Devolved Access Modalities

Lessons for the Green Climate Fund from existing practice

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1. INTRODUCTION

The Green Climate Fund (GCF) Board is in the process of considering *additional modalities that further enhance direct access, including through funding entities with a view to enhancing country ownership of projects and programmes*.[1] The term 'enhancing' in this context refers to a devolution by the Board of certain operational funding decisions to outside agencies: '(accredited) funding entities'.[2] This type of devolved/decentralized access modality has been proposed as an alternative to the more traditional model where detailed project approval is carried out at the multilateral level (e.g. by the Global Environment Facility Council/Secretariat, or the Adaptation Fund Board). It has been argued that this sort of decentralized/devolved model is key to the GCF being able to operate at scale,[3] but it is also clear that it could give rise to a fundamental tension in the partnership between the GCF and these accredited funding entities, in that they each may well have different objectives, say with regards to national development and global climate change benefits.

The aim of this Brief is to address certain concerns about this decentralized/devolved access model that have been raised (in personal communications) by Board members and other stakeholders. In order to do so, the Brief uses seven case studies to illustrate current practices that could provide ideas and insights about how the GCF might design its own approach (or set of approaches) for a GCF decentralized/devolved access modality, which may borrow features from the variety of forms used by others. The case studies are focused around four questions:

a. How does the funding model generally work, in terms of disbursing funds?
b. Who decides what? In particular, in the context of approval of funding, what decisions are taken by the governing funding body and what decisions are devolved and to whom?
c. How does this funding model ensure the governing body's objectives are met, and how does it ensure that the various fiduciary standards and safeguards are satisfied without the process being 'hands on'?
d. How is the funding level for a particular programme determined?

2. BACKGROUND

While the discussion on devolution of operational funding decisions at the GCF Board is still in its infancy,[4] the idea has been around for quite some time, both in the context of the wider debate on the nature of the GCF and beyond. Indeed, it was embedded in the GCF Governing Instrument (GI) in two different guises, namely as 'programmatic approaches' and as 'enhanced direct access' (EDA) through 'funding entities':

> *36. The Fund will support developing countries in pursuing project-based and programmatic approaches…*[5]

> *47. … The Board will consider additional modalities that further enhance direct access, including through funding entities with a view to enhancing country ownership of projects and programmes.*[6]

1 GCF Governing Instrument, paragraph 47.
2 See, for example, Müller (2014).
3 See, for example Müller (2013).
4 See Müller (2013a).
5 'Operational modalities: Eligibility', Governing Instrument for the Green Climate Fund.
6 'Operational modalities: Access modalities and accreditation: 1 Direct Access', Governing Instrument for the Green Climate Fund.

The notion of a 'programmatic approach' (PA) has a well-established meaning, particularly in the context of development assistance. Its defining characteristic has been a specific contractual arrangement between the funder and the programme implementer for a set of activities that is broader than a single project.

The concept of a 'funding entity' (as used in the GI) was a technical term defined by its authors as:

> *…the national legal entities and multilateral organizations that have been accredited by the GCF Board as meeting its criteria for accessing funding in order to approve and fund eligible activities.* [7]

The recent background paper (GCF, 2014) of the GCF Secretariat on the topic of enhancing direct access proposes the following operational understanding of the concept for the GCF:

> *Funding entities are a special case of intermediaries where the sub-national, national or regional entity is public in nature and related to an approved project or programme with decision-making authority for funding decisions.*[8]

There is a considerable overlap between PA and EDA. Most of the examples discussed in Section 3 and described in the appended Exhibits represent different programmatic approaches to devolution. However, EDA is possible without adopting a bilateral programme, as illustrated by the Quantity-Performance examples in Section 3.2 and Exhibit 7. For this reason, it may be useful to imagine the following spectrum of funding models to illustrate how they fit with these two ideas:

[A] The specific projects associated with a particular programme in a given country are approved by the GCF at the same time as the programme approval.

[B] A programme of activities is approved by the GCF, but requires subsequent GCF approval for each project once they are fully specified.

[C] The approved programme specifies in less detailed terms how the money will be spent – say, a particular wind farm and a sea wall – but without all the details that normally accompany project approval at a development bank (such as listings of co-financing partners, contracts, etc.)

[D] The approved programme allocates money for particular purposes – such as renewable energy and coastal protection – together with agreed criteria for project selection but does not specify particular projects.

[E] The approved programme provides a sum of money, perhaps into a multi-donor trust fund, and lists types of eligible activities – such as renewable energy and coastal protection – together with agreed criteria for project selection but without any sub-allocation. Payment might be provided up front, in line with projected expenditures, or upon completion and based on demonstrated results.

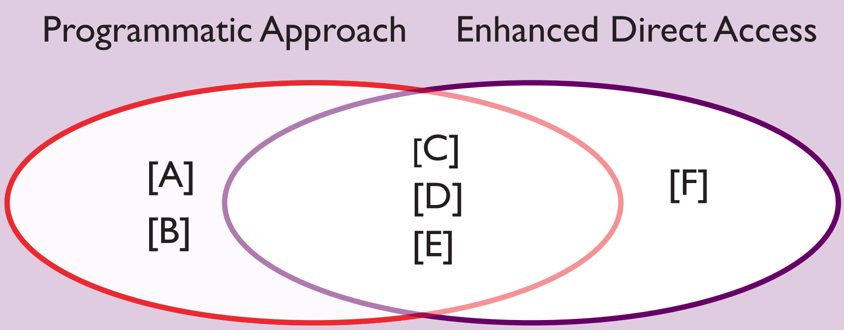
[F] Rather than focusing on a particular country, the GCF develops and approves funding rules for eligible activities – for example, a subsidy formula for eligible renewable energy projects – that could be used in multiple countries.

7 For more on the history of these notions, see Müller (2013b).

8 Paragraph 53.c in GCF/B.06/15 (GCF, 2014).

As it happens, [A] and [B] do not fit the above-mentioned idea of EDA, and [F] does not fit the idea of programme funding. The general relationship between EDA and PA can thus be schematically illustrated as shown in Figure below.

Figure 1: The relationship between the Programmatic Approach and Enhanced Direct Access



All of these ideas can play a role in GCF funding. EDA, however, offers certain advantages. In particular, such an approach improves a country's ownership by helping to ensure that the funded activities are well embedded in the country's overall expenditure programmes and in its policy and institutional reforms. It relies on and strengthens the country's own implementing institutions, rather than bypassing and fragmenting its institutional capacities, as often happens with project-based funding. Because of stronger country ownership and implementation by national institutions, it helps to ensure that the activities funded externally will be sustained beyond the period of that funding. For all of these reasons, PA/EDA are likely to enhance the long-term *effectiveness* of external funding and would also allow the GCF to more easily scale up funding, while freeing the GCF Board and staff to focus on more strategic matters, as more activities are bundled into fewer decisions with more administrative and implementation issues devolved to in-country decision makers.

3. BROAD APPROACHES TO DEVOLUTION

This Brief outlines alternative approaches that could be useful within GCF's portfolio of operational modalities. In broadest terms, there are two categories to consider: 'programme funding' and 'Quantity-Performance (QP) funding'.

- A programmatic approach to funding involves the negotiation and approval of a programme of activities to be implemented by a specific national entity, and this Brief will provide examples of the diverse ways in which programme funding has been used by the international development community for many years.
- The QP approach focuses on defining rules and payments based on the delivery of well-defined, verifiable quantitative outcomes that, once approved, could be utilized by many countries.

There is clearly potential overlap, as highlighted in Figure 1. A QP instrument could be negotiated with a specific country or be part of a package of activities included in a national agreement. In the discussion that follows, we distinguish between examples defined as a general QP model (and thus not tied to particular countries) and others that involve a specific contractual arrangement ('programme') with a single country (and may or may not include QP instruments). Both approaches have been implemented in different ways to date, as outlined below and discussed in more detail in the appended case study Exhibits.

3.1. Programme Funding

Programme funding for national entities generally devolves at least some decisions relating to specific expenditures and other activities (as well as the responsibilities for management and implementation) to those national entities within a negotiated framework. In this brief, we focus on examples where devolution is sufficient to be considered 'enhanced'. The national entity involved in programme funding is typically a ministry or government entity, but it could be a domestic non-governmental organization. Programme funding involves four key elements:

a. agreement about the activities and types of expenditures to be undertaken by the national entity that receives funding;
b. verification by the funder that the national entity can employ systems for financial management and safeguards of sufficient quality to ensure that the funder's interests are maintained;
c. mechanisms and/or indicators for monitoring progress in the implementation of agreed activities; and
d. rules for disbursing funds to the national entity.

Although all programme funding arrangements include these four elements, as practiced by international development agencies and multilateral funders, they vary considerably in terms of (1) the extent to which final decisions about expenditures are devolved from a national level government agency to lower levels within the society; (2) the extent to which the agreed activities are expenditures for particular types of goods and services or institutional and policy reforms; and (3) the extent to which disbursements are linked to outputs and/or outcomes.

