

DISCUSSION DRAFT

Guidelines for the
Africa Bureau of the
Agency for International
Development
for Programming
Local Currency Endowments

A report to AID/AFR/TR

by

W. Paul Weatherly

1212 New York Avenue, N.W., Suite 345
Washington, D.C. 20005

Telephone (202) 408-5112
FAX (202) 408-5021

28 October 1991



Part I—Background: the case for endowments	1
A. Introduction	1
A.1. The need for sustaining support of environmental programs.....	1
A.2. Scope of new institutions.....	2
A.3. Recent AID initiatives to create endowments.....	2
A.4. Why the FAA now permits interest retention in debt swaps	3
A.5. The NPA approach to endowment creation.....	4
A.6. Alternative routes to endowment creation.....	4
A.7. The role an endowment should be able to play.....	5
A.8. The need for an endowment to maintain a societal mandate.....	6
B. Summary of experience with endowments to date.....	7
B.1. Why debt-for-nature swaps have been prominent	7
B.2. Limitations of debt-for-nature swaps.....	8
B.3. The analytical framework of this paper.....	8
Part II—Understanding Options for endowments in Africa	10
A. Setting criteria for choosing design options.....	10
A.1. Long-term funding—beyond fads and the project cycle treadmill.....	10
A.2. Increased participation—beyond top down to empowerment.....	11
A.3. Innovative mechanisms—beyond donor aid to direct grant-making....	13
B. Summary of two major endowment models plus hybrids.....	14
B.1. Model #1: Use of debt-for-nature swap to create an endowment.....	14
B.2. Model #2: Use of NPA conditionality to create an endowment.....	15
B.3. Model #3: Hybrid or intermediate approaches.....	17
C. Concerns to be addressed when setting up endowments	17
C.1. Getting a mandate : a participatory process for selecting a board.....	18
C.2. Achieving creditability: models for board organization.....	19
C.3. Maintaining creditability: how to renew board membership.....	19
C.4. Creating a legal framework: the support of government.....	20
C.5. Programming grants: innovation and accountability.....	22
C.6. Dealing with inflation: asset transfer	23
C.7. Managing assets: investment of capital	24
C.8. Raising funds:.....	25
Part III—Recommendations	26
A. Introduction.....	26
A.1. Approach to choosing among models.....	26
A.2. Suggested criteria for selecting the best model.....	26
B. Issues in choosing a model and selecting among options.....	26
B.1. The endowment's relation to government.....	28

B.2. The endowment's relation to local NGOs	29
B.3. The endowment's relation to foreign donors.....	29
B.4. The endowment's relation to local private sector.....	30
C. Role of technical assistance.....	30
C.1. Choice of models and initial design.....	31
C.2. Negotiating a Memorandum of Understanding.....	32
C.3. Technical assistance for formation.....	32
D. Support for the for-profit private sector.....	33
D.1. Local entrepreneurs and cooperatives.....	34
D.2. Joint ventures.....	34
Part IV—References.....	36
Annexes—Case Examples.....	37

PART I—BACKGROUND: THE CASE FOR ENDOWMENTS**A. Introduction****A.1. The need for sustaining support of environmental programs**

Under AID's Africa Bureau's Development Fund for Africa, the Bureau has been assisting Missions to identify and develop programs promoting improved natural resource management. Essential to the ultimate success of these programs is the sustainability of activities which missions initiate. Sustainability requires both continued financial support and maintenance of a critical mass of competent and dedicated human resources.

Environmental sector projects, especially efforts to preserve biological diversity, need patient work by skilled persons in an atmosphere of steady financial and institutional support. In other, more traditional development sectors a longer history provides a sense of which approaches work. Relatively less experience in tackling environmental problems means that stability in the level of resources committed to a long-term goal, from problem identification through to evaluation, occupies a prominent place among factors determining success. Thus missions contemplating environmental efforts should take the long view and examine what steps they can take to provide the climate necessary for sustainability. Many may well find that they will have to help found or enhance appropriate local institutions if they want to see their efforts lead to continued action beyond the life of an AID project.

AID should work with host country governments to explore options for ways to commit resources to environmental problems. A likely conclusion is that present mechanisms and institutions do not have sufficient reach and capacity to assure a long term commitment. Missions may then wish to consider helping to set up an institution which is endowed with local currency so that it can provide a secure source of funding. Because such an institution, referred to in this paper as an "endowment," would be designed to last indefinitely, it must have sound management, i.e. a capability to guard its assets, develop programs and monitor its grantees.

To be truly sustainable an endowment or other long term funding source must be as independent as possible from short sighted policies and the pressure of momentary crises. Through its priorities for use of funds, an endowment must establish and maintain a framework which provides, and encourages participation by individuals, and other elements of society in solving environmental problems. On the other hand to maintain effectiveness such a source needs methods of operation which can evolve as the absorptive capacity of local NGOs, local communities and other implementers change.

A.2. Scope of new institutions

Solutions to environmental issues demand responsible trade-offs between conflicting, but legitimate desires. No foreign donor or international NGO has the moral authority to impose a view of how these trade-offs should be worked out. Rather the society of a country must find its own solutions based on compromise which takes into account different viewpoints and balances present aspirations and future needs. A donor could push for an agreement on a particular issue, but such an agreement if it does not reflect long-standing local political and social clashes will not be very secure.

Environmental problem solving is on better footing if it occurs through a mechanism by which a broad cross section of local society can participate in a process of creating (and updating!) a national consensus on priorities and approaches. To see environmental view points flourish donors must acknowledge that ultimate responsibility rests with the society. A donor's best long term strategy may be to plant "environmentalism" at the grassroots of society and nurture its growth in the understanding that it will change form as societal values change.

If a donor created institution is to identify and address national environmental priorities, it must be able to marshal local support, both political and financial, for a national environmental agenda. Donors have a role, not of determining the priorities of this agenda, but of seeing that institutions which they help set up have a scope which is broad, i.e. supportive of efforts to preserve as appropriate, protect where necessary, and sustainably develop when possible, the nation's natural resources.

Whether preserving biological diversity or cleaning up water resources, the institution needs to provide financing which is secure in the face of shifts in national policy, political party, or donor priority. At the same time the ideal institution should reflect the evolution of national priorities as economic and social conditions change. The institution which seems most likely to meet these needs is an endowment managed as a philanthropic foundation. Specifically missions should consider the example of "community" foundations, which have boards of directors drawn from the community which the foundation serves.

A.3. Recent AID initiatives to create endowments

Within the last two years interest in endowments has grown rapidly. While AID has had the ability to work with host governments to create endowments for some time, most of this experience has been limited to endowments for individual institutions, typically an educational or research institution which needed longer term financial security than afforded by annual project funding from foreign donors (see AID publication, "Terms of Endowment," for a review of this experience).

AID's endowments have yet to address environmental issues at a national level. One reason for this limited history has been the stricture placed on AID money by its enabling legislation the Foreign Assistance Act (FAA) which prohibits an endowment from using interest income earned from depositing an endowment's assets in a bank account, whether this is in dollars in a U.S. bank or in local currency in a local private commercial bank.

The FAA now allows AID to create local currency endowments with grant money from either development assistance (DA) or economic support funds (ESF). This authorization, as stated in the Global Environmental Protection Act of 1989 and the FY 1990 Appropriations, and as interpreted in policy guidelines, specifically provides for the creation of endowments which can use interest earnings for supporting a range of activities. AID is currently exploring the application of this mechanism in the Philippines, Costa Rica, the Dominican Republic, and elsewhere. In addition, this recent blossoming of interest in endowments has led AID in Madagascar to propose creating an endowment without specific use of the FAA's time limited authority.

A.4. Why the FAA now permits interest retention in debt swaps

The FAA's explicit authorization stems from the growing interest of AID and conservation-oriented U.S. NGOs in the debt-for-nature swap. These NGOs have developed this financing technique as a kind of banker's "appropriate technology." Now after several years of debt-for-nature swaps, experience has shown the limitation of debt-for-nature swaps. NGOs which are active in programming debt-for-nature swaps have led the search for ways to overcome these limitations.

For example, one of the chief attractions for NGOs, i.e. the swap's leverage, which can multiply the exchange rate several fold, creates a problem of how to match the sudden availability of a large amount of money with well designed, ready to implement, projects. As a result NGOs are forced to keep the local currency proceeds of a swap in a local bank until they have effective ways to spend the money.

