Buy-downs for Education

GPE Board Meeting

Addis Ababa, Ethiopia

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RESULTS FOR DEVELOPMENT

Outline

- Why Buy-downs Now?
- Basic Education Needs
- Declining Aid to Education
- Previous Loan Buy-downs
- Analysis of Buy-downs
- Which Countries?
- Linking to Results
- Operational Issues
- Recommendations



Why Buy-downs Now?

A buy-down is an arrangement whereby a third party buys down all or part of either the interest or the principal of a loan, or both.

- Countries could be induced to borrow for social sectors against monitorable reforms.
- Crowd in extra resources
  - Grant aid is declining, in general and for education.
  - Huge unmet need for basic education in creditworthy countries.
  - GPE countries potentially gain more than the $100 million cap.
- Keep education “competitive” with other sectors to adapt to harder aid environment.
- GPE approached by the Islamic Development Bank.

Illustration of a buy-down

What if a $100 million loan with 2% interest were bought down to a $50 million loan with 0% interest? Below is the total stream of payments over 5 years, paying back both interest and principal, with and without a buy-down.

Loan Repayment without Buy-down

Year

- 1: $ 21.6 million
- 2: $ 21.2 million
- 3: $ 20.8 million
- 4: $ 20.4 million
- 5: $ 20.0 million

Loan Repayment with Buy-down

Year

- 1: $ 10 million
- 2: $ 10 million
- 3: $ 10 million
- 4: $ 10 million
- 5: $ 10 million



Cost of buying down interest	$4 million
Cost of buying down principal	$40 million
Total Cost of buy-down	**$44 million**

Basic Education Needs

We define countries with education challenges as those who perform 1 standard deviation worse than average of all countries' performance, in at least one of the listed indicators:



- Out-of-school children
- Gender Parity
- Wealth inequality
- Pupil/teacher ratio
- Political commitment
- Need for financing in the near future

Source: UNESCO Institute for Statistics.

Top 5 countries with outstanding education challenges, 2011

Out of School Children, millions

Nigeria	Pakistan	Ethiopia	India	Burkina Faso
10.5	5.4	1.7	1.7	1.0

Percent of female students, primary

Afghanistan	CAR	Chad	Yemen	Pakistan
40	42	43	44	44

Percent difference between top and bottom income groups of OOSC

Somalia	Chad	Nigeria	Burkina Faso	Pakistan
78	63	62	51	46

Pupil/teacher ratio

CAR	Malawi	Zambia	Chad	Rwanda
81	76	63	63	58

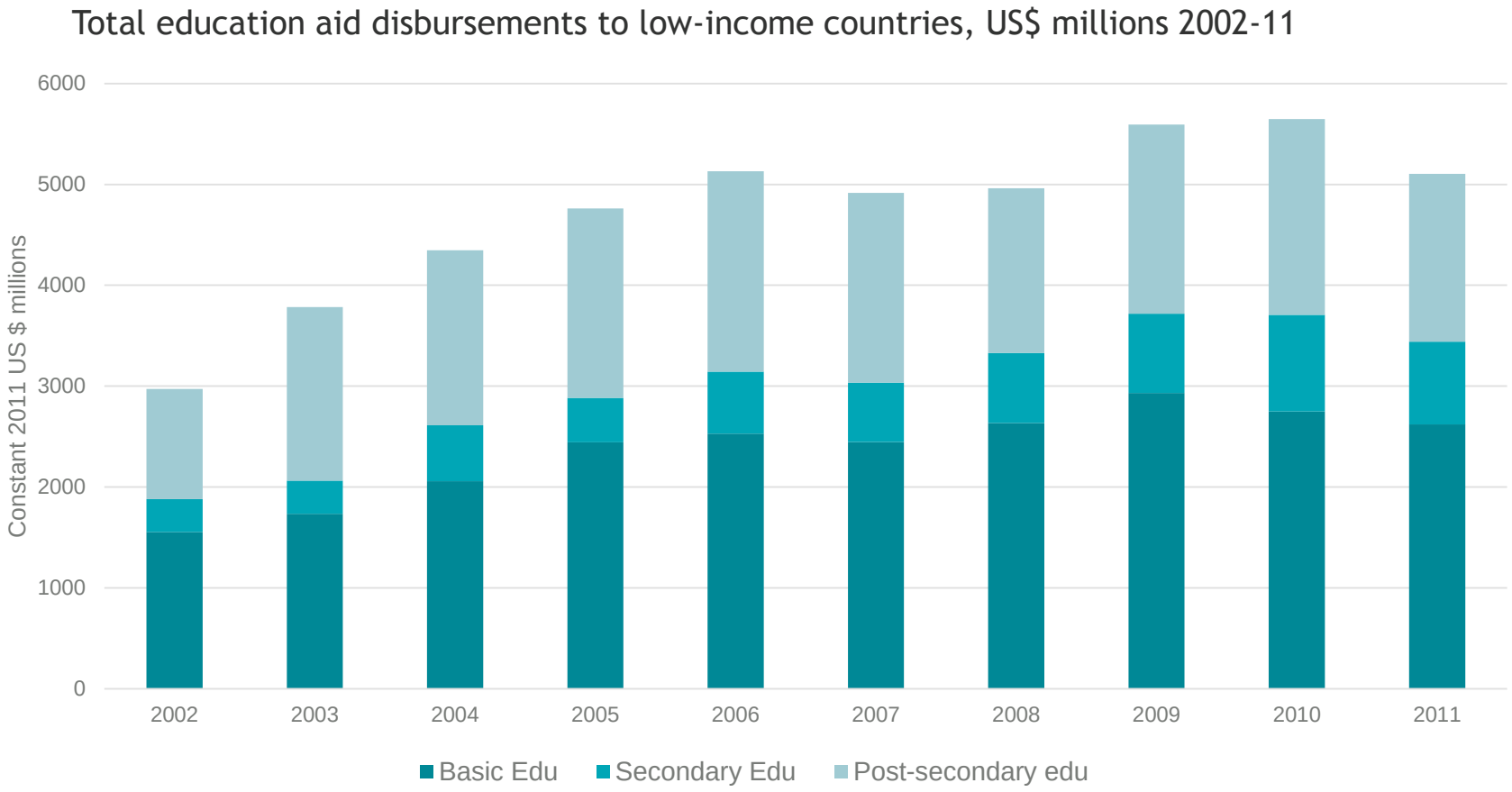
Public spending on primary education as % of govt. expenditure

