

# The International Finance Facility

## A Proposal to Optimize MDB Balance Sheets in the Short to Medium Term

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Working Paper  
November 2022

# Summary

## This paper covers the innovative guarantee model developed by the Education Commission: the International Finance Facility (IFF).

The facility was first developed for financing education (and known as the International Finance Facility for Education – IFFEd) in close partnership with 4 major multilateral development banks (MDBs) and development partners. It has potential for much wider application in other sectors as recognized by the recent G20 Independent Review of Multilateral Development Banks’ Capital Adequacy Frameworks (Expert Panel 2022). Using guarantees provided by shareholders for sovereign loan portfolios, the mechanism frees up multilateral development bank (MDB) capital for additional lending.

**The IFF provides a much more efficient way to use sovereign commitments to support MDBs than existing options (e.g. MDBs’ regular capital increases or single loan guarantees).**

Every 15 cents of cash as paid-in capital to an IFF financing vehicle, alongside a sovereign guarantee, could produce \$4 dollars in loans for financing development in the form of non-concessional loans provided by MDBs to middle-income countries – an overall leverage rate of 27 times. In contrast, the current strategic capital adequacy framework for IBRD, the lending arm of the World Bank supporting middle-income countries, requires at least

20% equity (including paid-in capital) relative to loans. This means that, all else equal, IBRD or an MDB operating on similar terms would require 80 cents of donor cash resources, compared to only 15 cents under IFF, to support the same \$4 dollars in loans. This means that the IFF, supported by sovereign guarantees, is five times more efficient in leveraging paid-in capital.

**Portfolio guarantees, like those proposed for IFF, can be leveraged.** This is in contrast to country-specific or single loan guarantees that are unleveraged – i.e. a \$1bn country loan guarantee can only support \$1bn in additional loans. The leverage that a portfolio guarantee can

secure depends on the credit risk and concentration risk but it would generally increase with the number of sovereigns “insured.” The IFF extends the portfolio guarantee of multiple loans to cover “all” loans. In the case of the World Bank IBRD this could be the entire loan portfolio and as such it could be termed an “equity” or “portfolio” guarantee.

**The G20 Review notes that “contract provisions defining the contingent terms are more predictable and clearer than callable capital, thus enhancing the value of the guarantee.”** The IFF guarantee is similar to callable capital but its contract of operation is irrevocable, legally binding, and unambiguous – e.g., a guarantee payment would be made within a specified time frame.

**Another important aspect which allows IFF guarantees to provide more support to MDBs is that the IFF explicitly guarantees MDBs as creditors (or lenders).** The IFF makes a guarantee payment to support the MDB’s equity/capital as any payments, interest or principal, fall into non-accrual. By contrast, callable capital can be viewed as a shareholder guarantee to MDBs as debtors – i.e., the guarantee can only be called when the MDB itself is at risk of default. However, it cannot be called as “working” capital, i.e., when loans it has provided as a creditor are in default.

**The IFF is also potentially politically more feasible than subscribed capital.** This is because it would require only a coalition of “willing” donors rather than the approval

of, and contributions from, all shareholders in the case of a General Capital Increase (GCI).

**IFFEd was developed with contributions from sovereign donors as well as four large MDBs, who reviewed the portfolio insurance it offers and the indicative leverage it can provide.** It was also reviewed by credit rating agencies, notably S&P and Moody’s, who provided a preliminary evaluation that it could be strongly rated. The IFF proposal has benefitted from several years of investment in its development around legal, financial, and accounting frameworks to support MDB capital adequacy. With commitments from donors and MDBs it could be launched and scaled very quickly as an urgent response to the pronounced and worsening crises that developing countries now face.

**The IFF is the most cost-effective way available in the short term to scale up MDB financing,** reverse the collapse in development progress, and accelerate progress towards the UN Sustainable Development Goals (SDGs). More broadly, the grant resources it requires can be supplied by any grant-awarding body including governments, philanthropic foundations, and private sector companies.

# Introduction

*The UN's most recent report reveals that the 2030 Agenda for Sustainable Development is in grave jeopardy due to the multiple, cascading and intersecting crises (UN 2022). The pandemic has likely resulted in four years of progress on poverty eradication being lost, 50 million more people are now facing hunger, 100 million people without electricity, 54 million women pushed out of the workforce and setbacks in education outcomes predicted to have very large long-term economic consequences (United Nations Inter-Agency Task Force on Financing for Development 2022) (Shah 2022).*

The rising inflation in the post-Covid economic recovery weakens an already insufficient international response. After accounting for inflation, world food prices are now the highest ever since records began in 1961 (FAO Food Price Index). Consequences are devastating for the global economy and will be most severe in developing economies where energy and food costs represent a larger share of household spending.