Banking the local currency proceeds of a swap in order to fund projects over a longer period of time makes it easier for NGOs to match money and projects when private sources (e.g. U.S. foundations or corporations) fund a swap. But if AID funds the swap, AID considers swap derived local currency to be project money just as other accounts of local currency "generated" in the course of AID activity. NGOs were, until the FAA authorization, prohibited by U.S. law from retaining interest they earned on such local currency.

In many countries a high rate of domestic price inflation will quickly erode the gains in the exchange rate obtained through swap leverage. NGOs might well have more money to use on projects if they kept AID grants in

dollars and exchanged them at the official rate only as they needed local currency for projects. But, such a course would rob NGOs of the benefits (e.g. leverage, publicity) which they get when they set up a debt-for-nature swap. Consequently NGOs pushed for the U.S. Congress include a special authorization in the FAA as a way to protect the swap's leveraged exchange rate.

A.5. The NPA approach to endowment creation

The rush to endow has stimulated AID to examine the possible role of endowments in the environmental area. That climate of exploration of alternatives has led to an innovative proposal in Madagascar. There the USAID mission, through the KEAPEM Non-Project Assistance (NPA), has proposed that the Government of the Democratic Republic of Madagascar (GDRM) consider using its own local currencies "freed up" as a result of the NPA grant to endow a foundation.

The use of an NPA grant as a vehicle to create an endowment offers several advantages: it does not require a debt swap; local currency is not "generated" counterpart funds; and, AID does not have a direct management oversight role in the use of freed up local currency funds or endowment financial accountability.

However, such an endowment requires a formal Memorandum of Understanding between AID and the host government which, among other points, commits the host government to finance the endowment after two parallel processes have run their course: building an institution to manage the endowment and creating through fundamental reform the legal and regulatory framework governing the operation of a philanthropic foundation. Implicit in both processes is that the host government and the local NGO community agree on the need and purpose of an endowment.

A.6. Alternative routes to endowment creation

The report presents and compares three models with reference to case examples of endowments (also termed: "trust funds") either already in operation or under development. The models are:

Model #1: The debt-for-nature route via U.S. NGO control—A U.S. NGO swaps debt, negotiates with the Central Bank and set up an endowment whose governing board's majority membership is U.S. NGOs, or with U.S. NGOs holding a veto. (example: Bhutan)

Model #2: The NPA route via local control—Local NGOs control the process of drafting a charter, setting up an administrative capacity and selecting a governing board whose majority membership is drawn from the local society.

(examples: the Ford Foundation's Puerto Rican Community Development Foundation, the AID mission's proposal in Madagascar)

Model #3: Transition of control from U.S. NGO to local NGOs—In some countries AID might consider a phased transition in control—i.e. an interim period (5 to 10 years?) during which one or more U.S. NGOs serves to incubate the indigenous capacity to manage an endowment and its programs. (example: the AID debt-for-nature swap national environmental foundation in the Philippines)

This report offer recommendations useful in choosing among the above three models as well as in programming an endowment. As the NPA model is the least well known, this report offers more analysis of this option. This report emphasizes a comparison of the advantages and disadvantages of the first and second model approaches to endowment creation, i.e. via a debt-for-nature swap and via an NPA.

This report contains less about the third model, a transition in control, because it is a hybrid of the first two models and cannot be programmed without, in effect, programming both the first and second models.

Yet another hybrid is being developed in Bolivia in which a foundation is being set up with a nongovernmental board of directors which has control over the totality of the endowment's assets with the proviso that special subaccounts are set up for special purposes. These subaccounts are in effect a form of restricted gift. This endowment has yet to be finalized, but it may offer a precedent for another way to combine models one and two above in that a particular subaccount could be created by a debt-for-nature swap for a specific purpose such as protection of a national park. Even in this case it is likely that the restriction would be time limited (25 years?) so that ultimately the local, nongovernmental board would be able to exercise full control over the money in the subaccount.

A.7. The role an endowment should be able to play

In providing long term financial and political security for the environment, an endowment, whatever its genesis, will foster new interrelationships among AID, the host government, local NGOs, and U.S. NGOs. An endowment which can play an independent role within a national society with the financial clout to advocate a long term viewpoint will work to open up governmental process to more viewpoints. Assuming such a role will mean that the endowment will be able to play a constructive and independent role in a dialogue with the government on national priorities. It will also be able to negotiate as an equal with foreign NGOs over the shape of environmental programs and projects which foreign donors and NGOs seek to promote.

However, the two primary approaches differ sharply in the ease with which this desired end can be achieved. This paper contrasts the two approaches (as well as various combinations and hybrids) to help missions choose an optimal model. Much of the analysis of differences focuses on the process of creation—who leads, who participates, and how that process determines ultimately who controls. To choose one approach to the creation sets up a bias which favors either a continued control or dominant influence from outside the country or control from within local society.

The debt-for-nature swap approach requires the leadership of a foreign NGO—first with the financial transactions, and then, if there is to be a transition, during the period of shift from foreign to local control. The NPA approach does not depend for leadership on an international NGO, but rather requires a process of dialogue and cooperation between the government and local NGOs. While the NPA model offers the chance of becoming a force for homegrown, broad-based environmentalism, it must start with broad support from local society.

A.8. The need for an endowment to maintain a societal mandate

Whether an endowment is created through the debt swap mechanism under the aegis of an international NGO or whether it grows out of a process of interaction between the government and the local NGO community, major issues will revolve around how the endowments are set up and controlled. AID will have a strong influence over the choice of which process of endowment creation. Therefore AID must help to set and maintain a balance between the need to maintain accountability to local society on the one hand and to the host government and donors, both AID itself as well as future donors, on the other hand.

In a fundamental sense the goal of an endowment must be first to empower those local NGOs which truly represent local interests and constituencies by providing them an opportunity to exercise meaningful control over an influential institution. While AID may have a strong bias toward ensuring that checks and balances are incorporated at the design stage, AID should avoid requiring controls which too tightly tie the board of directors to a fixed set of priorities and funding mechanisms.

AID should temper a desire to see a well defined procedural and management structure with the understanding that if an endowment is truly accountable to the groups it serves, then it must be able to evolve as local NGOs (and governments) grow in their capacity and as priorities change. Thus AID should look for accountability not just in procedures but in the process of creating and maintaining a mandate.

This paper offers analysis and recommendations to missions so that, whatever the process of formation, an AID initiated endowment can have the best chance to become an institution with financial and political independence.

B. Summary of experience with endowments to date

B.1. Why debt-for-nature swaps have been prominent

In Africa and in other regions, many missions and U.S. NGOs have viewed debt-for-nature swaps as an attractive option. Missions favor them because they have confidence in the managerial and administrative capacity of international NGOs. These NGOs offer a complete service: they arrange the swap with First World bankers; they coordinate the exchange of purchased debt with the host country Central Bank in return for local currency; they find a local NGO to serve as a counterpart; and, they manage the local currency to support biodiversity and conservation activities which they and their local partner program.

The NGO community has been particularly attracted to swaps because of several benefits: leverage on the conversion of their grant funds to local currency; publicity in several interest areas; and, opportunities to work cooperatively with Central Banks and private commercial banks which have traditionally not been actors in the conservation of biological diversity.

The media attention surrounding each new debt swap has given these transactions an aura of importance beyond the level of financing which has followed this route—either in comparison to the budgets of the NGOs or their financial backers. However, this aura pays dividends to the swap arranging NGOs—especially as it stimulates response to their fund raising efforts. A typical journalistic approach to a debt-for-nature swap, whether in the print or video media, inevitably centers the story around the NGO which coordinates the swap—a perception of crucial importance not only to individual contributors to that NGO but also to foundation and corporate donors.

None of these donor groups—the public, foundations or corporations (including banks)—have ready alternatives to these NGOs, which are incorporated under U.S. tax law as 501(c)(3) non-profits. Under U.S. law tax deductions for charitable giving are tightly defined and regulated. The effect of this close scrutiny has been that donors opt for the most conservative route in giving and choose to give almost exclusively to organizations which maintain a tax exempt charitable status under U.S. tax law.