Ethiopia	Benin	Solomon Islands	Gambia	Niger
16.5	14.7	13.6	12.6	12.2

Public expenditure on primary education as % of GDP

Myanmar	Liberia	Sri Lanka	CAR	DRC
0.39	0.47	0.48	0.64	0.84

Aid for basic education is declining



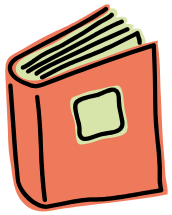
Source: OECD Creditor Reporting System (2013)

Previous loan buy-downs

Buy-down	Financing Agency	External donor	Loan/Credit (US$ million)	Status	Buy-down	Term shift	Triggers
China Education	IBRD	DFID	100.0	Closed	$34.5 million	IBRD fixed to approx. 2%	No
Pakistan Polio	IDA	Gates	138.3	Ongoing	NPV of Credit.	Credit to grant.	Independent results audit
Pakistan Polio	IsDB	Gates	227.0	Ongoing	Fees and mark-up of $3.6m p.a.	Repayment of principal only	Past performance
Nigeria Polio	IDA	Gates	138.7	Ongoing	NPV of Credit.	Credit to grant	Independent results audit
Botswana HIV	IBRD	EC	50.0	Ongoing	Euro14.0 million	Loan to credit	Achieved
China TB	IBRD	DFID	104.0	Closed	$37.0 million	IBRD fixed to approx. 2%	No
China Rural Development	IBRD	DFID	100.0	Closed	$32.4 million	IBRD fixed to approx. 2%	No
Samoa Power	ADB	AusAid	26.6	Ongoing	$4.0 million	Softening of Loan terms	No

Lessons from previous buy-downs

- Limited experience to date.
- Only one buy-down in education between DFID and China.
- Buy-downs provided by bilateral agencies with multilateral banks as lenders, all on new lending.
- Buy-downs encourage borrowing for education and health from otherwise reluctant countries.
- Can stimulate specific results if triggers are appropriately specified.



From our analysis so far…

- Low- and middle-income countries still have major challenges of both access and learning in basic education.
- These countries face an increasingly difficult external aid environment.
- Major multilaterals lending for basic education are
  - World Bank Group.
  - Islamic Development Bank.



