

# Can Donors Be Flexible within Restrictive Budget Systems? Options for Innovative Financing Mechanisms

**Benjamin Leo**

## Abstract

This paper focuses on how budgetary scorekeeping systems affect governments' ability or willingness to support innovative development finance initiatives and explores several options to overcome the restrictions the systems often impose. As a starting point, it assumes that donor governments, such as the United States, will not reform their budgetary system regulations to accommodate innovative development finance commitments due to political and budget policy concerns. In general, each option outlined entails important financial, political, and bureaucratic challenges and tradeoffs. In other words, there are no silver bullets. However, there are possible approaches that may merit further exploration by donor governments that want to support specific innovative development finance initiatives but are constrained by existing budgetary systems.

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## **I. OVERVIEW**

Over the last decade, a relatively limited number of donor country governments have financially supported several innovative development finance initiatives. These initiatives have taken a number of forms, such as providing market purchase guarantees to stimulate vaccine development for neglected diseases (Advance Market Commitments) and securitizing future aid budgets (International Finance Facility for Immunisations). Currently, several bilateral and multilateral donors are considering making aid disbursements contingent upon achievement of pre-agreed development outcomes (Cash on Delivery aid). Donor motivations behind these initiatives have been as varied as the structures themselves. Some donors have focused on a big financial push in support of the Millennium Development Goals (MDGs). This has led to front-loading future aid budgets or imposing unrelated taxes to mobilize incremental aid outlays. Others have focused on increasing the effectiveness of aid programs, increasing value for money, or addressing market gaps.

The global economic crisis – and resulting pressures on donor aid budgets – may lead to even greater exploration of innovative approaches to mobilizing development capital or increasing the impact of existing resources. Against this backdrop, this paper focuses on one important, yet largely unexplored facet – how donor governments’ budgetary scorekeeping systems impact their ability or willingness to support innovative development finance initiatives.

With very few exceptions, governments that have supported innovative initiatives in the past also have the most flexible budgetary rules (i.e., UK, France, and Norway). These rules generally allow governments to keep multi-year financial commitments off-budget until the fiscal year in which expenditures are actually made. Some countries, such as the UK, make extensive use of these types of commitments – both for domestic and international programs. Donor governments with more restrictive budgetary regulations, including the United States and Japan, have not been able or willing to support them. These and other governments typically must secure upfront congressional or parliamentary appropriations that cover the entire multi-year financial

commitment. In other words, the entire commitment is secured in the current fiscal year, which then feeds into top-level budget ceilings and out-year deficit projections.<sup>1</sup>

This paper explores several potential options for overcoming these budgetary scorekeeping restrictions. As a starting point, it assumes that donor governments, such as the United States, will not reform their budgetary system regulations to accommodate innovative development finance commitments due to political and budget policy concerns. In general, each option outlined entails important financial, political, and bureaucratic challenges and tradeoffs. In other words, there are no silver bullets. However, there are possible approaches that may merit further exploration by donor governments that want to support specific innovative development finance initiatives but are constrained by existing budgetary systems.

## II. INNOVATIVE DEVELOPMENT FINANCE INSTRUMENTS

This section provides a brief overview of several innovative development finance instruments – including their financial structure, operational modalities, projected disbursement profile, budget certainty (or contingencies), and donor government participation. In doing so, I identify a number of structural issues that present difficult challenges to donor governments with restrictive budgetary scorekeeping systems.

Advance Market Commitments: An advance market commitment (AMC) is a binding contract, typically offered by a government or other financial entity, which guarantees a viable market if a new product meeting agreed upon specifications is developed. Under the contractual terms, the sponsoring entities commit to subsidizing or paying for the purchase of a specific product – possibly specifying in advance the volume that will be purchased, the price which will be paid, or both.<sup>2</sup> This commitment is designed to create sufficient market certainty to incentivize production capacity and/or research and development (R&D) for traditionally neglected products or sectors. In terms of initial expenditures, no financial outlays would occur until the product is manufactured and ready for distribution. To date, donor governments have focused on using AMCs to overcome highly uncertain and commercially unattractive markets for neglected disease vaccines, such as pneumococcal disease.

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<sup>1</sup> For example, U.S. congressional appropriation acts include explicit budget ceilings for government departments and programs.

<sup>2</sup> See Michael Kremer (2001) “Creating Markets for New Vaccines: Part I: Rationale and Part II: Design Issues,” in Adam B. Jaffe, Josh Lerner, and Scott Stern (eds.), Innovation Policy and the Economy, MIT Press, Volume 1, 2001. Also see Michael Kremer, Owen Barder, and Ruth Levine, Making Markets for Vaccines: Ideas to Action, Center for Global Development, 2005.

In February 2007, five donor governments (Canada, Italy, Norway, Russia, and the United Kingdom) and the Bill & Melinda Gates Foundation committed \$1.5 billion to launch the first AMC to accelerate commercial availability and affordability of a new pneumococcal vaccine tailored specifically to developing country requirements.<sup>3</sup> In addition to the donor funds, GAVI and recipient governments will co-finance the vaccines. By accelerating production and distribution of the vaccine, the AMC initiative aims to save up to 7 million lives by 2030. In 2009, these sponsoring entities reached agreement with the GAVI Alliance, the World Bank, WHO, and UNICEF on appropriate implementation modalities.<sup>4</sup> In 2010, GlaxoSmithKline and Pfizer became the first two pharmaceutical companies to make long-term commitments to supply new pneumococcal vaccines in developing countries.<sup>5</sup> The two participating firms each committed to supply 30 million doses annually over a ten-year period. Given its early success at mobilizing private sector activities, donor governments now are assessing whether AMCs could be applied to other development-related issues, such as new agricultural seed varieties or other technologies.<sup>6</sup>

While AMCs provide market certainty for producers through a binding agreement, they also involve significant budgetary uncertainty for the sponsoring organizations. There is no guarantee that private companies will pursue R&D activities or successfully develop and market a product that meets the AMC specifications. As such, financial commitments and resources may never be tapped. Assuming that the appropriate product is developed successfully, there still remains significant timing uncertainty. By illustration, an AMC agreement may project that the respective procurement entity would begin purchasing a new vaccine in 2014. However, pharmaceutical companies may not develop the vaccine until 2016 or even later. As such, predicted budgetary outlays would not occur for 2014 and 2015. For donors with flexible budgeting systems, this uncertainty does not present a significant problem. However, some donor governments have restrictive or highly conservative budgeting laws and regulations (see section III for details). For them, the purchasing and timing uncertainty raise very important policy tradeoffs. Should donor governments tie up scarce budget envelope resources or re-allocate them to other high impact development programs now? To date, countries like the

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<sup>3</sup> Pneumococcal disease is a major cause of pneumonia and meningitis, which kill roughly 1.6 million people every year. A 9-valent pneumococcal vaccine has been available for many years. However, this vaccine does not address pneumococcal strains prevalent in developing countries. The AMC requires pharmaceutical companies to create a vaccine that addresses these developing country strains.