However, AID's experience in developing countries gives it a wide array of options for delivering financial support. That body of experience gives AID missions the perspective to base their natural resource programming on an

objective comparison of debt-for-nature swaps with other mechanisms of dealing with environmental needs.

B.2 Limitations of debt-for-nature swaps

Even the groups which advocate debt swaps acknowledge limitations such as: the lack of buyable debt; a swap's inflationary impact (and conflicts with IMF mandated efforts to control the money supply); as well as the difficulty in administering and programming a sudden and large infusion of local currency. With more experience with debt swaps—especially those tied to biological diversity—other criticisms have been heard: lack of participation by either local NGOs or communities in and near areas proposed for protection; the growth of a perception among the leaders of local society that environmentalism is a foreign agenda; and, perpetuation of a senior-junior relationship between foreign NGOs and local NGOs.

Another problem is that the technique of the debt-for-nature swap has tended to take precedent over the patient, less glamorous work of program development. The negotiations necessary for arranging a debt swap must take place according to the pace of business of the international banking community and in response to market opportunities for getting a favorable leverage in a debt purchase. In other words the process of making a swap drives the program funded by the swap rather than the reverse. In such an atmosphere it is difficult to find and follow a process which provides local communities with a sense of ownership and control over activities.

Nonetheless, the debt-for-nature swap, in the tradition of appropriate technologies, has acquired a life of its own as a programming approach. Whatever the problems in implementation, swaps continue to pay multiple dividends for debt swapping NGOs which continue to press for more transactions and more public funding for swap deals. It behooves AID to examine carefully the stated aims of a proposed swap to compare a swap with alternatives. If an endowment is the goal, then the use of an NPA related process offers a clear and often preferable option if a goal is constructing a institution with widespread participation in advance of funding.

B.3. The analytical framework of this paper

Whatever the financial and institutional mechanism chosen, a mission should aim to create a more stable base, both financially and politically, for the support of long term efforts to conserve and preserve the environment. This long term goal defines the set of needs which any proposed mechanism must meet. This set of needs provides the context for the analysis of this paper.

This paper analyzes issues surrounding the use in Africa of local currency endowments or trust funds and offers recommendations for use by missions and mission contractors as they design projects using either the FAA endowment

creating mechanism or the NPA precedent now under consideration in Madagascar. This paper will describe these two models as well as possible hybrid approaches. The focus is on the process and what programming issues will have to be considered.

PART II—UNDERSTANDING OPTIONS FOR ENDOWMENTS IN AFRICA

A. Setting criteria for choosing design options

Virtually all environmental programs could use an endowment mechanism which provides long term funding as a key way to ensure sustainability. In the case of efforts to conserve biological diversity it is particularly important that this mechanism have a strong base of support within local society which allows society to participate in setting national conservation priorities in the context of national environmental and developmental goals. A local currency endowment is a preeminent choice for such a mechanism. Design options need to be judged to the extent that they meet the following three needs:

A.1. Long-term funding—beyond fads and the project cycle treadmill

Whatever the endowment creating option chosen, the mission should develop a detailed strategy to ensure that the endowment will have adequate financial and program management. This need is particularly important because:

1. long term security of funding requires sound management of the endowment's principal to ensure a steady income; and,
2. an endowment created via the NPA model would, once established and funded, not be subject to AID oversight—unlike existing local currency accounts over which AID has a continuing management role.

Whether the path chosen, the ultimate aim is to make support of conservation and renewable natural resource management and development activities less vulnerable to: 1) changes in AID's priorities; 2) evolving relations between host country governments and foreign donors; and, 3) host country political and policy shifts.

The endowment mechanism offers a clear advance beyond traditional options. Currently an NGO, whether U.S. or local, can only get AID funding in so far as there are more or less immediate prospects of spending that money on specific projects; moreover, AID funding is linked to specific project activity. Any interest earned on AID monies (either as dollars or local currency) while it was being held by the NGO waiting use for a project had to be returned to AID. The FAA now allows AID recognized non-profit non-governmental organizations (NGOs), or as AID terms them, private voluntary organizations (PVOs), to create endowments and keep interest earned on grant funds to be used to support general areas of project activity. Similarly the NPA mechanism also allows for interest earning accounts to be set up.

AID's Office of the General Counsel has interpreted the FAA authorization to allow AID to contract with either a U.S. based NGO or one incorporated in the host country for arranging a debt-for-nature swap. So far missions have worked exclusively with U.S. based NGOs, which missions find to be attractive mechanisms for arranging swaps. AID missions could continue to make grants to international NGOs who serve as intermediaries for the procurement of local currency through swaps for the new purpose of endowing institutions for long term support of environmental and conservation activities. However, as local NGOs continue to improve their project capacity, they are likely to see such a mechanism as limiting their participation in national policy dialogue as well as inhibiting their realization of their role as partners with their own government in environmental activities.

If the goal is to provide the most secure base of funding for the long term, then it seems prudent to provide a funding base for local NGOs which is independent of, and complementary to, the funding resources available to the international NGOs, i.e. foundations, corporations, and the concerned public of the developed world. Further, growing tension between NGOs of the North and South over issues of program direction and management mean that AID should not rely exclusively on First World NGOs.

The primary alternative to use of a U.S. NGO would require AID to get a host government to agree to create an endowment as part of an NPA reform agenda. Because this is a relatively new option, which has only been proposed in Madagascar, much of the analysis and recommendations of this paper will address issues related to this innovation so that missions will be able to evaluate this relatively less well known option fairly in comparison to better known mechanisms such as the debt-for-nature swap.

A.2 Increased participation—beyond top down to empowerment

Sustainability of natural resource management can not be assured by a focus on technical and scientific aspects of problems alone. Viable solutions to environmental issues, perhaps more than other development issues, require that leaders and leading institutions of society become actively committed to the process. While a strong governmental commitment is needed, government actions alone cannot assure sustainability. Needed is the active participation of as broad a range as possible of people and constituency based local NGOs in the facilitation and implementation of environmental and conservation activities.

If the debt-for-nature swap route is chosen as the means of creating an endowment, then the intermediary organization chosen to arrange the debt swap is likely to play a dominant role in the process of designing a management and administrative structure. The direct endowment option would allow for a broader range of NGOs to participate in the setting of priorities for

endowment funding areas as well as to receive the benefits of sustaining funding support from the endowment.

The process of forming a Board for the endowment (under both options) is crucial to the participation question. If the process is open to all local NGOs which represent constituencies within society, then a broad range of NGOs would be much more likely to participate in the endowment's activities. On the other hand, if the formation process is limited to a few and conducted in secret, then many NGOs might well view the result as an institution under the control of a small, elite group.

Long term stability of the management of renewable natural resources requires that the understanding of environmental principals and the will to act in the long term interest of a nation's resource base become widespread within society. To do so requires that an endowment be set up and managed by individuals and organizations seen by the public as holding the public interest foremost. The growth of "grassroots" support also requires that the government recognizes the value of the endowment's activities and provides a supportive regulatory and legal framework for the endowment. In other words the endowment must gain and keep "legitimacy" both in the view of the people and the government.

The concept of a locally managed endowment derives from three bodies of experience, which are: the community foundation concept (see box on Puerto Rico); AID's local currency endowment (see box on the Philippines); and the Enterprise for the Americas mandate to create local environmentally oriented foundations in Latin American countries. In all of these cases the fundamental concept is to give local communities a long lived institution which is managed by and for the people of those communities, whether at the level of the nation, a region, or a local community. This concept may be termed a "democratic" foundation. In the U.S. this concept most closely parallels the "community" foundation which is meant to imply that the foundation's board is drawn from the community it is intended to serve.

In the U.S. the community foundation concept is widespread and offers many examples of purpose and ways to establish and operate. There are community foundations dedicated to public education, local arts, community services, poverty alleviation, civil rights, as well as local environmental problems. Many community foundations were established by local philanthropists, others by church councils and social service organizations as cooperative funding vehicles. Many have as an explicit purpose the empowerment of disadvantaged communities. This body of experience offers lessons in how to conduct a process of recruiting a board of directors which the community the foundation is intended to serve can accept as representative.

The Enterprise for the Americas Initiative calls for the establishment of local currency endowments managed by a nongovernmental board of directors

in Latin American countries which conclude a debt restructuring agreement with the U.S. Government. At the moment several Latin American countries have made proposals for such an agreement, but no endowment has yet been set up.

