Unlock Aid read USAID's [proposed] Local Capacity Development Policy with great interest. There are many parts of the policy we enthusiastically endorse:

- The policy states that local actors have the most important roles as systems changemakers. **It also recognizes that there is enormous untapped potential in countries** and "embrace[s] the spirit of 'nothing about us, without us.'"

- The policy emphasizes that USAID should focus on systems-level investments and recognizes that there are many players within the international development ecosystem, including government, nonprofits, faith communities, and the private sector.

- The policy states that building capacity requires new and innovative approaches that go beyond traditional training. USAID should be open to funding different approaches such as learning by doing and investing in local leadership development.

- The policy recognizes that USAID's over-emphasis on compliance over performance "often shifts the focus of our partnership towards risk avoidance, compliance, and short-term, easily-counted results, instead of focusing on improving the performance of the partner to pursue their own mission."

- The policy recognizes that aid can distort local markets, especially if donors have an over-emphasis on compliance and/or focus on delivery of short-term results, which can increase aid dependency and "stifle local revenue generation." The pursuit of donor funding can also result in organizations molding themselves around donor priorities. Unlock Aid would add "and around particular donor compliance systems," which foists yet more burdens on small local organizations and does not necessarily result in them being more "governance worthy" overall.

- The policy acknowledges that USAID needs to update how it measures and evaluates progress by moving to models that measure outcomes.

There are areas where we'd like to see more explicit recommendations, especially focused on **results, innovation,** and **transparency**.

As the proposed policy recognizes, there is enormous untapped potential in countries where USAID works. However, according to a soon-to-be-published report that was commissioned by Unlock Aid last year, 35 percent of the pace-setting organizations we surveyed that work with other international development funders, including major foundations and multilateral banks, do not work with USAID. Many of these organizations have chosen to avoid working with USAID as a matter of policy. Some of the major reasons include:

- **USAID compliance requirements are too burdensome.** USAID structures the vast majority of its awards using what are known as "cost-reimbursable" methods, which come with extremely onerous application and compliance requirements that discourage local organizations from working with the agency. For example, to calculate costs as part of a cost-reimbursable award, organizations often need to produce arcane documentation like a Negotiated Indirect Cost Agreement (NICRA) or multiple years of (expensive) audited financials, which few organizations outside of USAID's legacy implementing partners have. Further, once an organization receives agency funding under an award that uses cost-reimbursable methods, it needs to make significant investments to acquire and train staff to use USAID-compliant accounting and management systems. Cost-reimbursable methods do not work well if a local organization uses any kind of remuneration model other than a strictly billable hours one (e.g. if they license services, provide fixed-price services, etc.). While cost-reimbursable methods may work for organizations that generate revenue by charging for time and materials, it is not a good fit for more diverse actors that have different and often more innovative, performance-based ways of doing business.

- **Requirements to work through large implementing partners.** Many local organizations do not feel it is worth the business development costs and time and effort to work with USAID's large implementing partners, but this is the main way by which a local organization can receive USAID funding.

  Since so many of USAID's awards are made via its large implementing partners, many local organizations feel the key to winning USAID is business is based on "who you know," not what you do or how well you do it. Organizations that have never worked with USAID or its implementing partners find this insider community difficult to penetrate. Whenever USAID makes a funding announcement, the way for a local organization to work with the agency is almost never to directly apply. Instead, local organizations must identify the handful of large implementing partners that will submit a proposal to USAID, determine who within that implementing partner is leading proposal development, persuade that person and/or their team to invite the local organization to join their consortia, and then hope that the implementing partner wins.

Further, even when a local organization's larger implementing partner has won the award, there is no guarantee of work. As documented elsewhere, many of USAID's large implementing partners have financial and management incentives to put their own staff on projects instead of sub-awarding directly to a local organization that is equally or more capable, so working through large implementing partners is rarely an effective way for a local organization to deploy a proven intervention at scale. Many of USAID's large implementing partners also routinely promise local organizations significant scopes of work to secure their participation in proposals submitted to the agency, only to later cut down their scopes once USAID announces the award.

Implementing partners rarely invite local organizations to participate in work planning sessions with USAID, which is where many of the most significant funding decisions are made. Local organizations also rarely see the proposals that large implementing partners send to USAID. Since there is such a significant power imbalance between primes and their smaller partners, local organizations that have been taken advantage of by larger implementing partners will rarely report wrongdoing to USAID.