<sup>4</sup> Under the pneumococcal AMC, the sponsoring entities make grant payments to the IBRD according to their specific contribution schedules or through an agreed demand-based payment arrangement. The IBRD holds donor payments on its balance sheet. These are designated assets with a corresponding liability and are paid to GAVI under the AMC terms and conditions. In turn, the WHO is responsible for establishing the minimum technical criteria for a suitable pneumococcal vaccine and UNICEF is responsible for vaccine procurement and distribution.

<sup>5</sup> These commitments illustrate a commitment of interest and are contingent upon the companies successfully developing a pneumococcal vaccine that meets the pre-determined specifications.

<sup>6</sup> For an overview of potential agricultural sector applications, see Kimberly Elliot (2010), "Pulling Agricultural Innovation and the Market Together," Center for Global Development, Working Paper 215.

United States and Japan have been unable to overcome these challenges – even if they were to support the underlying objectives and rationale for an AMC-type initiative.

International Financing Facility for Immunization: The International Finance Facility for Immunization (IFFIm) was established in 2006 to increase the availability and predictability of funding for immunization programs. At its core, the IFFIm is designed to front-load donor funding committed over the medium- to long-term through securitized bond offerings. In turn, bond proceeds would finance near-term immunization campaigns. The IFFIm aims to provide the following benefits: (1) increased purchasing power (i.e., lower costs through large bulk vaccine purchases); (2) allowing procurement organizations (ex – GAVI Alliance, UNICEF) to enter into long-term purchase commitments which can significantly reduce the unit cost of vaccines; (3) reductions in the long-term disease burden by front-loading of immunization, which increases “herd immunity” in affected communities; and (4) improved planning and budgeting in recipient countries.<sup>7</sup>

The IFFIm’s basic financial and operational structure is as follows:

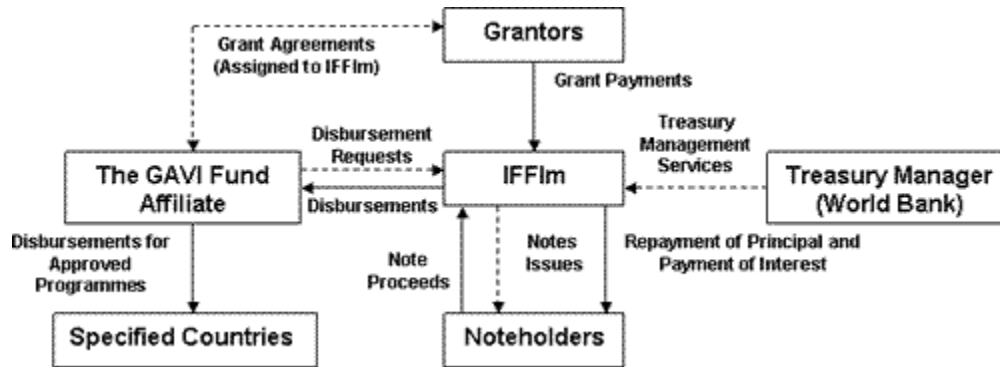
- (1) *Donor Commitment:* Sponsoring governments (United Kingdom, France, Italy, Spain, Sweden, The Netherlands, Norway, and South Africa) make legally binding commitments to contribute \$5.3 billion to the GAVI Alliance over twenty years. In turn, the GAVI Alliance formally agrees to transfer these donor contributions to the IFFIm over time.
- (2) *Bond Issuance:* The IFFIm – as a special purpose vehicle<sup>8</sup> – issues bonds on international capital markets backed by the guaranteed stream of donor payments (see appendix I for list of IFFIm bond offerings). Based on this guaranteed payment stream, credit agencies have assigned a AAA bond rating to the IFFIm.
- (3) *Financial Management:* The World Bank, on behalf of the IFFIm, manages bond proceeds as liquid investments until utilization for immunization programs in recipient countries.
- (4) *Program Utilization:* Funds flow from IFFIm to the GAVI Alliance to finance approved immunization programs in developing countries.
- (5) *Bond Repayment:* IFFIm repays bondholders using funds provided by donors pursuant to the agreed and legally binding grant payment obligations.

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<sup>7</sup> Source: [http://www.gavialliance.org/vision/policies/in\\_financing/iffim/index.php](http://www.gavialliance.org/vision/policies/in_financing/iffim/index.php)

<sup>8</sup> IFFIm was established as a charity with the Charity Commission for England and Wales (UK charity registration number 1115413) and registered in England and Wales as a company (registration number 5857343).

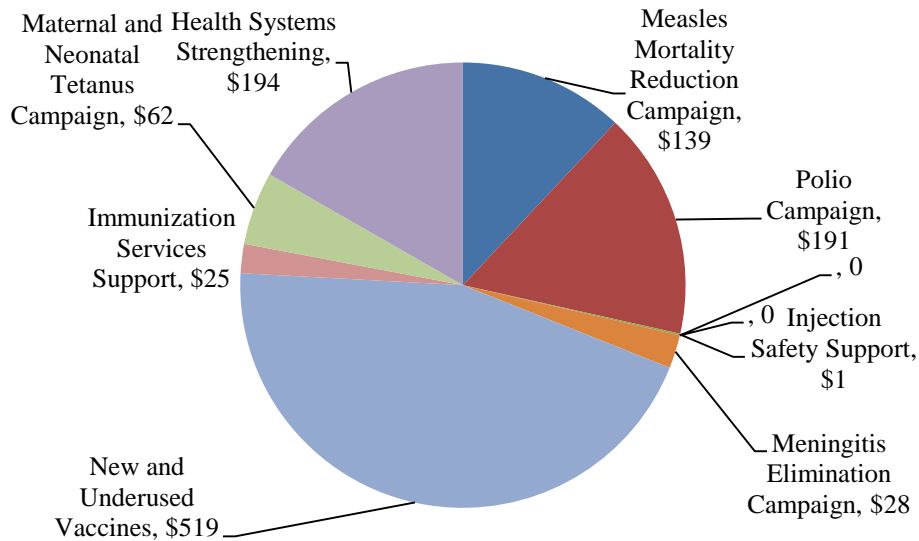
**Figure 1 – IFFIm Financial Structure**



Source: IFFIm

To date, the IFFIm has mobilized over \$2.6 billion to support GAVI Alliance immunization programs. The IFFIm’s average interest rate cost has been 1.6 percent – or 0.05 percent below the average London Inter-Bank Offering Rate (LIBOR).<sup>9</sup> In terms of operational programming, GAVI has provided more than \$1.4 billion as of April 2010 to support vaccine delivery in 70 developing countries (see figure 2 for allocation details).<sup>10</sup> The IFFIm expects to prevent more than 4 million premature deaths by end-2010 and protect more than 500 million children through immunizations over time.