3.1.1. Exhibits

We provide five exhibits that highlight different approaches. Exhibits 1 and 2 are examples of specific programmes where key decisions have been devolved not just to the level of national government agencies, but to regional or even local governments. Exhibits 3, 4, and 5, are examples of more general ways of structuring agreements between funders and recipients, to fund a wide range of activities. Such agreements might support activities such as those in Exhibits 1 and 2, but have the flexibility to do even more. Here, we provide a brief comment about the key features of each example, which are discussed at length in the exhibits, as well as some summary observations.

Exhibit 1. In the Honduras Rural Infrastructure Project, the World Bank used the Honduran Social Investment Fund (FHIS) and existing administrations to fund a wide-range of small rural infrastructure projects. Detailed project selection was done by local administrations, subject to review by the national-level FHIS, and the FHIS provided oversight of financial management, procurement, and safeguards. Funds received from the World Bank were disbursed by the FHIS on a quarterly basis to local administrations, based on the approved budgets.

Exhibit 2. The Kecamatan Development Programme (KDP) in Indonesia specialized in making block grants for local governments through a highly decentralized programme. Grants of between $50 and $150,000 were provided to groups of 20–50 villages so that they could develop and implement small-scale infrastructure, social, and economic activities (chosen within the communities themselves). Each district, or Kecamatan, conducted a competition for funds among villages and oversaw disbursements. The KDP was funded by a combination of World Bank lending and contributions from the Government of Indonesia, as well as Dutch, Japanese, and other, multi-donor trust funds.

Exhibit 3. Kenya's County Adaptation Funds (CAFs) provide an example of sub-national, devolved funding. The UK's Department for International Development provides £500,000 annually for the CAFs, of which 70% is allocated to fund investments in public goods prioritised by communities through Ward Adaptation Planning Committees, or WAPCs (£70,000 per ward), and 20% for county-level investments or urgencies identified by the County Adaptation Planning Committee (CAPC). It is envisaged that the CAFs will eventually be integrated with County Integrated Development Plans, and become part of the countys' annual planning cycles.

Exhibit 4. The Millennium Challenge Corporation (MCC) provides large, multi-year programmes of investments – called 'compacts' – that are developed by the country and managed by a domestic agency(s). The MCC emphasizes (1) competitive selection among countries based on historic performance indicators, (2) predictable, multi-year funding, and (3) rigorous measurement and evaluation of impact. Countries qualify for the MCC based on independent and transparent measures of good governance. The MCC then invites the governments of selected countries to propose a set of specific investment activities consistent with national priorities. Decisions about these investments are typically made at the level of national ministries and are well-defined with the 'compact' document.

Exhibit 5. Policy Based Funding is a general approach that emphasizes policy and institutional reforms and is supported by unrestricted funding to a government. The World Bank's Policy Loan to Morocco for 'Inclusive Green Growth', for example, provided a $300 million loan following the government's approval of certain energy efficiency standards and price adjustments to refined petroleum products.

Exhibit 6. The Global Climate Change Alliance (GCCA) provides funding to increase capacity in the most vulnerable developing countries through a variety of modalities, one example being their recent €28 million contribution to the Bangladesh Climate Change Resilience Fund (BCCRF). The BCCRF is a multi-donor trust fund overseen by a board and management committee of senior Bangladeshi government officials and ministers that also includes donor and civil society representatives. While the World Bank currently serves as interim trustee and secretariat, a domestic BCCRF secretariat is being set up to take over those activities.

3.1.2. General Observations

Several general observations should be made about these alternative forms of programme funding. First, the use of programme funding has, thus far, been constrained by the limited number of national entity(s) assessed as having the required capacities for financial management and for application of environmental and social safeguards. This is especially important for programme funding in which the agreed programme involves a set of expenditures, rather than institutional reforms or outputs/outcomes. Concerns about the adequacy of such capacities is a particular constraint for contributors when considering the devolution of expenditure decisions.

Second, the most appropriate form of programme funding and devolution will vary according to the activity to be supported. For example, relatively large infrastructure investments lend themselves to the devolution of expenditure responsibilities to national ministries, and small-scale adaptation investments, to district or community level organizations. Legal and pricing policy reforms lend themselves to policy-based funding.

Third, by its nature, programme funding facilitates joint funding by two or more external funding entities. This helps to reduce fragmentation of external assistance and would also provide a potential vehicle by which the GCF could pursue its mandate to mainstream climate concerns into broader development programmes.

Finally, when outcomes are physically measurable, with the potential for independent monitoring and verification, another possibility for devolution exists: one could link funding disbursement to physical delivery (with or without upfront specification about eligible activities and other guidelines). This approach devolves funding decisions – perhaps in a more transparent way than any other – to a national agency (or to multiple national agencies, sub-national agencies, or private firms). For that reason, we treat it separately, under the next section on 'Quantity-Performance approaches'.

3.2. Quantity-Performance approaches

Quantity-Performance (QP) instruments[9] are instruments used to provide ex post ('on delivery') funding for transactions of (physical) quantities, such as tonnes of CO2, kWh of renewable energy, or hectares of forests, generally involving some form of 'forward' contract.

QP-instruments are determined by four key elements: counterparty selection, definition of results, price setting, and the setting of transaction volumes. They can be structured in a variety of ways. Counterparties, volume, and price could be determined competitively through auctions; alternatively, volume and price could be set through negotiation with each counterparty on a first-come first-served basis, or by using a standard formula. The transactions, in turn, may be (project-level) micro transactions with private-sector counterparties or (programmatic) macro transactions with public-sector counterparties. The latter could be designed to reward performance measured at a national, sub-national, or sectoral level, depending on the particular public-sector counterparty and definition of results.

There are a number of existing experiments and conceptualizations of QP-instruments at a macro- and a micro-level. Examples of the former, discussed in Müller et al. (2013), are:

- the ***Norwegian International Forest Climate Initiative*** (NICFI) with the Brazilian Amazon Fund and the Guyana REDD+ Investment Fund (GRIF) as funding entities;
- the ***Energy+ programme***; and
- a scheme to reward accelerated transition pathways proposed by the Center for Global Development (CGD).

Examples of the latter include:

- the ***Global Energy Transfer Feed-in Tariffs*** (GET FiT) program from the same CGD paper and
- a proposal for a **Clean Development Mechanism (CDM) Stabilization/Capacity Fund** by the High-Level Panel on the CDM Policy Dialogue.

In September 2013, the World Future Council also published a proposal – see Michaelowa and Hoch (2013) – for a ***Renewable Feed In Tariff (REFIT) Facility*** as part of the GCF Private Sector Facility, for which they envisage a structure that would pay a subsidy for renewable power generation through national funding entities.

Ultimately, the QP approach has the potential for the greatest possible devolution of operational funding decisions: the funders, as quantity purchasers, do not need to take any particular decisions regarding the production of what they wish to purchase. All they need to do is to give a general specification of the desired product, which may or may not include specifications or restrictions on how it is to be produced.

9 The term 'Quantity-Performance (QP) instrument', as used here, was first introduced by Ghosh et al. (2012) in the context of mobilizing private sector mitigation activities and subsequently operationalized in the context of Enhanced Direct Access (EDA) in Müller et al. (2013), on which this section is primarily based.

Such an approach would give the GCF's counterparties the greatest possible freedom to choose (within the eligibility limitations given by the funder) how they wish to produce these quantities. One advantage for the Fund is that the delivery risk is mostly with the domestic producer, who is in a far better position to manage it.

However, not all climate change funding lends itself to being carried out through QP instruments. The QP approach is probably best suited to funding mitigation activities where various environmental and social safeguards are easily specified, and where monitoring and verification are straightforward.

We provide an exhibit which illustrates the use of QP payments with results measured at a macro level with a fixed-price transaction methodology.

Exhibit 7. In order to illustrate the use of QP payments with results measured at a macro level with a fixed-price transaction methodology, this Exhibit summarizes a model put forward by Müller et al. (2013) which uses proposals developed by the ***Center for Global Development*** to enhance the modalities used in the ***Norwegian International Forest Climate Initiative*** (NICFI).

4. STAKEHOLDER CONCERNS

A number of concerns relating to the idea of a decentralized/devolved access model have been raised by stakeholders.[10] They are here sorted into four groups, each examined in turn.

4.1. Concerns about negative effects on contribution levels

[a] *If there is EDA, then contributors will be less inclined to provide funding.*

Ultimately, EDA only makes sense if it benefits recipients and contributors. From a contributor perspective, EDA can be a more cost-effective way to deliver assistance, improve country capacity, and/or provide more accountability for results. Moreover, by focusing on programmatic approaches that can scale up funding, EDA satisfies a contributor's need for management efficiency. We provide a number of exhibits that illustrate EDA-like approaches in order to stimulate a debate over how this can best work in the context of the GCF. It has also been argued11 that without a devolution of funding functions to the national level, the GCF would not be able to reach the double-digit billion dollar scale of operations which is envisaged.

[b] *Contributors will not want to lose control of the purse strings.*

The underlying issue is not control, per se, but whether a particular modality employs checks and balances to effectively achieve the objectives of the GCF without violating the standards and safeguards desired by many stakeholders. All funding approaches will need to ensure that those checks and balances are in place, and that the board retains the authority to decide whether that is true in any instance.

