37. The proposed RBF for programs modality seeks to fill this policy gap. The RBF for programs modality will help ADB address sector-wide challenges more effectively, and provide ADB and DMCs with more choices to select the most suitable modality for different development challenges. It will also help ADB better clarify and define the boundaries of the three broad types of modalities: project-, program-, and policy-based operations.

38. The RBF for programs will guide RBF operations which are already gaining momentum in ADB. Feedback from staff indicates that RBF for programs will be well suited to many sectors. For example, these programs can help to integrate scattered interventions in some sectors. They are also suitable for some new sectors. For example, climate change interventions and carbon finance are usually results-based through disbursements for carbon emission reductions, energy efficiency, or increased use of renewable energy. As international negotiations on climate change focus more on measurable, reportable, and verifiable results, the adoption of RBF for programs in climate change mitigation operations will be increasingly relevant.

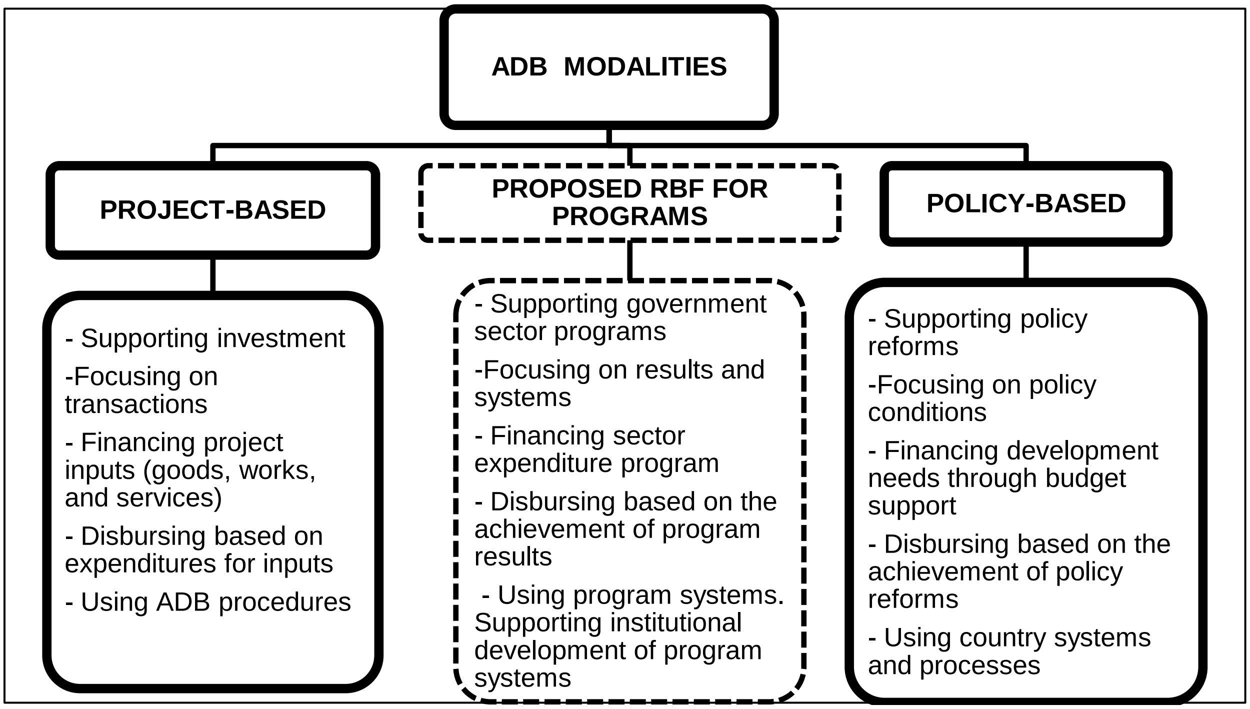
C. Results-Based Financing for Programs as a Third Lending Modality

39. If adopted, the RBF for programs modality would be a third lending modality for ADB, positioned between the two existing modalities: policy- and project-based lending modalities. RBF for programs would complement, not replace, policy- and project-based operations.

40. RBF for programs 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 behavioral and institutional changes necessary for delivering and sustaining results. An RBF for programs operation will require expenditures to deliver its results, which ADB financing will support. RBF for programs will disburse funds 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 RBF for programs. The willingness and commitment of the government to engage development partners in improving its program and institutions are essential for the decision to choose the RBF for programs modality. Overall, RBF for programs will be a practical choice when the objective of an operation is to support the performance of a government program using the government’s systems, when the results require expenditures, and when the major risks to achieving the program’s results relate to the capacity and performance of the program systems.

41. Figure 1 summarizes the key features of policy-based, project-based, and RBF for programs modalities. More details on the features of RBF for programs are in para. 59.

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



ADB = Asian Development Bank, RBF = results-based financing.
Source: ADB.

D. Expected Benefits from Results-Based Financing for Programs

42. Adopting RBF for programs 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

43. RBF for programs 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 an results-based approach from development partners that is integrated, focuses on results and system performance, and addresses system weaknesses. They need financing and expertise from their development partners to implement and improve these programs. During consultations for the proposed RBF for programs modality, DMCs expressed a strong desire for ADB to put in place such a programs modality.[20] The experience of other MDBs, especially the World Bank, confirms this strong demand from borrowers.

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

2. Enriching ADB Operations

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

45. **Increasing ADB's leverage**. RBF for programs will enhance ADB's leverage in expanding the development impact of its operations. As DMCs grow, development financing as a share of DMCs' total public finance has become smaller. Development agencies are shifting from being primary providers of funds to being catalysts for development. RBF for programs will provide an opportunity for ADB to finance a portion of a large government program, while being able to influence the whole program positively, thereby increasing ADB's development impact. ADB assistance will help DMC systems converge with internationally accepted good practices, which can have far-reaching implications for sustaining results.

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

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

47. By focusing on results and institutional development, RBF for programs will also 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 linked to the delivery of verified results. The disclosure of results and system-related information to the public will increase transparency. RBF for programs will cover the key components of governance: financial management, procurement, and anticorruption measures. Through rigorous assessments, capacity development, and fiduciary risk management, RBF for programs will support governments 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. Contributing to the Aid Effectiveness Agenda

48. RBF for programs will contribute to the achievement of the goals of the aid effectiveness agenda.

49. **Sharpening the results focus.** RBF for programs will makes achieving clearly defined results the basis for receiving ADB financing. It will provide a powerful incentive for borrowers to deliver the intended results. The adoption of RBF for programs is in line with the development community's broader emphasis on strengthening the link between disbursement and results, and providing DMCs with greater latitude to develop their own strategies and plans and to use of their results frameworks. RBF for programs will provide flexibility for DMCs to manage processes, thereby fostering country ownership and creating opportunities to discover new and

better ways to achieve desired results.[21] ADB can add further value in assisting the DMCs' development journey by devoting more resources to program design, problem solving, and capacity development.

50. **Strengthening program institutions.** Institutional development and the achievement of results go hand in hand in RBF for programs. Institutional development serves as both a means to achieve results and as a vehicle for risk mitigation. Closely linking institutional development with development results helps ensure that the institutional development remains focused, purposeful, and owned by the governments. RBF for programs will directly confront institutional weaknesses and bring about incremental, positive, and sustainable changes. Organizational learning is an intrinsic part of RBF for programs. Through the Paris Declaration on Aid Effectiveness and other related declarations since 2002 (para. 10), the international development community has reached a consensus that using and strengthening country systems is an important part of the development agenda. Enhanced program systems will contribute to improvements in country systems.

51. **Increasing alignment and harmonization.** Under RBF for programs, development assistance will be aligned through shared results and common systems. RBF for programs are natural platforms 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. This stretches DMC administrative capacity and causes delays. Using the program systems will save resources and reduce transaction costs for DMCs, especially in the long run. RBF for programs will help institutionalize the scrutinizing and strengthening of government systems. This will enable development agencies' assistance to be seamlessly mainstreamed into existing government implementation arrangements.

52. For these reasons, RBF for programs have great potential to increase development effectiveness.

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

53. ADB has carried out extensive internal and external consultations on the proposed RBF for programs modality. An interdepartmental team was established, which has provided a forum for exchanging experiences and developing ideas. An informal Board seminar was held in November 2011. ADB surveyed all its DMCs to gauge their demand for an RBF for programs modality and to get their feedback on the proposal. ADB also fielded missions to selected DMCs in different sub-regions. A broad web-based public consultation was also conducted. All the 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.

54. ADB has consulted its development partners, especially the World Bank and the IDB, which both have rich experience in RBF operations and/or policies. During the development and implementation of the World Bank's program-for-results financing instrument, two World Bank missions visited ADB for consultation and dissemination of information. ADB carefully studied the stakeholder feedback to the World Bank's consultations on the program-for-results financing.

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

55. Stakeholder feedback indicates broad support for developing an RBF for programs modality in ADB. Most appreciated the potential of this proposed modality for focusing on results, strengthening institutions, enhancing government ownership, and facilitating development coordination. Stakeholders also provided many constructive comments and suggestions, and asked many useful questions. Questions were raised about how to define results, how to monitor results, how to carry out effective capacity development, how to mitigate fiduciary risks, how to manage potential environmental and social impacts, and how to reduce transactions costs. Appendix 4 summarizes the key points from the consultations. All comments, suggestions, and questions were carefully considered in drafting the policy.

56. In addition to learning lessons from its own operations, ADB has carefully studied the lessons from implementing operations with RBF features in other MDBs (paras15, 16, 21, and 26). 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 an RBF for programs modality. Key lessons are summarized in Appendix 5.

VII. PREPARING AND IMPLEMENTING RESULTS-BASED FINANCING FOR PROGRAMS

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

57. The proposed RBF for programs will support a government-owned sector program and disburse ADB financing based on the results of the program. A government program can cover the whole, part, or a time slice of a sector with the aim of improving sector performance, and can be new or ongoing.[22] The term “sector” can mean a sector, a subsector, or a cross-sectoral theme such as environmental protection, poverty reduction, women in development, public financial management, and private sector development. The government can be national or subnational.

58. The objectives of RBF for programs are to increase accountability and incentives for delivering sector results, improving the effectiveness and efficiency of a government-owned program, strengthening program institutions and systems, facilitating development coordination and harmonization, and enhancing development effectiveness.

59. RBF for programs operations will have the following key features:

(i) **Supporting government sector programs**. These operations will support government-owned sector programs, and finance the program’s expenditure framework.

(ii) **Linking disbursements to results**. Disbursements will be linked to the achievements of the program results—the DLIs. The DLIs can be sector outcomes, outputs, and other related results.

(iii) **Strengthening institutional development**. Institutional development is a key motivation and objective of the RBF for programs. The RBF for programs operations will focus on key program systems, including M&E, governance or fiduciary (financial management, procurement, and anticorruption measures), and safeguards. Institutional development will also include organizational and

[22] ADB may support in full or a slice of a government program. The program or the part that is supported by the ADB RBF for programs modality will be the ADB RBF for programs operation. The term “program” in this policy refers to the ADB RBF for programs operation as defined unless otherwise specified.

behavioral changes that strengthen the accountability and incentives for results. The aim of institutional development will be achieving and sustaining sector results. The close integration and feedback between institutional development and results will be designed to promote government ownership of institutional development.

(iv) **Managing risks adequately.** RBF for programs operations will include rigorous assessments of the systems to implement the program, follow-up capacity development measures, and implementation support. ADB and the borrower 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**. RBF for programs operations will support development partnerships by sharing a common government-owned results framework, using common systems, and financing common expenditure frameworks.

60. An RBF for programs operation will have five building blocks: (i) relevance and appropriateness of the program, (ii) expenditures and financing, (iii) results and links with disbursements, (iv) fiduciary systems, and (v) safeguard systems (Figure 2).

Figure 2: Building Blocks of Results-Based Financing for Programs

Sector Strategy

Relevance and Appropriateness	Expenditure and Financing	Results and Links with Disbursements	Fiduciary Systems	Safeguards Systems
• Justification • Soundness • Implementation arrangements	• Expenditure framework • Financing plan	• Results (outcomes, outputs, other results) • Links with disbursements • Monitoring and evaluation	• Financial management • Procurement • Anticorruption measures	• Managing environmental and social impacts

Source: ADB.