Development finance and the international financing architecture will need to play a major part in the efforts to achieve the 2030 Agenda for Sustainable Development and reverse the setbacks caused by the pandemic and other crises. The widening financing gap must be filled if the SDGs are to be achieved.

There have been repeated calls for MDBs to scale up their financing and to make their existing capital go further, including from the G20 that launched an Independent Review of MDBs' Capital Adequacy Frameworks. The Independent Review puts forward a number of recommendations for the G20 to consider. Among those are several innovations to strengthen MDB capital adequacy and lending headroom, including guarantees by shareholders for sovereign loan portfolios as

with the International Finance Facility (IFF) model (Expert Panel 2022).

This paper presents the IFF model that is at present a more cost-effective financial tool to scale up MDB financing than the MDBs' traditional recapitalization, and it could be a stepping stone to wider innovations and optimization of MDB balance sheets in the longer term. The IFF is an approach to expand the lending capacity of MDBs through the provision, by a strongly rated finance facility, of portfolio guarantees to MDBs that they can, in turn, use as quasi-equity to expand their lending. The IFF requires two types of contributions: guarantees from sovereign donors, and cash (grants) as paid-in capital that could be supplied by a variety of donors including public, philanthropic, and corporate donors. The IFF proposal has benefitted from several years of investment in developing its legal, financial, and accounting structures. With commitments from a coalition of willing donors and MDBs, it could be launched very quickly at scale as an urgent response to the rapidly increasing financing needs of developing countries to meet both short- and long-term development and global public goods challenges, including for education, climate, and health.

## Why we need innovation in the MDBs

*The multiple intersecting crises facing emerging markets and developing countries require us to come together to develop new strategies to mobilize financing more effectively including the domestic and international sector as well as the public and private sector. MDBs are a critical part of the solution. For the past 75 years, they have been at the forefront of supporting economy-wide development strategies and have provided financing for critical development sectors on financial terms that countries cannot access from the market (Yellen 2022b).*

MDBs have also been at the center of the response to the pandemic, and they have significantly accelerated their lending with their sovereign commitments increasing by 39% from \$87 billion in 2019 to over \$120 billion in 2020. However, this is much less than the 77% increase in MDB lending through the Global Financial Crisis and far short of the much greater economic and social costs of the pandemic (Lee and Aboneaaj 2021).

Moreover, MDBs have been criticized for not mobilizing finance quickly enough in the health sector during the pandemic and for not coordinating their actions and working collectively as a system to address this global pandemic crisis (Lee and Aboneaaj 2021). More recently, the credit rating agency S&P also confirmed that MDBs could increase their lending headroom without risking a downgrade to their important AAA status (Gold 2022).

MDB financing is particularly important at this time of growing fears over unsustainable debt. Unlike in the past, more debt is now owed to commercial creditors and not to bilateral creditors in the Paris Club or multilateral institutions

like the World Bank or other MDBs (Prizzon, Greenhill, and Mustapha 2016). At the end of 2020, low- and middle-income economies owed five times as much to commercial creditors as they did to bilateral creditors. For this year, of the nearly \$53 billion that low-income countries will need to make in debt-service payments on their public and publicly guaranteed debt, just \$5 billion will go to Paris Club creditors (Estevão 2022).

But the increase in outstanding debt does not necessarily mean that countries should invest or borrow less. These investments and loans, and the key sectors they underpin, will be critical to the economic recovery and long-term development in the countries concerned (IMF 2022). Rather, countries should be offered financing on more concessional terms, including from the MDBs, which would help prevent them from having to borrow at much less favorable terms from the private sector. In the long term, addressing debt sustainability in this crisis will require finance that bridges the gap between grants for the very poorest countries and "hard" loans for the richest.

Financing must also be offered at cheaper terms. Developing country borrowers pay interest charges in global capital markets that are often 5-10% points higher than the borrowing costs paid by rich countries (Sachs 2021).

The realities of large and growing financing gaps to meet the SDGs, the need for more concessional financing in the face of a new debt crisis, the shortcomings in the global financing architecture, and the criticism of an inadequate response by the MDBs has led to a growing number of initiatives and proposals to reform and expand the capacity of the MDBs as well as reorient the activities of these institutions, including towards a greater focus on global public goods (GPG).

For example, as noted, the G20 commissioned an Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks with the task of providing transparency and clarity on the financial capacity of the MDBs. This is seen as a first step in the discussions around MDBs' enhanced contributions to development finance (Humphrey 2021).