**Figure 2 – IFFIm-Supported Expenditures, as of April 2010 (in USD millions)**



Source: IFFIm

<sup>9</sup> Source: IFFIm Update – 5 June 2010, “IFFIm on track to help save four million lives”

<sup>10</sup> *Ibid*

The IFFIm is an innovative way to frontload long-term donor assistance ahead of the Millennium Development Goals (MDGs) deadline in 2015. In budgetary terms, this frontloading creates policy tradeoffs for sponsoring governments as well as challenges for other donor countries with more restrictive regulations. After 2015, sponsoring governments will utilize a portion of their aid budgets to repay IFFIm bondholders. The budgetary size depends on a number of factors, such as the nature of the financial commitment (size, duration, etc) and whether the respective government has increased their aid budget in the interim period. At its inception, many IFFIm donors planned to increase aid budgets considerably over the medium-term.<sup>11</sup> In simple terms, the IFFIm allowed these countries to securitize future planned aid increases for immediate usage. Ostensibly, the impact could be modest and justified by the benefits of bringing services forward, which increase the economic and social returns generated by child vaccination programs. However, if the financial commitment is sizable relative to a respective government's overall aid budget and aid increases have failed to materialize in the interim (ex – Italy), then the impact could be significant. This could lead to a reduction in continued vaccination or other development programs after 2015.

For governments with restrictive budget scorekeeping rules, the IFFIm would require an upfront appropriation covering the entire financial commitment. This requirement undercuts the IFFIm's central financial engineering focus – securitizing future aid budgets. Instead, governments like the United States would provide a massive upfront contribution immediately, which is not tied to future aid budgets.

Cash on Delivery Aid: Under Cash on Delivery (COD) aid, donors would commit ex-ante to pay a set monetary amount once a specific development progress measure has been achieved.<sup>12</sup> Progress-based disbursements could be time-bound or more flexible over a longer time period. By illustration, donors could commit to pay \$100 for each additional child who completes primary school and takes a standardized competency test. A credible baseline survey would be conducted, the country would publish completion numbers and test scores, and then the donor would pay for an independent audit to verify performance figures. Donor disbursements would be executed following completion of the independent audit. This outcome-based approach allows the recipient country to determine the most appropriate policies and activities to achieve the agreed progress targets. In the education example, the country could choose to build new schools, train teachers, distribute conditional cash transfers, or even build new roads or provide school feeding programs. Nancy Birdsall and other staff at the Center for Global Development,

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<sup>11</sup> European nations committed to raise aid levels to 0.7 percent of their gross national income. To achieve this target, most countries' aid budgets would have to increase significantly. Several Nordic countries, such as Norway and Sweden, already provide 1.0 percent of their GNI towards development assistance.

<sup>12</sup> See Nancy Birdsall and William Savedoff (2010), Cash on Delivery: A New Approach to Foreign Aid, Center for Global Development.



who originally proposed the COD aid approach, are exploring potential applications across a number of sectors, such as education, health (maternal mortality), and water.<sup>13</sup>

COD aid could provide several distinct advantages over traditional donor approaches. First, it ensures that donor taxpayer resources only fund demonstrable outcomes. Traditionally, donors have taken a very hands-on approach to developing aid projects – including dictating specific strategies and activities. However, some argue that donors rarely can identify the most optimal use of funds across vastly differing country and social circumstances. By placing decision making authority squarely in the hands of recipient governments and local populations, COD aid hopes to improve resource productivity and the probability of programmatic success. Relatedly, empowering recipient governments can facilitate organic learning over time. It allows them to learn from mistakes as well as build on successful programs. Second, COD aid would utilize recipient countries' existing budget and procurement systems. To date, a significant portion of donor funding has circumvented local systems. While the concern about corruption and misallocation of scarce donor resources is understandable, this circumvention can undermine country institutions and processes – thereby hindering the long-term development of local capacity.

As proposed, COD aid programs would not include financial, environmental, or social controls. However, a sponsoring entity could restrict COD contracts to countries whose national systems, such as financial management and anti-corruption controls, meet an agreed acceptable standard. Alternatively, the underlying agreement could stipulate that COD disbursements would not be provided if corruption scores deteriorated in relative or absolute terms. This approach may actually have a positive dissuasion impact due to the government's incentives to ensure receipt of the financial payout.

While COD aid's outcome-based approach could provide significant benefits for recipient governments and donor country taxpayers, it also creates budgetary challenges for some donor governments. Similar to AMCs, COD aid inherently involves uncertainty that donor resources ultimately will be spent in the future. This uncertainty is one of the key benefits since it ensures that donor funding only is allocated in response to independently verified results. Yet, donors with more restrictive budgetary rules have viewed this as a decision between tying up scarce budgetary authority versus allocating it upfront to other development programs.

### **III. BUDGET SYSTEM RULES**

Budgetary systems vary widely across donor countries. For innovative development finance initiatives, the most important differentiator is whether governments must provide budgetary

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<sup>13</sup> See [http://www.cgdev.org/section/initiatives/\\_active/codaaid](http://www.cgdev.org/section/initiatives/_active/codaaid)

authority upfront before entering into legally-binding multi-year commitments – including contingent commitments – or whether they can provide budgetary authority over time as financial outlays are required. Governments that must provide budgetary authority upfront recognize financial commitments against the budget ceiling in the fiscal year in which the obligation is made – regardless of the time horizon (i.e., one-year or multi-year outlays). Other governments have the ability to record budgetary authority only when they outlays are incurred – not when the original commitment was made. In both cases, the spending is recorded against the deficit in the year in which the liabilities are realized.

Upfront budget authority scoring for all financial commitments is designed to ensure that decision makers fully consider all known costs before entering into irrevocable financial commitments. In addition, it aims to prevent governments from shifting budgetary and financial burdens onto future generations of taxpayers and government officials. This helps to ensure the government’s ability to address future priorities and challenges. For example, multi-year commitments could constrain a respective government’s ability to use spending cuts for counter-cyclical policy. However, upfront budgeting also produces significant challenges with respect to financing large capital investment programs or multi-year programs. Including all medium- and long-term commitments in the current fiscal year’s budget creates political disincentives to immediately tying up scarce budgetary authority, which could be utilized for shorter-term programs and activities. In contrast, more flexible budgetary systems (i.e., not providing full upfront budget authority) can smooth out capital funding or multi-year obligations by recognizing outlays only in the fiscal year with which they are spent.<sup>14</sup> It also enables governments to increase the productivity of public expenditure by entering into long-term commitments and by inter-temporal optimization. There can be very significant economic benefits from long term commitments and shifting payments – which is why the private sector has evolved institutional arrangements for entering into and enforcing long-term contracts.