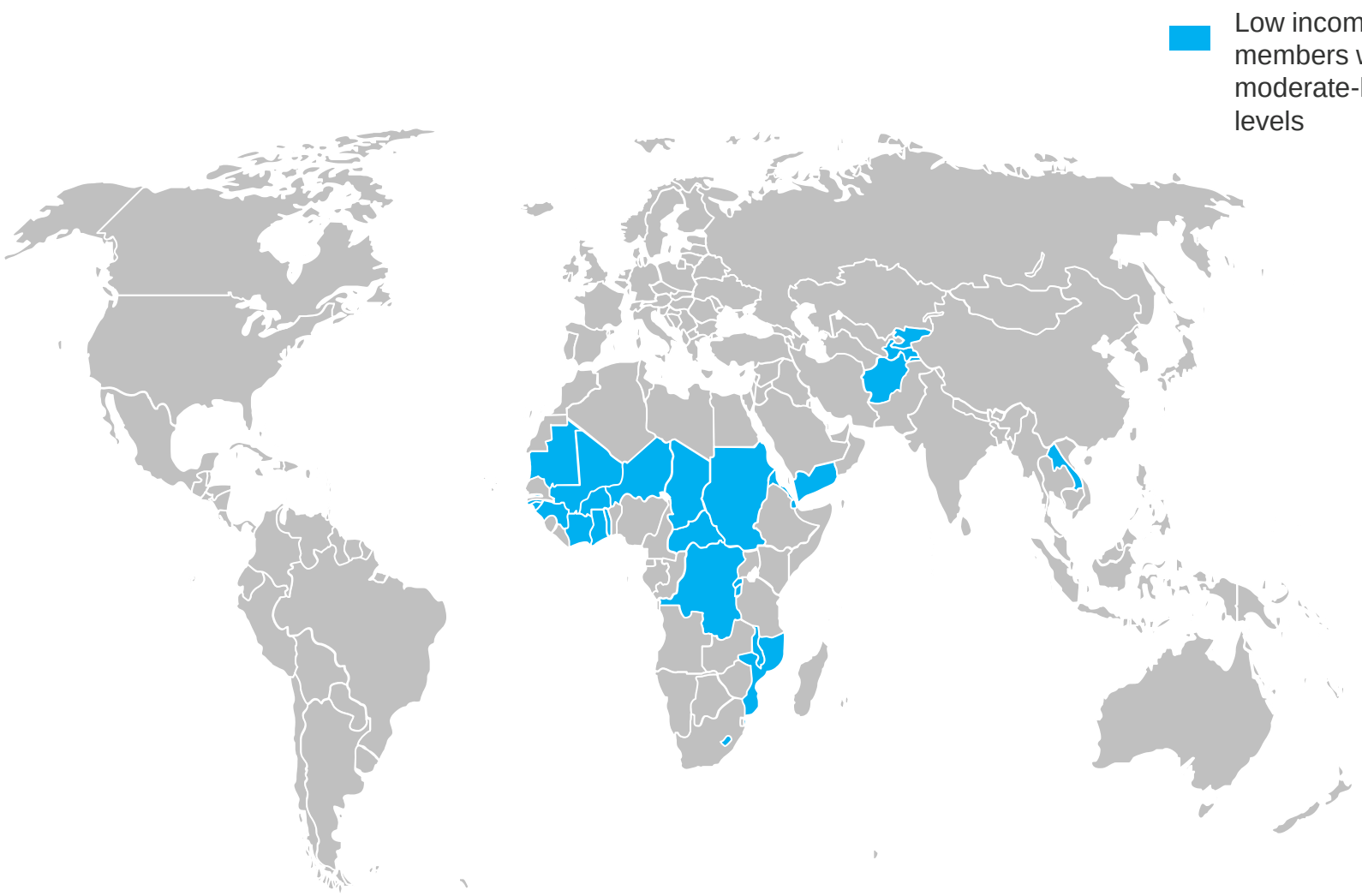
Which countries could buy-downs be piloted in?