B. Suitability and Identification

61. Identification and design of an RBF for programs operation may consider several factors.

62. **Definition of the program**. An RBF for programs operation will have a defined scope, expected results, expenditure framework, financing plan, and accompanying institutions and systems.

63. **Development constraints**. An RBF for programs operation will support the delivery of sector results and strengthen program institutions through a system-based approach. The two key development constraints that RBF for programs are well suited to address are (i) the need to strengthen incentives and accountability for results by directly linking financing with results,

and (ii) the need to use and, as appropriate, improve the program institutions and systems in order to deliver and sustain results through a system-based approach.

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

65. **Established engagement with development agencies**. In sectors or programs where the government and development agencies have an established engagement, the RBF for programs approach may be appropriate to translate the discrete policy reforms, projects, or dialogues into sector results and to deepen sector engagement.

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

67. **The institutional capacity**. The capacity of the implementing institutions and the risks associated with a potential program should be considered. The program institutions and systems, through capacity development and other measures, 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 the capacity can be improved.

68. **Exclusion.** RBF 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).[23]

69. Experience has shown that RBF for programs can be implemented in DMCs with different income levels. The experience of MDBs and other development agencies also shows that RBF operations have been used in increasingly diverse sectors. Thus, ADB will not limit the sector or country selections in piloting the RBF for programs. This will enable ADB to monitor what will emerge as the main sectors and countries for RBF for programs and learn a diverse range of lessons.

70. Similar to other ADB operations, a potential RBF for programs operation will be identified as a part of the CPS, country operations business plan, or policy dialogue process. A program should be underpinned by the government's sector strategy (or a similar document), which defines the sector objectives and strategies to achieve them.[24] 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

[23] It is proposed that the specified monetary amounts 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 IT systems and non-consulting services; and $15 million for consulting services. The amounts may be changed from time to time.

[24] DMCs may use different terms to describe a sector strategy or other terms used in this paper. ADB's assessments should focus on their substance, as appropriate.

private sectors. The sector analysis and strategy will form the basis for the identification of an RBF for programs operation. The sector strategy will not be a rigid blueprint; it will instead establish basic principles, 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.[25]

71. ADB will assess the quality of the sector analysis and strategy as a basis for preparing an RBF for programs operation, and will support required improvements where appropriate. ADB will identify the need for the RBF for programs operation in consultation with the borrower, taking into consideration factors such as the nature of development constraints.

C. General Approaches and Considerations

78. Each proposed RBF for programs operation will undergo a rigorous assessment covering the five building blocks (Figure 2). The assessments related to program relevance and appropriateness, financing, and results - will assess the degree to which the program achieves its development results. The fiduciary or governance systems assessment will assess 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 assess the degree to which the program systems manage and mitigate the environmental and social impacts. The assessments and related measures and assistance will be tailored to suit different operations and be appropriate to the nature and circumstance of a specific program.[26] ADB will work closely with the borrower and development partners, as relevant, to undertake or deepen these assessments. The assessments will identify the weaknesses and strengths of the program, and inform the risk mitigating measures and capacity development needed.[27] ADB will assist the borrower in strengthening the program systems, as appropriate.

79. The design and implementation of an RBF for programs operation will be guided by several considerations:

(i) **Focusing on results and systems***.* It may not be feasible 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 the number of agencies involved. Thus, ADB financing in an RBF for programs operation 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—is necessary.

(ii) **Guiding principles**. The assessment and improvement of the program systems will be guided by commonly accepted good practice principles.[28] Development

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[25] 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.

[26] For example, for a conditional cash transfer program, the main focus will be placed on the integrity of fund flows and the required behavior linked to the conditions. For a program that involves a large number of infrastructure activities, such as a rural road program, procurement and safeguard issues will be especially important.

[27] The assessments will draw on and make best use of existing documentation, analytic work, work by other development partners, and other relevant sources as appropriate. ADB will also coordinate with other development partners in carrying out the assessments as appropriate.

[28] The principles depend on the areas of assessments. Safeguard Policy Statement lists policy principles for environmental and social management. The procurement principles are embedded in ADB's procurement guidelines. They are competition, efficiency and economy, transparency, and fairness and equal opportunity. The principles for financial management are efficiency and economy, effectiveness, adequacy, accountability, and transparency, which are the same as those for other operations. See Section D for more details on the principles and assessments.

financing may account for a moderate share of total program financing.[29] Further, a government program may have been in place before ADB's participation and involve multiple development agencies. System assessments and improvements, guided by the commonly accepted good practice principles, will help program systems to converge towards these principles, and allow adaptation of systems to the country context to ensure DMC ownerships.

(iii) **Covering the whole program.** ADB's assessments will cover the whole program supported by the RBF for programs operation, not just the part financed by ADB. Helping to improve the systems in order to manage all resources for a program—domestic and external—will provide a productive development assistance route for expanded development impacts.

(iv) **Avoiding prohibitive processing costs and setting overly ambitious targets**. Bringing about incremental positive and sustainable changes will be more beneficial than setting up unachievable targets that stretch government and ADB capacity, demand large resources, and in the end achieve little. The incremental changes aim to yield material improvements in the medium to long run.

D. Assessing the Building Blocks

1. Relevance and Appropriateness

80. ADB's support for a government sector program can come at any time in a program's duration—from the conceptualization to an ongoing program. For a new program, ADB will support the borrower in designing the program. For an ongoing program, ADB will assist the borrower in improving the program design as necessary. ADB will assess the relevance and appropriateness of the program.

81. **Justification.** ADB will ascertain whether a program is strategically relevant and its outcomes are important. ADB will also determine the justification for the intended public interventions in supporting 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 limited public resources and efficiency issues, the program needs to explore the role of the private sector in contributing to the development results, including through public–private partnerships (PPPs). Ensuring that public financing has a sound justification is an important step towards efficient public expenditures.

82. **Soundness.** A sound program will adequately consider effectiveness, efficiency and economy, and sustainability dimensions**.** The effectiveness of a program is the extent to which it will achieve the intended results. ADB will determine whether the program scope and design is sound and can be expected to improve the 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 wither the program uses resources optimally. ADB will ascertain whether the program (i) will get the incentives right and induce the desired organizational and individual behaviors, (ii) will be likely to generate distortions, and (iii) will attract or crowd-out private sector participation. Sustainability requires that a program's results not be short-lived and

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

easily reversible. The program's sustainability will be reviewed to determine whether it can be sustained in the medium term to achieve its outcomes.

83. The soundness of a program will hinge upon a broad range of institutional, organizational, and individual factors. It may include regulatory issues for the sector, optimal division of responsibilities between the public and private sectors in financing and providing services, and service delivery on both the supply and demand sides. The RBF for programs operation will aim to induce institutional, organizational, and individual changes that can deliver and sustain the results. ADB can add value to all these aspects.

84. **Implementation arrangements**. ADB will assess the agencies that will be responsible for implementing the program, including their roles, interagency relations, incentives, resources, and capacities. ADB will work with the borrower (and other development partners as appropriate) to strengthen the program implementation arrangements as necessary. ADB will also assess the commitment of the government to the program, especially in delivering results and improving systems.

2. Expenditure and Financing

85. **Expenditure framework.** The expenditure framework will make a program operational, ensuring that the priorities and costs are realistic.[30] ADB will assess the efficiency and economy, effectiveness, adequacy, sustainability, and transparency of the entire program expenditure framework, not just the share it is financing, as follows:

(i) Efficiency and economy require that the limited public finance is used optimally. 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 PPPs. The RBF for programs operation will strive to bring about incremental efficiency gains.[31]
(ii) 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 the program results, ADB will try to identify any mismatches between expenditures and the problems they intend to address.[32]
(iii) Adequacy requires that expenditures are sufficient for the program results. ADB will assess whether the allocation across components reflects the resources required to generate the results.
(iv) Sustainability requires that a program's expenditure framework be able to generate sustainable results over the medium term.
(v) To ensure transparency, ADB will assess whether the budget and reporting systems provide timely and sufficient information on program expenditures.

86. **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 financing is predictable and sustainable. ADB will

[30] The expenditure framework is sometimes supported by a medium-term expenditure framework.
[31] 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.
[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).

assess the government's medium-term fiscal projections and determine whether the underlying assumptions are realistic. ADB will also analyze whether there are significant discrepancies between budget allocation and budget execution.

87. 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 overall expenditure needs, ADB's lending in the country, the strength of the program, and the priorities of the government and ADB. ADB financing can be pooled with the borrower's resources and/or financing from other sources, if any.

3. Results and Links with Disbursements

a. Results

88. A clear definition of the results and a strong emphasis on achieving them are defining features of RBF for programs. ADB will assess the existence and quality of the results framework of the program, 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 frameworks.[33] The indicators will depend on the nature of a 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 result chains to establish the links between intermediate and final results (the program outcomes).[35] The causal relationships in the results chain should be well established. While disbursements will be based on a selection of key milestones—the DLIs—a clear understanding of the overall program results is essential to ensuring the success of the program. If the results frameworks are not well defined, ADB will work with the borrower to develop or refine them.[36]

89. Outputs are the most important results in an RBF for programs operation because they are directly within the program's control and the means through which the outcomes are achieved. Outputs are the driving force in deciding how inputs should be selected and used.

90. RBF for programs operations will stress that the outputs should be defined from the perspective of program beneficiaries. 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 tests are more relevant outputs for parents. Similarly, water

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[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 ineffective as a program indicator.

[34] For definitions of outcome, outputs, and other result definitions, see ADB. 2008. *ADB Results Framework*. Manila; and OECD-DAC. 2002. *Glossary of Key Terms in Evaluation and Results Based Management.* Paris. The applicability of ADB's design and monitoring framework needs to be reviewed to ensure that it fits the design parameters of RBF for programs operations. As funds will be disbursed based on results, ADB will 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, the results framework of an ongoing program may be implicitly included in a government strategy or other document.

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.

91. Outputs that are defined from the perspectives of program beneficiaries 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. The perspectives of beneficiaries will help shape the definition of program results. ADB will assess whether the program result indicators, especially outputs, are sufficiently relevant to program beneficiaries and meet their needs. Focusing on results, ADB will also assess whether the program approach embodies sufficient flexibility to motivate and support innovations.

b. Links with Disbursements

92. **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 government's results framework.[39] If necessary, DLIs may exceed a government's results framework. For example, if vital institutional indicators are not included in the government'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. Ideally, however, DLIs should be the same as those in the program results framework to ensure synergy, government ownership, and integration between the government and ADB assistance. ADB and the borrower will agree upon the DLIs.

93. **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 it will be measured and verified. ADB and the borrower will agree upon a credible verification mechanism. The verification will depend on the nature of the DLI, the program, and the country context. It can be carried out by public, private, semiautonomous, or civil society entities, as appropriate, as long as the credibility of the verification is ensured. Program beneficiaries should be given a role in verifying the results where appropriate. To support timely results verification, ADB and the borrower will work together to plan and prepare the results verification.

94. **Linking results with disbursements.** Proceeds from an RBF for programs operation will be disbursed to the account of the borrower or the appropriate entity following the achievement and verification of the agreed DLIs.[40] 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 RBF for programs operation. 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 date.

95. **Partial disbursement**. An RBF for programs operation will allow partial disbursements if DLIs are partially met. The design of the disbursement 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. DLIs may be "priced" equally or differently depending on their purposes. Using an equal

[37] For example, a stable supply of quality water is more likely to lead to improved health indicators than just water pipes.
[38] Under an RBF for programs, ADB financing will not be paying for the costs of achieving the DLIs. DLIs are a part of the RBF for programs results, which will be achieved by using all the resources available for the program.
[39] For a spatially diverse program, the DLIs may be different for different areas. A DLI may have one or more values to be achieved over the lifetime of an RBF for programs operation.
[40] Verification of results for the advanced financing may occur after the disbursement.

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 schedule depending on the achievement of the DLIs.

