Education Outcomes Fund (EOF) for Africa and the Middle East: Is it a Game Changer?

Keith M Lewin

Emeritus Professor of International Development and Education, University of Sussex.[1]

9 September 2018

The Education Commission and the Global Steering Group for Impact Investment (GSG) have made a proposal for an Education Outcomes Fund (EOF) to accelerate progress towards achieving the Sustainable Development Goals (SDGs) for education[2]. This paper reviews the proposal and identifies a range of critical issues of interest to different stakeholders in education and development.[3]

Background

The EOF describes itself as a "game changing" strategy to "transform educational attainment in the Africa and Middle East Regions and achieve SDG4". Its method is to "pool grant funds from official aid donors, foundations, CSR and private philanthropic funders to pay for outcomes in education with impact investors providing working capital at risk through Development Impact Bonds (DIBs)". It claims that its "game changing" approach is built from a "growing body of evidence that this approach has huge potential… by aligning incentives around outcomes, fostering innovation and flexibility in service delivery" and "bringing in new sources of private capital". It seeks to "rapidly scale up proven and / or innovative services from non-state actors that can "strengthen state education systems and help low income countries "leapfrog" their quality of provision. The EOF sees itself complementing other initiatives by providing results-based finance for non-state actors in low middle-income countries. Bilateral agencies and the Global Partnership for Education (GPE) already provide this kind of support in low-income countries.

The EOF seeks to use an "outcomes fund" so that:

- "We could ensure tax payer-funded aid budgets achieve guaranteed results by only paying for what works

[2] "***Game Changing Way to Finance Results in Education: An Education Outcomes Fund for Africa and the Middle East,"*** Education Commission and Global Steering Group (GSG), Washington.

[3] This review was invited by Education International and supported by the Open Society Foundations.

- We have full transparency as to the effectiveness and cost efficiency of different programmes to allow us to focus on rapidly scaling the best interventions
- We could coordinate public, private, and civil society actors to work towards a common goal and strategy
- We could bring the entrepreneurialism of venture capital, and the rigour of the private sector to hep NGOs tackle social challenges".

The fund will contract non-government service providers to deliver educational outcomes in a total of 20 countries, 9 initial pilot countries and 11 potential second wave countries in Africa and the Middle East. The eligible countries in West Asia are targeted for "refugee education". Most other countries are low middle income countries in Africa. The EOF focuses on low middle income countries because the GPE and bilaterals provide grants rather than loans for education in low income countries, and the World Bank International Development Association (IDA) provides concessional loans. Some countries of interest to EOF have IDA eligibility and others do not.

Critical Issues

The EOF proposal glosses over four critical issues.

1) **The EOF has considerable ambition for itself and its partners** (the 'we' and 'us' of the EOF proposal), **and an assertive approach** to development that assumes that "impact investing" in education supported by financing from venture capital markets and aid donors will lead to accelerated development in low income countries. The legitimacy of the proposal stems from its sponsorship by the Education Commission. The main assumptions behind the EOF seems to be that the "learning crisis" is a result of previous under-investment in education by governments; that it would be more effective to sub-contract non-state organisations to deliver educational services with payments linked to outcomes, than to give aid to States directly; that aid dependence and the creation of more debt related to educational expansion are not problematic; and that the previous commitments of billions of dollars to aid to education failed to achieve results because the aid was not focussed on payment by results. The suggestion that "only paying for what works" is a game changer is a convenient fiction. Development agencies have been using results-based aid (RBA) for more than a decade and planning with logframes that link inputs to outputs and payments for more than four decades. If they failed to get results it was not through want of trying. The reality is far more complex than this naïve and ahistorical diagnosis suggests.