A.3. Innovative mechanisms—beyond donor aid to direct grant-making

Supporting sustainable development and renewable natural resource conservation will require long term aid for finding and nurturing new ways to encourage individuals and communities to view their resource base as a trust to be cared for in light of the needs of future generations. These new mechanisms may include decentralization, stronger NGOs, innovative partnerships among NGOs and government agencies, and new roles for the private sector. Supporting these new directions should be an endowment capable of seeking creative sources of funding from both local and non-national corporations and communities and persons of wealth.

For example, the endowment could support decentralization strategies in several ways: it could fund NGOs which are able to work with local communities in identifying resource problems and opportunities, provide technical assistance, and help to form cooperatives for credit, inputs, and marketing. Since many of these strategies would involve closer collaboration between NGOs and governmental extension agents, the endowment's support would create an indirect incentive for governmental agencies to strengthen their field presence in order to fulfill their role in partnerships with local NGOs.

The endowment, however, needs to recognize and support NGO-based activities which contribute to sustainable use of renewable natural resources. Presumably the endowment would support NGOs in these efforts through long-term institutional development, training, information gathering, and planning. This strengthening needs to occur at two levels. At the grassroots, the NGOs which serve local communities' needs should have sustaining support. NGOs which work at the national level should have their ability to articulate policy alternatives enhanced. Further the legal and regulatory framework for their activities needs to be defined clearly. The endowment would be able to serve these two levels directly in the form of sustaining financial support as well as indirectly through Board level decisions which set priorities for environmental problems and approaches.

Renewable natural resources management problems are intimately linked with problems of economic development, poverty alleviation, livelihood creation, social organization, etc. Solutions to these problems require innovation, cooperation, and the mobilization of all sectors of society. Success will come about in different ways in different societies; however, in all cases success depends on creating and sustaining cost-effective ways to tackle

renewable natural resources problems and economic development opportunities. New partnerships will be necessary.

The endowment must be able to respond to opportunities to try new ways to manage resources with whatever combination of institutions and services is most effective. These combinations may be partnerships or formal collaborations between public and private sector, between NGOs and entrepreneurs, between NGOs and government agencies, etc. Therefore, even though the guiding purposes of the endowment have specific ends, the endowment needs to be able to support innovative partnerships which can find and demonstrate the most effective approaches to renewable natural resources management problems. Thus both the endowment's charter and government regulation need to allow for the broadest possible array of actions.

B. Summary of two major endowment models plus hybrids

This section reviews the two major models and describes the steps involved in designing projects which incorporate endowment mechanisms. This section also gives an overview of what the elements of an endowment structure might be.

B.1. Model #1: Use of debt-for-nature swap to create an endowment

The traditional "debt-for-nature" swap involves the following steps which are usually taken in the order given (note that variations are possible):

- i. A donor makes available cash in a hard currency (say 1,000,000 U.S. dollars) to a U.S. NGO, i.e. a non-profit recognized by the U.S. Internal Revenue Service as a 501 (c)(3), for the purposes of funding a conservation (or sustainable development) project in country X.
- ii. The U.S. NGO negotiates in advance with the Central Bank of country X for a swap "quota" (say \$5,000,000 in face value of debt) which would allow the NGO to swap notes it would purchase for local currency obligations of the Central Bank at a set exchange rate. Note that this swap may occur in several tranches up to the total of face value agreed to by the Central Bank.
- iii. The U.S. NGO then goes to the secondary market in the debt of country X to purchase Central Bank obligations from U.S. commercial banks at the prevailing market discount of 60% in country X (i.e. buys notes with a face value of \$2,500,000—note that the market discount is different in different countries and varies over time in each country as a result of many factors, including political change, shifts in international commodity prices, debt

restructuring plans, as well as the supply of money from donors for the purchase of debt instruments in the secondary market).

- iv. The U.S. NGO then swaps the notes for local currency obligations of the Central Bank, usually at a redemption discount on the official exchange rate, say 20%, and often with staggered dates of maturity and interest (thus the U.S. NGO in country X would get a package of obligations worth \$2,000,000 in the local currency of country X).
- v. The U.S. NGO then turns over the local currency proceeds of the swap, whether in cash or Central Bank bonds to its counterpart local NGO which may or may not be an affiliate of the U.S. NGO for funding of a program of conservation activities, typically including some or all of the following: surveying biological resources of particular note, determining what land is worthy of status as a national park or protected area, buying land found to be prime habitat for endangered species, setting up park management plans, sponsoring research into endangered species and their habitat, paying for the services of park rangers and guards, educating the public about conservation, training park staff, employing local residents as guides, informants, etc.

Each of the participants in a "debt-for-nature" gains a benefit: the donor gains a bigger impact from its grant through the leverage of the secondary market discount; the international NGO gains funding and valuable free publicity from arranging a swap; the Central Bank of country X retires debt; and, the local NGO partner (or affiliate) of the international NGO gains support.

B.2. Model #2: Use of NPA conditionality to create an endowment

Because the process of writing a NPA PAAD, or program document, follows a sequence parallel to the writing of a traditional project paper, there is ample opportunity to explore in systematic fashion a process for the use of freed up local currency funds for creation of an endowment. The process is similar to a debt-for-nature swap in that there are multiple parties involved and that local currencies wind up in an endowment managed by a local corporation. However, a major difference of great interest to AID missions is that the local currency is "freed up" rather than "generated." There is no "swap."

In an NPA arranged endowment the host government agrees to use its own revenues of local currency, which had been budgeted to use for the purchase of foreign exchange to pay debt service, and give it to the endowment. As these local currencies are not generated as the direct result of an AID grant, then AID has no fiscal or programmatic responsibility over the use or accounting of those funds.

The NPA endowment process follows these steps:

- i. AID offers a hard currency NPA grant (say 10,000,000 U.S. dollars) to Country Y with the intention of making the grant conditional on a series of policy reforms in the natural resource area.
- ii. As part of the process of writing the NPA agreement, the design team develops a list of reforms and a best estimate of the cost of these reforms to Country Y's national budget. One reform could call for the host government to work with the local NGO community to develop a plan for an endowment. In a hypothetical case if AID and Country Y agree that all other reforms would cost \$5,000,000 worth of local currency, then \$5,000,000 worth of local currency would be available for capitalizing the endowment.
- iii. As a part of the NPA agreement AID would negotiate with Country Y a memorandum of understanding (MOU) which covered all aspects of creating an endowment. On the financial side the MOU would set out the terms under which Country Y's Central Bank would agree to turn either cash or notes or a combination over to a legally recognized entity when that entity is acknowledged by both the host government and AID to be the product of the formation process.
- iv. The MOU would detail a formation process which would involve a broad grouping of local NGOs. The MOU would also commit AID to fund (or arrange funding) for technical assistance for a period of two to three years to work with the local NGO community to develop a plan, a charter, an administrative structure, and a board of directors for the endowment. Perhaps this TA might cost \$250,000. The source of the TA would likely involve expertise from the U.S. development community experienced in working with local PVOs/NGOs, the U.S. foundation community, and the international community of NGOs concerned with a broad spectrum of environmental issues.
- v. Via the MOU AID could require that certain program areas be given primary attention. However, such restriction need to be broadly sketched so as not to constrain the latitude of the new endowment's board to develop its own approaches and goals. The new endowment should be able to accept donations either in foreign exchange or local currency to extend and enhance its programs. Host country tax law may need review and reform to encourage this fund raising as the potential to raise additional funds serves as a powerful incentive to maintain the highest standards of accounting and administrative control.

B.3. Model #3: Hybrid or intermediate approaches

Other approaches which combine aspects of the debt-for-nature swap and NPA conditionality are possible. The variety is limited only by the creativity and openness of the process of negotiations between AID and the host government. In the Philippines, the mission is now (October 1991) eighteen months into the development of a hybrid approach (see case examples).

The AID mission, the Government of the Philippines and two consortia of local Philippines NGOs agreed on a process by which a board of directors dominated by local nongovernmental leaders would be selected as the governing structure for the endowment. The funds for this endowment would be generated through a "debt-for-nature" swap to be carried out by a U.S. NGO—the World Wildlife Fund (WWF). All parties have agreed that WWF will eventually turn over management of the endowment funds to the board once the administrative structure capable of managing the endowment, its assets and grant making operations, has matured.

