

EFA-FTI CATALYTIC FUND

Concept Note for a Replenishment Mechanism

1. **Introduction.** The Education for All (EFA) Fast-track Initiative (FTI) is an evolving global partnership which focuses on accelerating progress towards universal primary completion of quality education for boys and girls alike by 2015. The FTI Partnership is built on the Monterrey Consensus, i.e. the mutual accountability that partners should commit to fund FTI-endorsed Education Sector Plans (ESPs). To support that goal, the Catalytic Fund (CF) was established in 2003 as a multi-donor, multi-recipient trust fund designed originally to provide transitional short term funding to low income countries for up to three years. It was expected that this would help them establish a good performance record to attract longer-term support through increased donor contribution from existing and new donors. Experience has shown that donors have not stepped-up their efforts to make that happen. In response, the FTI Partnership revised the CF instrument in 2007 to provide longer term financing for FTI-endorsed ESPs with insufficient funding. However, the lack of predictability of CF resources has made the exercise of allocation limited funds to eligible countries difficult. This note outlines a proposal for a replenishment mechanism for more predictability.

2. **Rationale for a replenishment mechanism.** The number of FTI-endorsed ESPs reached 33 by end-2007, close to a threefold increase since 2004. The number of countries with an FTI-endorsed plan is projected to stabilize at around 60 countries by 2009-10. In addition to the demand from new developing country partners, the financial needs for existing beneficiaries have increased due to required education quality improvements to sustain early gains. On the positive side, most governments continue to demonstrate commitment by increasing domestic budget shares devoted to basic education; and overall disbursements of external aid is also rising. But overall financing gaps for basic education in low income countries remain high, estimated at about US\$9 billion per annum. For instance, current pledges to the CF do not go further than 2009, while allocations to countries are made for the period 2009-2011. Unless more pledges are made, the projected needs in 2008 (estimated at US\$860 million) for endorsed programs cannot be met. Thus, the CF trust fund is in a difficult position: the Committee (CFC) can either ration the available resources or provisionally commit funds not yet formally pledged by the donors; and either choice wouldn't be optimal. Thus an important contribution to resolving this issue would be to design and implement a robust long-term replenishment mechanism for the CF.

3. **Projected external financing needs.** Most global estimates for external financing needs for achieving universal primary education in low-income countries range between US\$4-10 billion. As reported in the FTI Annual report for 2007, the estimated financing gap for the 56 countries expected to join by end-2009 is about US\$2.4 billion per annum by 2010 (*Chapter 2, table 2.1, page 11*). Clearly, it may not be realistic or feasible for the CF to cover all these needs. In this proposal, it is assumed that seeking to cover about 40-50 percent of this gap would be a loadable objective. Under this assumption, CF donors would aim at mobilizing around US\$1 billion per year in each replenishment cycle. And therefore a three-year cycle would require US\$3 billion and a five-year cycle would require US\$5 billion. These estimates would be refined, with the possibility that unused funds can be transferred between cycles.

4. **Description of the mechanism.** The proposal is to establish a cycle of resource replenishment, whereby donors are invited to commit resources to the fund for a period, generally three or five years. Such mechanism is used by many institutions such as IDA, the Global Fund, and GEF covering both resources management and country allocations. Given the specificity of FTI, however, any attempt to make upfront commitments to countries would present difficult challenges because of the unpredictable endorsement schedule. Every three or five years, donors commit money to these funds by a certain date, and the total amount collected defines the scope of activities that can be financed during the period of implementation. Three examples are as follows:

- **The Global Fund (GFATM).** Since the establishment of the Global Fund to Fight AIDS, Tuberculosis and Malaria in 2002, more than 45 countries as well as private foundations, corporations and individuals have pledged significant resources to support its work. However, the ad hoc system of contributions made it difficult to plan the work of the Global Fund and to provide sustained and predictable support for the many programs in more than 130 countries. As a result, the Board of the Global Fund decided to reform its system and to introduce a funding model based on periodic replenishments. The primary purpose of this replenishment process is to increase the predictability of the Global Fund's resource mobilization efforts. The replenishment provides a means for donors to exchange views on the operations and effectiveness of the Global Fund. The first replenishment process was chaired by the then UN Secretary General Kofi Annan, with Sven Sandström acting as Vice-Chair; and it covered the period 2006-2008. It was hosted in March 2005 by the Swedish government in Stockholm. An interim meeting was hosted by the Italian government in Rome June 2005; and a final meeting for this cycle of the replenishment was hosted by the UK government in London on 5-7 September 2005.

