SOCIAL FINANCE

What role could outcomes-based contracting play in the recovery of Ukraine?

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Part 1: Introduction

1.1 Background

As the Russia-Ukraine war continues, the international community has started to look towards Ukraine's recovery needs, recognising the level of planning required to deliver efficient and effective support.

Currently, Ukraine's reconstruction and recovery bill is estimated at somewhere between $225 billion to $1 trillion[1]. Despite these divergent estimates, there is no dispute about the complexity of the challenge ahead, which is characterised by:

- **A significant financing gap:** Whilst the international community has made significant financial commitments to support Ukraine, the reconstruction and recovery needs, even using the lower end of the estimates, dwarf donors' immediate pledges. Indeed for 2023 alone the IMF estimates a $42 billion funding gap[2].
- **A vast number of competing needs:** The Ukrainian Government and World Bank's joint needs assessment highlighted housing, transport, energy and agriculture as some of the sectors experiencing the most damage[3]. However, Ukraine's needs extend well beyond physical infrastructure to all aspects of its society.
- **An ambition to 'build back better':** The recovery process presents Ukraine with a unique opportunity to accelerate its development. If taken advantage of, Ukraine could transition towards a green, digital and inclusive economy, emerging as a more resilient country and a member of the European Union[4].

In response to these challenges, it will be critical that the needed large-scale funding is deployed efficiently and effectively. There will also need to be stringent checks and balances to prevent potential corruption from taking place.

With this context in mind, outcomes-based contracts could play an important role in supporting the recovery of Ukraine.

1.2 What is outcomes-based contracting and what value does it bring?

Outcomes-based contracting is a form of results-based financing (RBF) that links contract payments, contract extensions, and contract renewals, to the achievement of measurable outcomes. This shifts the focus away from inputs towards delivering longer-term outcomes for end users. Unlike typical RBF projects, outcomes-based contracting has more of an emphasis on independently verified benefits at the end-user level.

Outcomes-based contracts are underpinned by principles of governance, transparency and accountability for impact. They help to align priorities, foster collaboration, increase value-for-money and promote adaptive delivery (the latter being particularly important in unforeseen and quickly changing circumstances such as one would expect in post-war Ukraine).

[1] Skidmore.D, Wessel.D, and Asdourian.E; Financing and Governing the Recovery, Reconstruction and Modernisation of Ukraine; Brookings; 2022; https://bit.ly/3R4c7gO
[2] Ukraine FAQs; International Monetary Fund; https://bit.ly/3Ej1eA7
[3] Ukraine Rapid Damage & Needs Assessment; World Bank, Government of Ukraine, EU, UN; 2023; https://bit.ly/3L4m4ac
[4] European Commission; Proposal for a Regulation of the European Parliament and of the Council on Establishing the Ukraine Facility; 2023; https://bit.ly/3OWkQ1P

A common form of outcomes-based contracting is Impact Bonds, where external risk capital provides up-front capital in the expectation of being repaid with a profit, if and when, verified outcomes are achieved. More than 280 Impact Bonds have been launched since their inception in 2010[5]. They are now used across a broad range of sectors and geographies, and by various organisations, including government bodies, bilateral agencies (e.g. the UK Foreign Commonwealth and Development Office and USAID), and multilateral agencies (e.g. EBRD, the Global Financing Facility and the World Bank).

1.3 What role could outcomes-based contracting play in the recovery of Ukraine?

The ability of outcomes-based contracts to align priorities, ensure accountability and drive impact in the face of uncertainty suggests that they could play a valuable role in Ukraine's recovery. However, the relative urgency and scale of the required recovery efforts means that they are unlikely to be used in their purest form, where *all* payments are linked to verified outcomes. This is because pure outcomes contracts require complex and often time-consuming arrangements to fund their working capital requirement (the capital needed to bridge the gap between project costs being incurred and payment for eventual outcomes being made), which is not the most cost-effective means of funding large-scale infrastructure projects. Nevertheless, the principles and characteristics of outcomes-based contracts are relevant, and could be applied through a modified mechanism, where only *some* payments are linked to achievement of verified outcomes.

There are two key areas where this kind of partial outcomes-based contracting could play a role.