The Philippine experience offers lessons about how a process involving an equal say for the local NGO community can be started and conducted. This case example combines aspects of an NPA with the traditional debt-for-nature swap. The money will be moved via a U.S. NGO, but the swap will be linked to an NPA policy reform program which does address some of the policy (and regulatory) questions surrounding the activities of the NGO sector. In many aspects the Philippines offers a transitional example which has led to the Madagascar example—the first AID use of the NPA mechanism to cause an endowment to be created and funded and to encourage the host government to reform its policies so as to provide a regulatory and legal framework fully supportive of the aims and operations of the endowment. Recommendations for developing hybrid models are given in a later section.

C. Concerns to be addressed when setting up endowments

There are three principal categories of issues which must be addressed in the process of setting up an endowment whether the approach is via a U.S. NGO or through a process more controlled by local NGOs. These areas are: manpower, finances, and regulation, which, broadly defined, covers the milieu of regulatory constraints, laws and policies in which an endowment will function. These three areas are used as categories for the recommendations section, which follows after this section.

This section identifies and discusses concerns which are likely to arise in the course of designing an endowment whether that endowment is created via a U.S. NGO through a debt-for-nature swap or via a NPA grant through action of the host government. Many of these concerns are traditional ones which every institution building project must address. These familiar issues include:

draining available human resources from other critical efforts; setting up reliable, but not burdensome accounting procedures; minimizing rivalries within the NGO sector; etc.

Other issues which will differ in their importance for the two models are: conflict between international and local NGOs on leadership; fear of a decrease in foreign aid donations in general and for Africa specifically; and, the struggle for more democracy.

C.1. Getting a mandate : a participatory process for selecting a board

The primary reason for an AID mission to consider an endowment stems from the need to build a solid base of support from within society for the purpose of making and supporting a long term commitment to the solution of environmental problems. Achieving the endowment's *practical* purpose, i.e. long term commitment to environmental goals, requires that local communities identify with this purpose through *participation* in shaping the endowment policies and programs. An endowment of the sort envisioned in this paper will, if successful in this aim, become an important force for democracy in that society.

If the endowment's purpose is able to evolve in response to changes in the social, economic and resource conditions, then the opportunity for popular participation must be real and open ended. This need for participation effectively rules out a governing structure over which the host government retains a veto. However, at the same time, governments have legitimate interests in how the endowment manages its finances and evaluates, selects and monitors grantees.

An effort to found an endowment must simultaneously follow a process to establish a governing board and rules of governance independent of the government as well as a process to define the relationship between the endowment, its finances and operations, and the government. In the first process society defines the endowment's mandate and in the second the government legitimizes the endowment's scope of operation.

Each process needs to be guided by early decisions about the desired end product. For example, the major question concerning the board's make-up revolves around how best to ensure that board is free enough to rise above the "web of obligation" yet structured enough so that through time as board members change the overall composition of the board does not drift toward a particular viewpoint, i.e. become a runaway board.

When an AID mission considers the suitability and practicability of setting up an endowment, it should view these two processes not as independent tracks, but rather pay particular attention to the links. For example if the board of directors has only non-governmental persons, then the

government might legitimately ask for a thorough case-by-case accounting of endowment operations. On the other hand if the government is guaranteed a permanent voting presence on the endowment's board of directors, then the requirement for detailed audits for the government may not be necessary from the government's viewpoint. Of course, in both cases funders, both present and future, would have their own requirements for accounting.

C.2. Achieving creditability: models for board organization

The importance of the process of board selection cannot be overemphasized. The board will be responsible for all decisions affecting the progress of the endowment, including: personnel, investments, grants, and priorities. They are ultimately responsible for maintaining good relations with all the groups important to the endowment, including: foreign donors, local and international NGOs, the host government, local and international private sector. They must start, through the selection process, with a mandate from their local NGO community and build credibility with the other groups listed.

Two concerns should guide board selection. One is the need for accountability and the second is the need for independence. From these two viewpoints, the first question to address concerns the makeup of the board and what restrictions are placed by charter on its members. A board of trustees can follow one of several models. Missions might consider endowment charters specifying boards whose members:

1. Represent different interest groups or organizations
2. Select their own replacements
3. Occupy seats with different and restricted qualifications

These types of boards, respectively known as: "representative," "self-perpetuating," and "restricted," are not the only ways an endowment's charter can specify for the initial selection and periodic replacement of a board; however, these do cover the major options. The following section discusses what each model implies for the replacement of board members. A study of the process of replacement will illustrate the factors which need to be considered when considering the restrictions placed on a board.

C.3. Maintaining creditability: how to renew board membership

Foremost is the need to find and continue to find replacements candidates for board membership who have a demonstrated ability to think creatively with a minimal obligation to a fixed point of view or philosophy or a particular group. A representative board would likely tend to reinforce a members obligation to the group which chose him or her. Even if members were to be limited to only one term, the possibility of that member returning to that group will exert a strong influence over that member's decisions while on the board.

On the other hand a purely representative board would more likely keep the endowment from drifting or evolving in its understanding and priorities. Such a drift would only be possible if the groups chosen to select board members become marginalized in the local NGO community.

Self-perpetuating and restricted boards would expect that their members would be less bound by old associations with particular philosophies. The self-perpetuating board would be the freest in this regard, but the danger is that it can over time and replacement drift to extreme positions. In the U.S. there are cases of non-profits whose boards developed particular views which were extreme in the context of the times and mainstream social concerns. In the U.S. experience, contributions, both from the public and foundations, declined as the board drifted. However, in the case of capitalized foundations, such as most major U.S. foundations, the role of gifts is less influential in maintaining a check on board drift.

The restricted board offers a compromise between the self-perpetuating and representative board. The charter of an endowment may specify specific seats on the board with special qualifications, e.g. experience of a minimum period in the community development field, residence outside the capital city of specific duration, indications of leadership on particular issues as evidenced by published articles or speeches, etc.

As U.S. experience offers few examples of boards other than self-perpetuating (although a few U.S. environmental organizations have boards elected by member groups), it seems wise to look to local traditions of self-governance for inspiration. Boards whose membership selection derives at least in part from local models may offer promise of wider acceptance locally; however, this gain needs to be weighed against the same need for international donors to see a structure recognizable from their own experience.

Whatever structure and scheme for selecting board members, AID needs to face another issue early in the endowment design process—the question of how broad a base of experience will the endowment be able to tap. In essence the question is: Does the endowment derive its mandate only from environmentally-oriented NGOs or from a broader constituency, such as women's groups, local community organizations, etc.? If the fundamental purpose of the endowment is to plant the seed of environmentalism at the grassroots of society, then it would seem necessary to include as broad as possible a range of groups. And, this broad range needs to be included both in the process of establishment (writing a charter) as well as in the selection of the board.

C.4 Creating a legal framework: the support of government

Early in the process of design the host government's commitment to the need for an endowment must be obtained. If a mission can get a solid

expression of support, then a process (described above) needs to be started to review national law and regulation governing the entire NGO sector. The goal of the the review process is to define as clearly as possible what the current regulatory and legal framework is as well as what specific reforms are needed to remove impediments to the activities of the endowment or its anticipated community of NGO grantees.

The reforms should cover a series of issues which arise out of the operations of NGOs, including endowments. The review should explore every aspect of the current and desired relationship between NGOs, including endowments, and the government. Assuming that the host government as a matter of explicit policy seeks to encourage the activities of NGOs, then the first issues deal with the definition of NGOs.

Missions are most likely to be familiar with the U.S. tradition of NGOs, which are known as non-profits which have a charitable or public purpose and do not have shareholders. In many countries the term "non-profit" is not used, but rather the term "non-stock" which reflects the lack of ownership.

Governments also categorize NGOs by definitions of purpose which are supported or recognized as acceptable. Typical purposes are: public education, policy studies, advocacy, research, community service, information exchange, promotion of cooperatives, etc. There is a similar broad range of issues which NGOs may address, including environment, women's issues, human rights, etc. Note that most countries will have definite, but not necessarily clearly declared, views on which types of purpose and which range of issues they find acceptable.