96. The rationale for partial disbursements is summarized as follows:[41]

(i) Deviations between expectations and actual implementation are always to be expected. Partial disbursement for partial performance is appropriate to recognize progress made.

(ii) Partial payment helps avoid a stop-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 the 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 for partial performance can help address this problem.

97. 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 and other actions, the expected timing and level of disbursements can be phased in a way that supports results as well as reflects the need for a predictable fund flow. Partial disbursement will also facilitate the predictability of fund flows.

98. **Advanced financing and financing prior results.** The financing gap may create a burden for the borrower given the resources required to achieve the DLIs. Advanced financing may also be needed for institutional development. To address the financing requirements and support the achievement of the DLIs, ADB can provide up to 25% of ADB financing as advanced disbursement. The amount of the advances will be recovered from the amount to be disbursed subsequently. Further advances can be made once an advance has been recovered or partially recovered, but the ceiling will be kept at 25% of ADB financing. Some results may also need to be achieved before an RBF for programs is approved, such as setting up the M&E arrangements. In such cases, ADB will be able to disburse based on the DLIs achieved within 12 months before the effectiveness of the RBF for programs operation. The total amount for financing for prior results should not exceed 20% of the ADB financing. The combined advance financing and financing for prior results may not exceed 30% of ADB financing, unless a higher amount is approved by Management.

c. Monitoring and Evaluation

99. Ensuring the reliability of the program's M&E system is essential for the success of an RBF for programs operation. 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 become results-based. Results-based M&E and RBF for programs operation have significant synergies. The program's M&E systems should enable transparent and reliable assessments of program performance, and facilitate timely remedies when problems occur. One lesson to emerge in recent years has been the need to use government systems for M&E, rather than to duplicate them.[42]

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[41] 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.

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

100. Under an RBF for programs operation, 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, an RBF for programs operation will strengthen the DMC's M&E systems. Setting up an acceptable M&E system can be part of the DLIs.

101. ADB will assess whether the borrower'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 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. M&E systems may include multifaceted approaches, such as information systems and beneficiary group feedback, as appropriate.

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

4. Fiduciary Systems

103. Strong fiduciary or governance institutions, 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, these systems provide reasonable assurance that program financing will be used for intended purposes (with due attention to economy and efficiency). ADB will assess the fiduciary risks and the program systems' ability to manage and mitigate the risks. The scope of the assessment will depend on the nature and scope of the program. The assessments may include

(i) applicable rules and procedures,
(ii) the capacity of the relevant agencies,[43]
(iii) the agencies' practice and performance in case of ongoing programs, and
(iv) the improvements required.

a. Financial Management

104. 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%.[44] RBF for programs operations will build on ADB's experience in using DMC financial management systems by tackling weaknesses at the program level.

105. ADB's assessment of the financial management system will determine the degree to which it manages the fiduciary risks and provide a reasonable assurance that program funds will be used appropriately. The assessment will be guided by the commonly accepted good practice principles: efficiency and economy, effectiveness, adequacy, accountability, and

[43] Agencies may need to be assessed on a sample basis or for key agencies, as appropriate.
[44] ADB. 2011. *Aid Effectiveness Report 2011: Overall Achievements on Paris Declaration Commitments.* Manila.

transparency.[45] The assessments may cover the following aspects:

(i) **Planning and budgeting**. Planning and budgeting are the transmission chain between strategic priorities and results. The planning and budgeting systems of the program should ensure that (a) the cost estimation and resource allocation for the program are realistic, (b) the results can be achieved within the program's resource envelop, and (c) no significant discrepancies exist between budget allocation and execution.

(ii) **Internal controls.** ADB will determine whether reasonable internal controls are in place to safeguard program resources 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. ADB will also assess whether the internal controls are efficient.

(iii) **Funds flow**. ADB will assess the fund flow arrangements, seeking to ensure adequate clarity, checks and balances, economy and efficiency.

(iv) **Accounting.** ADB will assess whether the program will have adequate program accounts and records.

(v) **Financial reporting**. ADB will assess the adequacy of the scope, form, content, and frequency of the program's financial statements.

(vi) **Independent audit**. The program financial statements should be subject to independent audit. ADB will assess whether the form, content, and frequency of the program's financial statements are acceptable. ADB will require the auditor to be independent and to have the capacity to provide audit reports and opinions to the quality required by ADB.

b. Procurement

106. Procurement assessment will be guided by the following sound procurement principles:[46]

(i) **Competition**. Open competition is the default approach, and conditions for other methods are clearly described.[47]

(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.

(iv) **Fairness and equal opportunity**. All eligible bidders should have an equal and fair opportunity. Procurement processes avoid preferential or discriminatory measures that might favor or affect certain participants.

107. An RBF for programs operation will rely on program systems for its implementation, including for procurement of goods, works, and services. ADB's assessment will determine the

[45] For more information on the 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.

[46] For more information on the procurement principles, see ADB. 2006. Procurement. *Operations Manual*. OM J3/BP. Manila; ADB. 2010. *Procurement Guidelines.* Manila; and ADB. 2010. Governance. *Operations Manual*. OM C4/BP. Manila.

[47] The degree of optimal competition depends on the size and nature of the procurement. Competitive processes take time and can 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.

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 same principles embodied in ADB's procurement and consulting guidelines (para. 106). The procurement assessment will be conducted for the whole program as defined.

108. The scope of the procurement assessment may cover the critical stages of the procurement cycle 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.

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

110. RBF for programs will exclude activities that would involve procurement of works, goods, and services under contracts whose estimated value exceeds specified monetary amounts (high-value contracts, footnote 23).

c. Anticorruption Measures

111. Through their built-in mechanisms, RBF for programs will provide an additional opportunity for ADB to assist DMCs in fighting 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 will help build robust and transparent public management systems and reduce opportunities for corruption. Third, RBF for programs operations will include specific guidelines to address corruption risks (Appendix 6).

112. A key aspect of ADB's assessment and assistance will be identifying the likely weak links in the systems that may create opportunities for corruption, and assessing how the program's systems can deal with these. ADB will assess the degree to which program systems prevent and deal with the risk of fraud and corruption. The program's approach to, and enforcement of, its anticorruption policies will also be assessed, remedies to strengthen weak areas will be applied, and progress will be monitored.

113. In 2006, ADB's Second Governance and Anticorruption Action Plan (GACAP II) introduced a risk-based approach to managing governance and corruption risks.[48] RBF for programs will benefit from GACAP II's work on fiduciary risk management. However, RBF for programs operations will require analysis to identify the risks of fraud and corruption at the program level, and to determine the degree to which the program's fiduciary systems provide reasonable assurances that finance for the program will be used for its intended purposes. The findings of the assessment will inform ADB and the borrower on the improvements needed, as appropriate.

114. The anticorruption guidelines for RBF for programs require that ADB and the borrower communicate allegations of possible fraud and corruption in a timely manner. To enable the

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

borrower to improve anticorruption systems, ADB will provide opportunity for the borrower to address any identified problem and implement measures to avoid its reoccurrence. ADB will expect that borrowers will take appropriate and timely measures to prevent, detect, and respond to allegations of fraud, corruption, and other prohibited activities in RBF for programs operations, in accordance with the guidelines for RBF for programs (Appendix 6).

115. Based on the findings of the assessment, ADB and the borrower will agree on measures to mitigate the risks of corruption. A reporting and complaint mechanism for allegations of fraud, corruption, and other prohibited activities will be developed and applied. Where remedial actions are identified, ADB will provide the borrower with appropriate assistance to strengthen institutions and the enforcement environment.[49]

116. While RBF for programs will encourage and support borrowers as they tackle fraud and corruption, ADB will retain the right to conduct investigations of alleged fraud, corruption, and other prohibited activities related to the program as ADB deems necessary, and to sanction entities that are found to have engaged in fraud, corruption, or other prohibited activities. ADB's sanction list will apply to RBF for programs. The borrower will ensure that entities debarred and suspended by ADB do not participate in contracts awarded during implementation of the program or during the periods of debarment or suspension. Employing its standard remedies, ADB will be able to respond when issues of fraud and corruption are not satisfactorily addressed by the borrower.

5. Safeguards Systems

117. ADB's Safeguard Policy Statement (2009) will apply to RBF programs. RBF programs will uphold the policy objectives and policy principles of the SPS.

118. The distinct nature of RBF for programs requires that the programs rely on the program system to address social and environmental issues. ADB will examine the program's potential safeguards impacts and, guided by the Safeguard Policy Statement principles, ADB will carry out diagnostic assessment of applicable and relevant laws, regulations/rules, and procedures for managing and mitigating the environmental and social impacts of the overall program.

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

120. The assessments will inform measures to improve the safeguard system and capacity at the program level if needed. The level of comprehensiveness and details of the assessments and measures should be commensurate to the nature and scope of the program. ADB and the borrower will agree upon measures to strengthen the program safeguard system and include these in an action plan. During implementation, the borrower will monitor and report on the safeguard aspects of program performance. ADB will monitor the implementation of the program and the agreed actions.

121. ADB will disclose the draft diagnostic assessment reports in the ADB website. Upon completion, the final assessment reports will also be disclosed on ADB's website.

[49] Different ADB departments have designed several fiduciary risk assessments and capacity development programs focusing on different segments of the fiduciary system. However, these are not coordinated and are not based on an integrated fiduciary assessment mechanism.

122. RBF programs will exclude activities that would be classified as category A in the Safeguard Policy Statement.

E. Integrated Risk Assessments and Mitigating Measures

123. The assessments will reveal the program's strengths, weaknesses, and risks. ADB and the borrower 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.

124. The program's risks can be broadly classified into five interlinked categories:

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

125. 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 borrower will agree upon robust capacity development and risk mitigating measures. Implementation of the risk mitigating measures will require sustained political commitment by the borrower. ADB will monitor the implementation of these measures.

126. If the assessment concludes that the program systems have major material weaknesses that cannot be effectively addressed through the program, ADB and the borrower may decide not to pursue the RBF for programs operation. In this case, ADB can still work with the borrower on institutional strengthening.

F. Capacity Development and Other Required Actions

127. The assessments will inform the appropriate scope, measures, and intensity for capacity development and other required actions. ADB and the borrower will agree on a program action plan to be implemented and monitored during implementation. Capacity development plans can include actions to improve the program's design and implementation, strengthen the program's institutions, increase the agencies' capacity, and mitigate risks. The action plan will be refined, improved, and updated during the implementation as needed. ADB may support the borrower through technical assistance (TA).

128. Under RBF for programs, 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 systems. Capacity and institutional development in an RBF for programs operation can

address a broad range of institutional, organizational, and individual aspects pertaining to the program, such as regulatory issues relating to barriers of entry, optimal division of responsibilities between the public and private sectors in financing and providing services, organizational changes in public institutions for better delivery of results, and efficiency and accountability of service providers.

129. Learning from the lessons of past operations (Appendix 5), RBF for programs will support behavioral and organizational changes that improve performance and deliver results by shaping incentives and increasing accountability. As the assessments will focus on the whole program, their findings can benefit the entire program, enhancing the effectiveness and sustainability of these capacity development actions.

130. 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 RBF for programs, ADB should aim to assist the borrower in achieving positive and sustainable changes. Incremental and continued progress is more beneficial than overly ambitious, short-lived changes.

131. In addition to the overall program-level support through the RBF for programs, ADB can also support capacity development through dedicated TA activities where needed. TA can be provided as an integral part of an RBF for programs operation, as separate products in the operation, or through parallel efforts financed by development partners.

VIII. APPROVING AND IMPLEMENTING RESULTS-BASED FINANCING FOR PROGRAMS

A. Application and Approval

132. Since RBF for programs operations support government-owned programs, they will be applied to sovereign operations. As with other modalities, the country, sector, or type of programs that may use the RBF for programs modality will not be predetermined. Each RBF for programs operation will be evaluated on a case-by-case basis. The RBF for programs modality can be adapted to a wide range of applications. Program implementation can be carried out by different public and/or private entities, as appropriate. The RBF relationship between the ADB and the borrower can be transmitted to the relationship between the borrower and other relevant entities, and between other relevant entities.