2) **The EOF promotes Development Investment Bonds (DIBs)** that are supported by "pooling grant funds from donors, foundations, Corporate Social Responsibility organisations, and philanthropists" who pay for outcomes in education" with "impact investors providing working capital through DIBs". DIBs are financed with loans that are repaid. Most of the money is not spent but lent. Grant money, which is given not lent, can be used to subsidise loan interest rates, but once it has been used for this

purpose, it cannot be used again. Guarantees to lenders against default have a cost. New money is not being generated if all that is happening is spending forward future aid by borrowing until the aid is paid when outcomes are achieved. Unlike some other types of investment the returns on education that justify the investment are typically long term and some of them are subject to multiple pathways of causality. This means that simple cause and effect can be difficult to establish. It needs to be a lot clearer about what the costs of DIBs are and who is paying for what over which time scale.

3) **The EOF proposal begs the question as to why yet another agency is needed.** The EOF would sit alongside a mosaic of existing agents, including the World Bank, the GPE, the other UN agencies that finance education (UNESCO, UNICEF, Education Cannot Wait, etc.), all the bilateral agencies and sovereign wealth funds active in education, and the proposed International Finance Facility for Education (IFFEd). The EOF would be competing with all these in one way or another for new investment from different sources. Governments and existing agencies would have to coordinate country-level interventions with the EOF to avoid duplication and unsustainable recurrent forward liabilities from EOF projects. The transactions costs of the EOF are likely to be much higher than expanding existing mechanisms to finance education which use existing infrastructure, governance and due diligence. The EOF has to make the case as to what it would do that other agencies are not already doing, or could do at marginal additional cost. If what it is doing is essentially back-stopping risks involved in financing non-state providers, and subsidising their financing with grant-based aid, the development Banks could already do this. If what the EOF is proposing, is changing the principal agent relationship between donor and recipient to include non-state actors and venture capital investors, this needs to be carefully spelled out. More clarity is needed.

4) **The EOF has little or nothing to say about the central financial issues of sustainable educational development**. The long-term problem is not short-term injections of non-recurrent capital to achieve results at a single point in time, defined by narrowly specified targets. It is how to develop methods of financing the recurrent costs of education systems from domestic revenue that are sufficient to ensure universal access to schools and equitable access to subsequent educational opportunities. Our modelling suggests that this can be achieved in Africa with a little over 6.6% of GDP on average in low income countries, and 6.1% of GDP in low middle income countries with feasible cost-saving reforms. This would cost at least another US$15.5 billion per year for the low income countries and US$26 billion for the low middle income countries on top of existing expenditure. This is about five times more than all current aid to education in Africa from Development Assistance Committee (DAC) countries The additional cost would be greater for the low middle income countries than the low income countries because their systems are much more expensive.

Currently, 48% of African countries actually spend less than 4% of GDP on education and only 22% spend more than 6% *including* contributions from aid. About 43% of countries allocate less than 15% of government budgets to education and 26% allocate more than 20%. Revenue collection averages only 17% of GDP compared to over 35% in OECD and other high enrolment countries. If government services are funded from 17% of GDP then more than 33% of all government revenue would be needed for education to generate 6% of GDP (33% of 17% = 5.6% only). Many African governments could finance most of their own investment programmes in education and take back control of their development agenda if they adopted fiscal reforms to increase revenue collection, reduced tax evasion and corruption, and managed public service efficiently. The financing gaps are recurrent and have to be supported from domestic revenue sooner or later. Grants are not useful for providing sustainable recurrent financing. Nor are DIBs.

This review raises a series of further question about the EOF to contribute to discussion of its strengths and weaknesses. These concern a) the scale of the EOF, b) returns on investment, c) transaction costs, d) non-state actors, e) systemic risks, f) results-based finance and DIBs. The review concludes with 12 questions as a take away.

a) The scale of the EOF

The EOF proposes the establishment of a US$1 billion fund that will be raised from donors and venture capitalists. The EOF will be funded by grants from development agencies and by issuing Development Impact Bonds (DIBs). Though a US$1 billion fund sounds large, when compared to national education spending it is small. If US$1 billion was spread across 20 countries over three years, it would amount to about US$17 million per year per country... assuming an “outcome payer” would agree to meet the cost of achieving the goals of the DIB. This amount compares with an annual education budget for a typical mid-size LMIC in Africa of over US$2 billion. The State is likely to be spending over 100 times more than the value of the DIB loan. Clearly, DIBs might achieve results in a controlled environment on a small scale. Whether they can be a national “game changer” when they are relatively small, sporadic and non-recurrent is clearly a matter of opinion.