Endowments are a special type of NGO or non-stock distinguished by the fact that they hold assets and are expected to manage those assets in such a fashion so as to be able to provide a steady and increasing amount of grant money to target NGOs and other entities. Crucial to an endowment's success is the development of laws and regulations which exempt the endowment from paying taxes on its income from investment of its assets.

Perhaps the most straightforward approach would be for governments to provide endowments with tax exemption on earned income in return for oversight by an agency of the host government. The decision as to what kinds of oversight and which agency has the responsibility need to be determined on a case by case basis in each country. The recommendations section suggests options.

A second area of tax issues relates to laws which regulate the endowment's solicitation and acceptance of gifts from foreign donors as well as local corporations and persons of wealth. In many countries, it may be feasible to establish tax incentives which encourage domestic corporations as well as

foreign companies operating in the host country to make gifts to the endowment.

If it is determined that there is a need for reform, then AID should be prepared as either part of the natural resources NPA or via follow-on TA to work with the host government to develop a reform agenda. This agenda needs to avoid simply copying U.S. or any other developed country tax and regulatory framework, but rather tailor recommendations to the specific conditions of each country.

C.5. Programming grants: innovation and accountability

If a central purpose of an endowment is to provide support for innovative action, then procedural barriers to new approaches and methods of funding need to be minimized. At the same time flexibility in management must not compromise accountability—both to the peer community of local NGOs or to donors. No type of activity should be ruled out of bounds *a priori* without clear reasons presented by donors which the NGO community understands and accepts.

Missions which seek to engage host governments and local NGO communities in discussions of the need for and structure of endowments need to write down general guidelines for what the endowment would do, and these guidelines should relate more to the type of organizations to be supported rather than to the particular technology or technique to be used. An outline of the scope of programming activities should start with several statements of general aims, e.g. the endowment seeks to reach a broad range of NGO types and an ever increasing number of individual organizations and/or the endowment seeks to develop NGO capacity as regards financial management, activity planning, and project direction. A statement about the range of NGO activity AID will support should include (or explicitly rule out) public education, research, credit mobilization, training, advocacy, lobbying, political activity, etc.

The specific sectors to be supported need to be subject to review and modification by the board. Such a policy, which is necessary for truly local control may lead to conflicts with donors more interested in specific issues rather than the growth of local institutions dedicated to grassroots determination of priorities. For example the board may decide that biodiversity should be less of a priority than other environmental needs, e.g. community waste recycling. In this situation a potential donor may well be reluctant to endow a program whose purpose could be changed. In such cases, it may be possible to negotiate time-limited program restriction on donor contributions to an endowment which would give the donor agency assurance yet not negate the principle of local control

The endowment's charter needs to be rooted in the philosophy that participatory processes should and do have great influence on the setting of priorities. Such an emphasis is necessary to maintain the endowment's mandate and to counteract the history in many countries of the effect of incidents when international groups have claimed that their advocacy of particular priorities was derived from unassailable "scientific" analysis. Unfortunately in many situations scientific analyses are prepared by experts only which meant that the results of the analysis did not take into account local needs and aspirations. In order to guard the endowment's credibility in the eyes of society, the charter should emphasize ways to set priorities, choose grantees, etc., which seek to combine local input along with other sources of analysis.

C.6. Dealing with inflation: asset transfer

In either approach to the creation of an endowment, AID (and an AID recognized U.S. PVO or NGO in the case of a debt-for-nature swap) will have to negotiate with the host government the terms of endowment. In the debt swap traditionally the U.S. NGO deals directly with the host government's Central Bank to set the terms of the swap, i.e. the discount rate, the period of maturity of notes if it is not a cash transaction. A concern of the Central Bank is the inherent inflationary impact of a swap which involves an increase in the money supply. AID is often indirectly involved in these negotiations as a member of the donor committee for the host country.

A typical donor committee is concerned that a country maintain low inflation of domestic prices, a stable money supply, and sound Central Bank policies. At times many issues can become entangled. For example, if a Central Bank opens a debt swap window for the purposes of attracting investments, they may find that it serves more to allow persons of means to repatriate their holdings of foreign exchange at an exchange rate premium. Such a phenomenon could adversely impact the poor through domestic price inflation. Thus both Central Banks and donor committees look carefully before taking steps which encourage large amounts of debt swapping.

Use of the NPA vehicle would eliminate an increase in the total money supply as the local currency used for the endowment would come from money already raised as revenue by the host government. However, if all this cash were released into circulation at one time, there could be transient inflationary pressure. Such pressure could have adverse effects in countries without exchange controls as it could stimulate imports of goods and services. The inflationary impacts of endowment creation can be minimized in several ways.

If a mission pursues the NPA model, then it is likely that the host government would favor an endowment which was established with assets combining cash and notes of the Central Bank according to terms set out in the MOU. One scenario would be for the Central Bank to issue notes which have a

staggered series of maturities lasting several years. In order to protect the endowment from loss of value of the notes, the Central Bank would pay interest at a rate several points over the rate of domestic price inflation as published by the World Bank annually. This rate, called the "indexed rate," would be set in the MOU and in the notes themselves. The notes would be assignable in order that the endowment may be able to sell them or deposit them with a local private commercial bank as loan collateral in order to raise cash if needed in advance of the maturity dates of note. Being assignable also affords more protection against default in payments.

If the debt swap route is favored, one way to minimize inflationary impact is for the swapping NGO to purchase foreign debt of a large company such as the national telephone company or electric power company. Because this debt is often guaranteed by the Central Bank it usually sells for the same discount in the secondary market as sovereign debt of the Central Bank. Consequently the Central Bank would still have to approve a swap, but the inflationary question could be finessed by swapping the debt not for local currency, but for equity in the private company. These shareholdings could immediately become the endowment's capital. As the endowment needed cash, it could sell the shares for local currency. The net result is little pressure to increase the inflation rate.

A similar swap may be arranged in countries where the host government is in the process of privatizing national companies. As part of the privatization deal, the endowment could be given holdings in the publicly offered stock of the newly private company in exchange for foreign debt purchased at a discount.

C.7. Managing assets: investment of capital

The financial *raison d'être* of an endowment is to protect the value of assets while generating income from the use of those assets through investments. There are numerous options open to the managers of the endowment's assets. Among these are: deposits in local private commercial banks, holding of government bonds or notes, equity or debt of established national companies (e.g. the telephone company), real estate, etc. The mix should be determined within broad limits set out in the MOU and charter.

One option, which has been proposed in Madagascar, calls for the endowment to hold the majority of its assets during the first five to eight years of its existence in government bonds which pay interest at a rate several points over the rate of domestic price inflation. Such indexed bonds would protect the value of the endowment and help to ease any problems arising from a too sudden infusion of cash into small economies. One proviso proposed in Madagascar is to allow these bonds to be traded to minimize the risk of governmental default.

The managers of the endowment's assets need to be able to draw on financial expertise from both local and international sources. Such expertise can advise on: appropriate investment strategy, innovative approaches allowing for investments to be related to the endowment's grant programs, and on monitoring of conflicts of interest.

C.8. Raising funds:

The endowment has the potential to raise money for its purposes and for increasing its capital assets from a wide variety of sources. These include: other aid agencies; the multilateral development banks (MDBs); the Global Environment Facility (GEF); multinational corporations; local corporations; individuals of wealth; direct solicitation from concerned citizens of their own country as well as of First World countries; etc. The potential of such endowments to raise funds in such a wide variety of ways has several important implications. One change is to provide a vehicle, which is missing in many countries, to raise money from the local private sector. Another is to provide a broker-like service for matching funders from inside and outside a country.

One example will illustrate how important having such a fund raising capability can become. If in a country with significant earnings from international tourism, the endowment were to develop over time lists of tourists, these lists might yield significant annual income from contributions in response to a direct mailing, much in same manner direct mail solicitations yield substantial income for U.S. non-profits. Further, such lists, which might be formalized as an organization of foreign "Friends of Nature of Country Y," could become a market outlet for a carefully chosen set of "green" products produced by cooperatives or NGO assisted local communities or even fledgling businesses.