- **Limited transparency and/or information about agency funding opportunities.** Anticipated USAID funding flows are rarely transparent. Once USAID has made an award to an implementing partner, it does not publish specific information about how that money will be spent, how money will be divided between primes and subs, against what set of milestones, and according to what payment timelines. Take the most recent announcement by the agency to spend $400 million as part of the new Global VAX initiative. Presumably there should be ample opportunities for local organizations with innovations and services to get vaccines into arms to compete to help the agency realize its goals. However, while the Global VAX factsheet indicates that funding will be used to shore up supply chains and support in-country vaccine manufacturing, it provides no information about who will receive that funding, to do what, and against what timelines and milestones. If a local organization had an innovation that could help Global VAX deliver results, how could it make that known to USAID?

USAID's push to direct more resources to local actors can catalyze needed **internal reforms** to drive **results, innovation, and transparency** at the agency. Below are six specific recommendations for reform that would enhance USAID's ability to work more closely with local organizations and improve outcomes for the people who live in the countries that USAID supports:

1. **Use more straightforward grantmaking (and contracting) methods.** As the agency shifts more funding to local organizations, the agency should consider increasing its use of fixed-amount awards (FAAs) when writing grants. Unlike cost-reimbursable methods, which come with many of the drawbacks described above, FAAs are far more straightforward. Local organizations can be paid against the delivery of agreed-upon milestones, so they do not need to invest in expensive systems or obtain US Government-specific documentation just to apply. Further, FAAs are especially flexible, so USAID can use them to pay organizations no matter their business model type, including for organizations that calculate costs using billable hours as well as those that provide fixed-cost services. Since payment is contingent on the delivery of milestones, FAAs are also an effective way to structure results-based awards, scale innovations, and enable the agency to work **directly** with local organizations instead of working via larger implementing partners. USAID already has the legal authority to structure awards using FAAs, it just rarely uses it. In 2019, the agency structured fewer than one percent of grants using FAAs.

   USAID's proposed Local Capacity Development Policy stipulates that overseas USAID missions should evaluate the range of contracting options available to do it when deciding how to make an award, but it should go one step further and explicitly recommend greater use of FAAs when writing grants (and when writing contracts, increase the use of firm-fixed-price (FFP) contracts, which is a close cousin of the FAA). Unlock Aid was encouraged that the agency recently published revised guidance to make it more clear to agency officials regarding how to structure FAAs. We hope to see this award mechanism used far more in the future as it would significantly increase the number of local organizations that can work directly with the agency.

   If USAID determines that using cost-reimbursable methods are absolutely essential, however, it should make the process to apply for those awards as simple as possible. For example, it could require smaller organizations to submit basic concept notes or other simplified proposals to apply for a direct agency award. Only if USAID decides to award funding to that organization should it then require it to submit a NICRA or other equivalent documentation, and agency staff should work with the organization to help it obtain the necessary systems and materials to comply.

*Additional Actions for Congress:* USAID should work with Congress to amend federal law to create simplified alternatives to submitting NICRAs and other arcane documentation to calculate costs. For example, if an organization has received funding from another approved international development partner(s) (i.e. another US Government agency, major foundation, multilateral bank, bilateral aid funder, etc.), USAID should accept evidence of those contracts in lieu of requiring a NICRA and similarly onerous USG-specific documentation.

2. **Create HR incentives for agency Contracting/Agreement Officers to direct more work to local organizations**. Writing grants, contracts, and cooperative agreements is USAID's core business. Unless agency Contracting/Agreement Officers have HR incentives aligned with USAID's updated localization policies, there is a significant risk of uneven implementation. USAID should revise HR performance metrics to include more incentives for officials to structure awards using FAAs, FFPs, and/or other straightforward mechanisms that pay for results and enable the agency to work more directly with local organizations. USAID's current risk appetite favors compliance over performance. The agency should flip that – the way other major international development funders have without experiencing increased levels of fraud, waste, or abuse – and Contracting/Agreement Officers' performance evaluation standards should reflect the agency's increased emphasis on performance and delivery of results.

   We recognize that USAID officials are under enormous strain. As Administrator Power has pointed out in testimony to Congress, the average USAID Contracting/Agreement Officer manages four times the per capita workload as their counterparts at the Department of Defense. In light of this, along with revising HR performance incentives, USAID should find other creative ways to address contracting bottlenecks; the agency's decision to empower locally-engaged agency staff to write awards is a good start. USAID could also call back more retired Contracting/Agreement Offices on a part-time basis to provide surge support.