133. Processing and approval of RBF for programs operations will follow standard ADB procedures.[50] Through the review and oversight mechanisms embedded in these procedures, ADB will assess the economic costs and benefits of an RBF for programs operation. ADB will form a conclusion on whether to proceed with an RBF for programs operation and how best to do so. The various assessments should conclude that the RBF for programs operation has a strong rationale, and confirm that the program results, system improvements, and other expected benefits will exceed program costs. It should also confirm that ADB can add value by refining the program, increasing the likelihood of delivering results, developing institutions, and promoting learning for DMCs and ADB.

134. To strengthen Management oversight, a Management Review Meeting will be held for all RBF for programs operations processed within 2 years after the effectiveness of the policy.

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[50] The design and implementation of the RBF program may also require revision of relevant ADB documents, such as the design and monitoring framework guidelines.

B. Financing-Related Issues

135. ADB financing for RBF for programs operations can come from various sources, for example ordinary capital resources, the Asian Development Fund (loans and/or grants), grants, or cofinancing. Financing-related aspects of RBF for programs operations are outlined below:

(i) **Cofinancing**. Since RBF for programs operations will provide a strong platform for coordinating external financing in a sector, they should explore the scope for cofinancing. If cofinancing materializes after an RBF for programs operation is approved by ADB, Management will approve such cofinancing and report it to the Board for information as part of the annual report on cofinancing.

(ii) **Additional financing.** RBF for programs operations can apply for additional financing following the ADB's additional financing policy and procedures.

(iii) **Project design facility**. RBF for programs operations can use ADB's project design facility.

(iv) **Technical assistance**. ADB can provide TA to RBF for programs operations, as a part of the operation or as separate operations.

(v) **Loan cancellation.** Loan cancellations will follow the same rules and procedures used for projects.

(vi) **Loan terms.** RBF for programs operations financing terms will be the same as those for projects.

136. **Use of proceeds and procurement**. The proceeds from the RBF for programs operations will be used to finance program expenditures aimed at achieving program results, improving program institutions, and providing other needed support for program objectives. ADB financing for a RBF for programs operation is not linked to specific transactions, but is an integral part of program financing as a whole, which may include financing from the borrower's own resources and cofinanciers.

137. The RBF for programs approach will require adoption and implementation of mechanisms and procedures to satisfy the Agreement Establishing the Asian Development Bank (the Charter) 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 value of the total program expenditure on goods, works, and services from ADB member countries, including from the borrowing country. Conversely, the total program expenditure excluding the procurement from nonmember countries should be at least equal to, or exceed, the amount of ADB financing.

138. At the processing stage, as part of procurement and financial management system assessments, ADB will take measures to ensure that the program's procurement and financial management systems will provide for procurement to be undertaken in a competitive and transparent manner, with due consideration to achieving economy and efficiency, and can adequately track and record awards to foreign bidders, particularly those from nonmember countries. During implementation, ADB will require the borrower to reflect the aggregate procurement value from ADB's nonmember countries in the program's audited financial statements and reports. This data will need to confirm that the value 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 ADB RBF disbursements during the relevant reporting period.[51] ADB will reserve the right to audit compliance with this

[51] This means that the total program expenditure excluding the procurement from nonmember countries is equal to or greater than the amount of ADB financing. In cases where there are cofinanciers who also have procurement

requirement. In certain cases, ADB may, where necessary, also support the borrower in establishing an adequate procurement bidder award recording and reporting system.

C. Implementation-Related Issues

1. Auditing and Reviews

139. **Financial auditing.** ADB and the borrower 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 the program nature, country context, and risk assessment. The borrower will submit annual audited financial statements of the program to ADB within the agreed time frame after the close of the borrower's financial year. In DMCs, statutory requirements may specify the use of the country's supreme audit institutions (SAIs) for a development program.[52] If the audit reports from the SAI cover multiple programs and do not provide sufficient details for the program, or are issued with significant delays, ADB will discuss and reach agreement with the borrower and the SAI on acceptable terms of reference to ensure that the audit of annual program financial statements is conducted in a timely and acceptable manner. If the SAI is unable or unwilling to audit the program, ADB and the borrower may agree on alternative audit arrangements for the program.

140. **Results verification and disbursement**. During the implementation of an RBF for programs operation, 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 borrower. ADB will disburse the agreed amount when DLIs are achieved.

141. **Other reviews or audits**. ADB and the borrower may agree on and arrange other reviews or audits as necessary. These may include assessments of environmental and social impacts management, procurement management, the reliability of grievance mechanisms, and complaint-handling mechanisms.

2. Changes in Scope and Implementation Arrangements

142. As in other operations, RBF for programs operations may require changes in scope 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 implementation arrangements will follow ADB's prevailing rules and procedures on change in scope.

3. Risk Monitoring and Addressing Performance Problems

143. ADB and the borrower will monitor risks during implementation, identify emerging issues, and make adjustments on risk management measures as necessary.

144. If performance problems arise during implementation, ADB's responses will depend on the nature and severity of the problems, as well as the response of the borrower. ADB will

country eligibility requirements, the program expenditure should satisfy ADB's requirements as well as those of cofinanciers.

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

promptly bring the problems to the attention of the executing agency, which will take timely and appropriate actions. ADB will also support the borrower in addressing the problems. ADB will follow up on the borrower's actions and results in addressing performance problems.

145. Depending on the nature, scale, and frequency of problems—and a borrower'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 government's actions or inaction in addressing performance problems. However, a borrower's failure to take corrective actions promptly for reasons under the borrower's control to address systematic performance problems may result in ADB applying corrective remedies provided and agreed in the financing agreement.

4. ADB's Key Corporate Functions

146. The RBF for programs operations will be subject to ADB's key corporate functions.

147. **Independent evaluation.** RBF for programs operations will be subject to independent evaluation if deemed appropriate by the Independent Evaluation Department.

148. **Accountability Mechanism.** RBF for programs operations will be subject to the Accountability Mechanism policy.[53]

149. **Anticorruption measures.** The RBF for programs policy will include anticorruption guidelines for borrowers and ADB to combat fraud and corruption in the programs (Appendix 6). Other anticorruption related measures are described in paras.111–116.

150. **Transparency**. Consultation and information disclosure of RBF for programs operations will comply with the ADB's Public Communications Policy (2011). For example, the reports and recommendations of the President for a RBF for programs operation—including the DLIs, assessments, and actions—will be disclosed to the public. The draft and final environmental and social systems assessment will also be disclosed.

IX. RESPONSIBLITIES AND PARTNERSHIP

A. Roles and Responsibilities

151. The borrower will be responsible for designing, implementing, and monitoring an RBF for programs operation. The borrower will also maintain the agreed implementation arrangements, including the M&E arrangements, fiduciary arrangements, and safeguard systems. Individual or systemic problems in the program will be addressed by the borrower in a timely and effective manner.

152. ADB will assess the program in coordination with the borrower. ADB will also support the government 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 borrower in implementing improvement measures, monitoring program performance and risks, and helping resolve emerging issues.

153. An RBF for programs operation will be characterized by capacity development to

[53] ADB. 2012. *Review of ADB's Accountability Mechanism Policy*. Manila.

strengthen the program, results, institutions, and risk management throughout the program cycle. The reason for using the program systems is to raise performance for the whole program. Capacity development will be an important aspect of support from ADB, which will work closely with other development partners as appropriate.[54]

154. ADB program teams will be responsible for standard monitoring and supervision functions.[55]

B. Development Partnership

155. RBF for programs will support government ownership and leadership. The program will be owned by the government and implemented using program systems. ADB disbursement will be based on DLIs, which are generally derived from the government's results framework. Capacity development will be geared towards improving the government's ability to deliver and sustain results.

156. By sharing common systems and results, RBF for programs will support development partner coordination and harmonization. Development partners can coordinate their assistance to the government to improve the program design, conduct assessments, identify risks, mitigate risks, coordinate capacity development, and undertake joint learning. Such coordination and harmonization will help to avoid duplication and fragmentation of development assistance. RBF for programs operations will be ideal for cofinancing.

X. CHALLENGES AND WAYS FORWARD

A. Risks and Mitigating Measures

157. The introduction of the RBF for programs modality may involve several risks that could affect ADB and the borrower. However, all the risks can be sufficiently mitigated or managed.

1. Definition and Verification of Results

158. 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. Another risk is that the definition of results will be overly ambitious or not sufficiently relevant. To address these challenges, ADB will support the borrower 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, especially outputs, from the perspectives of program beneficiaries will also guide the proper selection of relevant and appropriate result indicators.

159. Linking results with disbursements may expose a borrower 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 RBF for programs operations should take into consideration the need for predictability of fund flows. Further, the purpose of RBF for programs is to support achievements of results, and to recognize achievements through disbursement. It is therefore a risk worth taking to increase the prospect of achieving results. DMCs concerned about their ability to deliver identified program results may

[54] Recent analytical work and diagnostic assessments by other development partners, updated as required, can be used. Joint assessments with other development partners will be encouraged.
[55] For programs that cover wide geographical areas, ADB's monitoring may need to be sample based.

choose not to use the RBF for programs modality.

2. Institutional Development

160. Institutional development can be resource intensive, time consuming, and difficult. ADB should work with the borrower to develop and implement realistic action plans to bring about incremental, positive, and sustainable changes. ADB should also join other development partners in assisting governments 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 government will buy into institutional development.

3. High Transactions Costs

161. The assessments conducted for an RBF for programs operation may be excessively complex, time intensive, and costly; or too detailed and prescriptive. ADB should ensure that appropriate resources are available for the upstream assessments and downstream supervision. However, as analytic work and knowledge are accumulated, it should be possible in time to prepare RBF for programs operation with lower transaction costs. Transaction costs can also be partly offset by avoiding establishing and maintaining parallel systems, and by reducing procedural requirements.[56]

162. To reduce 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, by using existing assessments, and collaborating with other development partners and sharing the assessments. RBF for programs operations should use and/or build on the many sector analyses that have already been completed.

163. While system assessments and capacity development may initially require more time and resources, the benefits from a sharper focus on results, better sector knowledge, stronger institutions, and more sustainable programs can generate large payoffs in the long run.

4. Fiduciary and Safeguard Risks

164. RBF for programs operations will take measures to ensure that all program financing, including financing from ADB, is used appropriately and that fiduciary and safeguards risks are adequately addressed. However, improving systems and mitigating risks are demanding tasks for governments and development agencies. To address the risks, ADB will undertake careful assessments of the fiduciary and safeguard systems, assist the borrower in preparing action plans to address weaknesses, and support capacity development. More accountability for results, a built-in feature of the RBF modality, will also mitigate fiduciary and safeguard risks. Systematic M&E will track the achievement of results and the performance of institutions, and will allow the lessons learned to be incorporated into the programs. Credible result verification mechanisms will also help to increase accountability and reduce risks. While improving government 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 category A in the Safeguard Policy Statement will also reduce these risks.

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[56] For instance, fewer withdrawal applications will be processed for a 5-year program with a semiannual disbursement schedule compared with project-based operations.

5. Risk of an ADB Driven Agenda

165. RBF for programs will provide an added platform for ADB to work with the borrower 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 government in improving the local capacity and avoid an ADB-driven agenda.

B. Advancing the Results-Based Agenda

166. 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 effectively—and sustain them by making systematic changes in institutions. The huge potential benefits of the RBF for programs approach provide support for advancing the results-based agenda (paras. 42–52).

167. RBF features have already been included in the operations of ADB and other development agencies. These operations have shown promising results and demonstrated that RBF for programs pose no greater risk than other projects. The risk mitigating measures embedded in RBF for programs also provide a solid foundation for managing risks. The risks of introducing RBF for programs are expected to be outweighed by the benefits of having a lending instrument that focuses on achieving program results and institutional development.

C. Piloting Results-Based Financing for Programs

168. This paper proposes that ADB adopt a learning-by-doing approach by piloting the RBF for programs modality for 6 years. This is the minimum time frame required to process and implement RBF for programs in order to yield sufficient information for the subsequent review and evaluation. ADB may also consider limiting the lending volume for the RBF for programs during the piloting. The need for the ceiling, and if so, the size and approach required for applying this will be determined upon further consultation and analysis.