From another perspective, if the DIBs were to require US$1 billion to be replenished every three years, this is equivalent to about 0.01% of Africa’s annual GDP. It is about 0.3% of the GDP of each of the seven largest economies and about 0.1% of all domestic tax revenue. It is a bit less than 0.4 % of all public education budgets. US$1 billion is about 1% of the known assets of Africa’s billionaires. It is also less than 1% of annual spending on defence in Africa. A 1% asset tax on extreme wealth or a small peace dividend from reduced military expenditure that ensured that there were more teachers than soldiers, could easily finance a grant giving fund bigger than the EOF.

b) Returns on investment

Bonds pay interest, which has to be generated from returns on investments (ROIs) and/or from payments by “outcome payers” who may be donor agencies or philanthropists who wish to give away their money rather than lend it. Bonds are tradable assets that have a capital value that at some time has to be repaid to the capital investor. DIBs increase the cost of delivering an outcome over what it would have been if it were possible to purchase the outcome without the costs of employing additional service providers and the transaction costs of financial intermediaries. The rationale for DIBs is that the additional costs are more than covered by the increased efficiency of non-state providers motivated by performance-related contracts and outcomes-based payments. The evidence on whether this is true is very mixed but this is widely asserted by potential service contractors who may have conflicts of interest in making such judgements.

A key issue for the financing of DIBs is the rate of ROIs. If this is too low, then the DIB will be unattractive to investors. If it is too high, then the investors may be extracting a disproportionate amount of the benefits of growth linked to educational investment. DIBs have two levels of projected annual ROIs to investors. These are “capped to 5%-10%” to investors for large scale DIBs that raise US$20-50 million. Smaller DIBs (US$1-5 million) that are more speculative and higher risk, are uncapped and could return more or less to investors.

To put these DIB interest rates in perspective, since 2000, successful private equity fund managers have achieved ROIs of 15-20%. DIBs are therefore not likely to be attractive to commercial investors. Impact investors may have other reasons to lend money to finance DIBs at below market rates, but their appetite is largely unknown. Most obviously, DIBs can be made more attractive if the risks associated with them are reduced by guarantees of a return on investment but this would transfer risk to the guarantor.

The lowest risks will be in DIBs in the more developed low middle income countries and not where the focus is on the most marginalised. This may not be consistent with “changing the game” to favour interventions targeted at areas of greatest need. Outcome payers also bear the risk of having to pay again if outcomes are not achieved, and interest and capital repayments have already been made.

We should note that a US$1 billion endowment fund free of debt could generate US$150-200 million in income each year in perpetuity if it had successful fund managers. Charitable grant giving foundations pay very low taxes on investment income so most of this gain is available to allocate to a grant programme. In the USA, Charitable Foundations have to disburse at least 5% of their assets each year. The EOF may or may not be subject to this requirement and may or may not operate under US law and revenue reporting requirements. The key point is that if US$1 billion can be raised from venture capital and grants, it could support a grant programme that did not depend on borrowed money. There would be no defaults, and grant transaction costs would be lower than for loans. DIBs would have to add a lot of value to do better than this.

c) Transaction costs for DIBs

One of the EOF’s highest stated priorities of the EOF is to lower the transaction costs of its DIBs. It believes that the cost is currently too high and the result is to reduce returns to investors and elevate rates of interest for borrowers. The EOF argues that lower cost would mean that DIBs would offer better value for money than existing approaches to disbursing donor funds. Most of this claim depends on greater effectiveness in translating inputs into outputs since disbursement of large scale funds, especially grants, can be very cost efficient.

The method chosen to reduce the cost of DIBs is to develop " more standardised contracts, processes and legal structures", and "have larger pools of outcomes funds" using a "rate card to commission multiple contracts" with "larger DIB contracts and "plug and play" across multiple similar contracts per issue". This is designed to achieve economies of scale by homogenising performance contracting and offering the same outcome-based contracts across countries.