Before direct fund raising in the U.S. is considered the endowment will have to review options for preserving the charitable deduction which individuals and corporations can receive if they give money to a U.S. incorporated non-profit. At the moment there are few precedents for how this can be achieved. The most straightforward is to incorporate in the U.S. Another is to form a long term relationship with a U.S. non-profit so as to be able to use their 501(c)(3) status with the IRS. This question does not arise with U.S. foundations as they can declare that the endowment (or any other local NGO) is the equivalent of a 501(C)(3) in its function and purpose.

PART III—RECOMMENDATIONS

A. Introduction

This section offers recommendations for missions in choosing among the models, designing an endowment structure, and providing technical assistance for building up the institution to the point where it can function.

A.1. Approach to choosing among models

Any proposed approach to establishing an endowment will require that a number of groups be involved and become active supporters of the effort. An endowment cannot be designed in isolation from these groups and their legitimate interest in how the design is done, how the board is selected, and what the ultimate institution can and cannot do. These groups are: the host government, the local NGO community, the foreign donor community, and the local private sector.

Other groups may have roles depending on the model approach taken. These others are: foreign NGOs (both those which are engaged in debt-for-nature swap activities and those which are active in policy advocacy), multinational corporations, and U.S. philanthropic foundations. The recommendations of this section are organized according to how the endowment relates at all stages of its development to these groups.

A.2. Suggested criteria for selecting the best model

Table I shows a matrix of actions recommended for an effort to choose a model and design an endowment. The groups at interest are listed along the left side of the matrix, and the areas of concern are listed across the top of the matrix. In each box of the matrix are actions which the AID mission and its contractors and consultants should take as part of the process. The idea of the matrix is that the recommended action will, at least in part, help to answer issues the group at the left of the row will likely raise about the concern at the top of the column. The following section discusses briefly the recommendations contained in each box of the matrix of Table I.

B. Issues in choosing a model and selecting among options

The following subsections discuss the major questions which will arise in discussing how AID goes about the process of setting up an endowment. The three areas under which concerns are collected are: people, money, and regulation, which covers policy, laws, and contractual restrictions associated with gifts to the endowment.

TABLE I

Matrix of Recommended actions AID missions should consider when designing an endowment

	People	Money	Regulation
Host Government	Avoid salary structure which would drain skills from government	Establish laws allowing tax exempt earnings on investment of endowment assets	Demand agreement on guidelines for permissible activities and categories of grantees
Local NGOs	Seek active participation of local NGOs in the process of forming a board	Develop peer review input into grant making, monitoring, and evaluation	Invite regular dialog with local communities on endowment's priorities
Foreign Donors	Provide access to technical assistance as free as possible from biased viewpoints	Develop way to provide routine documentation needed by donors	Set clear policy on acceptance of restrictions on donor gifts

This table's recommendations are arranged by groups which have important roles to play listed along the left edge and three areas of concern about their possible role listed across the top.

People: Human resource development and manpower allocation have been traditional concerns of AID. In most countries the lack of skilled persons limits the growth of new institutions. Even in situations where the number of skilled persons is sufficient, often the need for advanced training, whether degree or non-degree, slows the pace of development.

Money: Maintaining adequate accountability for project management presents constant worries to AID. There is a tension between the need to have enough flexibility to pursue creative ideas and the need to have reliable systems for accountability. The recommendations of this section emphasize innovations which have incentives built in to establish and maintain accountability.

Regulation: Endowments operate within a framework of rules which are set by donors or contributors of gifts, the host government and the endowment's own charter. The key feature which distinguishes an endowment and allows, even requires, it to behave in ways which are unlike traditional NGOs or other public sector institutions is its ability to moderate the application of those rules. The endowment's board can amend the charter; the endowment can use its own financial resources as leverage in negotiations with donors over gift restrictions; and, the endowment as a democratically controlled institution set within the NGO community can speak effectively as that community's representative in dialog with the host government over policy and regulatory issues—especially including the legal framework which governs the endowment's operations.

B.1. The endowment's relation to government

Missions should be careful to avoid draining off critical skills and talent from ongoing and equally critical government programs as well as already established NGO activities and projects. Design teams should be instructed to justify salary levels and number of professional staff in the context of prevailing rates and shortages of manpower. If the endowment is set up as part of an NPA, then it is likely that the issues of civil service salaries would be a subject of analysis as part of the NPA reform agenda.

A critical aspect of the relationship between the endowment and the host government is the tax status of earnings which the endowment receives on investments. It is likely that most host governments do not grant a tax free status to a foundation-like endowment. An NPA established endowment could easily include such a reform justified on several bases: the need for NGOs in general to engage in and promote income generating activities in connection with natural resource management projects; the need for a foundation-like endowment to bank its assets and protect them from loss of value from domestic price inflation; and the need (see B.4. below) to push the private sector in the direction of "green" business development by selective and limited use of assets to invest in such business ventures.

Host governments which are persuaded of the value of a strong and creative NGO sector should be willing to write broad but clear guidelines which set out the activities and issues in which NGOs may legally engage. The NPA route to endowment offers the possibility of setting up a process by which the NGO community can participate in a structured way in the reform of national law and regulation. A debt-for-nature swap does not require such a process, but increasingly (e.g. Bolivia, Peru) the dialogue on setting endowment priorities includes a broader cross section of groups and viewpoints.

B.2. The endowment's relation to local NGOs

The endowment needs to cement its good relations with the local NGO community in several ways. The first way is to seek to include a broad range of groups in the process of formation. As has been described earlier, the endowment's credibility rests on its mandate from the community it serves. Preserving a mandate means that the endowment will seek ways to increase opportunities to work with the NGO community.

One way to build working relationships is to create mechanisms for the NGO community to have input into the grant making process. Such input could be in the form of peer review, with representatives of groups having an opportunity to evaluate and advise on proposals submitted to the endowment.

Another way would be having annual occasions for the NGO community to commit on the endowment's funding priorities. The model for this exercise in participatory governance might be a "town meeting," in which every person who attends has an opportunity to speak.

B.3. The endowment's relation to foreign donors

Foreign donors will have an important role to play in the affairs of the endowment from the beginning and continuing for some time. Most critically they should provide technical assistance to help establish the endowment. If AID chooses the debt-for-nature swap as the model, then the U.S. NGO will likely also provide the technical assistance as part of the overall program financed by a debt-for-nature swap.

On the other hand if the endowment is set up via an NPA, then AID will have to contract for the technical assistance either directly or through an Indefinite Quantity Contract (IQC) in the natural resources area. The key point to consider in identifying appropriate consultants is to emphasize the institution building aspects of the work rather than particular environmental issues and the technical skills which those issues require. The purpose of the TA is to help set up an endowment which serves the NGO community both as a source of funds as well as a mirror of their concerns and priorities.

Whichever route to endowment, AID missions need to be careful that personnel providing the TA are not strongly identified with one or another philosophical viewpoint on environmental issues. If the TA has a built in bias, then a fear is raised unnecessarily in the minds of many of the local NGO community that the endowment cannot easily serve to forge a local consensus on priorities.

After establishment, the endowment must have procedures for management and accounting of funds which satisfy the requirements of potential donors. It may well be worth while during the early TA to explore options for satisfying these requirements in ways which do not overly burden the endowment's administrative capability.

Another area of contention between potential donors and the endowment is the desire of donors to put restrictions on gifts. The early TA should examine options for a clear policy on gift restrictions so that the potential for these conflicts is minimized. Among the policy options are: limiting the life of restrictions; limiting the percentage of a gift which can be restricted; limiting the types of restrictions; and, pushing donors to focus on the process of funding rather than the subject areas to be funded.

B.4. The endowment's relation to local private sector

The endowment's relation to the local private for-profit sector offers a great deal of promise for innovation. To this point there has been little effort to bring local private businesses into a constructive role in dealing with environmental problems. There are several ways that the endowment can help to build a bridge to the local private sector.

One approach to incorporation of the local private sector is to seek out local business persons who are manifestly dedicated to environmental issues and recruit them for the board of directors of the endowment. Another is to develop ways to support "green" business (see discussion below).

Local businesses in countries with well developed private sectors can become contributors to the endowment. However, if this is to become a major source of funding for the endowment, then national tax law will need to be changed to provide an incentive for such charitable giving. Such review could be a part of the TA leading to the establishment of the endowment.

C. Role of technical assistance

Whatever model chosen, missions will have to commit to a substantial amount of technical assistance at all stages. However, the sequence of the TA required differs with the model. In addition requirements for mission oversight, both management and administrative backstopping, vary in timing.