169. To support the piloting, ADB will put in place measures for training, dissemination, consultation, and learning. ADB will develop a guidance document to support staff for designing and implementing RBF for programs. As the programs are rolled out, ADB may set up an advisory team as necessary, including experienced mission leaders from across ADB, to support other program teams. ADB will learn from its own experiences and exchange experiences with other development agencies, especially the World Bank. This paper proposes that the Independent Evaluation Department of ADB assesses the implementation experience of the RBF for programs. ADB will consider and decide on future direction of the RBF for programs modality in light of the Independent Evaluation Department findings.[57]

D. Resource Implications

170. RBF for programs operations will require proficient staff to carry out the assessments, assist the borrowers in improving program design and implementation, monitor the progress, and initiate timely corrections. Resource savings may come from reduced staff time for

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[57] The timing of the review by the Independent Evaluation Department should be appropriate to provide sufficient time for ADB to decide on the future of the RBF programs modality, and if necessary prepare and adopt a policy document. It may therefore be appropriate for the review to be completed 1−2 years before the completion of the pilot.

supervising a large number of individual contracts and setting up parallel implementation arrangements.

171. ADB has strengthened staff capacity in the financial management area through the addition of new positions during 2010–2012 and redeployment of existing resources. ADB's procurement capacity has also been strengthened through the Accreditation Skills Scheme Program. Stronger staff capacity will aid the implementation of RBF for programs.

172. ADB should monitor the resource needs during the piloting of the RBF for programs and make adjustment as necessary. Training should be carried out to better equip all staff. Any future resource requirements should be balanced against the expected benefits from RBF for programs. RBF for programs will help ADB consolidate its institutional work and accumulate knowledge and expertise in financial management, procurement, safeguards, and M&E. To better use resources, ADB should cooperate with other development agencies and stakeholders in conducting assessments, building capacity, and generating knowledge products that will serve as public goods.

XI. REQUEST FOR BOARD GUIDANCE

173. The Board's guidance is sought on the proposed piloting of the Results-Based Financing for Programs modality set out in sections VII, VIII, IX, and X of this paper.

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 the World Bank's program-for-results financing; sector-wide approaches (SWAPs); RBF in health; conditional cash transfers (CCTs); cash on delivery (COD); performance-based contracts (PBCs); output-based aid (OBA); the Global Fund to Fight AIDS, Tuberculosis and Malaria; the Millennium Challenge Corporation (MCC); the GAVI Alliance (formerly the Global Alliance for Vaccines and Immunizations); and performance-driven loans (PDLs).[2]

2. These initiatives either cover programs or projects.[3] All share the common feature that disbursements are made upon delivering results.

A. General Approaches on Results-Based Financing

1. Sector-Wide Approaches

3. SWAPs adopt programmatic approaches, many of which also have a result focus. The Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC) describes a SWAP as "a way of engaging in development cooperation based on the principles of coordinated support for a locally owned program of development." It includes four elements: leadership by the host country 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.[4] 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.

4. 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).[5] 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. The performance of these projects compare favorably with the overall World Bank lending portfolio. SWAPs have generally been processed as projects or investment lending operations. Many bilateral development agencies have also used SWAPs.

5. 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

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[1] Lending includes grants and other financing; borrowers include recipients of grants and other financing.
[2] This section draws from the published information of various organizations, such as information on the websites of those organizations.
[3] Most MDBs processed these operations as investment projects because they lacked a dedicated instrument.
[4] 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.
[5] Appendix 2 provides more examples of ADB operations with RBF features.

higher-quality policy dialogue and has enabled governments to make better use of technical resources and reduce the time spent focusing on the concerns of individual development agencies.

6. 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 countries. Harmonization has often been based on rules and templates of the development agencies. The focus on SWAP processes rather than on sector outcomes has sometimes resulted in so-called SWAP fatigue.

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

2. Cash on Delivery

8. Developed by the Center for Global Development, COD aid builds on other approaches that have aimed to increase country ownership and payment for results.6 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 shared goals. It 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.

9. Under this approach, development partners pay for measurable progress on specific outcomes 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 outcome. This gives the recipient more authority to achieve progress however it sees fit, while ensuring that the recipient country's progress is transparent to its citizens.

10. The approach can be applied to any sector in which governments and their development partners are committed to making progress on shared, measurable outcomes. Governments can also apply it to their own transfers to states or districts. Once an outcome 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. The clarity of the disbursement against outcomes may reduce aid volatility that often results from domestic policy debates in developing partner countries or changes in policy priorities. Most of all, recipient countries can focus on what they need to do to make progress instead of spending time documenting expenditures or developing strategies that are most likely to please their funders.

11. The United Kingdom (UK) and Ethiopia were the first countries to propose a specific application of the COD aid approach. In a nationwide pilot,[7] the Department for International

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

[7] 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

Development (DFID) of the UK will make grant disbursements to the Ministry of Education to increase the number of students who sit for or pass the national grade 10 examination. DFID will make additional disbursements for students in emerging regions and for female students. A maximum of £10 million will be disbursed each year during 2012–2014.

12. The Government of Ethiopia maintains robust education examination and information management systems, which will be used for its reports on grade 10 examination results. DFID has contracted an independent agency to verify the results that the government reports. This agency will analyze reported data on enrollment, retention, and pass rates from Ethiopia's National Agency for Educational Assessment and Examinations, and will compare them by region and gender with that of the previous year to check for consistency and identify possible changes in trends. DFID will also visit a sample of schools in each region to compare national reports with the schools' reports, and to verify that the nationally reported results are accurate. Based on current discussions between DFID and Ethiopia, the exam data from 2010 and 2011 would provide a baseline that would be adjusted annually with the performance for 1 year becoming the baseline for the next year's disbursements. Once results are verified, DFID will disburse outcome disbursements 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, although DFID staff are responding to requests from the government for technical advice on allocating funds to regions and secondary schools.

13. The following lessons were learned:

- (i) Although the key interlocutor for the government is the Ministry of Education, education officials found that the increased interest of the Ministry of Finance in planning and designing the project has become useful.
- (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 aid 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.

14. The Center for Global Development is designing more COD pilots in collaboration with technical experts, potential official and private development partners, and partner countries, including designing research programs to accompany the pilots. The additional pilot activities aim to evaluate the effectiveness of COD aid relative to traditional projects and to determine under what circumstances this approach can be helpful. In addition to other education-related pilot activities, the application of COD aid in the health sector is also being investigated to help achieve goals such as improving maternal health, reducing child mortality, and preventing HIV/AIDS. Its application to development goals in other sectors is also being analyzed. The research aims to increase understanding of how aid can strengthen, rather than burden, local

institutions and provide insights about institutional change and good practices in different settings.

3. Results-Based Financing for Health

15. 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.

16. While policy makers care about results, governments and development agencies have typically financed inputs, such as salaries, medical equipment, 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 either lump sum grants or reimbursements for expenditures by governments and development agencies. This system encourages providers to devote energy to securing funds and justifying inputs rather than to improving 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.

17. ADB incorporated features of the RBF in health approach in the Second Urban Primary Health Care Project in Bangladesh.[8] RBF in health has been supported by the World Bank through the Health Results Innovation Trust Fund, which is financing the implementation and evaluation of six pilot programs in Africa. In September 2009, members of the High Level Taskforce on Innovative International Financing for Health Systems committed $5.3 billion to accelerate progress towards the Millennium Development Goals (MDGs). The UK and Norway committed $420 million to support results-based financing programs and buy-downs to improve maternal and child health. The Government of Australia committed A$336 million over 4 years for performance-linked aid to help partner governments in Asia and the Pacific. This funding will boost RBF in health. In addition, the World Bank identified 40 projects with elements of the RBF in health approach during FY1995–FY2008, mostly using investment lending modalities.[9] The World Bank found that RBF in health has helped in disbursing based on results, establishing monitoring and evaluation (M&E) frameworks, and supporting capacity development.

18. 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.[10] However, RBF in health must overcome some 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 performance 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

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[8] 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 Health Care 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).

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

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

context, implemented with the flexibility to make adjustments along the way, and diligently monitored and rigorously evaluated to draw lessons.

4. Conditional Cash Transfers

19. CCTs provide cash grants to poor households based on certain household behaviors, generally involving parents ensuring investment in the education or health of their children.[11] CCTs have dual objectives. First, they seek to provide poor households with a consumption floor for immediate poverty reduction. Second, for long-term poverty reduction, they seek to encourage 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.

20. First used in Latin America in 1990s, CCTs have been popular in developing countries since the 1990s. Recent reviews estimate that at least 29 developing countries have CCT programs in place.[12] 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 can vary widely—from about 40% of the population in Ecuador to about 20% in Brazil and Mexico to 1% in Cambodia.

21. CCTs have been used as vehicles for (i) reducing inequality, and promoting health and schooling for children; (ii) helping households break out of the vicious cycle that transmits poverty from one generation to another; and (iii) helping countries meet the MDGs. Evidence from many countries indicate 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 based on their keeping 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.[13] In Cambodia, a program financed by the Japan Fund for Poverty Reduction eliminated sharp socioeconomic gradients in enrollment among eligible households. CCTs have helped to reduce the education gender gap in Bangladesh and Pakistan, where school enrollment rates among girls are lower than among boys. CCTs also have a strong evaluation culture, well beyond traditional practice in social policy. This culture is spreading from one CCT to another, as well as to other programs in the same country.

22. The evidence on improvements in the final outcomes in health and education is more mixed. To maximize the potential benefits on the accumulation of human capital, CCTs need to be combined with programs to improve the quality of the supply of health and education services. Further, some

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[11] For example, children between 6 and 14 years old remain enrolled and attend school.

[12] D. Filmer and N. Schady. 2009. Are there Diminishing Returns to Transfer Size in Conditional Cash Transfers? *Policy Research Working Paper 4999. Impact Evaluation Series.* No. 35. Washington, 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.

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

of these programs have become large and costly, which raises the issue of sustainability, the potential politicizing of CCTs, and fostering a culture of dependence.[14]

5. Output-Based Aid

23. OBA uses performance-based subsidies to deliver basic services to poor households.[15] Basic services supported by OBA include water supply, sanitation, electricity, transport, telecommunications, education, and health care. OBA fills the funding gap between the cost of service delivery and the beneficiaries' ability and willingness to pay for the service.

24. The OBA concept was introduced in 2003 through the launch of the Global Partnership on Output-Based Aid 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 improving the delivery of basic infrastructure and social services to the poor in developing countries.

25. The OBA approach:

(i) uses performance-based subsidies to deliver services—with the aim of improving 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—with the aim of improving the efficient delivery of services that exhibit positive externalities.

26. The World Bank remains the primary source of OBA projects, with a portfolio of OBA subsidies totaling about $4 billion. The World Bank 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 Global Partnership on Output-Based Aid rated it a success.[16] 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%. The World Bank estimates its OBA projects have benefited at least 60 million poor people. In recent years, ADB has also started to implement OBA schemes through the joint efforts of the Office of Cofinancing Operations and operations departments (Appendix 2).

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[14] 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.

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

[16] The World Bank's project ratings include highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, and highly unsatisfactory.

27. OBA is based on procurement processes that results in a contractual relationship where disbursements are made to service providers for measured outputs. OBA allows disbursements to be linked to specific outputs, but remains focused on the transactions.

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

29. 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.

30. 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.[17]

6. Performance-Based Contracts

31. 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 goals to be achieved to defining the problems that need to be solved and results to be delivered.[18] This allows contactors to deliver the results by maximizing innovation and efficiency, and rewards them for doing so.[19] The objectives of PBCs are to lower costs, improve quality, and reduce risks. OECD countries have spearheaded the use of PBCs.

32. PBCs structure contracts around the purpose of 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

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[17] 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 specified infrastructure service contracts awarded to private sector or third party service providers.

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

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

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.