This global contracting to reduce transaction costs is difficult to reconcile with the EOF assertion that "Achieving quality learning outcomes requires clear causality addressing *all* the barriers to learning in a given community – we believe that supporting whole-community based interventions …. is the best way to do this". Or how EOF can claim ""to ensure that the full range of barriers to learning are addressed with context specific (rather than cookie cutter) interventions". Plug and play leads to one-size-fits-all and *is* a cookie cutter. It is widely regarded as inappropriate for interventions that reflect different country and community specificities in education systems in Africa.

d) Non-state actors

The EOF will "typically fund non-state actors rather than the state itself" and "funding will be provided for partner organisations to work with the State". This sounds paradoxical when put alongside the EOF arguing that is will "only support programmes that can demonstrate a sustained increase in learning outcomes beyond an individual cohort". If these gains require increased numbers of better paid teachers, DIBs cannot help because they do not provide recurrent finance. Determining if the outcomes have been achieved and sustained, requires longitudinal data over several years and then it may take a long time to get "outcome payers" to pay service providers. Innovations contracted outside public systems and developed separately rarely make the transition to become main stream practice. Claims that private sector providers innovate, compete with observations that fee paying schools are driven by examination cramming for high stakes selection examinations.

The EOF is unclear about which non-state actors are likely to be bidding for contracts related to DIBs. There is a great deal of difference in capacity, motivation and effectiveness between not-for-profit community-based organisations, national commercial operators, and large-scale international providers with global reach and global solutions located nowhere in particular. In the poorest countries, the domestic modern sector is often very small, accounting for less than 20 % of the labour force, half of which may already be in the public sector. Very few enterprises employ more than 100 workers, indicating there may be a supply-side constraint on national partners capable of large scale interventions or running many chains of schools successfully. The capacity to monitor and regulate non-state providers of services is widely inadequate to assure quality or compliance.

e) Systemic risks

Systemic risks are not discussed by the EOF but they are a serious issue The EOF assumes that non-state providers can support i) ancillary services to improve school quality; ii) privately managed state-financed schools; iii) community-based fee-paying private schools; and iv) new schools for under-served populations. All these activities could create considerable ongoing liabilities if '"scaled up" and if the service providers ceased to operate for one reason or another. Non-government service providers have failed in the past, sometimes on a large scale, and have left governments to step in and pick up the pieces. Their activities depend on their financing, their profitability, their legal compliance, and the political economy of their relationship with the State especially if they are foreign registered. Operators of educational services on a scale of tens of thousands of students should at the very least carry public liability insurance including comprehensive cover for the costs of liquidation and re-admission of children to other schools.

Other systemic risks include casualisation of the teaching cadre and contravention of employee rights, modification of national curricula for political or commercial gain, narrow focus only on those educational outcomes linked to test and payment, nepotistic and corrupt employment practices, and financial impropriety in the use of public and private funds.

It is not clear that the EOF gives much consideration to risk and responsibility. It appears to rest content with the State as the risk bearer rather than the non-state contractor and argues that "if student fees do not cover operating costs the government will need to take over the additional operating costs over the lifetime of the project". But this systemic risk has to be recognised. DIBs need independent risk assessments.

f) DIBs and results-based financing

DIBs depend on "providing programmatic, results-based finance for non-state actors" which is argued to have "the potential to achieve better overall value for money than (unspecified) traditional approaches." RBF has a very long history for education which reaches back to 1862 in England when "payment by results" was introduced, which linked attendance and examination performance to school funding. It lasted 35 years before its weaknesses overshadowed its strengths. It did succeed in i) reducing teachers' salaries and total expenditure, ii) increasing attendance for those who remained school, and iii) improving examination performance of those entered for examinations. It was widely criticised for i) undermining the professionalisation of teachers, ii) providing few incentives to teach children of low capability in difficult areas, iii) resulting in a narrow curriculum and teaching to the test.