[c] *EDA would be tantamount to writing blank cheques.*

[d] *Reputational risk with the tax payer: hint of corruption is enough.*

10 The concerns listed were communicated to the authors by key stakeholders under the Chatham House rule.
11 See, for example, Müller (2013).

[e] *How would one ensure that under EDA the GCF's social and environmental standards would be upheld?*

None of the approaches we describe are tantamount to writing blank cheques. They involve Board-approved agreements that (a) provide funding after outcomes have been verified; (b) specify in detail the programme of activities being funded; and/or (c) establish eligibility criteria, implementing guidelines, and transparency requirements. Fiduciary standards and social and environmental safeguards can be built into these mechanisms.

A key requirement is that a country using a particular access modality must have the capacity to carry out their responsibilities under that model.

If there are general concerns about a particular modality, it makes sense to explore the experience to date. No modality is devoid of risk, and evidence can be gathered to quantify and qualify various risk factors. Ultimately the risks of each modality in a particular context have to be weighed against achievement of the GCF objectives.

4.2. The question of sequencing

[f] *How can one have 'enhanced' direct access without having first had 'ordinary' direct access?*

Ordinary direct access is a simple question of whether national agencies can perform the role carried out by implementing entities such as the World Bank and other international organizations in the traditional funding models at the GEF, the Climate Investment Funds (CIFs), and the Adaptation Fund (AF). Enhanced access, whether direct or not, is a different model for funding activities, which can occur alongside a traditional funding model. Enhanced direct access has the additional goals of building national capacity, mainstreaming assistance, and focusing on delivering cost-effective results.

[g] *Should EDA be admitted from the outset, or should it be phased in over time?*

Given the examples we discuss, it seems reasonable to pursue these kinds of modalities in parallel with traditional access mechanisms.

[h] *The national climate funds have insufficient experience for them to be trusted with the large amounts of funds that could be transferred to them.*

It makes sense that countries and funding approaches will move forward at different speeds. While it would be unwise to mandate a large volume of funding to go through a particular mechanism or entity, it also seems unwise not to pursue EDA approaches and not to use them – where appropriate. As our Exhibits show, there are advantages, and those advantages could be lost if EDA is not part of the initial design and operationalization of the GCF.

It must also be remembered that, while still a relatively new phenomenon, there are nonetheless over 30 national climate funding entities and that their number (and experience) is growing. The GCF should start by engaging them from the beginning, not only to gain experience with EDA, but to be able to shape it.

4.3. Concerns about lacking capacity

[i] *What about countries that for some reason or other could not engage in EDA? Would they be left behind?*

EDA cannot be the only modality for accessing GCF funds. There will always be a need for 'international access' (access through international intermediaries), not only because some countries may not be ready for (enhanced) direct access, but also because there may be areas – regional cooperation, capacity building, technology transfer spring to mind – where it does not make sense to devolve funding decisions to the national level.

4.4. Concern about negative effects on ambition in recipient countries

[j] *It is not clear how we can ensure sufficient ambition (in the sense of climate ambition, in particular mitigation) if we devolve this authority to developing country level.*

This issue was taken up by Harmeling and Griesshaber (2013) when addressing:

> ' ... *fears that increased country ownership, for example direct or enhanced direct access to funds through national funding entities, might lead to money not being used for ambitious actions. [T]his argument neglects the important potential of direct access regarding enhanced ownership. At the same time, the call for ambition should not be regarded as contrary to the principle of country ownership; rather, it needs to be defined in the national context but with regard to the GCF's key objectives.*' [12]

In this context, it is also instructive that a recent survey conducted by the Federation of Indian Chambers of Commerce and Industry (FICCI 2013) among its membership (250,000 small and medium-sized enterprises) has unequivocally shown that an engagement of the Indian domestic private sector – in particular of domestic SMEs (this sector clearly being significant in determining domestic ambition) – will only happen under an EDA model. Submitting project proposals to entities outside their country is not within the comfort zone of (Indian) SMEs.

5. CONCLUSIONS

Programmatic and enhanced access approaches are going to be needed to address the range of needs faced by the GCF in order to enhance the effectiveness of its funding and to facilitate scaling up. There are many possible variations in these approaches, as demonstrated by our discussion and the exhibits that follow. It is unlikely that any single model provides a 'silver bullet' for how the GCF should approach funding modalities. Instead, these and other ideas should stimulate a discussion about when and where a particular approach makes sense. From our own analysis, we would point out:

- The level of devolution within a country depends on the activity: relatively large infrastructure investments lend themselves to being devolved to national ministries, while local mitigation and adaptation investments can be devolved to district or community level organizations.

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12 http://cdkn.org/resource/policy-brief-how-can-the-green-climate-fund-initiate-a-paradigm-shift-2/?loclang=en_gb

- All devolved modalities require upfront agreement on the activities, policy reforms, and/or outcomes that are being funded. The degree of specificity in any agreement is typically related to whether outcomes and other indicators alone are sufficient to ensure that all the funders' interests are being met.
- Most approaches hinge on countries having, creating, or contracting the capacity to manage funds responsibly. It is clear that this does not work in all contexts. But where it can work, it may help support the expansion of that capacity, which is a significant benefit.
- When outcomes are measurable and verifiable, tools such as QP funding devolve the most functions and flexibility to in-country decision makers.

What do these factors imply about the design of access modalities?

First, it suggests that multiple modalities are going to be needed to address the range of needs faced by the GCF. Activities with or without clearly quantifiable outcomes lend themselves to different models, as do policy reforms. This is true even within a single country. Where possible, best practice emphasizes tying payments to outcomes, while leaving as much flexibility as is possible and prudent to making decisions at country level.

Second, it suggests that the GCF should aspire to finding government ministries, or sub-units within ministries, that are seeking to make their policies and expenditures 'climate smart' and that have appropriate processes and procedures. In order to mainstream climate change awareness and mitigation activities as broadly as possible, the GCF should consider supporting cross-ministry National Funding Entities (such as the BCCRF) that can coordinate across the whole of government (without creating a separate ministry function). Such entities could be accredited to receive (programme) funding from the GCF, which could support them in the design of their programmes and processes. Importantly, using existing country systems, rather than a separate climate ministry, both helps to mainstream climate activities and strengthen in-country capacity.

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EXHIBITS

Exhibit 1. The Honduras Rural Infrastructure Project

Dan Morrow

In 2005 the World Bank approved an International Development Association (IDA) credit of US$47 million to the Government of Honduras to finance a programme of expenditure that was designed to promote an integrated, multi-sectoral, and locally-driven process of infrastructure service provision.

1. How does the funding model generally work, in terms of disbursing funds?

This funding modality involved a cooperative arrangement between the World Bank, the central government of Honduras and several of its sectoral ministries, an agency of the central government called the Social Investment Fund (Fondo Hondureno de Inversion Social – FHIS), and sub-national government units called 'mancomunidades', which are legally defined associations of many municipalities within a given area. In this model, the primary responsibility for selecting small projects for investment, and for implementing those projects, was devolved to the mancomunidades with support and supervision from FHIS. Funds were disbursed by the World Bank to the FHIS and then to the commercial bank accounts of the mancomunidades each quarter, based on their reports on budget execution and project implementation.

2. Who decides what? What decisions are devolved and to whom?

The detailed arrangements were negotiated between the Government of Honduras, FHIS, and the World Bank. The documentation for the credit that was submitted to the Board of Directors of the World Bank for approval contained a detailed description of this agreed arrangement, including the criteria for selecting which mancomunidades were eligible to participate in the programme, a description of the types of investment activities that would be eligible for financing, specification of the oversight responsibilities of the FHIS, and the guidelines for financial management, procurement, and monitoring and evaluation. Most importantly, it was the responsibility of each eligible mancomunidad to prepare its own Rural Infrastructure Action Plan (RIAP) within the menu of activities approved for the programme. These included upgrading rural road networks, improvements to water and sanitation systems, and electrification (such as off-grid systems using local renewable energy resources). These RIAPs were subject to FHIS review and approval under a Framework Agreement between the FHIS and each mancomunidad. Contracting out and supervision of investment activities was then also the responsibility of each mancomunidad, utilizing its existing administrative structure, although sub-projects costing more than US$250,000 were managed directly by FHIS.

3. How does this funding model ensure the governing body's objectives are met, as well as satisfying various fiduciary standards and safeguards, without being 'hands on'?

The objective of the funding entity to ensure that its funds were used for economically and socially sound investments, which were implemented with appropriate fiduciary standards and safeguards, was protected in several ways:

a. An experienced, capable national agency for oversight. The FHIS – a well-established agency with considerable experience in working with mancomunidades in these sectors and with which the World Bank was very familiar – was given responsibility for oversight of the participating mancomunidades and also for undertaking monitoring and evaluation of the programme.
b. Selectivity among mancomunidades and support for further capacity building. Among the poorest mancomunidades, only those that were evaluated to have sufficient technical and financial management capacity were made eligible for the programme. The programme started with only two and then expanded to six out of 50 mancomunidades in Honduras. The selected mancomunidades were provided with considerable technical support and training for the preparation and implementation of the Rural Infrastructure Action Plans and the sub-projects.
c. Limited scope of activities, and agreed technical and economic standards. Eligible investments were limited to three sectors – roads, water, and electricity – to ensure that adequate technical and economic standards could be met. Preparation of the RIAPs, and the selection and design its sub-projects, were guided by a detailed Operational Manual that had been agreed by the World Bank.
d. Agreed processes and standards for financial management, procurement, and environmental and social safeguards. Arrangements for financial management were agreed in advance, and the procurement guidelines of the World Bank would be followed. A Conceptual Framework for Social and Environmental Management was agreed, under which appropriate central government agencies would be involved only for the limited number of sub-projects involving high or moderate risks.