United States: Under the Anti-Deficiency Act, U.S. federal agencies must make budgetary authority available before entering into any binding obligation that will result in outlays immediately or at some point in the future.<sup>15</sup> This means that agencies must have budget authority sufficient to cover the total of such obligations at the time they are made. In most cases, this would require a congressional appropriation to fulfill the respective federal government obligation. Put differently, government agencies cannot make payments or financial

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<sup>14</sup> While this paper presents a binary picture of budget scoring, country systems and regulations may contain numerous nuances to address different dimensions of government commitments, such as whether they: (1) are posted publicly; (2) are subject to approval mechanisms; (3) fall within approved spending envelopes; and (4) are recorded against current or future years.

<sup>15</sup> An obligation is defined as a legally binding agreement that will result in outlays, immediately or in the future. The federal government incurs an obligation whenever it places an order, signs a contract, awards a grant, purchases a service, or takes other actions that require the Government to make payments to the public or from one government account to another.

commitments unless there is funding approved (i.e., available appropriation) to cover the *entire* financial commitment.

In broad terms, congressional appropriations provide government agencies with budgetary approval, which then can be mobilized immediately or over time for actual financial outlays. Annual deficit calculations are based upon these actual outlays – as opposed to approved budgetary authority. As such, upfront budgetary authority requirements for multi-year programs do not necessarily impact deficit calculations in the current fiscal year.<sup>16</sup> However, the Office of Management and Budget (OMB) utilizes projected outlay schedules for multi-year disbursements to calculate out-year deficit projections. The largest dissuasive impact of the upfront appropriation requirement actually is its impact on annual budget ceilings. Congressional appropriation acts typically outline specific limits (or ceilings) on overall agency or program funding levels. As a result, upfront appropriation requirements for multi-year commitments – especially if they are large – present significant zero-sum tradeoffs with disbursing programs. In effect, the U.S. Government would be shrinking the programmatic pot. These tradeoffs are even more material if the financial commitment is of a contingent nature.

Congressional appropriation acts typically specify a date when funds will become available for obligation. In the absence of a specific date, the appropriation is assumed to be effective upon enactment.<sup>17</sup> This date determines the fiscal year for which new budget authority is scored.<sup>18</sup> Congress has the authority to provide advance appropriations, which dictate that either all or a portion of the budget authority shall not become available for obligation until a future fiscal year. OMB scores advance appropriations in the fiscal year for which the new budget authority becomes available for obligation, not when Congress enacts the appropriations. In other words, advance appropriations shift budgetary authority into future years, but they still must be scored against the budget in their entirety as soon as the authority becomes available. Congress also may enact contingent legislation, which requires a subsequent appropriation act before budgetary authority may become available for obligation. In this case, OMB scores the new budgetary authority only following the subsequent appropriation.

In certain circumstances, a federal agency may receive contract authority permitting it to incur obligations in advance of an appropriation, offsetting collections, or related receipts to cover the outlay obligations at a later date. Typically, Congress provides contract authority in an authorizing statute that allows the agency to incur obligations in anticipation of the collection of receipts or offsetting collections. For some federal programs, the law authorizes the use of offsetting collections to liquidate the obligations incurred against the contract authority without further appropriation action. In a few cases, such as the foreign military sales program, the law

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<sup>16</sup> Unless the multi-year program commitment includes actual outlays for the current fiscal year.

<sup>17</sup> OMB Circular No. A-11 (2008)

<sup>18</sup> In simple terms, scoring means that the obligation is included on-budget.

that provides the contract authority also appropriates the receipts without further appropriation action. If the program does not have sufficient collections to cover the contract authority obligations, then Congress would enact a general fund appropriation.

U.S. budgetary laws and regulations provide some flexibility for the contracting of services or supplies. For example, the federal government may provide non-binding letters of intent without budgetary authority. However, this budgetary authority – almost always provided through a congressional appropriation – is required before the government can authorize the contractor to proceed with the respective services or provision of supplies. Typically, this occurs through a specific purchase order. Figure 3 below outlines obligation requirements and budget scoring timing for different types of U.S government contracts.

**Figure 3 – U.S. Procurement Contracts, Obligation Requirements and Timing**

<b>Types of Contracts</b>	<b>Required Obligation Amount</b>	<b>Obligation Timing</b>
Maximum price contracts	The maximum price	Upon contract signature
Letters of intent and letter contracts	Typically no obligation amount	N/A
Letters with binding agreements <i>(authorizing the contractor is authorized to proceed)</i>	The maximum amount indicated in the letter that the contractor is authorized to incur to cover expenses prior to the execution of a definitive contract.	Upon letter signature
Variable quantity contracts	Typically no obligation amount	Upon contract signature
Variable quantity contracts <i>(once purchase orders are issued)</i>	Total purchase order amount	Order Issuance

As applied to innovative development finance initiatives, these U.S. budgetary laws and regulations would require that the U.S. Congress provide an appropriation before the federal government could enter into a legally binding, contractual obligation. Moreover, the appropriation must cover the full amount committed over the initiative’s entire lifespan. For example, if the U.S. government signed a legally binding commitment to provide \$1 billion between 2013 and 2023 to finance a malaria vaccine AMC, then it first would have to secure a \$1 billion congressional appropriation in the current fiscal year. Alternatively, Congress could provide an advance appropriation stipulating that budget authority would become available for obligation in 2013. Nonetheless, OMB would score the entire \$1 billion appropriation in 2013. As such, U.S. budgetary rules do not differentiate the fact that the commitment would be spread over a ten-year period. In operational terms, the \$1 billion would be credited to the sponsoring agency’s (ex – USAID) account at the U.S. Department of the Treasury. USAID’s balance would remain there until utilized by the malaria AMC initiative.<sup>19</sup>

<sup>19</sup> This usually would be a virtual exercise. Money would not actually be deposited in an account. Instead, USAID’s approved budget authority would be tracked and then drawn down over time.

The practical consequence of these budgetary arrangements is that an appropriation for a forward commitment – while not adding to the deficit until specific outlays are made – does reduce the budgetary ceiling provided by Congress. As a result, it reduces the budgetary envelope available for immediate spending programs. Given these restrictive scorekeeping rules, the U.S. government has not participated in innovative development finance initiatives that entail a legally-binding multi-year commitment.<sup>20</sup> U.S. officials, as well as congressional representatives, have been unwilling to lock up scarce budgetary authority over the medium- to long-term instead of supporting development programs immediately. Initiatives that entail disbursement uncertainty, such as AMCs or COD aid, make that decision even more difficult.