Part 2: Mine Action

As of April 2023, an estimated 174,000 km² was contaminated with landmines across Ukraine[6], representing the heaviest landmine contamination since the second world war[7]. Whilst some work has already begun to map, record, and even clear landmines in unoccupied areas, a full-scale demining effort will not be possible until the conflict ends[8]. Given that mine clearance is a prerequisite for much of Ukraine's physical reconstruction, it is critical that it is delivered in as targeted and timely a manner as possible.

2.1 What value could outcomes-based contracting bring to mine action in Ukraine?

To date, mine action programmes (mine clearance plus post-clearance recovery) have typically been structured as input-based contracts and delivered in silo, lacking proper collaboration between development partners, governments and sector expert organisations. This means the prioritisation of mine action funding has been inconsistent, and activities have largely focused on mine clearance, with little consideration for how the land is used once it has been demined[9]. With low success rates of demined land being transformed into productive use, mine action programmes have not maximised the achievement nor the sustainment of longer-term outcomes.

[5] Impact Bond Dataset; Government Outcomes Lab; https://bit.ly/47TtB5o
[6] Waterhouse.J; Ukraine War: The Deadly Landmines Killing Hundreds; BBC News; 2023; https://bit.ly/3qZiur6
[7] Borger.J, and Mazhulin.A; 'We Couldn't Wait': Ukrainian Farmers Improvise to Clear their Land of Mines; Guardian; 2023; https://bit.ly/45xyRtV
[8] Clearing Landmines from Ukraine May Take Decades; GICHD; 2022; https://bit.ly/47VC9J0
[9] Nichloas.P, Wallen.C, Dallset.M, and Von Griesheim.A; Innovative Finance for Mine Action; Social Finance, The Halo Trust, and UK Foreign, Commonwealth and Development Office; 2021; https://bit.ly/3sEqle7

To address these potential deficiencies, an outcomes-based approach could be used in Ukraine, with outcomes linked to the socioeconomic benefits that mine clearance makes possible, but often aren't significantly achieved in practice. Making contract payments conditional on not only mine action outputs but also socioeconomic outcomes, would help to align priorities and foster collaboration across sectors. The target outcomes would be determined by Ukraine's national recovery plans, and thus linked to broader development and economic objectives. For example, demined land could be earmarked for urban renewal or high-value agriculture. This integrated approach would enable more effective prioritisation of mine clearance activities, focusing on the areas and sectors that represent the greatest needs and potential.

An outcomes-based approach would support not only national ownership of mine action programmes, but also anti-corruption efforts. With payments linked to outcomes, the incentives for contractual corruption lessen as payments are made against the value of the outcomes, rather than the negotiated price of contractual inputs.

Case study: applying outcomes-based contracting to mine action

The Mine Fields to Rice Fields Development Impact Bond (DIB) in Cambodia is an example of how outcomes-based contracting can be applied to a mine action programme to promote synergies with broader development goals through alignment of outcomes incentives.

The DIB is a partnership between the UK Foreign and Commonwealth Office, APOPO, Cordaid and three private family foundations. Launched in April 2023, it is the first impact bond in the mine action sector, and only the second in the agricultural development sector. Under the two-year pilot approximately 3.8 million m² of land will be de-mined and returned to local communities; and approximately 80 farming households will receive organic rice support tailored to their needs. The ultimate objective is to significantly increase small-holder farmers' net income from growing organic rice, so that they experience an improvement in their livelihoods.