Others, like the Center for Global Development (CGD), have also put forward concrete proposals to move the World Bank away from its traditional focus on individual developing country problems and priorities and toward a bank with a global presence capable of tackling global challenges and crises. Authors suggest "the Bank should bring the GPG agenda onto its balance

sheet as part of its core business. The most logical way of doing this is through a GPG capital increase where shareholders would design the financing and policy architecture that would guide this new agenda" (Dissanayake, Glassman, Landers, and Smitham 2022).

MDBs' design and unique support from their member countries make them the most efficient financial institutions to leverage private capital markets and provide low-cost financing for developing countries. But many of these deeper reforms of the MDBs will take time and would require significant political commitment as well as agreement of the shareholders of the MDBs. With this in mind, other proposals have also been put forward that bring substantial innovation and efficiencies to the MDB balance sheets but would, at least in the first instance, only require a coalition of willing donors. The International Finance Facility is an example of such a proposal.

## The context: The current MDB financing model

To meet the challenge of evolving financing for development through multilateral channels it is important to take stock of how donors currently support developing countries and crucially MDBs.

Commitments by sovereign bilateral donors to provide development financing can be characterized by the use of their cash – i.e., grant resources in the following ways:

- **Direct grants:** donors can supply grants to recipient countries directly;
- **Grants used as paid-in capital to mobilize non-concessional finance:** donors can use grant resource to finance paid-in capital for institutions such as the World Bank's IBRD (International Bank for Reconstruction and Development) that lends on market terms;
- **Grants used as contributions to concessional finance:** donors can use grants to 'replenish' institutions such as the World Bank's IDA (International Development Association) that lend on concessional or subsidized terms;
- **Future grant pledges:** donors can commit to providing conditional grants over time such as the pledges to the IFFIm (International Finance Facility for Immunisation) which borrows against these pledges to provide frontloaded grants to recipients;

- **Conditional grants as guarantees:** as a guarantor, donors can guarantee a creditor against the risk of default by a debtor. This involves a conditional commitment of grants (e.g., in the case of a credit event).

The MDBs use combinations of these different forms of donor commitment to operate. For example, the World Bank's non-concessional window, IBRD, uses grants (cash) provided by its shareholders to fund paid-in capital that is leveraged through borrowing on bond markets to finance loans to middle-income countries. Net income from these loans is added over time to reserves that along with paid-in capital forms shareholder equity, and increases IBRD's capacity to make further loans. Furthermore, as developing countries repay their loans, this capital can be used repeatedly to underpin new loans to other middle-income countries. In its Strategic Capital Adequacy Framework, IBRD requires at least 20% equity (paid-in capital and retained earnings) relative to loans, to cover its credit, market, and operational risks inherent in its borrowing and lending activities as a bank operating on commercial terms and to maintain its AAA rating. Country credit risk is the



greatest risk faced by MDBs though this risk is significantly reduced by their preferred creditor treatment compared with other lenders. So, broadly speaking an additional \$1 of paid-in capital financed by donor grant resources could support up to \$5 of loans on IBRD terms to lower- and upper-middle-income countries. This leverage of five times is far more efficient than any other institution (e.g. private commercial banks) could currently achieve with similar loans to these countries, reflecting not only the diversification of credit risk that the MDBs can secure at scale compared with bilateral loans, but also their unique preferred creditor treatment.

IBRD's financial efficiency is very significantly enhanced by the World Bank's preferred creditor treatment (PCT). PCT in practice means that IBRD has a history of very few loans to developing countries that have not been serviced on time – i.e., its non-accrual rate is very low. Most importantly, developing countries tend to prioritize payments to the World Bank (and other IFIs including the IMF) because arrears to the IFIs significantly reduce or eliminate access to capital markets at reasonable terms, in particular, when countries are subject to sudden stops in external financial flows in times of crisis. Furthermore, World Bank loans for many MICs are at significantly cheaper terms than what these countries would be able to secure directly on capital markets. Finally, the World Bank and other IFIs with PCT do not participate in restructurings of

official debt, and other official creditors have accepted this special status.

In addition to paid-in capital, IBRD's shareholders (and those of other MDBs) also provide callable capital that is broadly a promise to pay further capital to IBRD if it cannot service its borrowing and other financial obligations. Callable capital is effectively a guarantee to MDBs as a debtor and can only be "called" in an emergency when an MDB itself is at risk of default. IBRD, for example, states that uncalled subscribed capital may be called only when required to meet IBRD's obligations for funds borrowed or loans guaranteed and is, thus, not available for use by IBRD in making loans. These restrictions on the use and effectiveness of callable capital would also apply to the regional development banks (RDBs).