More recently, most bilateral agencies have operated with logframes specifying using Super Goals, Goals, Activities, Outputs, Outcomes, Means of Verification and Objectively Verifiable Outcomes, since at least the 1970s. Project-based aid is funded with results in mind and programmes and activities budgeted in great detail. Projects are not likely to be repeated if they fail to deliver outcomes.

Results-based aid has been common in the discourse the last decade. There is plenty of experience with contracting that links payment to progress and outcomes within an ongoing contractual relationship based on trust and commitment rather than being driven by contract law. The EOF proposal does not refer to this.

The EOF asserts that "we could ensure that taxpayer-funded aid budgets will achieve greater results by only paying for what works". It believes it can manage a tender process that identifies preferred bidders who take on the task of delivering defined educational outcomes at system level in low middle income countries. Prime contractors, whether national or international, run programmes, collect data on performance and are paid on achievement of agreed outcomes validated by independent evaluators. The core idea is that this provides incentives for Ministries of Education to enhance learning and run schools more efficiently, and that gains are sustained beyond the payment point. There are several obvious difficulties with RBF that can be signalled by simple questions that need answers.

- **Are incentives and sanctions that modify the behaviours of individuals applicable to Governments and Ministries of Education?** RBF typically links payments to indicators of achievement and withholds some funding unless performance targets are met. The assumption is that service providers will be motivated by the rewards to achieve the goals. But do people in organisations behave like this? Do political office bearers and public officials feel bound by promises made by predecessors? How are they motivated by targets set by others and rewards that make no difference to their personal income? Who is accountable to whom for what?

- **What happens when targets defined by RBF are not met?** Difficult issues can arise if performance targets for tranche release are not met. How can the cause of under-performance be attributed? If the reasons given for under-performance include insufficient resources and/or slow release of funds, what is the appropriate response – more or less money? If targets are not met, is the implication that there will be a reduced flow of funds in the future and thus greater likelihood of failing to achieve development outcomes? If targets are met, is further support withdrawn with the consequence that the achievement levels start to fall? Do failing schools and school systems need more or less resources?

- **EOF indicates that it "will set a price it will pay per child who achieves pre-specified learning outcomes (only) in a new school** (including amortised construction costs)". Investors "finance the cost of building the school and select and financially support an operator to run the school. Once the learning outcomes are achieved EOF repays the investor per child enough for their total investment plus a return". This does not sound like a proposal based on operational experience of a public administration system in low income Africa.

- **Can data on performance be provided by independent organisations that have no financial stake in the outcomes?** If data used to assess outcomes is generated by service providers there is a risk of bias. If data is collected independently, there is a cost that may be substantial. All indicators can be "gamed" unless steps are taken to discourage manipulation of data. Results measured by indicators are difficult to assess over a short time period with uncertain baselines and real-world constraints on the design of fair tests and singular attribution of causality. Many indicators are composite and ambiguous to interpret. Most low income countries do not have robust infrastructure to evaluate complex interventions on a significant scale and attribute causality. Conflicts of interest between providers and evaluators are endemic. Attributing outcomes to consortia resulting from the preferred "multiple provider bids to create "a price discovery" of the cost per outcome will increase costs and create impossible complexity in attribution.

- **If governments and service providers need to receive financial incentives from external agencies to achieve development goals, does this indicate a lack of commitment to goals and a lack of trust related to delivery?** If incentive payments are necessary to achieve goals, is there a prior problem about the motivation of the service provider? To whom does it matter if outcomes are sustainable after the incentive payments have been made? If there is more than one condition for continued funding, which conditions are sufficient to delay or suspend payment? Are multiple conditionalities ever applied? If there are incentive payments as a bonus when goals have been achieved, what are the activities they finance? The EOF assumes that financial incentives linked to "traditional approaches" have been lacking and that the "learning crisis" has not been ameliorated by the past flows of aid to education. The evidence for this lack of utility of aid is not presented, nor the counter factual.