If a mission chooses to fund conservation activities through the "debt-for-nature" swap mechanism, it would require an arrangement with a U.S. conservation NGO and the host government. Of necessity this option would continue to combine the functions of making financial arrangements (i.e. the "swap") with the development and management of projects. Since these functions are not easily separated in the debt-for-nature swap, this means that the sequence leading to an endowment in a debt-for-nature swap follows these steps, more or less in this sequence:

1. committing funds for a natural resources project, one item of which is an endowment
2. contracting with a U.S. NGO for a project
3. arranging a debt swap to get local currency
4. setting up an interest earning account for the local currency, i.e. the "endowment"
5. involving local NGOs in an endowment management

If the mission follows a hybrid model, the U.S. NGO would at some point proceed to a sixth step of:

6. transferring control of the funds to the local NGOs

If a mission chooses to follow the NPA model, then the steps and sequence would differ:

1. committing funds for a NPA, of which one element of the policy reform agenda calls for the government to establish an endowment
2. seeking commitment of the local NGO community to a process for creating an endowment
3. negotiating a MOU with the government on the process of creating an endowment
4. contracting for TA to help until the endowment is established
5. certifying that the terms of the MOU are satisfied so that the government can transfer NPA local currency to the endowment

C.1. Choice of models and initial design

If missions make the initial decision to consider an endowment, then the choice of models is a crucial step which will set the process on fundamentally different paths which have implications for what kind of endowment is

eventually set up. Therefore, missions may well seek help from consultants in making that choice. The consultants which missions select should be as free as possible from conflicts of interest. One particularly important and obvious conflict to avoid would come from retaining an NGO which is in the business of arranging debt-for-nature swaps for the initial work of characterizing and choosing among models. Missions should also be careful to be certain that individuals not have an extensive history of work for an NGO which stands to gain from the choice of model. However, such NGOs can be valuable sources of expertise which missions can tap after a local process has yielded priorities which turn out to be appropriate to the U.S. NGOs area of interest and experience.

If missions can avoid any appearance of conflict of interest they will find that obtaining the support of the local NGO community will be much easier, because the local NGO community will more likely feel that they are on an equal footing with foreign NGOs at the beginning of the process of establishment. Maintaining this favorable climate must be one of the prime responsibilities of the consultants the mission hires for the second phase, which is helping to negotiate the MOU.

C.2 Negotiating a Memorandum of Understanding

So far the precedents for a MOU are for endowments for existing organizations such as agricultural research and educational institutions. These endowments, and the elements of the MOU which set them up, are described in the AID report, "Terms of Endowment." The outline which was followed in these institutional endowments should suffice as a starting point for a scope of work for an MOU for a national environmental endowment.

C.3 Technical assistance for formation

If the debt-for-nature swap model is followed, the TA necessary for the formation of an endowment is most easily and logically carried out by the U.S. NGO which arranged the swap. As the endowment follows after the debt swap, this would entail an amendment or a second follow-on contract with the U.S. NGO.

On the other hand, if the NPA model is followed, then the mission must arrange for a substantial amount of TA either through a RFP or a IQC. In drafting the qualifications and terms of reference for this contract, the mission should emphasize experience in working with institution building in the nongovernmental sector. The persons selected need to have a demonstrated commitment to the value of local process rather than a commitment to a particular approach, whether policy or technology driven, to environmental and natural resource projects.

Whatever the model chosen, there will be a need to hire local financial and legal expertise. These early local hire contracts are likely to be candidates for long term roles as advisors to the endowment on such matters. Therefore it is important for the mission to insist that these local firms have solid reputations which include a scrupulous regard for understanding and avoiding conflicts of interest.

D. Support for the for-profit private sector

No matter which model chosen for an endowment, the charter of the endowment can allow a variety of ways for the endowment to help the private sector become more supportive of national environmental efforts. Many of these ways parallel how U.S. foundations work with the private sector, but many are also different. An effort to find or set up precise analogs should be avoided; however, because of the influence of the complicated U.S. tax law governing interactions between non-profit and for-profit private organizations. Some examples are: support for research and development; feasibility study support; program related investment; no-interest loans; and, endorsements for marketing arrangements.

Research and development: Many U.S. foundations have a long tradition of supporting R&D of technical innovations which become business opportunities for the private sector. A well known precedent has been U.S. foundation support for the "green revolution." Based on this experience it would seem appropriate for a local, environmentally oriented, endowment to support research aimed at "greening" the green revolution to make tropical agriculture more sustainable by emphasizing low input and organic practices.

Feasibility studies: Supporting the development of specific businesses (export of sustainably produced orchids endemic to local rain forests) rather than a research category (e.g. biotechnology applied to clonal propagation of horticultural plants) would require that the endowment maintain a buffer mechanism to minimize conflicts of interest as well as favoritism. One possible mechanism is a revolving fund set up and managed by an association of a particular industry. One example might be an organic food producers cooperative.

Program related investment: Recently several major U.S. foundations have created special mechanisms for investing a small portion of their endowment of capital directly in for-profit enterprises which purport to create an environmental benefit. These investments are made by portfolio managers with advice from the foundation's grant program managers. These are typically equity investments to be held for the long term.

No-interest loans: Within the last ten years a new mechanism which combines grant making and capital loans has become popular—especially in

efforts to create jobs and affordable goods and services in urban areas in the U.S. The U.S. IRS now allows foundations to make an interest free loan of their capital to an enterprise, e.g. a community bakery, for five years to purchase equipment. At the end of the five years either the loan is paid back or interest begins. The IRS allows the foundations which make these loans to count the forgone interest as a charitable deduction under certain circumstances.

Endorsements: U.S. tax regulation requires that well known non-profits can only receive income from endorsements of private businesses when the activity endorsed is closely related to the activity of the non-profit. This type of relationship is most fraught with danger for an endowment as it would be easy to lose credibility—either locally or internationally or both! However, under certain circumstances, e.g. monitoring of natural resource management practices of an "ecotourism" resort, there may be ample justification.

D.1. Local entrepreneurs and cooperatives

African countries vary greatly in the vibrancy and depth of private entrepreneurship. Thus a strategy to help local green business must be tailored to local conditions. In a country with a strong private sector, the provision of a limited amount of credit may begin to stimulate business interest. In countries with nascent private sectors, there may be justification for committing substantial resources to feasibility studies. In either situation the endowment needs to provide more than token support for the private sectors.

The private sector can become an important vehicle for tackling environmental problems if the endowment has programs which enable it to influence how local private capital investment flows. Without such influence an endowment would miss an important determinants of natural resource use which is defined by the collective business decisions of a wide variety of for-profit activities.

An endowment can have even greater impact if it can assume a role as a broker of mutually beneficial relations between local private business and local NGOs. The ecotourism example alluded to earlier might be a fertile area for exploring such cooperation—between local and international private businesses and between both local and international NGOs. An endowment could help to put together relationships which returned a substantial income to local communities in and around an ecotourism facility. The endowment could help by providing an endorsement to the facility based on guarantees that the communities benefited in ways which improved the management of natural resources by these local communities.

D.2 Joint ventures

Foreign businesses have become increasingly wary of investments which have the potential for adverse environmental impact. Within the last few years

both bilateral and multilateral sources of support for private investment have stepped up their scrutiny of environmental impacts and related issues such as resettlement and land claims of ethnic minorities. Bilateral agencies such as the U.S. government's Overseas Private Investors Corporation (OPIC) and multilateral agencies such as the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) now have stringent rules on what kinds of investments are subject to close inspection on environmental grounds.

Even more recently special funds for the support of environmentally beneficial joint ventures and other forms of investment have been announced. Notable examples are OPIC's new environmental equity investment fund and the World Bank's new Global Environmental Facility (GEF), a portion of which is slated for helping private ventures. These funds all face the same difficulty which is how to guarantee that their investments actually deliver environmental benefits.

Endowments may have several roles to play in helping these funds, as well as other private investors seeking "green" returns. An endowment could: find and nurture ideas from the grassroots; find local NGOs which can help to evaluate and monitor green investments; match foreign investors with local investors and NGOs; provide a channel for programming a portion of the profits of green businesses in ways that spread the benefits to a larger segment of society than would otherwise be possible.