In conclusion, MDBs mobilize financing by issuing bonds against their overall financial strength that includes equity (paid-in capital plus cash reserves), PCT, overall management, and also callable capital. But MDBs' callable capital is not incorporated in their Capital Adequacy policies and so it does not support their lending capacity directly, this means that paid-in capital and not callable capital is the binding constraint on how much additional financing MDBs could provide.

## The IFF model: Addressing MDB constraints in the short to medium term

Developed by the Education Commission in collaboration with staff from the MDBs and interested donors, the International Finance Facility (IFF) aims to provide additional public finance through the MDBs funded by contributions by both public and private actors. The IFF was originally developed to mobilize financing in education (and referred to as the International Finance Facility for Education or IFFEd) but it can be applied to any sector where MDBs provide loans.

The financing mechanism it employs provides a portfolio-wide guarantee from a AAA rated entity (the IFF) to the MDBs, comprising paid-in capital (supplied by sovereign donors or other grant donors such as philanthropic institutions) and sovereign donor guarantees. The portfolio guarantee in effect serves as quasi-equity for MDBs that they can then leverage in a similar way as their paid-in capital to increase loan financing in any eligible sector and country.

more efficient in the use of cash than "traditional" recapitalizations of MDBs where only paid-in capital, not callable capital, can be leveraged.

Sovereign donor guarantees used by the IFF are paired with paid-in capital that is "called" first and covers most of the risk. This means that these guarantees cover remaining risks that are very unlikely and with small costs even if the risks they insure do materialize. While MDBs do experience non-accruals in their lending, they occur rarely and the MDBs have always been able to secure a recovery of the financing they have advanced. This reflects in part the mutual commitment between richer countries and poorer countries that MDBs are effectively global development cooperatives owned, managed, and run in the interests of all their shareholders.

Countries differ in how they recognize guarantees in their government budgeting, whether a liability is recorded in full or in part immediately and hence how it impacts government spending, budget deficits, and debt. For European donors the

### The IFF vehicle has two key innovations:

1. **The portfolio guarantee insures the portfolio** of all MDB loans against non-accrual and can be leveraged. Hence, these guarantees are more cost effective than single loan guarantees that are unleveraged.
2. **The combination of donor sovereign guarantees** (that are legally binding, irrevocable, and enforceable) **and paid-in capital to backstop the portfolio guarantees** to the MDBs allows the vehicle to be very efficient in the leverage of cash contributions. The IFF is far

fiscal guidance is that for such low risks these conditional guarantees would only score as spending when the conditions were met and donors were required to make payments to the IFF. For other donors some budget might have to be appropriated as guarantees are issued to reflect any small expected cost, but even for these donors the budget cost of such guarantees would always be far smaller than the cost of providing paid-in capital as grant resource directly.

The parameters developed for the IFFEd to secure a AAA credit rating during the preliminary assessment of the vehicle indicated that donor commitments could be composed of 15% in cash as paid-in capital and 85% in contingent

commitments (guarantees). Thus, every \$1 of portfolio insurance supplied to MDBs by IFFEd would comprise \$0.15 in paid-in capital and \$0.85 in guarantees. In turn, preliminary consultations with four large MDBs indicated that they could leverage this portfolio insurance about four times (given a AAA credit rating for the IFFEd). Thus, every \$0.15 of cash as paid-in capital to an IFF financing vehicle could produce up to \$4 in loans for financing development, an overall leverage rate of 27 times of its paid in capital. By contrast as a counterfactual, IBRD would require \$0.80 of cash as paid-in capital to support \$4 of loans on the same terms to the same countries – a leverage rate of 5 times for paid-in capital. This means that the IFF, supported by

sovereign donor guarantees, is more than five times as efficient as IBRD in the use of cash, in leveraging paid-in capital to provide loans on commercial terms from MDBs to middle-income countries.