4. How is the funding level for a particular programme determined?

The estimated total funding requirements for six mancomunidades for a period of five years was based on a detailed prior study of the investments needed in rural roads, water, and electrification for the first two participating mancomunidades, as well as the likely costs for technical support and training. Taking into consideration the available allocation of IDA funds to Honduras, the World Bank agreed to finance about 82 per cent of total costs, and the mancomunidades were expected to provide counterpart funds for sub-projects. Co-financing of US$2.3 m for the solar electrification component was provided by GEF. In 2013 the World Bank approved an additional US$20 million to support expanded implementation of this programme.

Exhibit 2. The Kecamatan Development Program

Anju Sharma

The Kecamatan ('sub-district') Development Program (KDP) was launched in Indonesia in 1998 to address rural poverty and improve local governance. Its first two phases sought to empower village communities to address their poverty, and reduce official corruption as a key element in poverty reduction, by making block grants directly to sub-districts, instead of channelling money through line agencies, and by providing intense social and technical facilitation to build village-level capacity and to promote participation, transparency, and accountability in community-driven activities.

The third phase of the programme, which was designed during Indonesia's phase of decentralization in 2003, shifted its focus from poverty reduction to governance, with the aims of building local government capacity to support community-driven development, and supporting the development of permanent inter-village bodies to implement multi-village projects, mediate disputes, and give villages a stronger voice vis-à-vis higher levels of government (Binswanger et al., 2010).

The success of the programme led to a rapid scaling up – from initial pilots in 25 villages, the programme expanded to more than 28,000 villages by 2003 (Hartmann and Linn, 2008). An independent review of the economic impacts of the first two phases found that KDP's approach to infrastructure development has had very significant impacts on the economies of the villages analysed. Even by conservative calculations, significant benefits had accrued (Torrens, 2005).

1. How does the funding model generally work, in terms of disbursing funds?

KDP was initially funded through government budget allocations, donor grants, and loans from the World Bank. The funds were transferred into a special designated account in the Bank of Indonesia (see Figure: Flow of funds and the reporting mechanism for KDP) and were used to provide 'block grants' of Rupiah 500 million–1.5 billion (US$ 50,000–150,000) directly to sub-districts (consisting of 20–50 villages) for small-scale infrastructure, social, or economic activities.[13] There were two forms of block grants: one to support investment proposals made by villages and selected by consensus in inter-village decision meetings; and the second to support participatory planning processes to develop these proposals.

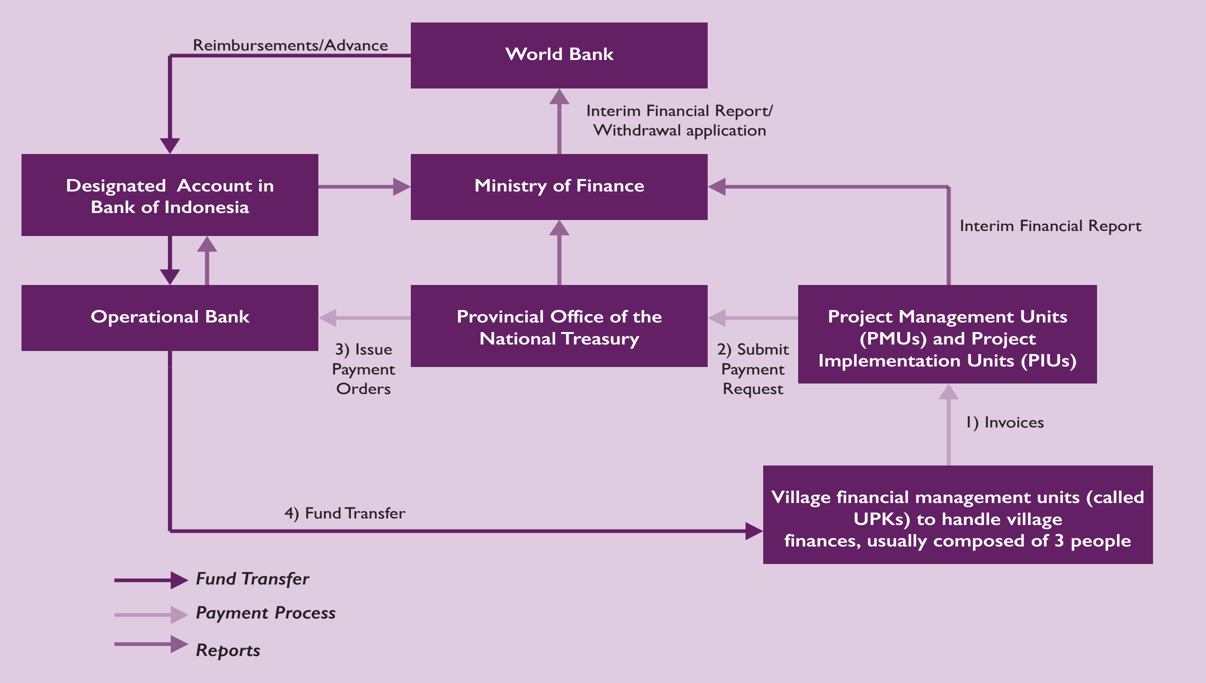
13 http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/EXTEAPREGTOPSOCDEV/0,,contentMDK:20477526~menuPK:502970~pagePK:34004173~piPK:34003707~theSitePK:502940,00.html

2. Who decides what? What decisions are devolved and to whom?

The World Bank had a central, but not determinant, role in decision-making under the KDP. Since the early 1990s, the World Bank was part of a working group within the Indonesian Ministry of Planning (Bappenas) for President Suharto's IDT (Inpre Desa Teringgal) programme to address poverty, and participated in the KDP in this capacity. In general, the Government of Indonesia decided all policies related to the KDP, while the World Bank was responsible for many, but not all, the technical designs. The World Bank also played a role in oversight and field supervision, with Bank teams visiting sites and reporting back to the Government.

At the sub-national level, development plans under KDP were prepared through a participatory process that typically lasted between four to six months. Villagers could propose virtually any investment they would like – from infrastructure provision to small-scale economic activities – and negotiated among themselves which proposals to submit. Each village could submit up to two proposals to the Kecamatan council. The requirement that villages compete for KDP resources promoted the development of high-quality project proposals. The Kecamatan council agreed which village proposal to accept, and this decision could not be overruled through other authorities. Funds were then directly released from the provincial branch of the national treasury to a bank account held by the village.

Figure: Flow of funds and the reporting mechanism for KDP



Source: Guggenheim, S (2014). Personal Communication.

The direct transfer of funds enabled villages to be autonomous in their development activities. KDP followed an 'open menu' policy, and villagers could choose to submit proposals for any productive infrastructure, social, or economic activities, except those on a negative short list that included: military or paramilitary purposes; civil works for government administration or religious purposes; manufacture or use of environmentally hazardous goods, arms, or illegal drugs; or financing of government salaries. Land acquisition is also restricted.

In the early stages, the programme did not involve provincial and district governments, contracted consultants to support the planning process and in the implementation of programmes from the private sector, and did not use civil servants. Although this allowed a more rapid scaling-up than would have been possible if government employees had been used (as they would have had to be redeployed and retrained), the decision was contentious, as important institution-building in the public sector did not take place, which resulted in a trade-off between rapid scaling-up and longer-term institution building (Hartmann and Linn, 2008). These concerns were addressed in the third phase, which focused on governance.

The programme led to the development of project-related skills among communities through a process of 'learning by doing'. This involved training in democratic decision-making and intensive awareness-building about the villagers' legal rights and resulted in a shift in power between communities and local government.[14]

3. How does this funding model ensure the programme objectives are met, as well as satisfying various fiduciary standards and safeguards, without being 'hands on'?