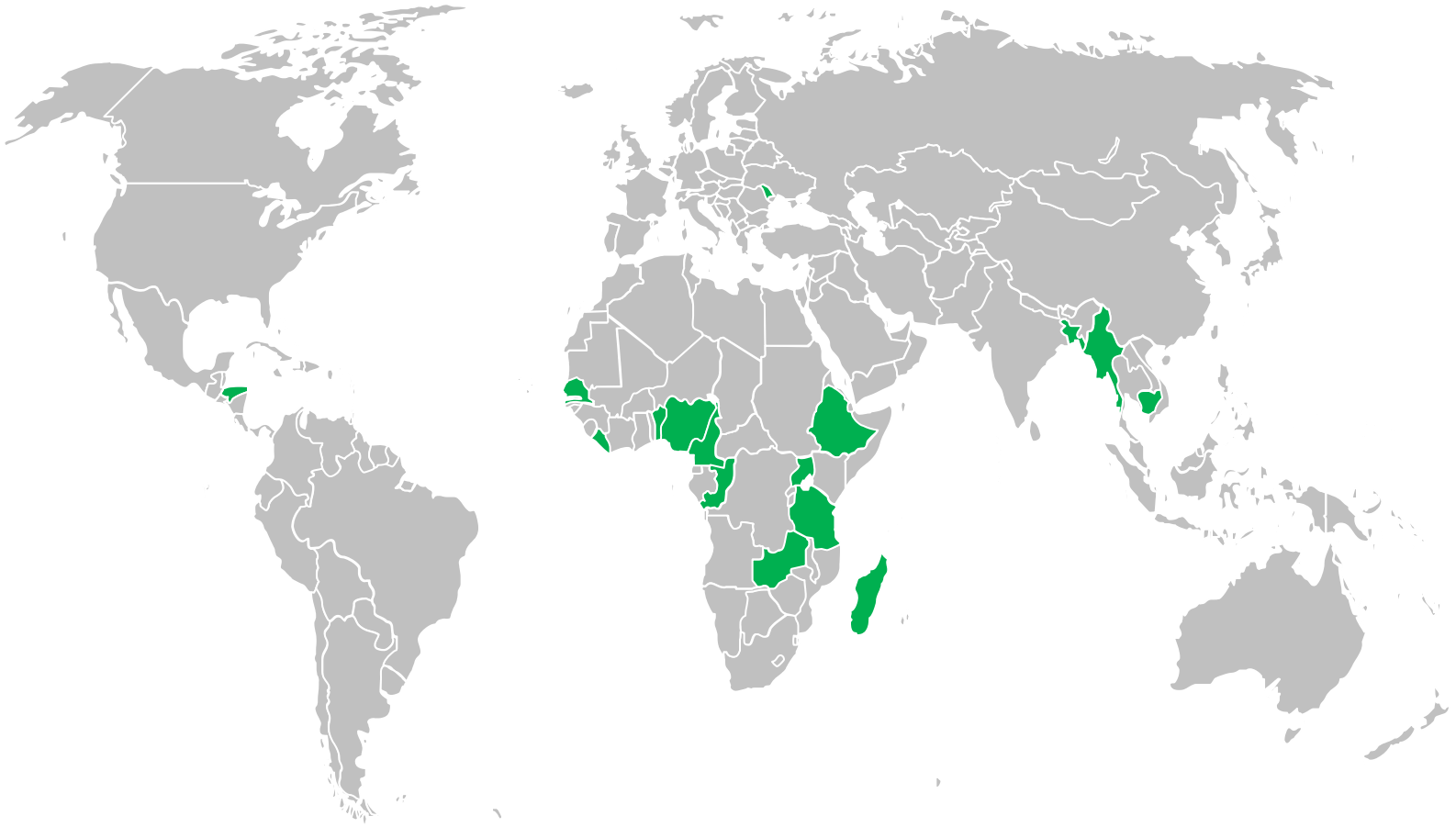


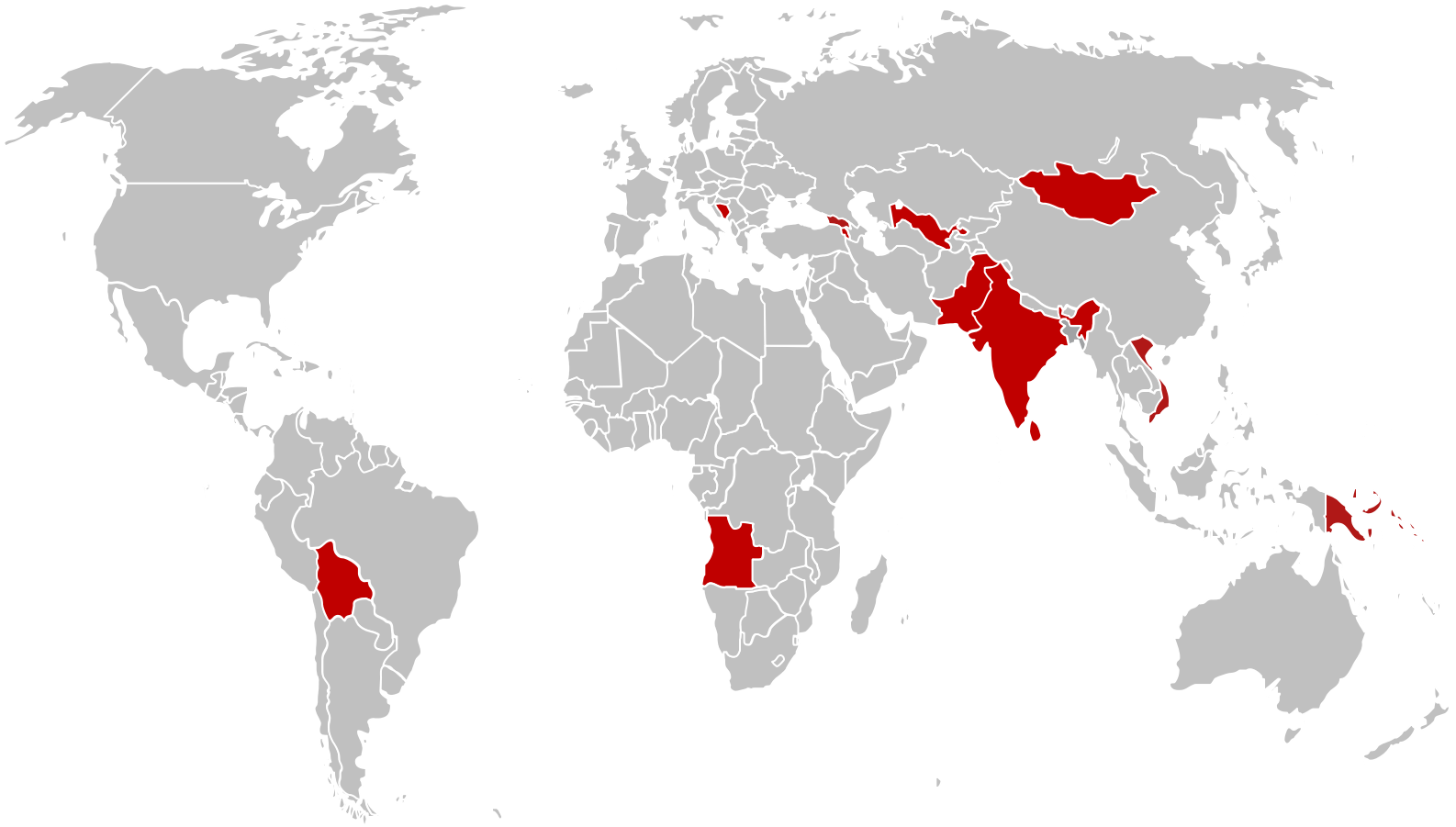
1. Low-income countries that are unable to borrow for education on hard terms.

2. Low- and middle-income countries that could absorb more debt on softer terms.

3. Middle-income IBRD borrowers who are reluctant to borrow for basic education on market terms.
   - IDA Category 2 or 3 blend countries.
   - IDA members that will or have recently graduated to IBRD.


Low income GPE members with moderate-high debt levels


Low-income GPE members that can absorb more debt


Blend IDA countries that are anticipated to graduate from IDA soon

Linking to Results

Four sets of issues need to be considered regarding buy-downs

I. Sectoral Programs

- Current GPE programs are board-approved and meet certain criteria.
- How can the quality of loans being bought down be kept to GPE standards?



II. Finance Ministries



- Loans, non-concessional or not, are more likely to be scrutinized by finance ministries than grants.
- Attaching triggers to loans may attract broader government attention beyond the MoE to the state of education than grants alone.

III. Triggers

- Carefully designed, triggers can raise incentives to get results.
- Should triggers be ex-ante or ex-post?
- Risk that the triggers will not be met and the buy-down will not take place.
  - Reduces incentive for countries to borrow for education.
  - Risk increasing a country's indebtedness.
- Who interprets if and when the triggers have been met?

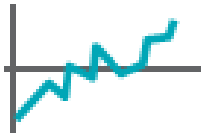
IV. Funding + Triggers

- Softer loans encourage more attention to sectoral performance.
  - Context of GPE's new M&E strategy

- Are minimum levels of funding with proper triggers needed to create sufficient country interest?



Operational Issues



- GPE Allocations
  - How can it be ensured that GPE country allocations remain the same?
- Donor Issues
  - Should there be a separate fund for buy-downs?
- Interest-rate environment
  - Current market rates are low. If rates rise again in the future, demand for buy-downs may rise.
- IDA Reflows
  - Any bought-down IDA credit is retired immediately, so there are no future reflows, which are a major source of future IDA replenishments.

Recommendation

Pilot program with consultation and testing

- To determine:
  - Country, lender, and donor interest.
  - Level of reform and progress in education sector.
  - Ex-post or ex-ante triggers and any disincentive effect.
  - Possibility of risks.



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