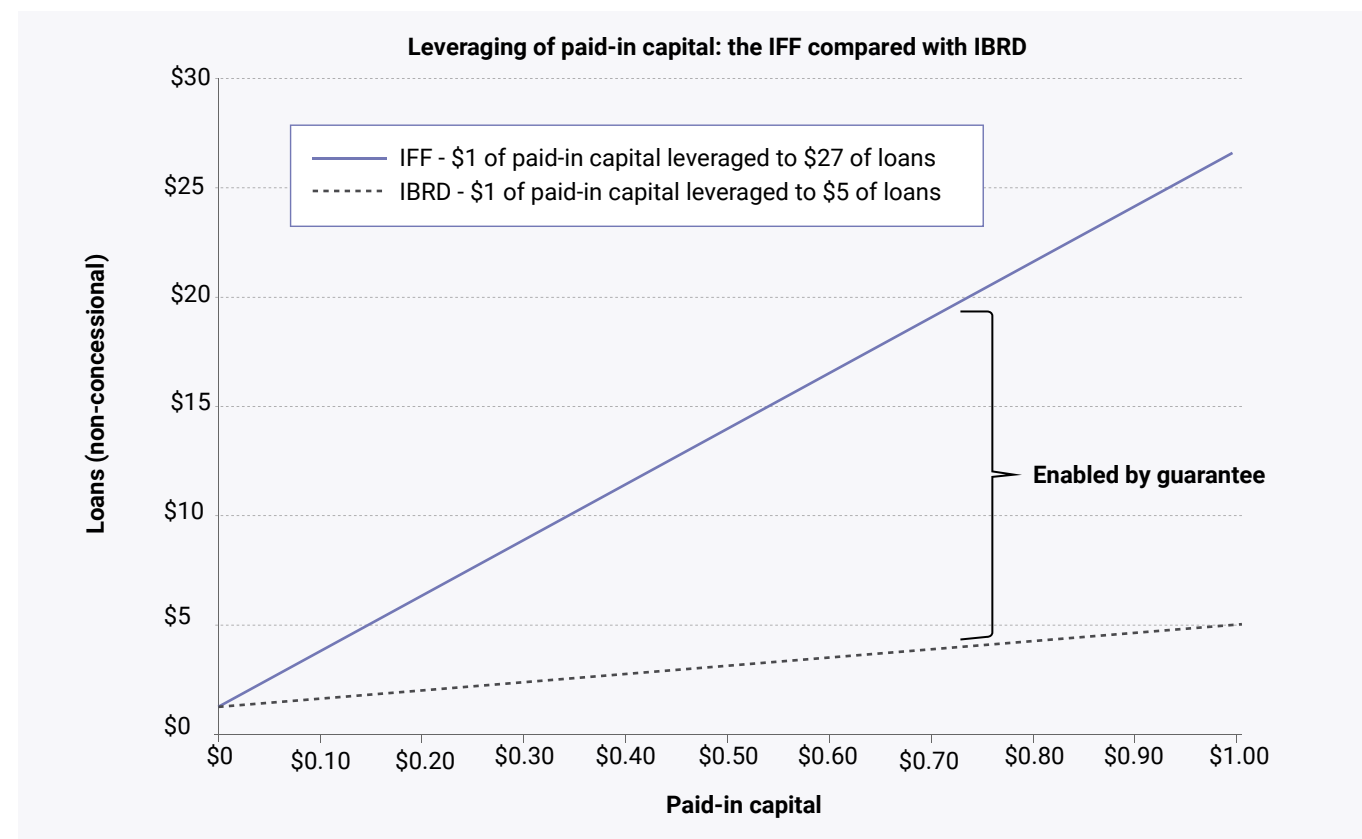
As an option for financing development, the IFF vehicle presents additional benefits as a quick response mechanism to the current crisis:

It could be implemented quickly given over three years of investment in developing the legal, financial, and accounting structures in conjunction with large MDBs and sovereign donors. As noted above, the IFF application to education (IFFEd) received a very strong preliminary credit rating evaluation.

Unlike a General Capital Increase (GCI) in MDBs that would require contributions from all shareholders, the IFF vehicle could be financed by a coalition of the willing including those countries most able to make the contributions.

Moreover, the portfolio guarantees provided by the IFF vehicle does not confer any voting power within MDBs and so would not change existing governance structures.

The IFF is a powerful innovation for donors to empower the MDBs to massively scale up financing for development. It would be a major step forward to strengthen the efficiency of the MDBs even further, building on their strengths and providing them with effectively more capital with smaller paid-in capital requirements than existing traditional mechanisms to capitalize the MDBs.



# IFF guarantees are not MDB loan guarantees

The key innovation with the IFF vehicle is that the portfolio guarantees cover an entire portfolio of MDB loans and can be leveraged. Hence, the guarantees are more cost-effective than single loan guarantees that are unleveraged. For example, the World Bank concluded guarantees in 2016 covering loans to Iraq with guarantees from Canada and the UK (Humphrey 2017), but these guarantees were not leveraged.

With country-specific shareholder guarantees a sovereign such as the UK acts as a guarantor to an MDB as a creditor for a loan. For example, the UK will provide an “India Green Guarantee” to the World Bank to unlock an additional £750 million (\$1 billion) for green projects across India. The financing will support clean and resilient infrastructure in sectors such as clean energy, transport, and urban development (Government of the UK 2021). In this context more generally, a \$1 billion guarantee would support \$1 billion of additional loans.