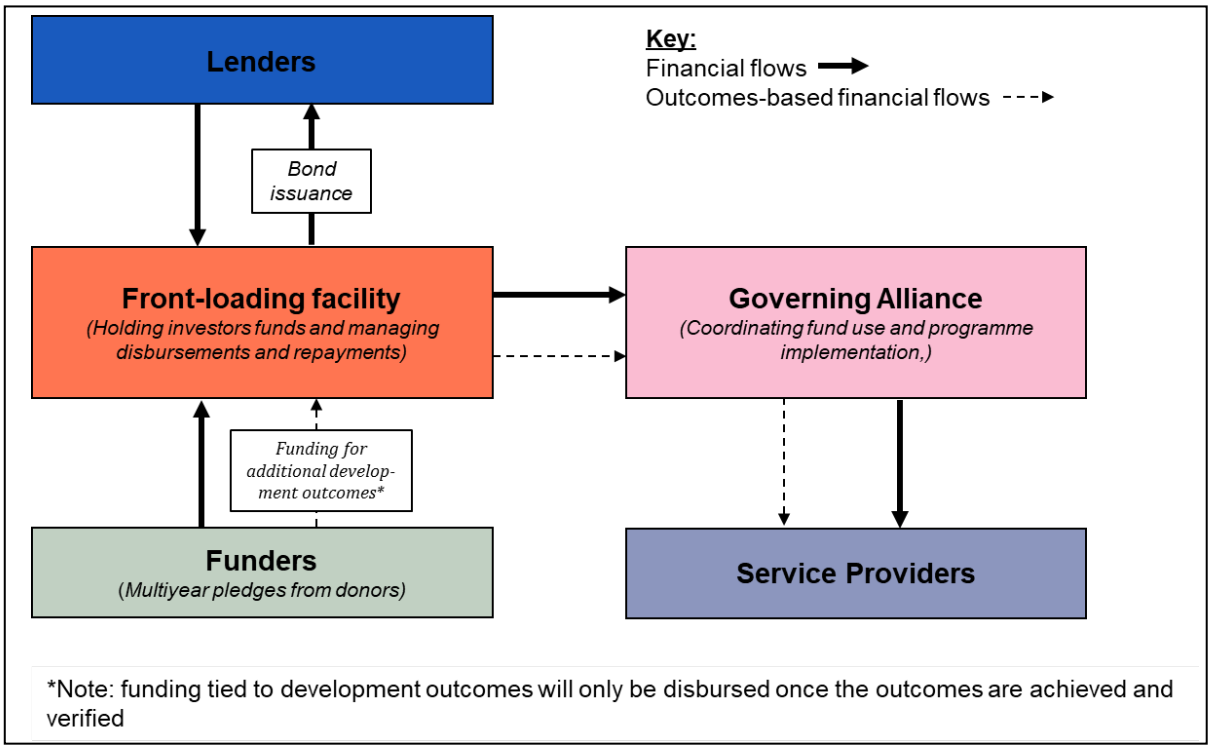
2.2 Combining outcomes-based finance with front-loaded finance

Given the scale of the mine action required, and the huge benefits in humanitarian and economic terms of achieving that clearance quickly, Ukraine needs to find ways to rapidly secure the very large amount of funding required, and to use it efficiently and effectively. One promising approach is a Front-Loading Facility, building on the highly successful model of the International Finance Facility for Immunisation (IFFIm), but also incorporating an outcomes-based element.

The IFFIm model front-loads finance based on multi-year donor pledges so as to support the early rollout of vaccines, but the model also has strong applicability to mine action. As outlined in the *Innovative Finance for Mine Action* report, the IFFIm model would have four key elements when applied to mine action:

1. Donor governments would make long-term, irrevocable and legally binding pledges of annual funding to mine action.
2. These pledges, backed by a treasury manager such as the World Bank, would support the issuance of highly rated bonds, allowing the securitisation of the pledges.
3. Funds would be disbursed for priority mine action projects.
4. The selection of mine action projects for funding, and the management of disbursing funds, would be governed by an alliance of the key actors.

Figure 1: Combining outcomes-based finance with front-loaded finance



Front-loaded funding would allow mine action to happen much more quickly. In addition, the certainty around the level of finance available would allow for more coherent planning, with a structured approach to the allocation of funding across multiple potential projects. These benefits could be further enhanced by adopting an outcomes-based approach, with projects' success judged against the achievement of longer-term benefits such as higher levels of socioeconomic activity on demined land. Payment would not need to be solely – or indeed mainly – made against socioeconomic outcomes to create an effective incentive. Indeed, making most of the payments against outputs rather than outcomes greatly reduces the working capital need and the associated costs. Once this approach has been demonstrated for mine action, equivalent front-loading mechanisms could be harnessed to finance other aspects of the reconstruction process.

Part 3: Reconstruction

The February 2023 Rapid Damage and Need Assessment estimated that there has been $135 billion worth of physical damage to Ukraine's infrastructure[10]. The most damage-affected sectors are housing and transport, representing 38% and 26% of the total damage respectively[11]. However, with all of Ukraine's sectors affected to some extent, the physical reconstruction process is expected to take more than 10 years[12]. As reconstruction will lay the foundations for overall recovery, it is essential that the reconstruction efforts take a holistic approach and reflect Ukraine's ambition to build back better. This means incorporating objectives around social inclusion, environmental efficiency and economic growth into physical reconstruction programmes.