- **The Global Environment Facility (GEF)** is one of the principal mechanisms for global environmental funding. It was originally established in 1991 as a pilot program in the International Bank for Reconstruction and Development (the "World Bank") to assist in the protection of the global environment and to promote environmentally sound and sustainable development. Every four years, the 32 donor partners commit money through a process called the "*GEF Replenishment*." In August 2006, they pledged \$3.1 billion to the fourth GEF Replenishment, which will fund operations between 2006 and 2010.

- **The International Development Association (IDA)** is the part of the World Bank Group that helps the world's poorest countries. Established in 1960, IDA aims to reduce poverty by providing interest-free credits and grants for programs that boost economic growth, reduce inequalities and improve people's living conditions. IDA is funded largely by contributions from the governments of richer member countries. Donors meet every three years to replenish IDA funds and review IDA's policies. The most recent replenishment of IDA's resources (IDA15) was finalized in December 2007. It raised US\$41.6 billion to finance projects over the three-year period ending June 30, 2011. To increase openness and help ensure that IDA's policies are responsive to country needs and circumstances, representatives of borrower countries from each IDA Region have been invited to take part in the replenishment negotiations since IDA13. A total of nine borrower representatives participated during the IDA15 negotiations.

5. **Advantages of a replenishment mechanism.** A decision to establish a replenishment mechanism has the following advantages:

- **Added predictability.** A replenishment mechanism would add more predictability for both donors and recipients. It would allow donor partners to plan their commitments better over time. It would also provide an opportunity for dialogue to maximize the probability that all donors will shoulder their share of the financial burden. For the CF trust fund, this would mean an additional benefit for a more solid financial basis, as opposed to the current situation where two donors underwrite more than 75% of the fund.

- **Increased absorptive capacity for the additional aid.** Prospects for increased external aid present FTI partners—and in particular developing country governments—with both opportunities and challenges. Recent debates have been around the absorptive capacity/fiscal space in education budgets to absorb the additional aid. In reality, the poor choices of financial instruments to deliver aid and its high volatility limit countries' absorptive capacity to use such aid effectively. Development programs based on knowledge about scaled-up aid from regular channels as well as from the CF will most likely create the capacity needed to increase spending and help accelerate progress toward FTI goals.

- **Better resource management and decision making.** A replenishment mechanism allows for better management of resources. Knowing how much money is available for a certain period comparable to that of the requests from countries would make it easier to make allocation decisions. In the particular case of FTI, where most potential beneficiaries are expected to be endorsed by the end of 2009, this knowledge of needs and available resources would allow a better, more transparent and equitable allocation of resources. This is typically based on a formula, which could involve needs and performance indicators. Such a formula has already been developed and discussed within the CF framework (see Needs-And-Performance-Framework).

6. **Risks of a replenishment mechanism.** A decision to establish a replenishment mechanism may entail the following risks:

- **Donor legal and budget frameworks.** One of the first risks which may present a challenge for many current and potential CF donors is securing longer term commitments within their own legal and budget frameworks. For many donors, this risk is directly linked with their legal and institutional frameworks which prohibit commitment of funds beyond a certain time period. Thus, there may be a risk of excluding some donors who are unable to commit resources for the agreed period of replenishment.