There are a few examples of sovereign donors guaranteeing a portfolio of loans made by MDBs – i.e. more than one loan. Piloted by Sweden at the Asian Development Bank (ADB) in 2016, Sweden’s development agency SIDA offered a guarantee to cover \$155 million of specific loans within the total portfolio of loans at the ADB (ADB 2016). As MDBs typically operate a capital adequacy framework that targets loans relative to equity, these loan guarantees created more lending capacity by “freeing up” equity. As a portfolio guarantee diversifies the credit risk they provide leverage, e.g., a \$1 guarantee could

support more than \$1 in loans. The SIDA guarantee was expected to “free up” \$500 million in lending over 10 years on ADB’s balance sheet. More recently in 2020 SIDA provided a portfolio guarantee to the Inter-American Development Bank (IDB) for \$300 million covering projects in three countries: Bolivia, Colombia, and Guatemala.

The IFF is a natural extension of a portfolio guarantee to cover the largest number of loans possible and so obtains the maximum leverage from the diversification of the credit risk in the insured portfolio and its risk transfer from the MDB to the guarantor – i.e., the IFF. For example, the IFF working with IBRD could provide portfolio insurance for sovereign loans to over 80 countries. The leverage that MDBs could obtain from such portfolio insurance would depend on their assessment within their own capital adequacy frameworks, and notably the credit risk and concentration risk within the portfolio insured.

# Further enhancements to the IFF model

## Addressing demand-side constraints

The IFF for Education i.e., IFFEd was initially developed in response to a long-standing structural challenge that lending for human development, and in particular education, falls when countries graduate from the World Bank’s IDA to IBRD and lose access to concessional finance. Research suggests that as countries graduate from low- to middle-income status (World Bank 2022) based on their income per capita there is a fall of 60% in lending for human development, that includes education, and this is more than double the average fall across all sectors. This reduction in financing for human capital is driven by supply- as well as demand- side constraints.

While the IFF’s innovative guarantee instrument described above operates on the “supply-side” to increase MDB financing, the IFF for education also operates on the “demand-side.” Demand incentives are provided through the provision of grants to lower the cost of loans and increase the concessionality thereby supporting the demand for loan financing. The cost of such grants is independent of how the loans are financed. In other words, it is independent of whether the loan financing is backed by an IFF guarantee or by traditional paid-in capital: a \$10 grant has the same cost to donors whether it is provided alongside a standard loan of \$100 from MDBs or a \$100

loan supported by IFFEd.

However, when considering the total cost to donors, in terms of grant resource to finance the paid-in capital required along with grants to lower the cost to borrowers, then for any grant-to-loan ratio, IFFEd is always more cost effective than a MDB status quo that relies on paid-capital i.e. equity alone.

IFFEd proposes a grant-to-loan ratio of 10%. This means that a \$10 grant provided “pari passu” with a \$100 loan on commercial terms from MDBs provides more affordable financing for education to lower-middle-income countries (LMICs). This would ensure that the cost of financing sits between the non-concessional loans provided by MDBs to middle-income countries and the cheapest loans provided by the MDBs to the poorest low-income countries – e.g. IDA.

To provide \$1 billion in concessional finance to LMICs – that is \$1 billion in market-based loans plus \$100 million in grants to make the loan concessional, IFFEd would require \$140 million in grant resource from donors. This would include \$40 million paid-in capital and then \$100 million in grants to borrowers, to provide \$1 billion in concessional finance (\$1.1 billion total finance of \$1 billion loan plus \$100 million grant) to LMICs. The financing model for IFFEd comprising an