One might argue that the U.S. government has made multi-year financial obligations (see figure 4). In May 2007, President Bush committed to provide \$30 billion over five years for the President’s Emergency Plan for HIV/AIDS Relief (PEPFAR). In addition, President Bush committed in 2005 to provide \$1.2 billion over five years to support the President’s Malaria Initiative (PMI). In addition, the U.S. regularly makes commitments to international financial institutions, such as IDA and the African Development Fund. However, none of these ‘commitments’ are legally binding and are explicitly contingent upon congressional appropriations over time.

**Figure 4 – Select U.S. Government Development Initiatives**

<b>Initiative</b>	<b>Commitment Size</b>	<b>Year Announced</b>	<b>Time Period</b>	<b>Legally-Binding</b>
Africa Education Initiative I	\$200 Million	2002	5 years	No
President's Emergency Plan for HIV/AIDS Relief I	\$15 Billion	2004	5 years	No
President's Malaria Initiative	\$1.2 Billion	2005	5 years	No
Multilateral Debt Relief Initiative	-	-	-	-
<i>World Bank (IDA)</i>	\$7.6 Billion	2005	40 years	No
Africa Education Initiative II	\$400 Million	2005	4 years	No
President's Emergency Plan for HIV/AIDS Relief II	\$30 Billion	2007	5 years	No
Basic Education Initiative	\$425 Million	2008	5 years	No

European Union – Role of Eurostat: Most European countries – such as the United Kingdom and France – have more flexible budgetary laws and regulations than the United States in terms of budget scorekeeping. In many cases, this is due to a differing relationship between the executive and legislative branches of government. While individual member countries have their own distinct rules (see examples below), the EU’s statistical body (Eurostat) plays an important overarching role for budgetary scorekeeping. Eurostat’s core mission is to collect and disseminate harmonized statistics for EU member countries, which can be aggregated at the regional level. It collects data on a very broad set of issues, ranging from crime to each government’s financial and budgetary accounts. At its core, Eurostat’s data harmonization

<sup>20</sup> The U.S. government also had policy concerns about a few of the previously proposed initiatives, such as the IFFIm.

mandate provides it significant influence in determining how government commitments should be scored in terms of annual budgets and deficits.<sup>21</sup>

In 2005, Eurostat ruled that IFFIm borrowing on international capital markets, which is backed by legally-binding donor commitments, would not be recorded as borrowing or debt obligations by the sponsoring countries themselves.<sup>22</sup> Eurostat based its decision on several factors. First, it argued that the IFFIm was a non-governmental unit. As such, the IFFIm's borrowing activities were not considered those of participating donor countries. Second, donor government commitments were provided conditionally based on the fulfillment of specific conditions by recipient countries.<sup>23</sup> Lastly, participating donor governments did not provide an explicit guarantee of IFFIm debt obligations. As such, bondholders assumed the ultimate risk of IFFIm failing to meet its principal and interest repayment obligations. By extension, Eurostat ruled that government donations for the IFFIm initiative should be scored on national budgets only once they are actually transferred to GAVI over time.

Eurostat explicitly stated that its IFFIm ruling is not precedent setting and that ongoing issues would be examined on a case-by-case basis. Despite this, it does suggest broad financial structure parameters that would raise the likelihood of similar budgetary rulings in the future. These include: (1) conditional, yet legally-binding, financial commitments; and (2) non-governmental organization participation as the capital-raising entity and financial clearing house.

United Kingdom: Under UK budgetary rules, the government may enter into long-term legally binding financial commitments. For most commitments, parliamentary approval is not required until the fiscal year in which the payment is made (i.e., off-budget commitments). However, projected future government spending programs of a significant size (such as the Public Finance Initiative and public sector pensions) are included in the government's deficit projections.<sup>24</sup> Multi-year arrangements are most common for public-private partnerships focused on domestic capital infrastructure investments. Under these so-called Private Finance Initiative (PFI) agreements, the UK government makes a contractual obligation to provide annual unitary payments for a specific period of time<sup>25</sup> in return for a particular service or capital investment activity. A COD aid program could be structured very similarly to these PFI agreements. PFI unitary payments are projected to total £7.8 billion in 2010, or roughly 2 percent of total

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<sup>21</sup> The Maastricht Treaty's budget deficit limits underpin this data harmonization mandate. In the aftermath of the Greek debt crisis, EU finance ministers have further expanded Eurostat's powers – allowing it to audit member countries' national financial accounts.

<sup>22</sup> EUROSTAT Press Release STAT/05/98 - *Accounting Implications of the "International Finance Facility for Immunisation" Initiative*

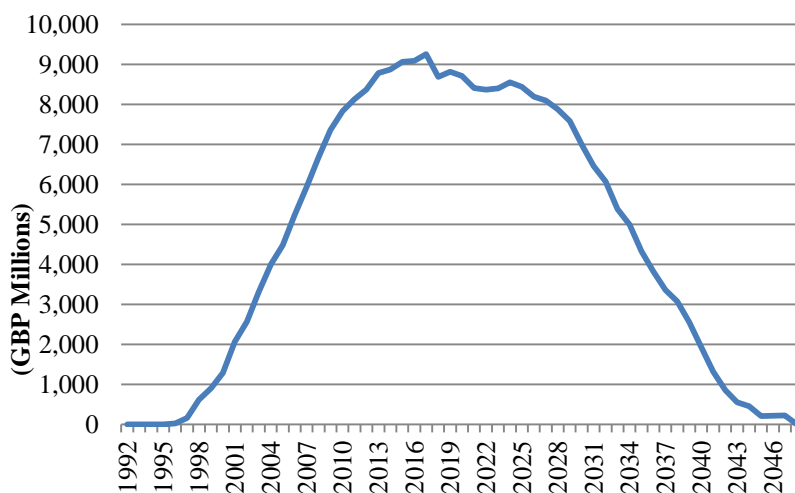
<sup>23</sup> Participating countries made their financial commitments contingent upon recipient countries remaining current on payments to the IMF (i.e., not falling into arrears).

<sup>24</sup> While these commitments may remain off-budget, the government is obliged to report them publicly.

<sup>25</sup> As of April 2010, Private Finance Initiative obligations ranged between 5 and 46 years. On average, PRI obligations span 26 years.

government expenditures.<sup>26</sup> As of April 2010, projected unitary payment obligations totaled £215 billion between 2011 and 2048 (see figure 5).<sup>27</sup> Of this amount, £173 billion is off-budget (over 80 percent). Although, the UK Parliament does not provide advance approval for these commitments, the associated payment projections factor into medium- and long-term deficit projections. As such, the UK government takes these future liabilities into account when determining current year spending ceilings.<sup>28</sup>

**Figure 5 - Projected UK Government PFI Unitary Payment Obligations, 1992-2048**



Source: HM Treasury

Over time, the UK has been a leading champion and participant in innovative financing initiatives. For example, it led technical and political efforts to establish the IFFIm and is the second largest contributing member to the pneumococcal AMC.<sup>29</sup> The UK Government's legally-binding commitments for these two innovative initiatives total nearly \$2.6 billion over time.<sup>30</sup> Currently, it is actively considering new innovative instruments, such as COD aid.<sup>31</sup>

Canada: Under the Financial Administration Act of 1985, government departments are required to secure a Parliamentary appropriation before executing expenditures for approved programs.<sup>32</sup> Moreover, they cannot enter into a contract or other arrangement that provides for a financial

<sup>26</sup> Source: HM Treasury. See [http://www.hm-treasury.gov.uk/ppp\\_pfi\\_stats.htm](http://www.hm-treasury.gov.uk/ppp_pfi_stats.htm)

<sup>27</sup> As of April 2010, the UK government had nearly 670 separate private finance initiative commitments on its books. See [http://www.hm-treasury.gov.uk/ppp\\_pfi\\_stats.htm](http://www.hm-treasury.gov.uk/ppp_pfi_stats.htm).