[10] Ukraine Rapid Damage and Needs Assessment 2023; World Bank, Government of Ukraine, EU, UN 2023; https://bit.ly/3L4m4ac
[11] Ibid
[12] Ibid

3.1 What value could outcomes-based contracting bring to reconstruction?

To rebuild the social fabric of Ukraine as well as the physical infrastructure, reconstruction needs to be linked to social, environmental and economic objectives. These linkages can be promoted by participatory and community-driven development (CDD) approaches, which seek to empower residents in shaping the design and implementation of infrastructure programmes[13].

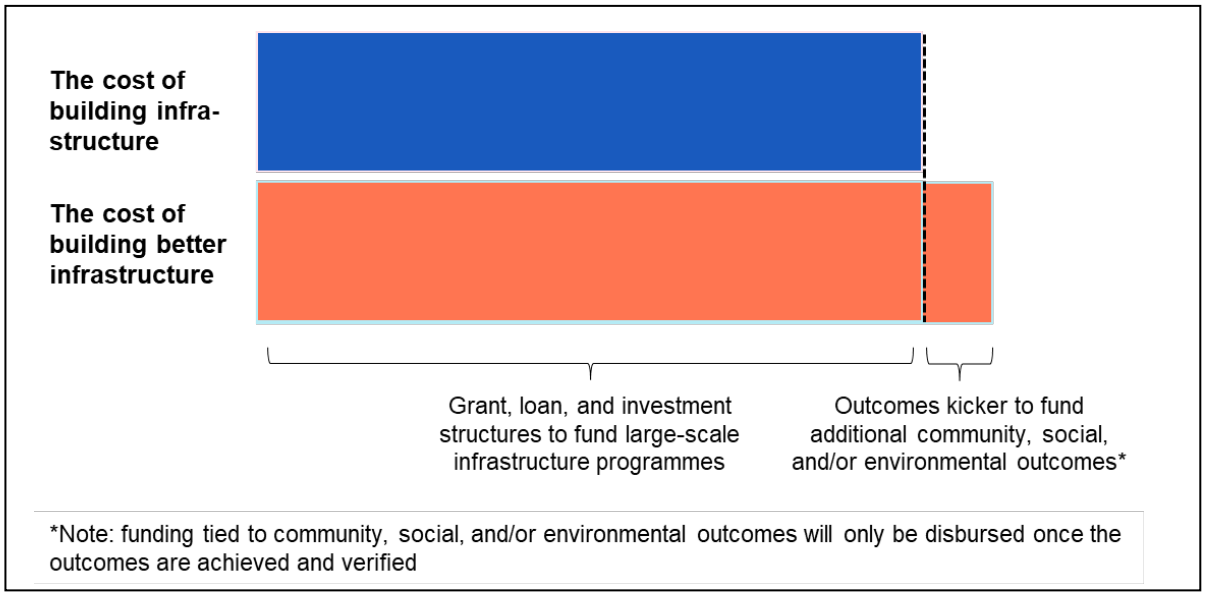
CDD hasn't yet been used in the context of outcomes-based contracting, and funding of infrastructure programmes has predominantly remained input-based. With no incentives to promote longer-term social and economic outcomes, there is often inadequate community engagement; or where there is community engagement, there is a lack of governance and accountability to ensure that the community's voice is actually reflected in project design and implementation.

There is a clear case for combining CDD and outcomes-based approaches in reconstruction projects in Ukraine, leading to more effective partnerships between local government agencies, communities and service providers. Communities would be empowered to feed into: (i) the regional planning process to identify community objectives; and (ii) the design and implementation process to ensure these objectives are met. Moreover, this approach would also incentivise stronger governance and accountability in support of anti-corruption efforts. Having community feedback tied to contract payments should lead to better monitoring of progress and achievement of results.

3.2 How could outcomes-based contracting be used to further Ukraine's reconstruction?

Given the scale of Ukraine's reconstruction needs, most infrastructure programmes are likely to take a focus on system-level improvements that might not fully take into account community-level needs. To address this, an outcomes-based element, building on CDD principles, could be incorporated into infrastructure programmes through an 'outcomes kicker'. The kicker would consist of outcomes-based funding which would sit alongside and complement the usual financing and contracting structure of an infrastructure programme.