Figure 1 – Mobilizing \$1 billion of affordable finance for education with IFFEd

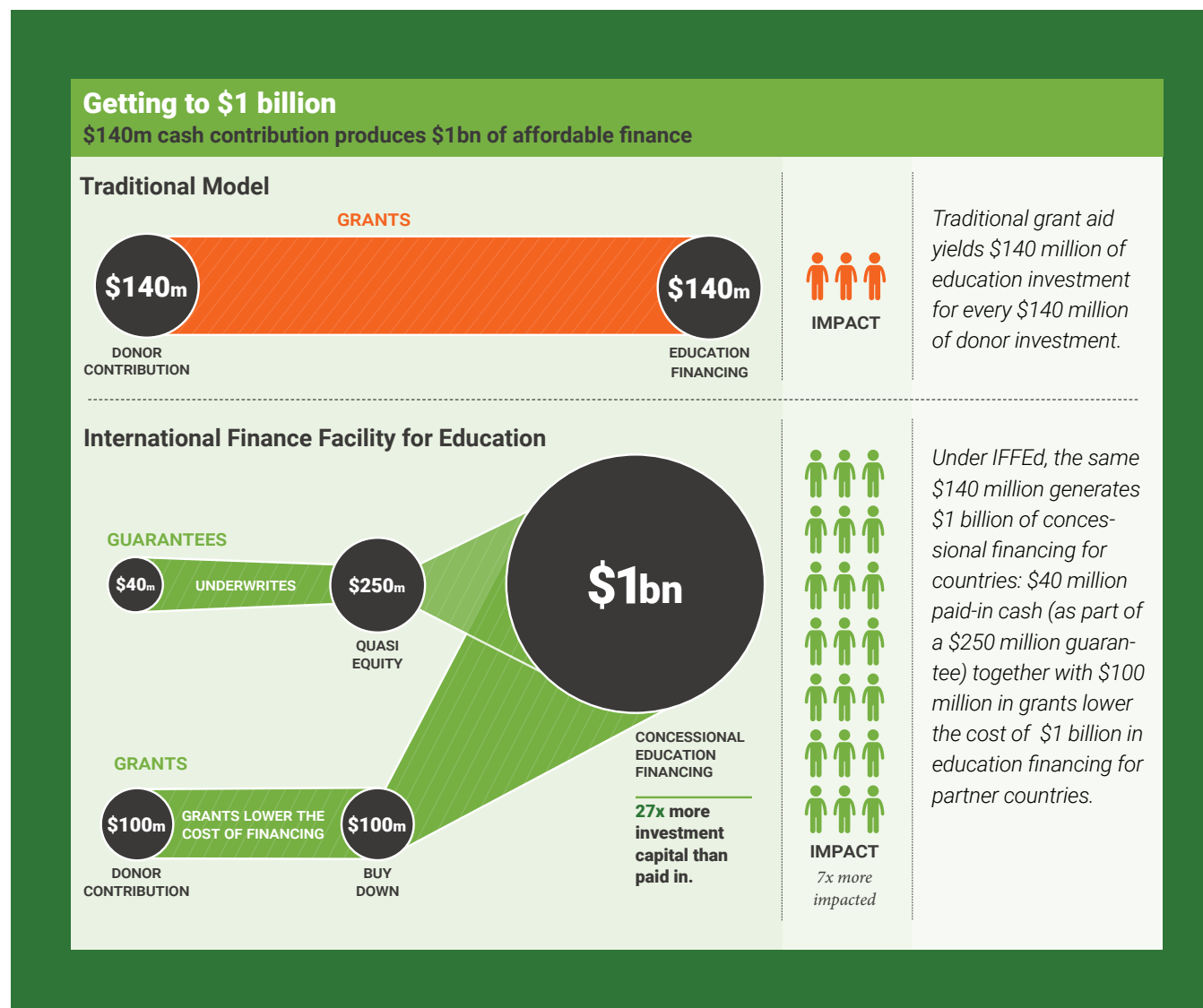


Figure 1 – Mobilizing \$1 billion of affordable finance for education with IFFEd

IFF to originate loans and then grants to deliver concessional finance is illustrated in Figure 1. By contrast, using traditional MDB windows, providing \$1 billion in concessional financing to LMICs on the same terms would require \$300 million in grant resource from donors, comprised of \$200 million paid-in capital and the same \$100 million in grants to borrowers. In conclusion, to finance education with a grant-to-loan ratio of 10%, the IFFEd could

be more than twice as cost-effective as the status quo.

## 2- Application in different sectors

While the IFF financing mechanism was initially developed to finance education, it is designed to support MDBs generally, and hence is completely neutral regarding its application. An IFF could support MDB loans in any sector where they provide

loans, e.g., energy and climate. The IFF provides portfolio insurance to MDBs across all their loans in all sectors and not just loans in the sectors that it supports. The means by which an IFF supports a particular sector is that the provision of the portfolio insurance is conditional on the origination of eligible loans. For education, IFFEd could provide \$1 portfolio insurance as participating MDBs originate \$4 of loans to the education sector.