<sup>28</sup> Again, the UK Government must publicly report these long-term commitments. As such, they may form part of the context for national discussions about long-term deficits and the affordability of spending programs.

Nonetheless, they are not subject to voting by the UK Parliament until the cash payments actually fall due.

<sup>29</sup> The Italian Government is the largest financial sponsor of the pneumococcal AMC, with a commitment to provide \$635 million over 20 years.

<sup>30</sup> The UK Government committed to provide \$2.59 billion to the IFFIm over 20 years and \$485 million to support the pneumococcal AMC. Source: GAVI Alliance.

<sup>31</sup> See *One World Conservatism: A Conservative Agenda for International Development*, page 6.

<sup>32</sup> Financial Administration Act of 1985, paragraph 29.1(2)

payment unless there is an unencumbered appropriated balance available to execute the contractual obligation.<sup>33</sup> While Canada's budget scorekeeping rules are restrictive, the government does have some flexibility in terms of managing the cash flow associated with multi-year commitments. For example, the Canadian Finance Ministry could utilize un-committed general appropriation resources to finance the upfront financial contributions. This has the effect of ensuring that the innovative development finance initiative commitments do not impact existing appropriations or budget ceilings for development programs.

Despite its restrictive budget laws, the Canadian Government committed to provide \$200 million to support the pneumococcal AMC. The Canadian International Development Agency (CIDA) provided \$115 million in upfront funding for this initiative, with the remaining funds payable upon demand annually until the \$200 million commitment is reached (despite the uncertainty of the demand schedule).<sup>34</sup>

Australia: Under sections 81 and 83 of Australian constitution, all monies drawn from the Consolidated Revenue Fund (CRF) must be appropriated through parliamentary acts. After this, budgetary resources are allocated to specific government agencies and departments. Under the Financial Management and Accountability Act of 1997 (FMA Act) and the Financial Management and Accountability Regulations (FMA Regulations), each agency or department then must ensure they have certain approvals before committing and executing spending outlays. Some approval powers are attached to agency or department chief executives while others are delegated by the Australian finance minister. Several key legal and regulatory provisions include:

- *FMA Regulation 9:* All expenditures must be approved by a relevant delegate who ensures that the expenditure (regardless of size) is efficient, effective and ethical.
- *FMA Regulation 10:* All multi-year expenditures must be approved in writing – typically by a higher delegate. Depending on the length of the spending proposal, this could range from senior management to the agency or department chief executive in consultation with the finance minister.
- *FMA Act Section 44:* Chief executives have the power to enter into binding contracts, agreements, and commitments provided that FMA Regulations 9 and 10 have been satisfied.

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<sup>33</sup> Financial Administration Act of 1985, paragraph 32. Exact language reads as follows – “No contract or other arrangement providing for a payment shall be entered into with respect to any program for which there is an appropriation by Parliament or an item included in estimates then before the House of Commons to which the payment will be charged unless there is a sufficient unencumbered balance available out of the appropriation or item to discharge any debt that, under the contract or other arrangement, will be incurred during the fiscal year in which the contract or other arrangement is entered into.”

<sup>34</sup> The first installment totaled \$115,000,000 while subsequent installments will provide the remaining outstanding balance. Source: [www.acdi-cida.gc.ca](http://www.acdi-cida.gc.ca)



Norway: Norway has participated in several innovative development finance initiatives, such as the pneumococcal AMC, IFFIm, and several outcome-based environmental programs. In 2008, Norway committed to provide \$1 billion to the Amazon Fund over a ten-year period. To qualify for each \$100 million annual installment, Brazil must ensure that deforestation remains at a rate lower than the average of the previous ten years. From a budgetary perspective, Norway's payments are recorded on-budget only once they are paid to Brazil.<sup>35</sup> This structure has strong similarities to COD aid's outcome-based disbursement approach. In 2006, the Norwegian Government made a legally-binding commitment to provide \$27 million to the IFFIm over a five-year period. In addition, it committed in 2007 to provide \$50 million to support the pneumococcal AMC. Like the Amazon Fund, the Norwegian Government's contributions to the pneumococcal AMC and IFFIm will remain off-budget until actual disbursements are made over time.

#### **IV. OPTIONS FOR OVERCOMING RESTRICTIVE BUDGETARY SYSTEMS**

Restrictive budgetary systems in several donor countries – including the United States – have contributed to their inability or unwillingness to financially participate in many innovative development finance initiatives, such as AMCs and the IFFIm.<sup>36</sup> This section explores several potential options for overcoming these restrictions going forward. Not surprisingly, none of these options provide an easy solution. Each option entails financial, political, and bureaucratic challenges and tradeoffs. In short, there is a reason that some donors are more apt to support innovative development finance initiatives while others are not. While the following language generally refers to U.S. budgetary and political systems, the options may also be relevant for other donor governments with budgetary systems that share similar restrictive characteristics.

##### **A. Make Non-Binding Commitments**

In lieu of a legally-binding congressional appropriation, the U.S. Government could make two types of non-binding commitments. First, the executive branch (e.g., White House, USAID, State Department) could announce a commitment to launch a new innovative development finance program. This announcement ultimately would include caveats about the U.S. Congress appropriating the requisite funds over time. Alternatively, the U.S. Congress could pass authorization language to signal its future intentions and support for a specific development initiative or program. Authorizations are used to establish a government entity (such as a department or agency), activity, or specific program. By itself, an authorization typically does

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<sup>35</sup> UK Department for International Development (2009), *Forest Investment Review*, p129.

<sup>36</sup> As noted previously, Canada did decide to participate in the pneumococcal AMC despite these restrictions. However, it was forced to appropriate its full \$200 million commitment over two fiscal years.

not permit the obligation of any funds. Instead, an authorization simply permits Congress – through the respective congressional committees – to appropriate such funds at a later date.