- **Uncertainty around the number of beneficiaries.** The number of potential developing country partners (and thus beneficiaries) is still increasing; and there is a great deal of uncertainty around the FTI endorsement schedule. As countries join the partnership at any given time, a replenishment mechanism which would have already allocated all the available resources to existing countries would present a risk that newcomers will not get any support until the next cycle. This contrasts sharply with, for example, IDA where a poor country is automatically eligible without having to meet any additional criteria such as an FTI-endorsed ESP and a Poverty Reduction Strategy Paper.

- **The crowding-in and crowding-out risk.** As the size of CF grants increases along with the number of eligible recipients, the CF runs the risk of competing—if not substituting for—credit operations funded by IDA, other development banks as well as bilateral donors. Thus, any viable replenishment mechanism has to demonstrate the additionality of these funds to those being provided through other regular channels.

7. **Key issues for consideration.** Several issues and challenges would need to be addressed by the CF Committee when considering the adoption of a robust long-term replenishment mechanism.

- **Replenishment process and cycle.** Ideally an efficient replenishment process and cycle should match closely the demand and use of funds. While the majority of CF recipients are still implementing their grants year-by-year—and the corresponding grant agreements cover a period of up to eighteen months—new recipients since May 2007 are following procedures with a single grant agreement for a three-year period. It is expected that all beneficiaries would have transited into the three-year mode by end-2009. Although a three-year replenishment cycle would, therefore, seem to be a natural option, it is actually not practical. One of the main reasons for considering a longer period is that countries may join at different time; and thus a five-year cycle might provide a better fit for predictability and flexibility. For that reason, a number of existing funds are already considering moving towards five-year cycles. Donors will need to agree on the length of the replenishment cycle.

- **An open mechanism for added flexibility.** While the replenishment mechanism offers clarity on the available resources, an open mechanism would help mobilize additional resources that could be made available during the cycle. Therefore, the CF replenishment mechanism should allow donors to contribute funds within the cycle and to thus allow these additional funding to be included automatically in the resource allocation decisions. Donors will need to

agree whether only additional funding can be accepted between formal replenishment cycles, as opposed to initial contributions. Such a prior agreement would remove the incentive for donors to delay timely support decisions.

- **Financial instruments for pledges.** Donors are not required to follow any firm rules, or to use any specific instruments when making their pledges. Hard pledges take the form of signed Administrative Agreements (AA) with the World Bank (trustee) to cover either a single year/single contribution, or a multi-year/multi-payment pledges. Other “soft pledges” are made through an informal written correspondence with the FTI Secretariat. Although the AA offers the possibility of using Promissory Notes when making pledges, none has been used to date. In that regard, the World Bank has also accepted that commitments to countries (Grant Agreements) cover all pledged funds, including unpaid balance in the future. Promissory are now an option for contributing to the CF trust fund. Donors need to agree on acceptable forms of pledges to the CF.

8. **Proposed timetable.** This consultation process started a year ago when large financial shortfalls were projected for the CF instrument. The number of donors has increased since then, and the deficits projected at that time have been covered. However, a significant shortfall of about \$500-600 million is projected by end 2008. Therefore, the aim is to present, discuss and agree on the broad outline and milestones for a robust CF replenishment mechanism at the Tokyo meeting in April 2008. Thereafter, this note would be finalized by June 30, 2008; and qualified resource mobilization experts would be hired to make concrete proposals to be presented and approved at the Oslo meeting in December 2008. The first replenishment meeting could thus be held in early 2009 for a first cycle starting in 2010.

Proposed Timetable

Tasks/ Milestones	Initiator/ Responsibility	Date/Deadline for delivery
1. Initial proposal	CF Committee	May 2007 (Bonn)
2. Draft Concept Note	FTI Secretariat	April 2008 (Tokyo)
3. Final Concept Note	FTI Secretariat	June 30, 2008
4. Developmental phase of the tool	Consultants/FTI Secretariat	October 30, 2008
5. Final approval of the tool	CF Committee	December 2008 (Oslo)
6. First CF replenishment meeting	CF Committee/Donors HQ	Quarter 1 - 2009
6. Final pledging conference/meeting	CF Committee/Donors HQ	Spring 2009