KDP's fiduciary structure represented a fairly radical departure from standard business practice for both the World Bank and the Government of Indonesia. There were five types of fiduciary policy issues to deal with:

- The first issue related to fund disbursement. Normally, for World Bank projects, the national government advances money and buys goods and services, and is reimbursed by the Bank. 'While everyone agreed on the need for direct financing, we still needed to know what it is we are disbursing for', says Scott Guggenheim, a former World Bank official who played a key role in the design and implementation of KDP.[15] 'In the end we took an odd analogy and argued that the case is similar to education fellowships, where poor students can access scholarships against an official letter of acceptance. In KDP, we are disbursing against an agreed community plan and set of priority investments. This is why the final minutes of the Kecamatan meeting actually take the shape of a payment release order'. Project disbursements therefore took place against agreed plans that were verified by the sub-district project manager instead of actual receipts. Villages procured and managed their own technical assistance for projects from lists of pre-qualified service providers. As a result, KDP experienced none of the lengthy procurement delays that often affect other projects.
- At the time, the World Bank required the same procedures and documentation for village-level purchasing as it did for massive infrastructure. The World Bank team in Jakarta worked with the Washington office to produce community-level guidelines, which have since been added to the Bank's standard procurement handbook.
- Because the KDP depends as much on social capital and public pressure as it does on formal oversight, a lot more emphasis had to go into structured procedures for transparency and information disclosure. This included a proposal to the World Bank's Board to allow public release of internal oversight documents.
- The fourth issue related to defining liability. The disbursement of grants to villages with limited discretion for local officials on their expenditure introduced a tension between authority and accountability. In the KDP, there was no formal liability for end-use outcomes. The Government was liable for any failure to follow the rulebook on planning, for managing the planning process, and for ensuring that funds were released against plans and signatures, but not for anything that went wrong in the implementation by villagers. This clarity on liability allowed local officials a level of assurance that they were not being held to account for decisions over which they had no control.
- The fifth issue was related to sanctions. In theory the World Bank's remedy against corruption is a declaration of mis-procurement and the return of funds to the Bank. Under the KDP, however, sanctions were imposed on individual Kecamatans against a corrective action plan, but the Government

14 http://siteresources.worldbank.org/INTCDD/550121-1138894027792/20806147/ CDDAFRSynthCAseStudies.pdf
15 Personal communication, 2013

> of Indonesia was not asked to return the funds to the Bank. The Government of Indonesia thus did not feel obliged to contest the application of remedies, since the total inflow remained unchanged. Social pressure was also used to limit infractions, by sanctioning the administrative level one step above the level of infraction. If things went wrong at the village level, the entire Kecamatan was suspended until a corrective action plan was executed; if at Kecamatan level, then the district was suspended. Corrective action plans were defined as either a return of the funds, or else completion of the works for which the money was originally given. Somewhere between 45–75 per cent of the recorded infractions were redressed in this way.

For the government, accepting KDP's system of direct transfers and disbursements against sub-district and village developments plans also required a big shift to standardized procedures. KDP's transfer system allows for very little discretion by officials. This may have resulted in some loss of technical oversight that the officials could have provided, but the benefits were seen in much higher release rates and much higher rates of end-user satisfaction (Guggenheim et al., 2004).

The strict enforcement of sanctions, the emphasis on transparency, a hard line on corruption, and the use of non-governmental organizations as independent monitors were all measures taken to ensure that project objectives were met. Effective transparency and accountability mechanisms enabled communities to identify and report corruption and abuses by local officials; helped minimize the leakage of project funds; and assert the power of communities vis-à-vis local officials. The rapid response by project managers and local police, often leading to arrest and prosecution, had a dramatic effect on villagers' belief in the justice system and their own legal rights.

4. How was the level of funds provided by the World Bank for the KDP determined?

This was based on rough calculations of what it would take to build one piece of infrastructure and finance one set of proposals per village, matched against how big an envelope the government thought it could provide. Crude targeting ('small, medium, and large') was preferred over more elaborate population-weighted allocations, which would be too complicated and hard for communities to understand.

According to Guggenheim, the KDP not only talked the language of partnership but financed it, and on a national scale using all government systems. It deployed not only an army of social activists, but also 2,000 civil engineers, and changed the narrative of local level development in Indonesia, leading to a wider recognition that communities can actually manage a great deal of community development work. The heavy investment in rigorous mixed methods evaluations also paid off. Guggenheim feels that the KDP provides a good model for activities that involve direct community participation, because it can use government systems, it can cover large areas without requiring a big management structure, its modular design allows for variance without worries, and, because of the first three factors, it is fairly easy to build in long-term predictability. He cautions against recording community empowerment as a cost rather than a benefit, which results in underinvestment in essential capacity building activities.

In 2007, the KDP evolved into a national-level 'incentivized community block grant programme' – Program Nasional Pemberdayaan Masyarakat Mandirithe (PNPM), or the National Program for Community Empowerment. PNPM is now in its fourth phase and, according to the World Bank, is the largest Community Driven Development project in the world.[16] The World Bank continues to support the project, which is

16 http://www.worldbank.org/projects/P122810/pnpm-rural-iv?lang=en

implemented by Bappenas and the Ministry for People's Welfare. PNPM provides 'incentivized' block grants to villages, where subsequent grant allocations are partly based on the village's performance.[17] Each village has an elected six-member financial management/implementation committee, and a village implementation team. All villagers are involved in approving the design and budget, and the rules state that poor villagers must benefit as labourers/suppliers during the project implementation. Village 'accountability meetings' are held, where the implementation committee reports to all villagers on work progress and the use of funds.

The KDP approach can hold the key to a problem that is becoming more and more apparent in the context of climate change adaptation: that climate impacts can vary greatly even over small geographical areas, and will need locally-relevant solutions that take on board local community knowledge and experiences. Planning and decision-making must therefore be localized rather than centralized. The KDP approach shows a way in which climate funds can be channelled to communities to enable them to implement locally identified solutions, within a set of guidelines on the scope of activities, to ensure that adaptation or mitigation benefits ensue.

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17 For more information, see http://psflibrary.org/catalog/repository/final_How%20it%20Works_English.pdf

Exhibit 3. Kenya's devolved County Adaptation Fund

Anju Sharma and Ced Hesse

Kenya's new Constitution, promulgated in 2010, grants county governments authority and responsibility for developing the social and economic aspects of their county according to local priorities. This has provided an opportunity to test a model for devolved County Adaptation Funds (CAFs), with the intention of wider replication, to prepare county governments to access global climate finance for adaptation and climate resilient development.

An Adaptation Consortium[18], led by the Kenyan National Drought Management Authority (NDMA), is piloting CAFs in five arid and semi-arid counties – Garissa, Isiolo, Kitui, Makueni and Wajir (29% of Kenya). A CAF is currently in its second year of operation in Isiolo County, and is expected to be operational in the other four counties by the end of 2014 (each county will manage its own fund – the Isiolo model will inform, but not determine, the structure of the CAFs in the other counties). The Isiolo CAF consists of a devolved fund, currently £500,000 annually, provided by the UK Department for International Development. In future, it is envisaged that counties will be able to draw down funds from a national climate change fund (yet to be established) as part of their wider development budget, where adaptation contributes to higher (climate resilient) goals. Until this integration into the county's budget cycle takes place, the funds are channelled through the International Institute for Environment and Development (IIED).

1. Who decides what?

Of the £500,000 provided, the fund committees have agreed a current allocation of 70% to fund investments in public goods prioritised by communities through Ward Adaptation Planning Committees, or WAPCs (£70,000 per ward); 20% for county-level investments or urgencies identified by the County Adaptation Planning Committee (CAPC); and 10% for running costs of the committees (coming in at 7.5% in practice). This allocation, determined by the CAPC, may be revised in future subject to a CAPC decision. The decision to divide the funds equally among the wards was taken because allocation on the basis of population or vulnerability in a particular area was found to be problematic, especially in drylands where communities typically access resources such as water and pasture across different ecological and administrative boundaries.

The WAPCs are responsible for developing project proposals within the budget envelope of £70,000. Within Isiolo County, WAPCs were established through a rigorous process of selection to include members based on

18 The Consortium includes NDMA, Christian Aid, Care International in Kenya, International Institute for Environment and Development, the Kenya Meteorological Services, and the UK Meteorological Office.

their local knowledge and representative capacity. The Isiolo WAPCs are composed of 11 community members (men, women and youth) with equal voting rights. Government technical staff are co-opted to provide advice as necessary, but do not have any decision-making or voting powers.

Together with government planners and local organisations, the WAPCs conduct participatory livelihood and local economy resilience self-assessments. The self-assessments enable different groups within the wider community to identify what either improves or undermines their ability to manage challenges like climate variability, changing market conditions, disease, insecurity, and so on. It highlights the positive and negative feedback loops between different components. For example, insecurity could limit the mobility of nomadic pastoralists – and hence limit access to nutritious pastures. This could lower the market value of livestock and render them more susceptible to disease, which will make them more susceptible to drought. The assessments use methods specifically designed to let local people, differentiated by age, gender and livelihood type, articulate the rationale underpinning their livelihood systems, and identify solutions that strengthen their adaptive strategies and capacities. All groups highlight the issue of improving resource access and governance.

The WAPCs then used the findings to prioritise investments up to their £70,000 allocation, which will promote climate resilient growth and adaptive livelihoods, based on the following seven criteria:

a. Must benefit many people.
b. Must support the economy, livelihoods or important services on which many people depend.
c. Must be relevant to building resilience to climate change.
d. Must encourage harmony, build relations, understanding and trust.
e. Must have been developed after consultation with all potential stakeholders.
f. Must be viable, achievable and sustainable.
g. Must be cost effective and give value for money.

The criteria are all linked to building climate resilience by dealing with the current underlying causes of vulnerability to existing and near future climate change. They are likely to change in the future to reflect the need for more "radical" adaptation, such as changes in land use and livelihoods.

How does the funding work in terms of disbursement?