33. ADB has developed guidelines to facilitate PBCs (Project Administration Instructions, 3.05 Section G). ADB has used PBCs in projects such as the Yunnan Integrated Road Network Development Project[20] and Second Heilongjiang Road Network Development Project (Appendix 2),[21] both in the People's Republic of China.

B. Results-Based Financing by Different Organizations

1. Word Bank Program-for-Results Financing

34. The World Bank approved the program-for-results financing instrument in January 2012.[22] 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. The program-for-results instrument also aims to enable the World Bank to leverage its own financing by joining other development organizations in supporting country programs.

35. 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 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.** A priority area for both preparation and implementation support will be to strengthen the capacity of the institutions to implement the program and achieve the desired results, thereby enhancing development impact and sustainability.

(iv) **Provides assurance that World Bank financing is used appropriately.** The World Bank will assess the program's fiduciary and environmental and social management systems. It will agree with the borrower on the additional measures needed to 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.

(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. The verification process will include independent or third

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[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 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).

[21] 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)

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

party monitoring, where appropriate. Program-for-results documents will be available to the public, giving stakeholders access to information about the performance of the public institutions and programs.

36. For each program-for-results operation, the World Bank will carry out a process of identification, preparation and assessment, appraisal, and implementation support. The identification of DLIs will be a central part of the preparation process. 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 monitoring and evaluation 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.

37. Program-for-results financing seeks the behavioral and institutional changes that are required to achieve results and manage associated risks. Hence, 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.

38. During implementation of the program, the World Bank will monitor progress, associated expenditures, and the achievement of results. It will monitor progress in implementing the action plan, changes in the program's risks, and compliance with the provisions of the legal agreements. Technical support from the 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 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.

2. The Global Fund to Fight AIDS, Tuberculosis and Malaria

39. The Global Fund to Fight AIDS, Tuberculosis and Malaria is a public–private partnership and international financing institution created to attract, manage, and disburse resources to fight three of the world's most devastating diseases.[23] 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.

[23] The Global Fund to Fight AIDS, Tuberculosis and Malaria. http://www.theglobalfund.org/en/about/whoweare/

Partnerships also bring together a diverse set of stakeholders, including government, civil society, affected communities, and the private sector.

40. The Global Fund's system of 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 programmatic 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.

41. The Global Fund was created in 2002. By 2010, it had approved funding of $21.7 billion for more than 600 programs in 150 countries. The Global Fund 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.[24]

42. 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 applications. To receive subsequent financing, a recipient must demonstrate results based on performance targets. These targets are proposed by the country for approval by the Global Fund to ensure that they are appropriate for the local context.

43. 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 streams to facilitate a program-based approach that is better aligned to national planning, reporting, and review cycles.

3. Millennium Challenge Corporation

44. MCC is a foreign aid agency of the United States (US).[25] Created by the US Congress in January 2004 with strong bipartisan support, MCC aims to deliver US foreign assistance by focusing on good policies, country ownership, and results. MCC forms partnerships with some of the world's poorest countries, but only those that are committed to good governance, economic freedom, and investment in their citizens.

45. MCC provides well-performing countries with grants to fund country-led solutions to reduce poverty through sustainable economic growth. MCC offers two primary types of grants: compacts and threshold programs. Compacts are large, 5-year grants to countries that pass MCC's eligibility criteria. Threshold programs are smaller grants to countries that come close to passing these criteria and are committed to improving their policy performance.

[24] The treatment benefits mothers, children of AIDS-infected mothers, and other dependents.
[25] Millennium Challenge Corporation of the United States of America. http://www.mcc.gov/

46. MCC looks at several elements in choosing indicators for a specific grant, including
(i) development by a third party;
(ii) links to policies the government can influence in 2–3 years;
(iii) links—theoretical or empirical—to economic growth and poverty reduction;
(iv) use of an analytically rigorous methodology and objective, and high quality data;
(v) broad country coverage and comparability across countries; and
(vi) consistency of results from year to year.

47. MCC emphasizes achieving and measuring results, concentrating on (i) identifying activities that have the greatest potential to reduce poverty through growth, (ii) measuring progress during implementation, and (iii) learning from its experiences. MCC collaborates with a country to finalize benchmarks and to create an M&E plan. Throughout an operation's life cycle, the achievements are reported regularly. MCC and its country partners hire independent organizations to conduct impact evaluations of their activities.

48. MCC has approved more than $7.4 billion in compact and threshold programs worldwide that support country-determined projects in 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.

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

4. GAVI Alliance

50. 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.[26] 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.

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

52. 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.

[26] GAVI Alliance. GAVI's mission. http://www.gavialliance.org/about/mission

53. 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 health care delivery services, thereby facilitating even wider vaccination coverage.

54. The GAVI Alliance's immunization services support (ISS) provides funding to immunization programs based on improved 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.

55. 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.

56. In GAVI Alliance's first decade, 288 million children were immunized against life-threatening diseases, and more than 5 million future deaths were prevented.[27] However, with 20% of children still unvaccinated, the GAVI Alliance's mission is far from accomplished.

57. 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.

58. 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.

5. European Commission Budget Support

59. Budget support is an important instrument in the comprehensive development policy of the European Union (EU) towards partner countries. It is a means of delivering better aid and achieving sustainable development objectives by fostering partner countries' ownership of

[27] GAVI Alliance. 2012. *Progress Report 2011.* Washington, DC.

development policies and reforms. Budget support is disbursed only when the eligibility criteria and additional agreed upon conditions on results are met.[28]

60. 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.[29] In 2011, the European Commission (EC) added a new criterion on public availability of most relevant budgetary information, which is essential for promoting greater scrutiny of the budget.

61. 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 governments systems.

62. 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., services such as health, education, and water and sanitation). The EC intends to use sector budget support more to address sector constraints, promote reforms, and improve service delivery to populations.

63. The geographical coverage of EC budget support has expanded to cover many countries with widely varying levels of wealth. 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 29).

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

- (i) an assessment of 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;
- (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 agreed upon objectives were achieved with budget support operations; and
- (v) the results orientation in the partner country's development strategy including a monitoring system.

[28] 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.

[29] European Commission. 2008. *Budget Support: The effective way to support development?* Brussels.

65. 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, including the MDGs.

(ii) EC budget support should continue to ensure a high degree of predictability in order to put emphasize 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 countries.

(iii) The EC will refrain from establishing global targets for EC 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 aid modalities in response to a partner country's specificities and agreed upon development objectives.

(iv) The EC will strengthen its risk management framework for EC budget support in line with the Court of Auditors' recommendations.[30] This will include closely monitoring progress in the fight against corruption and fraud with a view to ensuring sustainable development benefits.

66. The 2007 budget support guidelines have been revised to reflect the orientations set out in the 2011 communication.[31]

6. Inter-American Development Bank Performance-Driven Loans

67. The Inter-American Development Bank (IDB) adopted PDLs in 2003 in response to borrowers' demands.[32] The PDL was to be piloted for 6 years. In 2006, the IDB reviewed the implementation progress of the PDLs. As the review indicated that the interest in PDLs among borrowing member countries was growing, the IDB decided to continue the pilot program.

68. The PDL has the following features:

(i) It is an investment lending instrument.

(ii) Disbursements are conditioned on the achievement of results and verification of expenditures. Recipients are required to track eligible expenditure directly related to the outputs and outcomes in addition to achieving results.[33]

(iii) Results are defined by outcomes—the effects from outputs delivered by a project. For example, higher school enrollment and achievement (outcomes) are attributed to the construction of a new school and training of teachers (outputs).

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[30] European *Court of Auditor's Special Report No 2/2005 concerning EDF budget aid to ACP Countries: the Commission's management of public finance reform aspect.* This report made a number of recommendations in the area of public financial management and budget support to which the Commission has made replies. This report follows two earlier reports by the Court of Auditors, one on ACP countries, and the other on MEDA countries as well as the use of the MFA instrument. Source: European Commission. 2007. *Guidelines on the Programming, Design & Management of General Budget Support.* Brussels, Belgium.

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

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

[33] 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

(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.

69. The demand for PDL operations has been moderate. From 2003 to 2009, the IDB approved 17 PDL projects. The IDB indicated that two main factors have influenced demand. First, results are defined as development outcomes, which can take a long time to achieve and can be outside the control of a project. Second, PDL operations are in the form of investment lending, which requires the achievement of results as well as the fulfillment of many investment lending requirements. For example, PDL operations are required to track eligible expenditure directly related to the outputs and outcomes established in the results matrix. This may not be feasible, particularly in sectors where the IDB, governments, and other development partners are supporting a national development goal.

70. In the health sector, for example, the costs of outputs such as the training of health professionals can be estimated, but the final outcome of reducing mortality rates for children under 5 years old is achieved by financing a combination of activities and many outputs. Since the executing agency is accountable for selecting the most cost-effective input–output mix for achieving the performance targets, the task of estimating the costs of activities and outputs loses relevance. PDLs carry the same accounting and reporting requirements as regular investment loans in addition to the results requirements, which is a burden for both the borrower and IDB staff and results in high transaction costs.

71. However, projects 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. The PDL piloting phase expired in 2009. The IDB is expected to evaluate its implementation experience soon and make a decision on the way forward.[34]

[34] At the end of the pilot (2009–2010), IDB Management provided its board of directors an evaluation of the PDLs financed under the program and including recommendations for future action. IDB Management has been in discussion with the Board regarding the recommendations presented in the evaluation document which takes into account IDB's recently approved strategy to use and strengthen country systems, which would provide a criteria framework, should its board of executive directors decide to extend or mainstream the PDL. Source: World Bank. 2011. Meeting Summary of the Program-for-Results Consultations with the Inter-American Development Bank. Washington, DC. 25 May 2011.

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) instrument, some operations in recent years have incorporated RBF features. This experience is 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) sector-wide approaches (SWAPs) in which one or more development agency supports a government-owned program;
- (ii) conditional cash transfers (CCTs), which transfer cash to poor households based on certain household behaviors generally relating to investing in the education or health of their children;
- (iii) 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;
- (iv) 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); and
- (v) performance-based contracts (PBCs), which are structured around the purpose of the work desired rather than the manner in which the work done.

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.[1] Operations that satisfy one of these two aspects are considered to have RBF features.

1. Sector-Wide Approaches

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

5. **Bangladesh: Third Primary Education Development Project**.[2] 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.

6. The project, approved by the Board of Directors on 5 July 2011, has three key features. First, it focuses on results. Disbursements are linked to achieving nine outputs, or 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.

7. 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,

[1] Policy-based lending operations have not been considered as RBF unless they incorporate unique features such as CCT. This is to distinguish between RBF and policy-based lending instruments.

[2] 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).

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.

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

9. **Philippines: Health Sector Development Program**.[4] 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 loan is ongoing.

10. 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 (TA) attached to the program has helped to develop and pilot test new insurance schemes and studies, and community-based re-insurance; in the licensing and accreditation support, engage more staff, and set up additional offices.

11. A 2007 country assistance program evaluation (CAPE) by the Independent Evaluation Department found that the program helped to improve the health care service infrastructure, and was *relevant* and generally *effective*.[5] Strong government support and ownership was a major positive feature of the program. However, the implementation of the reforms locally or the localization of reform 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 finance 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.

[3] ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant to the People's Republic of Bangladesh for the Public–Private Infrastructure Development Facility.* Manila. (Loan 2453. 2454-BAN, $83 million [ADF], $82 [OCR], approved on 2 October 2008).

[4] 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).

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

2. Output-Based Aid

12. **Solomon Islands: Domestic Maritime Support Sector Project**. The project aims to reduce economic disadvantage 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.[6]

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

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

15. 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.

16. Observations from the profitable FSS route have been encouraging. In addressing economic disadvantages in remote rural areas, the first outgoing voyage to the rural destination transported empty fuel barrels, which are used to build copra drying structures. The direct income of the third voyage was about twice the amount of the first two voyages because of the high volume of freight, predominantly copra from the rural communities. The voyages have been scheduled monthly, which has also enabled government staff from the health and education ministries to visit these rural areas more regularly.