- **How does RBF respond to the aspirations of the SDGs to invest in Education for sustainable development?** Education for sustainable development means investing in ways that value the future at least as much as the present. RBF generally values results in the near future over those in the longer term that reflect sustainable development. It links payment and reward to defined outcomes over the short lifetime of a (aid financed) project. It may use a high rather than low discount rate and thus value the present over the future. Should the discount rate applied to educational projects be low or high? How can RBF value sustainable (educational) development? As already noted, the EOF indicates it "will only support programmes that can demonstrate a sustained increase in learning outcomes beyond an individual cohort". This captures almost nothing of the ideas behind education for sustainable development and is only a partial recognition of the ideas behind sustainable educational development. DIBs cannot be used to fund recurrent cost without unacceptable systemic risks. If "outcome payers" are external agencies, why should outcomes be sustained beyond their engagement and financing?

Takeaways

All new methods of financing education, and of mobilising more finance from international sources for low-income Africa, like the EOF, should be tested against some key questions. All should have straightforward and simple answers.

1. Are the methods suitable for financing recurrent costs or only for capital investments?

- What are the transaction costs of generating additional resources, who pays them and who receives benefits from them?
- Do new methods of financing genuinely create new money or do they use “magic money tree” economics to give the appearance of new money?
- Do new methods of financing education increase indebtedness, and, if so, who bears the cost and who gains from the costs of borrowing?
- If governments do not borrow enough to finance education in the international capital market is this because they do not believe in the benefits or because the their return on investment is not sufficient?
- Who are the beneficial owners of capital and fund management companies that will arrange DIBs and what rates of return will attract investors into DIBs in different countries?
- In which tax jurisdiction would the EOF be located, to whom would it report, and would the dividends it paid its investors be subject to a withholding tax?
- What conflicts of interest exist between potential non-government service providers and those who finance DIBs; will there be a register of interests for principals, contractors, investors and funders?
- Is the domestic private sector large enough in low income countries to be a sufficient source of new investment and service providers?
- What are the systemic risks of increased dependence on financing of educational expansion and quality improvement which externally finance DIBs and what are the consequences if service providers fail?
- How will new methods of financing educational services benefit the poorest and most marginalised children, whose circumstances create the highest risks and the lowest rates of return?
- Fiscal reform and more efficient collection of existing taxes could generate far more than DIBs and would be new money: could DIBs be used to achieve a 5% increase in domestic revenue earmarked for investment in education?

Conclusion

The proposal for an EOF raises more questions than it answers. The diagnosis of the reasons for problems in participation and achievement in education is not robust and does not explain why major investments in aid linked to outcomes have not been successful in the past. The EOF would add a further layer of complexity and costs and institutional rivalries to an already-crowded landscape of agencies that provide loans and grants and technical assistance.

The marginal costs of expanding existing capacity must be much less than the transaction costs of a new and relatively small agency to issue DIBs and manage their impact. Importantly, DIBs would not generate new money, but would pre-commit future aid expenditure by "outcome payers" and governments to pay interest and repay capital on off shore loans assuming educational goals were achieved. It is not clear how this would result in sustainable outcomes or whether DIB bond-holders would pay tax on dividends and capital gains in the jurisdictions of the countries where the EOF invests. They should, otherwise the tax revenue will revert to the countries where investors are domiciled.

Finally, the core problem of educational financing remains how to ensure the development of "fiscal states" that are able to generate sufficient domestic revenue to finance nationally-defined educational goals delivered through predominantly publicly financed systems. DIBs do not address this critical problem and may end up being a distraction with high transaction costs and limited impact. This may be the reason why impact investing has had limited traction and mixed results in financing mass education systems in high income countries and why the strongest advocates of the approach are themselves service providers.

The EOF is in competition for funds with existing institutions that invest in education and development. It needs to demonstrate its unique comparative advantage. If donors make contributions to the EOF through grants or guarantees, there will be an opportunity cost that will reduce their appetite and ability to support existing grant programmes and concessional loan programmes. The choices need more analysis and less unconditional advocacy.