In January 2021, the G20 established a High-Level Independent Panel (HLIP, co-chaired by Tharman Shanmugaratnam, Lawrence Summers, and Ngozi Okonjo-Iweala) to recommend actionable solutions for reliable and sustainable financing of the global commons for pandemic prevention, preparedness, and response. In their report (The G20 High Level Independent Panel on Financing the Global Commons for Pandemic Preparedness and Response 2021), the HLIP reviewed in an Annex an illustrative costing model where the IFF model was used to finance PPR in comparison with the status quo of IBRD. In this costing, each loan of \$3.25 on commercial terms to middle-income countries was accompanied by a grant of \$0.75. This grant-to-loan ratio of just under 25% was sufficient then to provide a level of concessional financing roughly equal to that provided in IDA Regular loans by the World Bank to low-income countries. The panel stated:

“As an illustration, to provide an extra US\$4.5 billion annually in financing to Middle-Income Countries (MICs) by the World

Bank’s IBRD with the same grant element or concession equal to IDA-regular terms through a combination of a loan and a grant, would require an annual grant inflow of US\$1.57 billion if this was done by using a standard capital increase mechanism and grants to recipients in conjunction with the loan to increase the grant element. This annual grant inflow from donors would be split between an increase in paid-in capital of US\$0.73 billion (20 per cent of the US\$3.66 billion IBRD loan) and US\$0.84 billion for the grant to the recipient to bring the total finance provided to IDA terms. With the IFF model, in comparison, the same increase in lending would require an annual grant inflow of US\$0.98 billion split between paid-in capital of US\$0.14 billion (accompanied by guarantees of US\$0.78 billion) to support the loan, and the same grant of US\$0.84 billion to recipients.”

In addition to its application in health, the IFF model is also being explored in the climate sector. To lead the Asia and Pacific region’s response to climate change, the ADB is now designing the Innovative Finance Facility for Climate in Asia and the Pacific (IF-CAP) – using the IFF mechanism.

Finally, as noted earlier, the G20 Independent Review of the MDBs’ Capital Adequacy Frameworks has recommended that the use of guarantees such as those employed by the IFF should be explored for financing cross-cutting priorities, and suggests that they could be applied broadly in areas of interest to both potential donors and most borrowing countries, such as climate mitigation and adaptation finance.



# Next steps: Delivering the IFF to finance global public goods

The IFF proposal has already benefitted from several years of investment in its development with MDBs, and with commitment from donors and MDBs it could be launched very quickly at scale. Discussions are already underway to develop an IFF mechanism for the education and climate sectors, but progress will require:

1. commitments from sovereign donors in the form of new portfolio guarantees;
2. innovation from MDBs willing to develop and implement the IFF to support expansion of their lending capacity – e.g., for climate and education; and
3. sufficient grant finance from public and private donors to provide the paid-in capital and fund any grants to make the loans more concessional.

Janet Yellen, the US secretary of Treasury, in her joint IMFC and Development Committee Statement IMF statement (Yellen 2022c) asked “WBG Management to identify gaps in the WBG’s current institutional and operational framework, and within the context of the international development finance architecture, deliver a roadmap by year-end for consideration by the World Bank Executive Board.”

And that “The roadmap should include proposals to strengthen the WBG’s role and capacity to address global challenges, including by mobilizing private capital and domestic resources; incentivize country demand and

the effective use of WBG financing for global challenges; contribute to strengthening coordination and collaboration across the broader international financial architecture; and design pertinent financial reforms to make the most efficient use of the WBG’s balance sheet and generate new resources.”

The IFF is the most cost-effective way to scale up MDB financing, reverse the collapse in development progress, and accelerate progress towards the SDGs. More broadly the grant resources it requires can be supplied by any grant-awarding body including governments, philanthropic foundations, and private sector companies.

With coordination between public and private capital, the IFF could deliver an extraordinary step forward in financing for GPGs including for education, climate, and health.

Development Financing:	Financing <sup>1</sup>	Grants-to-loans <sup>2</sup>	Grants	Loans <sup>3</sup>
Low Income Countries LICs	\$11	10%	\$1	\$10
Lower Middle-Income Countries LMICs	\$11	10%	\$1	\$10
Upper Middle-Income Countries UMICs				
Donor Commitments	IFF(Ed)	MDB	Difference from MDB	
<i>Grant resource (total) [1]</i>	\$1.38	\$3.00	-\$1.63	-54%
<i>Paid-in capital</i>	\$0.38	\$2.00	-\$1.63	-81%
<i>Grants to recipients</i>	\$1.00	None	None	
<i>Guarantees (Sovereign [2])</i>	\$2.13	\$0.00	+\$2.13	N/A
<i>Grant and Guarantees [1]+[2]</i>	\$3.50	\$3.00		
Leverage of donor grant resource:				
<i>Total financing of \$11</i>	8.0 x	3.7 x		
<i>Soft financing of \$10</i>	7.3 x	3.3 x		
<i>Paid-in capital to loans</i>	26.7 x	5.0 x		

1. *Loans + Grants: a \$10 hard loan + \$1 grant provides \$10 in soft financing.*
2. *A ‘grant-to-loan’ ratio to soften financing terms for borrowers and increase concessionality.*
3. *‘Hard’ loans on non-concessional terms from MDBs operating on commercial terms.*

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