The proposals developed by WAPCs are submitted for review to the Isiolo CAPC, made up of representatives from the ward committees, local government and other stakeholders. The CAPC does not have authority to reject WAPC prioritised proposals if the first five criteria are met. They are expected to provide additional technical support to the WAPCs, and work together to ensure the proposals meet the last two criteria.

Once CAPC approves the project, the WAPCs conduct a public procurement process, requiring competitive tendering and public analysis of bids (requirements are based on Kenyan public procurement legislation). WAPCs then negotiate and sign contracts with service providers based on phased payments where subsequent payments are subject to certification of completion of the previous phase – by the WAPC and CAPC, and a nominated technical officer where necessary. Upon evidencing the procurement documents and contracts, IIED releases phased payments to the contracted executing entities. Over 2014/15, control over the CAF will pass over fully to the county government as it is mainstreamed within the Isiolo County Integrated Development Plan, and the funds will flow to the CAF as part of the county's annual planning cycle.

3. How does this funding model ensure the programme objectives are met, as well as satisfying various fiduciary standards and safeguards, without being "hands on"?

The programme objectives relate to improving vulnerable communities' resilience to climate change, mainstreaming climate resilience into county development and planning, and the integration of climate information into planning. To achieve these objectives, public good adaptation investments accessible by vulnerable people are prioritised; county governments are engaged in project design and monitoring in a gradual process of integration, including inter-ward planning to ensure coordination, avoid replication and identify common interests that may be better implemented at the county level; and the use of climate information and assessments is a criteria for approval of all projects. Adherence is monitored through periodic checks and audits by the donor and external auditors, while the impact of the funds on resilience is monitored through the application of the Tracking Adaptation and Monitoring Development (TAMD) framework to track adaptation and measure its impact on development.

In summary, to satisfy fiduciary standards and safeguards and monitor impacts, the process relies on:

- The Isiolo Climate Adaptation Fund Procedure Manual and committee constitutions, designed through consultation with WAPCs, the CAPC, and finance and project management specialists, and certified by an auditor as meeting donor standards. The manual details requirements for reporting, monitoring and evaluation, accountability etc.
- Payments of running costs and payments to service providers are conditional on demonstrating adherence to the steps and provisions in the procedure manual and constitutions.
- Auditors are engaged to conduct periodic spot checks of documentation and field visits to projects. This role has also been conducted by IIED during the set up phase. Arrangements for monitoring and auditing in future, after the model has been integrated into county government plans, have not yet been determined.
- CAPC meetings provide a forum for public accountability amongst WAPCs and the CAPC.
- Local radio (soon to be functional in Isiolo) is expected to play a major role in increasing accountability of the committee members to the local community, and for community monitoring of the implementation of projects, with CAF committees being required to receive public feedback on air.
- The CAPC, accompanied by the CAF Monitoring and Evaluation Officer from NDMA, conducts periodic monitoring visits to certify completion of projects, make technical recommendations on ongoing projects, and to record adaptation impact against baseline indicators, as developed under the TAMD framework.

Since it was initiated in September 2012, CAF has completed one cycle of investments in public goods and started the second cycle. Achievements of the first cycle include:

- Design and implementation of 13 investments in water infrastructure and governance, improved pasture management and veterinary control that are addressing the underlying causes of vulnerability to climate change and strengthening adaptation to future extremes events;
- Integration of ward climate adaptation priorities in the 5-year County Integrated Development Plan, potentially increasing adaptation benefits from county government investments over the course of the plan; and
- Integration of CAF experiences in Kenya’s National Adaptation Plan.

The Isiolo CAF is attracting additional donors including DANIDA, the USAID Resilience and Economic Growth in the Arid Lands (REGAL) programme, Kenya’s Ministry of Water and Vétérinaires Sans Frontières. The CAF approach is now also being tested in three districts in Tanzania - Longido, Monduli and Ngorongoro.

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Exhibit 4. The Millennium Challenge Corporation

William Pizer

1. How does the funding model generally work, in terms of disbursing funds?

The Millennium Challenge Corporation (MCC) was created in 2004 to deliver US foreign assistance with a focus on country selectivity, country ownership, and measuring results. A key feature is that countries qualify for MCC support based on a range of indicators in several broad areas (just and democratic governance, investments in their people, and economic freedom). Indicators are typically provided by independent, third-party institutions, rely on objective, publicly available data, and have an analytically rigorous methodology. The chosen indicators and country scorecards are posted each year.

The process of developing programmes begins with a data-driven constraints to growth analysis performed by the country with MCC technical assistance. This constraints analysis identifies the broad sectors of focus for a programme. Countries then develop an overall programme with broad domestic consultation in these sectors. MCC teams help countries refine the programme. These programmes, or 'compacts', involving large-scale five-year grants, are then approved by the MCC Board of Directors. The country sets up its own local Accountable Entity, including a local board of directors (often government ministers) and management unit, to manage and oversee all aspects of implementation. For example, the $698 million Tanzania compact, signed in 2008, involved three areas of work: transport, energy, and water. The Government of Tanzania established the Millennium Challenge Account Tanzania (MCA-T) as a legal accountable entity that is responsible for managing the implementation of the projects and activities funded by MCC (see www.mca-t.go.tz/en/). Funds are disbursed by MCC to MCA-T based on a quarterly disbursement request package (QDRP) identifying funding needs in the upcoming quarter. The MCC provides guidance on procurement and financial management through publicly available documents and regular consultations (www.mcc.gov/pages/countrytools/tools/compact-implementation).

2. Who decides what? What decisions are devolved and to whom?

In general, the MCC Board of Directors is only involved in major decisions. These include: (a) selection of eligible countries; (b) approval of the compact outlining the projects that will be funded; (c) approval of major changes to a compact; and (d) when and if a compact should be scaled back or terminated early.

Once eligible, compact development is undertaken by a team from the selected country and MCC staff over a period of 1–2 years and then presented to the MCC Board for approval (see www.mcc.gov/pages/countrytools/tools/compact-development). During programme implementation, the Management Unit of the Accountable Entity is in charge of the day-to-day tasks of the office, which include planning for procurements and managing contracts. The Management Unit of the Accountable Entity prepares all contracting documents. The Management Unit also prepares the quarterly disbursement request package (QDRP) (the formal mechanism to request funds). The QDRP includes a narrative report, the disbursement request, a quarterly performance report, an indicator tracking table, and a conditions precedent report. The QDRP is approved by the in-country board, then submitted to MCC staff for review within five days (the QDRPs do not rise to the level of MCC Board approval).

While the programme is country-led and implemented entirely by the in-country management unit and board, with MCC oversight, the degree of specificity in the compact could be viewed as a limit on devolution. In practice, this depends on the type of project. Large singular investments may be outlined in some detail by the compact. However, decisions in a decentralized programme – for example, community development grants – could be much more devolved.

3. How does this funding model ensure the governing body's objectives are met, as well as satisfying various fiduciary standards and safeguards, without being 'hands on'?

As per the MCC mission, all compacts have the ultimate goal of economic growth and poverty reduction. All projects are developed with this goal in mind, and indicators are developed to track progress. For example, in the Tanzania Mainland Truck Roads Activity, indicators include: (a) better quality roads (reduced roughness) leading to (b) increased traffic volume, reduced transportation costs, and reduced travel times leading to (c) increased cash crop revenue (or higher incomes). For each compact, detailed Monitoring and Evaluation (M&E) Plans describe the goals of the programme and how progress toward these goals will be tracked; these plans include specific baseline and target values for most indicators and descriptions of any analysis or evaluations that will be done. The Management Unit is responsible for compiling the data on these indicators, which is submitted to MCC quarterly via the QDRP.

On the fiscal management side, monitoring of funds is rigorous and transparent, typically through independent Procurement Agents and Fiscal Agents hired by the local Accountable Entity. The Procurement Agent 'assists the Accountable Entity with carrying out procurement related activities to procure goods, works and services on behalf of the Program'. The Fiscal Agent is 'responsible for assisting in preparation of the fiscal- and procurement-related controls, ensuring and certifying payments are properly authorized and documented, releasing payments from accounts, managing cash and reconciling accounts, maintaining and retaining proper accounting and records, etc.' The Fiscal Agent can be a private firm, the Ministry of Finance, or another government entity, as agreed between the Government and MCC. In the case of Tanzania, the procurement agent was a private firm (Crown Agents Tanzania) and the fiscal agent was the Accountant General's Office of the Government of Tanzania.

4. How is the funding level for a particular programme determined?

Funding levels depend on many different factors, these include: the number of countries that will be developing a compact in a given year, the budget that MCC has been allocated for that year, the size of the country (population), and the needs of the country (which are related to how many feasible, high-return projects can be implemented).

Exhibit 5. Policy Based Funding

Dan Morrow

1. How does the funding model generally work, in terms of disbursing funds?

Policy based funding (PBF)[19] refers to a funding modality in which the external funding agency disburses funds to a government conditional on that government's implementation of agreed policy and institutional reforms and not specifically linked to any expenditures by the government. The intention of PBF is to support the government's efforts to undertake policy and institutional reforms designed to promote the country's social and economic development and, in some cases, to indirectly compensate the government and the country for any short-term costs associated with these reforms.