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

18. To complement the project, ADB provided TA to establish the Solomon Islands Maritime Safety Administration. The Parliament passed the Maritime Safety Administration Act in 2009

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[6] 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).

along with regulatory reform to improve maritime administration and marine safety. In addition, the project provides a loan of safety equipment to ship operators to ensure that safety regulation requirements are met**.**

19. The project design considered and reflected local conditions. Because of the limited capacity of private operators in Solomon Islands, it was important to simplify the bid documents and conduct pre-bid meetings to ensure that the scope of shipping services was fully understood. In addition, while services were procured was through national competitive bidding procedures, a longer bid period of 8 weeks was provided to allow the operators sufficient time to prepare their bids. Extensive capacity development of private operators resulted in successful tenders.

20. The project is a good example of an OBA that delivered shipping services to remote areas where people lack access to basic socioeconomic 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 safeguards 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.

21. **Papua New Guinea: Community Water Transport Project.**[7] The project aimed 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.

22. **Nepal: Second Small Towns Water Supply and Sanitation Sector Project**. The project provides subsidies to water users and sanitation committees upon confirmation of agreed output.[8] 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.

23. **Samoa: Power Sector Expansion Project**. The project comprises (i) support for the Electric Power Corporation (EPC) investment plan, 2008–2015 through three investment components and a project management component; and (ii) a TA cluster for Implementing the

[7] 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).

[8] 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).

Samoa National Energy Policy. The total project cost is $100 million, with $42 million financed by ADB.[9]

24. The project forms part of the government's plan to improve the capacity of the sector in order to provide sustainable and reliable electricity services to all consumers at affordable prices. The project includes an innovative loan buy-down mechanism whereby the Australian Agency for International Development provides a grant to help the government repay the loan once Samoa achieves the agreed upon reforms. The RBF feature of the project is that the provision of half of the grant from the Australian Agency for International Development is triggered by three reforms that also form part of the specific assurances to be given by the government and EPC.

25. The Government of Australia will provide a grant of A$4 million to the Government of Samoa to buy down a portion of an ADF loan. The loan buy down mechanism will be triggered by the government achieving specific reforms by 31 December 2012**,** including

- (i) the establishment of an independent technical and price regulator for the power sector,
- (ii) EPC's collection performance improving such that accounts receivable do not exceed 2 months of electricity sales for a minimum of 2 years, and
- (iii) 75% of EPC's active electricity customers using prepayment meters.

3. Conditional Cash Transfers

26. **Papua New Guinea: Pilot Border Trade and Investment Development Project.** The project aims to improve the business environment in areas of the West Sepik Province.[10] One project component finances activities to improve human development in health and education in the border villages. CCTs are used for (i) heads of households connecting to electricity on a cost sharing basis, (ii) heads of households constructing standard septic tanks and toilets, (iii) pregnant women obtaining doctor certificates on specified maternal health visits, and (iv) heads of households enrolling disadvantaged children in school.

27. **Philippines: Social Protection Support Project**. ADB approved the project to support the government's CCT program—the Pantawid Pamilyang Pilipino Program (Building Bridges for the Filipino Family Program)—which provides cash grants to targeted poor families that comply with health and education conditions.[11]

28. 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 this 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

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[9] ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loan, Asian Development Fund Grant, and Technical Assistance Grant to the Independent State of Samoa for the Power Sector Expansion Project.* Manila. (Loan 2368-SAM, $42 million from ADF, $8.9 million from Australia and $0.35 million from Finland, approved on 21 November 2007)

[10] 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).

[11] Compliant 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; 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/.

September 2010. The project, which became effective on 12 January 2011, directly supports the government's CCT program, with the loan funding about one-third of the grants to the first 1 million beneficiary households.[12] The government and a loan from World Bank each funds one-third of the CCT program. ADB is also providing three TA projects totaling $2.5 million, covering capacity development, gender mainstreaming, and support for broader rationalization of social protection sector programs.[13]

29. The progress of the project has been encouraging and emerging evidence for Pantawid Pamilya (including the portions supported by ADB) appears promising. This is the result of factors including (i) the government's commitment to Pantawid Pamilya; and (ii) the program's ability to address demand-side constraints directly, which appears 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 that was provided to ADB in January 2011.

30. 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 posed some difficulties. Second, the government is seeking to scale up Pantawid Pamilya aggressively, targeting 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 capacities and related 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.

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

4. Results-Based Financing for Health

32. **Bangladesh: Second Urban Primary Health Care Project.** The project contracts out primary health care services to nongovernment organizations through partnership agreements.[14] The project is being implemented in the following municipalities: Dhaka, Chittagong, Khulna, Rajshahi, Sylhet, Barisal City Corporation and Comilla, Bogra, Sirajgonj, Madhabdi, and Savar.

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[12] The project directly funds a portion of grants in localities covering about 582,000 households in 436 municipalities and 37 cities in 53 provinces.

[13] Information on ADB support is available at http://www.adb.org/projects/project.asp?id=43407 and http://www.adb.org/projects/project.asp?id=43263

[14] 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 Health Care Project.* Manila. *(*Loan 2172-BAN, $40 million [ADF] and $25 million [UK] and $5 million [Swedish Development Cooperation Agency], approved on 31 May 2005).

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

5. Performance-Based Contracts

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

35. **People's Republic of China: Yunnan Integrated Road Network Development Project**.[16] The project supports improvement of the road transport system in Yunnan 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. ADB has assisted the prefecture and county communication bureaus in implementing the PBCs and in capacity development for the county communication bureaus and the community maintenance groups.

36. **People's Republic of China: Second Heilongjiang Road Network Development Project**.[17] 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

[15] 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).

[16] 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).

[17] 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).

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 assists the provincial government's capacity in prioritizing and budgeting maintenance works.

6. Other Operations with Results-Based Financing Features

37. **Bangladesh: Power Sector Program**. The program is an example of results-based programmatic sector support.[18] In addition to using traditional ADB products, including project investment loans, sector development programs, and an independent power producer by the ADB's Private Sector Operations Department, a pragmatic results-based approach was followed. This meant that certain key policy actions, such as financial settlements and unbundling of key government power sector entities into state-owned enterprises, were included as processing conditions and undertaken before loan approval. This 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 the 2009 CAPE for Bangladesh, the 2009 sector assistance program evaluation,[19] and the Asian Development Fund XI paper on development effectiveness. [20]

38. **Lao People's Democratic Republic: Northern and Central Regions Water Supply and Sanitation Sector Project.** The project was approved in 2005 and a supplementary grant was approved in 2010.[21] 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.

39. The number of beneficiaries is 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 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

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[18] 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 no. 36107); 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 no. 36205).

[19] ADB. 2009. *Country Assistance Program Evaluation: Bangladesh*. Manila; and ADB. 2009. *Sector Assistance Program Evaluation: Bangladesh Energy Sector*. Manila.

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

[21] 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).

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.

40. 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.

41. **Indonesia: Urban Sanitation and Rural Infrastructure Support to PNPM Mandiri Project.**[22] 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.

42. 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 criteria for the financing of construction of basic rural infrastructure or sanitation facilities in urban areas. A cycle of block grants consists of at least three block grants to a selected community. A menu of investment opportunities is open for these communities with financing to be selected based on the guidelines of the project.

43. 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.

[22] 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

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

A. Project-Based Lending

2. ADB provides project lending to finance specific investments for sovereign and nonsovereign operations.[1] These operations disburse based on specific transactions and expenditures, most of which are used to purchase works, goods, and services.

3. Project-based lending comes in various forms. In addition to stand-alone projects, ADB provides sector lending to finance investments in multiple (relatively small) subprojects in a sector.[2] Disbursements for a sector loan are made in amounts requested based on the costs of the subprojects. ADB's emergency assistance loans provide immediate, short-term transitional assistance to help rebuild high-priority physical assets and restore economic, social, and governance activities after emergencies.[3] Financial intermediary loans finance projects wherein individual financing requirements are not large enough to warrant the direct supervision of ADB.[4] Technical assistance loans finance detailed engineering design through capacity building and other related activities.[5]

4. Project-based lending generally supports a predetermined design, or a blueprint capital investment project, such as construction of a road, dam, or bridge. Assessments of projects are based on their technical soundness, financial and economic viability and sustainability, governance, social and environment impacts, and poverty impacts. The projects are implemented following ADB's procurement guidelines and Safeguard Policy Statement (2009). Risks are managed through setting up project-specific implementation arrangements, a practice commonly referred to as ring-fencing.

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

6. In recent years, ADB has introduced new modalities, all in the project lending category. These instruments have expanded the options available to developing member countries (DMCs). They include (i) the multitranche financing facility,[6] which allows ADB to finance a time slice of a long-term investment program organized in a series of funding blocks or tranches; (ii) nonsovereign public sector financing,[7] which provides loans and guarantees to selected

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[1] ADB. 2012. Lending Policies for Sovereign and Sovereign-Guaranteed Borrowers (Ordinary Capital Resources). *Operations Manual.* OM Section D1/BP. Manila; and ADB. 2007. Lending and Grant Policies (Asian Development Fund). *Operations Manual*. OM Section D2/BP. Manila.
[2] ADB. 2003. Sector Lending. *Operations Manual.* OM Section D3/BP. Manila.
[3] ADB. 2004. Disaster and Emergency Assistance. *Operations Manual.* OM Section D7/BP. Manila.
[4] ADB. 2003. Financial Intermediation Loans. *Operations Manual.* OM Section D6/BP. Manila.
[5] ADB. 2011. Technical Assistance. *Operations Manual.* OM Section D12/BP. Manila.
[6] ADB. 2010. Multitranche Financing Facility. *Operations Manual.* OM Section D14/BP. Manila.
[7] ADB. 2011. *Mainstreaming Nonsovereign Public Sector Financing*. Manila.

nonsovereign public sector entities without a central government (sovereign) guarantee; and (iii) additional financing to scale up ongoing projects that are performing well, finance changes in project scope, meet cost overruns and financing gaps, or finance a combination of these.[8]

B. Policy-Based Lending

7. ADB's policy-based lending is provided in conjunction with policy reforms of a development member country (DMC).[9] It disburses in tranches based on the fulfillment of policy conditions. The amount of earlier policy-based lending tended to be determined on the basis of adjustment costs of reforms, but now it may reflect broader development financing needs.

8. ADB has four policy-based lending products, each catering to a different situation in a DMC. Stand-alone policy-based lending provides budget support and is typically packaged as a multitranche loan to support structural reforms in a particular sector. The program is short- to medium-term. The second policy-based lending product, the programmatic approach, is ADB's primary mode of policy-based lending that is provided in conjunction with structural reforms over a medium-term time frame. Programmatic budget support finances a series of subprograms, each of which should be designated as a fully front-loaded single-tranche intervention. The programmatic approach can take the form of chronologically sequenced packaging (over time), vertical packaging (across levels of government), and horizontal packaging (intersectoral). The third policy-based lending product, special policy-based lending (SPBL), is used for emergency BOP support to a DMC in times of payments crisis. It is short-term, large, and quick disbursing with nonstandard lending terms, and it focuses on actions to reduce the severity of the crisis. The fourth policy-based lending product is a loan from the Countercyclical Support Facility (CSF), which provides budget support to facilitate a DMC's fiscal stimulus at the time of the economic crisis. It has the pricing and terms scheme equivalent to the SPBL.

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

10. Policy changes that improve growth prospects and economic efficiency are the basis for policy-based lending to a DMC. Policy-based lending requires knowledge of the public financial management environment in the country and needs to be supported by up-to-date diagnostic work. Risk assessments are to be carried out at the country, priority sector, and program levels to evaluate public financial management, procurement, and integrity issues following the Second Governance and Anticorruption Action Plan (GACAP II).[10]

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[8] ADB. 2011. Additional Financing. *Operations Manual.* OM Section H5/BP. Manila.