   *Additional Actions for Congress:* Prioritize working with Congress to secure funding to hire more Contracting/Agreement Officers.

3. **Embrace an era of transparency at USAID.** For every USAID award, the public should be able to see who will get paid to do what, against what specific milestones, and according to what payment schedule. Once a contract, cooperative agreement, or grant is underway, the public should also be able to track progress made towards achieving those milestones.

   Currently the only meaningful way the public has to determine whether USAID's implementing partners are delivering against their intended objectives is to hope for the occasional Government Accountability Office or USAID Inspector General report, or by lodging a Freedom of Information Act request, with responsive and oft-redacted documents being produced only months or even years later. The agency maintains the Development Experience Clearinghouse, which could serve as a repository for such data, but because too few implementing partners submit information here and USAID does not appear to enforce strict compliance, it is not a useful tool for outsiders to meaningfully track progress.

   Further, by requiring major implementing partners to publicly report the percentage of funding they promised USAID during the proposal stage would go to local organizations and other smaller partners, as well as the percentage of funding they actually subsequently directed to those organizations, this would enforce greater accountability and transparency regarding how primes spend taxpayer dollars.

   Finally, since big implementing players are often the conduits through which local organizations can receive funding, USAID should make it easier for local organizations to identify which implementing partners will submit proposals. This would make the process to work with USAID less based on "who you know." For example, USAID could expand its WorkWithUSAID.org website and require large implementing partners to publicly register their intent to submit a proposal so that smaller organizations may contact them. USAID could also advertise on its website opportunities for local organizations to participate in co-creation exercises.

4. **Increase the use of fiscal agents.** While large U.S.-based implementing partners often have conflicting interests related to the management of USAID awards – it is in their financial interest to use their own staff or local subsidiaries instead of truly local, indigenous organizations – they nonetheless solve an important problem for USAID. The agency needs to move billions of dollars every year and these legacy players have the systems in place to absorb large sums. The agency could increase its use of another kind of organization that could

meet this same kind of need, however, and without many of the inherent conflicts of interest: fiscal agents.

Fiscal agents are a kind of pass-through entity that can absorb large sums of money. They have the financial management systems to ensure funds are appropriately spent which is why many large foundations routinely use them to direct multi-million dollar awards to smaller organizations, especially to groups that might have weak back-office systems. While fiscal agents will often take a small management fee, their costs of doing business tend to be much lower than large implementing partners and they do not have financial interests that are in direct competition with smaller partners.

There are some barriers to working with fiscal agents. First, the US Government's fixed-amount sub-award threshold (SAT) is $250,000, which means that any fiscal agent would be limited to writing a maximum $250,000 fixed-award sub-agreement(s) to any single local organization. In this case, for awards above $250,000 fiscal agents would need to pay local organization(s) according to cost-reimbursable methods which come with many of the compliance headaches described above. This is one of the reasons why many fiscal agents choose not to work with USAID. Nonetheless, fiscal agents are a relatively untapped resource. USAID should proactively identify and partner with more of them.

*Actions for Congress:* USAID should work with Congress to significantly increase the sub-award threshold or remove it entirely as Senators Kaine and Rubio propose to do in their New Partners Initiative legislation.

Note: The $250,000 SAT only applies to sub-awards that an intermediary organization like an implementing partner or fiscal agent may make to a third party; there is no such ceiling on awards that USAID may write to a smaller organization as a direct award via an FAA or FFP.

5. **Improve prime-sub partnership dynamics.** While USAID wants to work more closely with local partners, we recognize that the agency will nonetheless continue to direct a significant share of work via its large, legacy implementing partners, at least for the foreseeable future. Until this dynamic changes, there are many things that USAID could do to improve prime-sub dynamics to ensure that local organizations and other smaller partners are treated more equitably.

   First, USAID should prohibit implementing partners from requiring sub-partners to submit information about how they arrive at estimated costs during proposal negotiations. Primes routinely require smaller partners to hand over proprietary trade information during negotiations as a condition of joining their consortia (for example, organization financial statements, cost calculations, etc.). This puts the smaller organization at a significant competitive disadvantage against the larger implementing partner and further exacerbates power imbalances between large US implementing partners and smaller local organizations. If USAID needs to see evidence to show how a smaller partner estimates its costs, the agency should request that information directly. Enabling sub-partners to submit "sealed" costing information is standard practice at other US Government agencies.