The underlying rationale for PBF is that development progress depends significantly on the quality of the country's policy and institutional environment, broadly defined. The policy and institutional environment encompasses many things – ranging from the broad parameters of macroeconomic management, to pricing policies for particular goods, to regulations governing provision of particular services. In many cases, achieving adequate returns on public and, especially, private investments depends on improving that policy and institutional environment. Over the past decade or so, PBFs have been used by the World Bank and others increasingly to support reforms in sectoral policies and institutions, rather than in macroeconomic and trade policy.[20] In response to recognition that effective and sustainable reforms depend on country ownership, the conditionalities of PBFs are intended to be consensual, arising from a dialogue between the recipient agency and the funding agency about desirable and achievable reforms.[21] An example of a PBF by the World Bank, to support low-carbon development in Morocco, is provided in Box 1.

BOX 1: World Bank's Development Policy Loan to Morocco for 'Inclusive Green Growth'

19 This modality has gone by several names. Perhaps the most generic is 'policy-based lending', but that term is not used here because the modality can also be used with grants or soft-term 'credits'. Historically the modality is often referred to as 'structural adjustment lending', and most recently the World Bank and others use the term 'Development Policy Lending'.

20 In the PBF's original incarnation as Structural Adjustment Loans, the conditionalities dealt largely with macroeconomic policies and were often regarded as coercive. Hence this modality had been perhaps the most controversial mode of development assistance.

21 For example, the 2011 World Bank's 'Good Practice Note for Development Policy Lending' stresses that the reforms supported by such lending must enjoy strong country ownership, and specifically states that 'Development policy lending should not be used to induce a government to undertake reforms that it does not wish to do because it is unlikely that these reforms will be fully implemented and sustained.' (para. 8).

In November 2013, the World Bank approved a loan of US $300 million (disbursed in full as a single tranche) to support a programme designed to improve the management of natural capital, to 'green' physical capital, and to strengthen and diversify the rural economy. The prior actions taken by the government to satisfy the conditions of the loan included: (a) final approval of a decree on energy efficiency in the building sector and (b) official publication of automatic price adjustments for diesel, gasoline, and fuel. A follow-up loan is anticipated within 24 months, and the expected triggers for that second loan include: (a) approval of a law creating the National Agency for Energy Regulation and (b) adoption of a decree allowing renewable energy generation to connect to the medium-voltage grid.

2. Who decides what? What decisions are devolved and to whom?

Typically the PBF funding modality involves a sustained dialogue between the recipient government and the staff of the funding agency about desired reforms, and that dialogue is usually supported by prior analytical work. The funding agency staff and the recipient government design a 'policy matrix' or 'programme matrix' which involves a well-defined set of government measures and a schedule for their implementation. In addition, the funding agency staff must satisfy themselves that the country's macroeconomic policy framework is adequate.

Once an agreement on the policy matrix is reached between government and funding agency staff, a document recording those agreements is presented to the funding agency's authorizing body (such as a Board of Directors) for approval. Subject to approval by its Board of Directors, the funding agency commits to disburse to the government pre-specified amounts conditional on the actual implementation of agreed measures. A PBF may involve a single 'operation' (i.e., conditional disbursement), a planned series of annual operations (referred to as programmatic), or, now uncommonly, a 'multi-tranche' operation in which each tranche is disbursed upon implementation of the agreed measure associated with that tranche.

Subsequent to approval of the document that records the agreements between the government and the funding agency, the only decision prior to disbursement is whether or not the measures specified in the policy matrix have indeed been implemented. This may involve additional discussions and investigations by the staff of the funding agency and subsequently a brief report to the Board of Directors. If 'waivers' or changes of some element(s) of the previously agreed measures are recommended by the staff, this may require an additional formal approval by the Board.

3. How does this funding model ensure the governing body's objectives are met, as well as satisfying various fiduciary standards and safeguards, without being 'hands on'?

The rationale of PBF is that the objectives of the funding agency include the promotion of desired policy and institutional reforms in the recipient country, and the instrument is designed to ensure that these reforms are implemented. The government's use of funds disbursed from a PBF is not specified in the agreement between the government and the funding agency, and their use is not constrained by rules for procurement, financial management, or specific safeguards associated with other funding modalities. In this sense, PBFs constitute unconstrained budget support to a government. However, in some cases, the funding agency might, as a pre-condition for PBFs, seek to satisfy itself that in general terms the fiduciary standards and safeguard processes of the recipient government are satisfactory.

4. How is the funding level for a particular programme determined?

The amount of any particular PBF is based roughly on the relevant fiscal needs of the government, constrained by the allocation of funding resources by the funding agency among recipient countries and among types of funding modalities. Unlike most other forms of programmatic funding and as noted above, the amount of a PBF need not be dependent on the level of any particular expenditure programme or even on the costs of the associated policy reform programme.

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Exhibit 6. Global Climate Change Alliance funding of the Bangladesh Climate Change Resilience Fund

Sophie de Coninck and Gonzalo Serrano de la Rosa

The Global Climate Change Alliance (GCCA) was launched in 2007 by the European Union to support developing countries most vulnerable to climate change in the task of increasing their capacity to meet climate change challenges. With funding close to €300 million, it now covers 37 countries and 8 regions and sub-regions, and works with Least Developed Countries (LDCs) and Small Island Developing States (SIDS) across Africa, Asia, the Caribbean, and the Pacific. The GCCA funding modalities include general budget support, sector budget support, and other sector policy support programmes and projects.[22] While the preferred management modality is budget support,[23] other modalities[24] also allow contributions to multi-donor funds, such as the Bangladesh Climate Change Resilience Fund (BCCRF).[25]

In order to harmonize the expected increase in the number of climate change-related interventions, the Government of Bangladesh (GoB) published the Bangladesh Climate Change Strategy and Action Plan (BCCSAP) in September 2008. This document provides an ideal opportunity for development partners to align their actions in the area of climate change and pool their funds into the BCCRF.

Due to fiduciary risks, budget support for Bangladesh remains, for the time being, problematic for most grant donors. Currently, only the EU provides targeted budget support in the education sector. However, there is a clear movement towards more joined-up approaches (such as multi-donor trust funds) in ever more sectors, especially among the European Commission and EU member states.

The challenge that Bangladesh now faces is to scale up these investments to create a suitable environment for the continued economic and social development of the country and to secure the well-being of its people, especially the poorest and most vulnerable groups (including women and children), taking into consideration the expected negative impacts of climate change.

22 See Table 1–4 in GCCA (2013).
23 See Chapter 3 and Table 3-2, op. cit.
24 'Decentralized' or 'joint management' (in the case of the BCCRF with the World Bank as interim BCCRF administrator).
25 See Table 1-5, op. cit.

The majority of the previous interventions have taken place through the implementation of a large number of individual, mainly stand-alone, projects. The proposed action aims to be an example of a mechanism with multi-development partner support in the area of climate change that interacts and coordinates with a wide range of crucial development sectors.

The multi-donor trust fund approach aims to support the principles of aid effectiveness of the Paris Declaration, by bringing together a range of development partners in support of a government-led strategy.

The overall objective of the GCCA contribution to the BCCRF is to protect and improve the lives of 10 million climate-vulnerable people in Bangladesh by 2015 through climate change adaptation, mitigation, and disaster risk-reduction measures. The purpose is to support the GoB with the implementation of the BCCSAP.

The Bangladesh Climate Change Resilience Fund

The BCCRF is an innovative partnership trust fund between the Government of Bangladesh, development partners, and the World Bank which aims to address the impacts of climate change. A key purpose of BCCRF is to support the implementation of the Bangladesh Climate Change Strategy and Action Plan for 2009–2018. This fund, one of the first of its kind in the area of climate change, was established in May 2010 with a view to funding climate adaptation and mitigation activities, increasing the climate resilience of Bangladesh's national economy and the lives of its people. The European Union and the Governments of Australia, Denmark, Sweden, Switzerland, the UK, and the USA have provided the financial support.

As for BCCRF governance mechanisms, a Governing Council (GC), comprising a core group of cabinet Ministers, representatives of civil society, and two rotating donor representatives, provides overall strategic guidance and ensures its alignment with the BCCSAP. The GC sets grant criteria and approves project proposals to be implemented by Ministries or civil society.

The BCCRF Management Committee (MC) is a small technical committee, led by the Secretary of the Ministry of Environment and Forests (MoEF); it comprises one civil society representative, two rotating donor representatives, and representatives of other ministries and the World Bank. The MC reviews grant requests and recommend projects to the GC. A BCCRF Secretariat is being set up and trained, so day-to-day functions such as technical support, advocacy, and communication functions can be transferred from the World Bank.

1. How does the funding model generally work, in terms of disbursing funds?

1.1. GCCA disbursement to the BCCRF

The EU has signed a Financing Agreement with the GoB, which has appointed the World Bank as interim Administrator of the BCCRF. Implementation takes place through 'joint management' with the World Bank. The Administrator manages the BCCRF work programme on behalf of the GoB and contributing development partners, through the BCCRF Secretariat.