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

[10] ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

C. Sector Development Programs

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

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

Table A3: Summary of ADB's Lending Modalities

Modalities	Key Features
	Project-Based Lending
Sovereign project lending	Finances specific stand-alone investment projects with sovereign guarantee. Consists of ordinary operations financed by OCR and special operations financed by special funds, including ADF loans and grants. Finances project costs subject to ADB rules.
Nonsovereign project lending	Finances project or corporate finance requirements (operating or capital expenses) without sovereign guarantee. Introduced under the Innovation and Efficiency Initiative in 2005. ADB directly assumes the credit risk of the borrower. Financial terms (pricing) are set on a commercial basis, similar to that applied to ADB's private sector loans.
Sector loans	Finances a large number of subprojects in a sector. Investments are made in a geographic area (an area slice), or over a period of time (a time slice), or both. "Subprojects" refer to (numerous and comparatively small) projects that make up a sector loan.
Financial intermediary loans	Finances directed investments of financial intermediaries, usually as credit lines. Can be used in conjunction with ADB's guarantee products to enhance the availability of funds for financial intermediaries.
Technical assistance loans or grants	Finances capacity development or engineering design of a project.
Disaster and emergency assistance	Provides immediate short-term transitional assistance to mitigate immediate losses to priority assets, capacity, or productivity. Can be provided in different phases of an emergency: (i) development or prevention phase (e.g., mitigation measures); (ii) emergency response or transition phase (e.g., rehabilitating high-priority physical and social infrastructure, revitalizing basic services, and jump-starting economic

[11] ADB. 2003. Sector Development Programs. *Operations Manual.* OM Section D5/BP. Manila.

Modalities	Key Features
	productivity); or (iii) recovery phase (based on joint damage and needs assessment with partners). Can use (i) portfolio restructuring or loans savings, (ii) emergency assistance loans, (iii) normal development loans, (iv) additional financing, or (v) technical assistance.
Multitranche financing facilities	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. “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). “Tranches” comprise loans, grants, guarantees, or ADB-administered cofinancing.
Guarantees	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.
Equity investments	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.
Syndications	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.
Additional financing (previously supplementary financing**)**	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. All forms of public and private sector projects can receive additional financing.
Policy-Based Lending	
Policy-based loans (or grants)	Supports reforms and disburses in tranches based on the fulfillment of agreed upon policy conditions. Provides budget support to address development financing needs or finance balance of payments. There are four types of policy-based lending: (i) stand-alone policy-based lending, (ii) the programmatic approach, (iii) special policy-based lending, and (iv) countercyclical support facility.
Sector Development Programs	
Sector development program loans	Finances a reform program and specific projects linked to a sector and program. A combination of project lending and policy-based lending, not a separate modality.

Modalities	Key Features
Financing Facilities	
Retroactive financing	Finances expenditures incurred before the ADB loan, grant, or TA becomes effective. Should not exceed 20% of the ADB financing, and should be incurred within 12 months before the effectiveness of the ADB financing. The 2011 review of policy-based lending eliminated the ceiling on retroactive financing for policy-based lending.
Local currency financing	Provides loans in local currencies to reduce mismatches between income received in a domestic currency and debt repayments in a foreign currency. Can be attractive to private, state-owned enterprises, local governments, as well as public services, utilities, and infrastructure projects that are subject to regulated tariff regimes. ADB can only offer local currency loans in selected DMCs where it has secured approvals to access the local capital market.
Project design facility	Provides quick-disbursing resources though PDAs to fund detailed engineering design and broader project preparation. It has shorter processing time compared with a TA loan. It helps in providing more realistic cost estimates, obviating the need for large contingencies and relieving resource constraints for project preparation. PDF is undergoing pilot implementation until 31 December 2013. 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.

ADB = Asian Development Bank, ADF = Asian Development Fund, DMC = developing member country, MFF = multitranche financing facility, OCR = ordinary capital resources, PDA = project design advance, PDF = project design facility, TA = technical assistance.
Source: ADB (various policies and operations manuals of 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 financing (RBF) program modality. Key consultation activities included:

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

2. All comments and suggestions received were carefully considered in drafting the RBF policy paper. In addition, ADB is conducting a broad web-based public consultation with all stakeholders and the public, who were invited to submit comments and suggestions on the draft policy paper in June and July 2012.[1] ADB also used the social media (Facebook and Twitter) to announce the consultation in order to increase the outreach to stakeholders and the public.

B. Major Comments and Suggestions

3. The consultations suggest broad support for the RBF for programs. 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 the RBF for programs. Many stakeholders also see RBF as an instrument for greater innovations and efficiency as it focuses on results. The prospect of using and improving program systems is considered a major potential advantage of RBF for programs.

4. Survey results from DMCs suggest that a diverse range of sectors can be suitable for RBF for programs, including agriculture and natural resources (e.g., livestock, disease 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 management; public sector management; and food security and food distribution. DMCs expressed strong support for having such a modality as they see the programs as having many potential benefits including:

(i) contributing to the implementation of the Paris Declaration principles;
(ii) enhancing the achievement and sustainability of development results, especially outcomes;

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[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).

(iii) supporting effective and efficient program selection, planning, implementation, monitoring and evaluation (M&E), results verification, and program management;
(iv) effectively and efficiently allocating and using scarce public resources (including healthy competition for funds among programs);
(v) achieving procedural efficiency;
(vi) enhancing institutional development and capacity development in financial management, procurement, safeguards, M&E, achievement of targets, skills development, competence improvement, and performance budgeting;
(vii) mitigating risks;
(viii) reducing corruption;
(ix) improving country ownership;
(x) establishing a platform for development agencies to coordinate more efficiently; and
(xi) establishing a platform for stakeholder participation.

5. 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 is over should be a major consideration for designing the instrument.
(ii) The defining, measuring, monitoring, and evaluation of results should not be overburdened by tedious and overly demanding data and procedural requirements. Instead it should be practical, feasible, and effective. M&E and credible verification are important.
(iii) Results indicators should be concrete, measureable, controlled by the program and attributable to the efforts made.
(iv) Large amounts of up-front financing by the government may not be affordable for many countries. Advanced financing should be provided to bridge the financing gap.
(v) RBF for programs operations should be strongly linked to the government's financing needs. Predictability of funds is important.
(vi) RBF for programs operations should carefully consider existing program systems first to avoid undesirable and unworkable reengineering.
(vii) Public–private partnerships should also include communities and nongovernment organizations.
(viii) ADB should arrange participatory knowledge-sharing sessions with stakeholders to disseminate the approaches of RBF for programs. Awareness-raising and rollout activities will be important when introducing the new modality.
(ix) Intensive and continual capacity development (e.g., proper guidance and follow-ups on changing attitudes for improvements in systems and processes, and aligning institutions with sound principles) will be critical.
(x) Capacity development in operational aspects (e.g., financial management, procurement), in results-focused program design and management, and in M&E tools are critical. Training should be provided.
(xi) Learning from experience and involvement of stakeholders will be important.
(xii) RBF for programs should be governed by efficient procedures. This will be consistent with the RBF approach.

C. Major Questions

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

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

8. ADB is considering introducing the RBF for programs to provide more choices for DMCs and ADB operations, enhancing incentives and accountability for results, and strengthening program systems. RBF for programs will disburse based on results, not expenditures. The programs will be system-based, not transaction-based. These features of the RBF for program will help deliver sustainable results. ADB has adopted a results-based corporate performance system. ADB is also moving towards results-based country strategies and internal work plans that are closely linked with results. This new instrument will constitute a step in the results-based reforms in ADB.

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

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

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

12. The disbursement linked indicators (DLIs) will be decided through dialogue between the government and ADB. DLIs will generally be a subset of indicators from the government's results framework. They will be the result indicators that are critical to the success of the program.

13. 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.

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

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

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

17. Tackling systematic weaknesses is a key objective of RBF for programs. RBF for programs 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. The RBF for program will adopt specific anticorruption guidelines to support DMCs to deal with fraud and corruption. ADB will support DMCs' efforts. At the same time, ADB reserves the right to investigate. ADB's standard

remedies provide sufficient tools for ADB to deal with fraud and corruption. RBF for programs will exclude activities including high value contracts.

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

19. Another objective of RBF for programs 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 RBF for programs to minimize fiduciary and safeguard risks. ADB will assess the strengths and weaknesses of the program's fiduciary and safeguard systems, institutional capacity, and performance. Capacity development will be carried out and risk-mitigating measures will be incorporated. Exclusion of category A activities in the Safeguard Policy Statement and high value procurement contracts will also help reducing risks.

20. *Will the assessments be too demanding?*

21. Rigorous assessments are a key input of RBF for programs, necessary activities that ADB and DMCs must carry out. Sound assessments will require time and resources from both ADB and the borrowers. 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.

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

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

- (i) refining the program design;
- (ii) refining the results frameworks;
- (iii) assessing system strengths and weaknesses;
- (iv) identifying risks and mitigating measures;
- (v) supporting capacity development;
- (vi) providing implementation support;
- (vii) assist with 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.

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

25. As with all ADB operations, key stakeholders participation will be important in RBF for programs operations. The degree and nature of such participation will be decided at the operational level. CSOs could be involved in the implementation of the program, monitoring and evaluation, results verification, providing feedbacks, 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 an RBF for programs modality.

A. Policy and Operations

2. An enabling policy framework is needed. The absence of such a framework for RBF for programs 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 RBF for programs can be high because the systems, institutional development, and results verification need to be assessed. However, while transaction costs are likely to decline over time, the RBF support structures can strengthen the quality of institutions over the long run. Development agencies need to factor in these costs when allocating resources.

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 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 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 RBF for programs. 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.

7. Development agency financing generally accounts for a moderate share of total program resources. Thus, it would be difficult to single out the cost of each result indicator. Attention should be placed on the results for the whole program and the financing needs for achieving all the results.

C. Institutional and Capacity Development

8. A significant objective of RBF for program is to improve program systems. Decades of development assistance offer numerous lessons.[1]

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[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. United Kingdom.

9. Many studies have found that effective capacity development must be owned by a government.[2] External assistance can support capacity development, but it cannot be a substitute for it. Capacity development is most likely to succeed when countries view it as serving their own interests. Supply-driven and fragmented assistance is not effective.

10. 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]

11. 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 will make a difference. Capacity development thus requires a long-term perspective.

12. 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.

13. Capacity development requires flexibility**.** In a complex system, it is not possible to identify all the relevant capacity development 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 to respond to unforeseen events.

14. 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. The result could be lower transaction costs.[4]

15. These lessons should be carefully considered in designing the RBF for programs modality.

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[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.

[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 FINANCING FOR PROGRAMS

A. Purpose and General Principles

1. 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 the results-based financing (RBF) for programs 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 RBF for programs modality (the programs).

2. These guidelines do not limit any other rights, remedies, or obligations of ADB or the borrower under the loan agreement or any other document to which the ADB and the borrower are both parties.

3. All persons and entities participating in the programs must observe the highest ethical standards; take all appropriate measures to prevent 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.[2]
   - (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

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1 ADB. 1966. *Agreement Establishing the Asian Development Bank.* Manila.
2 To act “knowingly or recklessly,” the fraudulent actor must either know that the information or impression being conveyed is false, or be recklessly indifferent as to whether it is true or false. 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.[3]

C. Borrower's Actions to Prevent Fraud, Corruption, and Other Prohibited Activities in the Programs

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

(i) ensure that the program is carried out in accordance with these guidelines;

(ii) avoid real or perceived conflicts of interest in the programs;

(iii) prevent fraud, corruption, and other prohibited activities from occurring in the programs, including 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 programs; and

(viii) ensure that persons or entities sanctioned by ADB do not participate in the program-supported activities in violation of their sanction.

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

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

(i) inform the borrower of credible and material allegations or other indications of fraud, corruption, and other prohibited activities related to a program, consistent with ADB's policies and procedures;

(ii) have the right to investigate allegations independently or in collaboration with the borrower;

(iii) inform the borrower of the outcome of any investigation, consistent with ADB policies and procedures;

[3] ADB. 2009. Whistleblower and Witness Protection. *Administrative Orders.* AO 2.10. Manila. http://www.adb.org/employment/whistleblower-witness-protection.asp

(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 a program-financed activity indefinitely or for a stated period of time;[4] and

(v) recognize sanctions determined by other multilateral development banks in accordance with the agreement for the mutual enforcement of debarment.

[4] Participation does not include the performance under contracts entered into or other engagements begun before the date of the loan agreement.