For many development finance initiatives, a non-binding political commitment likely would be insufficient to mobilize the required private capital, business activity, or recipient government action. For example, one of the IFFIm’s central attributes is its ability to leverage donor governments’ investment grade credit ratings to raise development finance at a relatively low cost of capital. A stand-alone congressional authorization would reduce the IFFIm’s medium- and long-term financial certainty – and by extension, its ability to attract bond investors at low interest rates. Credit rating agencies and investors would price the IFFIm bonds based in part on the probability that the U.S. Congress would appropriate the respective funds over time.<sup>37</sup> While this calculation would include a number of factors – such as overall political support – this pricing likely could make the bond vehicle uncompetitive or prohibitively costly.<sup>38</sup> At a minimum, the interest rate required to attract investors could be significantly higher than if the U.S. commitment was backed by a congressional appropriation. Moreover, the U.S. authorities may raise objections to credit rating agencies even producing such a probability and pricing estimate.

AMCs or COD aid would be plagued by a similar shortage of financial certainty. For an AMC, an authorization by itself likely would fail to provide adequate assurances to pharmaceutical or other companies to invest in the development of a new product. As such, this would undermine AMCs’ central objective of “pulling” research and development investments forward. For COD aid programs, developing country governments may not make the necessary incremental program investments upfront in response to a non-legally binding contribution commitment.

## **B. Provide Parallel Financial Guarantees**

While a stand-alone authorization may be insufficient in most cases, there are ways to increase its financial certainty. One option is to utilize a financial guarantee provided by a third party, such as an international financial institution (ex – World Bank), insurance company, or commercial bank. Financial guarantees are used widely by sub-national governments, investors, and private companies to improve the risk profiles and cost structures of debt instruments (i.e., loans or bonds). While a wide variety of guarantee instruments are available, most ensure that a party is paid in full in the event that the counterparty fails to meet its payment obligations. For

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<sup>37</sup> For this example, credit rating agencies would examine the payment risk associated with all sponsoring donor governments – of which, the United States would be only one.

<sup>38</sup> The profile and nature of the political commitment could be an important factor in terms of providing assurances to third parties. For example, a specific presidential commitment would receive higher priority by OMB in the budget development process and subsequent outreach and advocacy with the U.S. Congress. In addition, non-compliance could entail sufficient reputational risk to ensure that the U.S. Government follows through on political commitments. Nonetheless, even a presidential announcement could entail significant political commitment risk. For example, budget priorities and program funding can shift substantially following administration transitions.

sub-national governments, financial guarantee insurance can make municipal bonds more attractive (in addition to their tax-free status) – thereby, lowering their cost of capital.

Many donor governments actually provide financial guarantees in the context of development programs. For example, USAID’s Development Credit Authority (DCA) provides partial credit guarantees to encourage financial institutions in developing countries to lend to creditworthy but underserved borrowers. DCA guarantees cover up to 50 percent of default losses – after which the partner financial institution takes remaining losses.<sup>39</sup>

There are several structural features that would increase the technical and political feasibility of financial guarantee-backed initiatives. First, an existing non-USG entity should be responsible for implementing the innovative development finance initiative. This ensures that the U.S. Government would not need to contract the financial guarantee itself, which could be problematic politically and/or bureaucratically. For example, this could require a congressional appropriation or approval to re-program existing funds to pay for the financial guarantee, which in turn would enhance the creditworthiness of an authorization-backed commitment. Even with this, the U.S. legislative or executive branches may still raise concerns about optics (i.e., that the U.S. Government is unreliable and needs a third-party guarantee). Second, the required size and cost of the guarantee should be minimized to the greatest extent possible. In this regard, broad-based participation by a number of donor governments – especially those with flexible budgetary rules – and other sponsoring entities would be important.

In operational terms, the process could work along the following lines in the context of a COD program in Ethiopia.

- (1) *Congressional Authorization*: Congress passes a non-legally binding authorization noting the U.S. Government’s support and commitment to implementing a \$50 million COD aid program in Ethiopia. The program would be implemented by a World Bank trust fund, on behalf of sponsoring bilateral governments. The legislation authorizes the U.S. Government to seek appropriations of \$10 million annually between 2015 and 2020.
- (2) *Financial Guarantee*: The World Bank trust fund secures a financial guarantee from an insurance company to cover any unfilled financial commitments that arise if the U.S. Government contributions are not made. The respective fee is paid out of the trust fund’s general pool of resources.<sup>40</sup>

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<sup>39</sup> USAID’s partial credit guarantees are backed by the full faith of the U.S. Treasury. Between 1999 and 2008, DCA provided more than 225 partial credit loan and bond guarantees – enabling roughly \$1.8 billion of private capital to be lent in more than 60 countries. The USAID budgetary cost has been only \$61 million – leading to a leveraging factor of over 30:1. Moreover, non-performing loans have averaged approximately 1 percent.

<sup>40</sup> In practice, other sponsoring governments may request that future U.S. Government contributions be used to reimburse the trust fund for the financial guarantee costs.

- (3) *COD Aid Agreement*: The World Bank trust fund enters into a legally-binding agreement with the Ethiopian government to pay \$200 for every child (up to 500,000 children total) that complete primary schooling and takes a final school exam between 2015 and 2020.<sup>41</sup>
- (4) *Regular U.S. Budget Process*: The U.S. Government (through USAID) requests \$10 million annually between 2015 and 2020. The money is scored against the U.S. budget and deficit projections as it is appropriated over time.

### **C. Utilize an Existing (Reserve-Rich) Financial Vehicle**

Similar to a financial guarantee, a congressional authorization could be backstopped by the existing assets of a third-party institution – whether or not it is responsible for implementing the respective innovative development finance initiative. In this instance, these assets could include reserves, excess liquidity, receivables, or some other form. In practice, this institution would explicitly commit to offset any shortfalls in donor contributions over time.

The U.S. Government attempted to utilize this approach for the pneumococcal AMC. At the time, the GAVI Alliance (then called the Global Alliance for Vaccines and Immunization) had significant excess liquidity due to rapid increases in donor contributions and slower than expected ramp-up of vaccination campaigns. This liquidity totaled over one year's worth of operational activities. Importantly, donor governments had committed to provide additional contributions over the near- and medium-term. As a result, the GAVI Alliance was overly-capitalized. The U.S. Government's idea was to secure agreement by the respective GAVI Alliance governance bodies to earmark a modest portion of this liquidity to backstop a political commitment to support the pneumococcal AMC over time. The U.S. Government, through regular budget appropriations, would continue to provide annual contributions to the GAVI Alliance. A portion of these contributions would be informally earmarked for the AMC while the remainder would finance the GAVI Alliance's ongoing vaccination campaigns. While the U.S. Government did not participate in the pneumococcal AMC in the end, the GAVI Alliance and other donor governments displayed some willingness to accommodate the U.S. budgetary system constraints.<sup>42</sup>

Ultimately, the respective volume of earmarked reserves required would depend upon several factors – such as: (1) number of sponsoring entities; (2) nature of entities' financial commitments (i.e., legally-binding or political); and (3) payment history of the sponsoring entities. For the pneumococcal AMC, the required reserve backstop would have been modest due to the

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<sup>41</sup> For the sake of simplicity, these figures assume that the entire \$100 million will be utilized for the COD aid program. In practice, they would be reduced modestly to account for the financial cost of the third-party guarantee.