Development partners contribute non-earmarked funds to the BCCRF. All contributions, and correspondingly all payments out of the BCCRF, are made on a grant basis. In order to keep the transaction costs low, the minimum contribution is fixed at US$1 million.

At present, 80 per cent of out the US$190 million pledged by development partners is committed, and around 50 per cent (US$90 million) has been disbursed to the World Bank. At the time of making its contribution, each development partner signs a contribution agreement to BCCRF with the World Bank. In the case of the European Commission, this 'administration agreement' (AA) amounted to €28.5 million.[26] After an initial 50 per cent disbursement, the AA stipulates certain conditions for subsequent disbursements in terms of the BCCRF's level of commitments and progress.

1.2. BCCRF disbursement to activities

Overall, the GC initially agreed that 90 per cent of the BCCRF grants will be executed by GoB institutions/agencies, while the remaining 10 per cent will be allocated to the NGO window, according to a system of 'calls for proposals'. The MC invites GoB agencies to submit proposals, which are screened according to seven criteria: size of proposal, consistency with the BCCSAP, experience with development operations, readiness, results targeted, complementarity, and social and environmental aspects. Regarding size, the GC targets GoB proposals between US$15–25 million, based on the cost-effectiveness of carrying out the appraisal and supervision of individual grants, while NGO-funded proposals average US$0.3–0.4 million.

Joint GoB–World Bank preparation of projects takes around 18 months, and after final approval by MC and GC, World Bank guidelines are followed in terms of financial management, procurement, and ensuring environmental and social safeguards.

The MC endorses the work programme and appropriate funding levels. Funds are drawn on a proportional basis from each contributing development partner, in accordance with the development partner's relevant contribution to the overall fund. As for approval and implementation procedures for all projects and programmes financed by the BCCRF, and actual disbursements made by the World Bank (12 per cent of total budget by November 2013) standard World Bank International Development Association (IDA) grants rules are followed for the different government and CSO projects, and analytical studies. IDA sets out detailed schedules and plans, as well as administrative, financial, procurement, reporting, and organizational arrangements for the implementation of all activities financed out of the BCCRF.

All implementing contracts must be awarded and implemented in accordance with standard World Bank practices.

2. Who decides what? What decisions are devolved and to whom?

2.1 GCCA-level decisions

Once a candidate country has been selected for support under the GCCA, the EU Delegation consults with the relevant in-country counterpart(s) and provides support in formulating a specific programme (in the form of a so-called Action Fiche or Action Document) together with assistance from the Headquarters GCCA Team. Once the programme has been approved by the Commission, management of the operation is devolved to the

26 €8.5m from the GCCA budget itself and €20m out of the geographic budget as a top-up.

EU Delegation, while the GCCA Team provides overall oversight for the GCCA. The full process takes 12 to 18 months, depending on country needs and circumstances.

2.2. BCCRF-level decisions

The BCCRF favours coordination and a collective voice among development partners. The two rotating development partner representatives take part in project approvals and are in close contact with the World Bank to follow up progress in terms of project preparation, appraisal, monitoring and evaluation, and reporting.

3. How does this funding model ensure the governing body's objectives are met, as well as satisfying various fiduciary standards and safeguards, without being 'hands on'?

The GCCA relies on the BBCRF administrative, monitoring and evaluation, and audit requirements.

The GoB leads on the management and implementation of the BCCRF. On behalf of the European Commission/ GCCA and other contributing development partners, the World Bank administers the trust fund to ensure due diligence requirements (including fiduciary management, transparency, and accountability) and it also provides technical assistance and analytical/advisory support.

Overall responsibility for managing the risks and monitoring the implementation of the BCCRF activities lies with the BCCRF Secretariat. A monitoring matrix for the BCCRF to track inputs, outputs, results, and impact is agreed by the Management Committee.

Evaluation and audit are scheduled by the BCCRF Secretariat and respect the rules set out within the Administration Agreement with the World Bank.

Additional audit arrangements have been made in order to satisfy the requirements of the different contributing development partners.

4. How is the funding level for a particular programme determined?

At the outset of the initiative (EC, 2008), the European Commission defined a range of criteria to set an order of priority among the large group of countries eligible for GCCA funding.[27] Funds (varying from €3 to 15 million) are allocated to the highest-ranking countries, based on population figures and availability of funds. Consultations are then undertaken to confirm the allocation and its timing (see Section 2: Who decides what?). Funding levels are decided on needs, absorptive capacities, and availability of resources, on a case-by-case basis.

As for BCCRF, an initial amount of €8.5 million was allocated from the GCCA budget itself, which was later topped up by another €20 million out of the geographic budget.

27 The first set of criteria relates to the eligibility of a country for funding under the GCCA. The country must belong to either the group of LDCs or the group of SIDS recipients of aid (in line with the official OECD/DAC and UN lists). The second set of criteria comprises the vulnerability of the country to climate change, in particular its risk related to: floods, droughts, storms, sea level rise or glacier melting, and the coastal zone elevation, with proportion of the population at risk. The importance of the agricultural sector, being one of the most sensitive sectors, is also taken into account. The third set of criteria relates to the adaptive capacity of the country. As proxy indicator, the composite Human Development Index ('HDI') from UNDP has been used.

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Exhibit 7. The Enhanced NICFI Model

Benito Müller

1. How does the funding model generally work, in terms of disbursing funds?

Müller et al. (2013) use proposals developed by the Center for Global Development to enhance the modalities used in the Norwegian International Forest Climate Initiative (NICFI) in order to illustrate the use of results measured at a macro level with a fixed-price transaction methodology. Under this model, the GCF would use general methods for determining sets of sectoral pathways which, when applied to (eligible) countries, would determine the minimum ('expected') performance level from which performance-related payments would be made. The price, in turn, would be fixed by dividing the potential total eligible performance across eligible countries by the available funding. The actual transactions would be payments made each year to countries, based on their performance above the minimum pathway. Countries would thus stand to 'make a profit' on achieving low-cost emission reductions (such as through energy efficiency), while at the same time they might need to find additional domestic funding, or low-cost loans, to bring down the cost of more expensive actions. Box 1 gives a more formal description of this model.

2. Who decides what? What decisions are devolved and to whom?

QP-instruments relate to the purchase of verified quantities. As such, they are 'activity-based' – if only because the quantities to be transacted have to be generated by particular eligible activities. But the specific decision over which activity is to be carried out – within the bounds of the eligibility criteria – is solely in the hands of the counterparty (project developers, developing country governments, etc.). The GCF, as operator of the QP-instrument, would only be interested in the 'quality' of the quantities it is offered for purchase, subject to eligibility rules. Depending on the price setting mechanism, the GCF may also seek 'value for money'. The role of the GCF Board would essentially be to define the instrument, that is to say the counterparty selection, definition of results, price setting, and the setting of transaction quantities, as well as criteria relating to the type of eligible activities – that is activities that can be used to generate quantities admissible to being transacted.

3. How does this funding model ensure the governing body's objectives are met, as well as satisfying various fiduciary standards and safeguards, without being 'hands on'?

By setting the parameters for QP-transactions, particularly the eligibility criteria, the Board can ensure that any objective, standard, and safeguard can be met, so long as it can be measured and verified. Quantities have to be eligible to be put up for sale according to criteria set by the Board. This eligibility will have to be verified, and the process should include a verification of the provenance.

If the Board decides, say, that F-gas emissions reductions do not have sufficient 'transformational capability', then all it needs to do is to make them ineligible for purchase. Similarly, it can put restrictions on eligible activities with regards to, say, sector characteristics, social and environmental standards etc. etc. All this can be done without having to actually approve individual activities. In other words, by setting activity eligibility criteria and transaction methodologies (e.g. rules for benchmark and price setting), the Board can influence the transformative effect of its spending under a QP-instrument.

4. How is the funding level for a particular programme determined?

This depends on the specification of the QP transactions. In the case of the above-mentioned enhanced NICFI model, the funding level for a particular programme is tied to the allocation mechanism: the 'Quantity Performance Payment' (see Box below) is very simply the relevant unit price times the verified eligible performance in question. Under a competitive instrument, the funding level would have been determined through bids by potential providers.

BOX: The Enhanced Macro Model in formal terms

$VP_k(t)$: country *k's* ***measured and verified*** sectoral level for period t;

$E_k(t)$: k's ***expected*** level for t;

$A_k(t)$: k's ***ambitious*** level for t;

$VEP_k(t)$: k's ***verified eligible performance*** in t:

$$VEP_k(t)=\begin{cases} 0, & \text{if } VEP_k(t) \leq E_k(t) \\ A_k(t) & \text{if } E_k(t) \geq A_k(t) \\ VP_k(t)-E_k(t), & \text{otherwise} \end{cases}$$

Country k's ***maximum eligible performance*** in t: $MEP_k(t)=A_k(t)-E_k(t)$;

Total eligible performance level in t: $TEP(t)=\sum_k A_k\ (t)-E_k(t)$;

$F(t)$: ***funding*** available for t;

Unit disbursement ('***price***') for period t: $P(t)=TEP(t)\,/\,(F(t)$;

Quantity Performance Payment to k for the performance in t: $QPP_k(t)=P\times VEP_k(t)$.

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