Figure 2: Using outcomes-based finance to cover the additional cost of building better infrastructure



[13] Holmlund.M, Vijayendra.R; Where and When is Community-Driven Development Effective?; World Bank 2021; bit.ly/47ZSoVC

Whilst there wouldn't be any loss for service providers if they don't achieve longer-term outcomes, the kicker would be set at a level sufficient to incentivise meaningful community engagement and focus on longer-term socio-economic outcomes. This funding would only be paid once communities and independent observers have verified that the specified outcomes have been met. This would help to motivate a move from stock infrastructure to community-responsive infrastructure. Such kickers could be particularly valuable for incentivising 'last-mile outcomes', where additional financial incentives might need to be put in place for harder to reach or vulnerable populations to ensure equal access.

Case studies: applying outcomes-based contracting to sanitation and road safety

Whilst there has been limited experience with outcomes-based infrastructure projects to date (though the GPRBA infrastructure facility has recently launched an Outcomes Fund[14]), and none where a CDD approach has been incorporated, the examples below demonstrate how outcomes-based contracting could apply.

In the WASH sector, the Cambodia Rural Sanitation DIB, which is a partnership between USAID, iDE, and the Stone Family Foundation, demonstrates how outcomes funding can be applied to a market-based solution where the majority of intervention cost is funded outside of the outcomes-contract. The flexibility of the DIB means that iDE is able to adapt their delivery to find ways of making buying and selling toilets more attractive and accessible for even the poorest households[15]. By addressing the need for household behaviour change, the DIB aims to generate jobs and promote the market for sanitation products to accelerate the achievement of universal sanitation in Cambodia[16].

For the transport sector, the World Bank report *Saving Lives Through Private Investment in Road Safety* demonstrates how an outcomes-based funding supplement for road construction could promote better user safety[17]. Such funding could incentivise safety measures like wider centre-lines, better signage, safer crossings and sidewalk facilities; as well as community engagement and education.

Part 4: Conclusion

4.1 Challenges in adopting an outcomes-based approach to recovery in Ukraine

Whilst there are significant opportunities to apply an outcomes-based approach to Ukraine's mine action and reconstruction, and many potential benefits of doing so, it is important to be aware of some of the potential challenges and risks. These include:

[14] Outcomes Based Financing and the Outcomes Fund; GPRBA; www.gprba.org/outcome-based-financing-and-outcomes-fund
[15] Bringing Safe Sanitation to Rural Cambodia; Social Finance; https://bit.ly/46dgavF
[16] Ibid
[17] Saving Lives Through Private Investment in Road Safety; World Bank; 2022; https://bit.ly/481M0wP

- **Unwanted behaviours:** With any outcomes-focused programme there is a risk of encouraging perverse incentives, where a focus on a narrow sub-set of community outcomes could detract from responding to service users' wider needs. There may also be a risk of encouraging gaming amongst service providers, where they misreport outcomes to maximise the amount of outcomes-based funding they receive. The latter might be particularly significant in the context of community feedback which could be more easily misrepresented or corrupted. To be effective, independent checks and balances are likely to be needed.
- **Measurement of outcomes:** It could be challenging to identify easy, yet robust, outcome measurement and verification processes given the breadth of potential social, environmental and economic outcomes and the likely complexity of delivering these. This is made more challenging by the fact that data might be limited, or in the case of community feedback, very subjective. New approaches to impact measurement – supported by technology where possible – could help to improve reliability and keep costs low.
- **Attribution of outcomes:** It can also be challenging to attribute the achievement of outcomes to a specific intervention and service provider given various other contextual factors at play, including other support users might be receiving. Outcomes measurement approaches that recognise contribution as well as attribution, may be most appropriate for a reconstruction context.
- **Implementation capacity:** An outcomes-based approach requires service providers to use data to adapt their delivery to be more outcomes focused. Likewise, a CDD approach requires service providers to use community engagement to inform their design and delivery of infrastructure. As these may be new ways of working for service providers, it will be important to ensure capacity building support is available alongside outcomes funding.

We believe these potential challenges can largely be mitigated through a robust design process and selection of outcome metrics, effective monitoring and management throughout the course of implementation, and the use of experienced independent observers to monitor CDD and outcomes verification processes.

If you would like to discuss how to integrate outcomes-based thinking into mine action or reconstruction design, please contact:

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