Second, USAID can mandate in RFPs, RFAs, scopes of work, and other program design statements that large implementing partners must include local organizations and other smaller partners as "core partners" as well as require primes to invite smaller partners to all work planning meetings where funding decisions are made.

Third, USAID can hold a table-top exercise(s) with its Chief Innovation Officer, Director of the Office of Acquisitions and Assistance, and its most forward-thinking contracting officers and agency lawyers – including those from other agencies that have progressive contracting models – to evaluate past large USAID contracts, grants, and cooperative agreements. Then, go line-by-line to determine what is statutorily required and what is not, and review which requirements should apply to primes but do not need to devolve down to smaller sub-partners. Based on those findings, strip out all but what is absolutely necessary and make that the template for major RFPs and RFAs going forward. Further, state in RFPs, RFAs, Scopes of Work, and other related documents that large implementing partners shall not devolve requirements that apply to them but not to their subs down to their smaller partners.

Fourth, as the agency has increasingly moved to models that promote participation from smaller organizations like co-creation, it has also increased the requirements for admission for entry, such as requiring organizations to submit evidence of past performance reviews (PPRs). Co-creation is a step in the right direction, but if the agency requires USAID-specific documentation to participate, or if it puts primes in the position of deciding who to invite, it takes a step back. USAID should return to first principles by enabling smaller organizations to submit just a concept note to get in the door.

Finally, USAID can increasingly structure awards so that local organizations are designated as the "primes" with the agency's traditional implementing partners filling back-office roles as a sub-partner(s). Fiscal agents could serve this role, too. Alternatively, awards can mandate that the prime and local organization sub-partner "flip" roles during the course of execution, an approach that has been tried, with some success, in the past.

6. **Avoid writing "local" awards to primes that are not truly indigenous, local organizations.** Some of the past agency efforts to diversify its partner base, including by awarding more funding via "small business set-asides" and local organizations have been co-opted by bigger prime contractors and international NGOs that have set up spinoffs, subsidiaries, and/or registered as local organizations to become eligible for these awards. Unlock Aid is presently commissioning research to document how larger primes do this, quantify how widespread the problem is, and explain its corrosive effects for promoting locally-led development. As USAID increases the share of funding that goes to local organizations, it should carefully consider how it defines a "local entity" to ensure these funds go to truly indigenous, locally-led organizations.

   However, it should at the same time also avoid adopting overly-prescriptive definitions that may inadvertently cut out many of the best local innovators. For example, many of the best local organizations have executive teams and the vast majority of their staff are based in low-income countries. Yet these organizations may still maintain an office in the United States, for example in Washington, DC, for the purpose of working with USAID, or elsewhere in the Global North because they offer a product or service that is in demand in high-income countries as well as in low-income ones.

   As USAID considers how it defines "what is local" it should take into account the considerable nuance regarding how local organizations structure themselves to ensure that the agency does not unintentionally cut out the very organizations it is trying to attract.

Administrator Samantha Power has outlined a bold vision for reform that includes allocating 25 percent of agency funding to local organizations over the next four years. Unlock Aid supports this goal and applauds the proposed Local Capacity Development Policy.

But moving money from A to B is not enough. If that becomes the primary metric used to evaluate success, the localization agenda runs the risk of creating just a different set of big implementing partners with new addresses based in low- and middle-income countries, but which lack the requisite incentives to drive results, innovation, and act transparently as they mold themselves to reflect international donor priorities. An optimal outcome would be one where local organizations can build truly sustainable, scalable business models that in-country governments can rely on to deliver high-quality outcomes so that over time we can move to a world that is free from dependence on foreign aid.

Administrator Power's localization agenda is exciting not just because it can catalyze a new era of locally-led development, but also because it can become the driving force behind many other much needed internal agency reforms.

Our comments propose specific changes for USAID that go above and beyond the high-level Local Capacity Development Policy. Nonetheless, we think it is imperative that subsequent agency Local Capacity Development Policy materials address granular levels of reform since it is often in the absence of specific directives that reforms can stall.

Big, bold change is hard. Unlock Aid supports the highly capable personnel at USAID to realize the agency's new and ambitious vision for locally-led development. We stand ready to do our part to help the agency succeed and usher in a new era of results, innovation, and transparency at USAID.

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