<sup>42</sup> In the end, the U.S. Government did not participate in the pneumococcal AMC due to policy concerns.

preexisting U.S. contribution track record and the strong, legally-binding financial commitments provided by the other donor governments.

Other existing reserve vehicles include: the International Development Association (IDA)<sup>43</sup>, the International Bank for Reconstruction and Development (IBRD)<sup>44</sup>, the Global Fund to Fight AIDS, Tuberculosis, and Malaria, Gates Foundation, and several other organizations. While donor governments – including the U.S. – do not provide financial contributions to the Gates Foundation, it does have substantial financial resources that potentially could be used to backstop non-legally binding donor commitments. However, donor governments as well as the Gates Foundation may have political and/or policy objections that would prevent it from doing so.

#### **D. Leverage an Existing Contribution Stream**

Similarly, the U.S. Government could attempt to utilize existing appropriation streams to support an innovative development finance initiative. Basically, a third party organization would enter into a legally-binding financial obligation. This obligation would be backstopped, or informally underwritten, by expected contributions from the U.S. Government and/or other donor governments.

The U.S. provides regular contributions to a large number of international development entities (see figure 7 below). Examples include: UN Agencies (ex – UNDP, UNICEF, World Food Programme), multilateral development banks (ex – IDA, African Development Fund, or International Fund for Agricultural Development), and private-public organizations (ex – GAVI Alliance). Under this option, the third party organization would assume a degree of payment risk. Ultimately, the risk profile would depend upon the nature of donors' financial commitments. For example, UN agencies with assessed dues (i.e., FAO, UNICEF, WHO) potentially could face lower risks than specialized agencies with voluntary contribution structures (i.e., UNDP) *ceteris paribus*.

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<sup>43</sup> As of June 2009, IDA had over \$26 billion in liquid assets. Some of these resources were obligated for project/program disbursements, advance commitment authority, and other issues.

<sup>44</sup> The IBRD has become more financially constrained due to its large-scale lending response to the global economic crisis.

**Figure 7 – U.S. Contributions to Development Entities, FY2000-FY2010 (USD millions)**

Multilateral Organization	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
<b>Multilateral Development Banks (concessional facilities)</b>										
International Development Association	775	792	845	913	843	909	941	942	1,115	1,263
Asian Development Fund	72	98	97	144	99	99	99	75	105	105
African Development Fund	100	100	107	113	105	134	134	135	150	155
International Fund for Agricultural Development	5	20	15	15	15	15	18	18	18	30
Global Environment Facility	108	101	147	-	-	79	79	81	80	87
<b>UN Agencies</b>										
FAO (assessed dues)	82	73	73	72	90	85	93	97	109	120
UNESCO (assessed dues)	-	-	-	84	77	71	73	78	76	81
World Health Organization (assessed dues)	108	108	94	74	97	96	101	101	107	109
UNDP (voluntary contribution)	87	97	100	101	108	109	109	97	100	101
UNICEF (voluntary contribution)	110	120	120	119	124	126	126	128	130	132
<b>Other Organizations</b>										
Global Fund to Fight AIDS, Tuberculosis, Malaria	-	275	347	547	347	545	724	840	1,000	-
GA VI Alliance	-	48	53	58	60	64	69	69	72	75

Source: Congressional Research Service, Global Fund, World Bank

This option does entail several potential operational concerns for multilateral organizations. Most multilateral development agencies that provide concessional financing, such as IDA and the African Development Fund, utilize allocation formulas to determine recipient countries' annual funding levels.<sup>45</sup> Recipient governments may be hesitant or possibly unwilling to utilize a portion of these finite annual allocations for contingent programs that never disburse the related funding (e.g., COD aid).<sup>46</sup>

## E. Create a Hybrid Option for Pooled Risk Mitigation

Another option is for donor governments, or third party organizations, to pool the contingent financial commitments associated with several development programs or initiatives. In practical terms, the sponsoring entities would create something akin to actuary tables that project the probability that specific development program outlays will occur over time. These projected outlays then would be aggregated to provide a portfolio-level expectation of financial commitments. The overall objective is to establish greater payment certainty across a broad number of contingent obligations, which then could feed into donor governments' respective budgetary and financial management processes. In many ways, pooled risk mitigation would resemble how insurance companies manage their portfolio risks, financial reserves, and expected policy disbursements. For them, actuary tables are essential tools for pricing insurance products, ensuring adequate reserve levels, and projecting future insured events (i.e., death, disability, or vehicular accidents).<sup>47</sup>

<sup>45</sup> See Ben Leo (2010), "Inside the World Bank's Black Box Allocation System: How Well Does IDA Allocate Resources to the Neediest and Most Vulnerable Countries?", Center for Global Development, Working Paper 216.

<sup>46</sup> IDA and the African Development Fund may be hesitant to pursue contingent programs as well given the potential negative impact on institutional disbursement rates.

<sup>47</sup> Actuaries utilize mathematical models of the rates and timing of the events, which draw on historical incidence data as well as variable factors subject to change over time.

This approach likely is the most relevant for COD aid programs, but conceivably could apply to AMCs as well. To work effectively, donor organizations would need to establish a robust, conservative projection methodology (see appendix II for illustrative example). First, they would need to conduct extensive research on how similar programs or projects have performed in the past. Second, they must determine the timing profile of these respective program achievements (i.e., how much was achieved in year 1, year 2, year 3, etc). Lastly, donors would need to account for a wide range of explanatory factors, such as income levels, program budgets, environmental factors, population size, and cultural practices. All of these issues entail significant challenges in terms of data availability, quality, or explanatory power. Ultimately, the models' predictive power will only be as good as the mathematical formula and the quality and sample size of the underlying data. As such, appropriate caution – including conservative margins of error – would be required. In addition, this approach would require significant amounts of staff expertise and time to build and use the mathematical models – which potentially could become cost prohibitive.

Another complicating factor is that sponsoring entities would need to establish separate models for each type of development program objective. For example, one model could predict the likelihood that a COD aid program will be successful at educating children in Liberia while another would be required for a different COD aid program focused on increasing access to clean water in Pakistan. Given this, donors may have an incentive to focus COD aid programs, or similar innovative development initiatives, in a select number of sectors or areas to achieve economies of scale.

Alternatively, the U.S. Government or other sponsoring governments could outsource the pooled risk mitigation effort to a third party – most likely an insurance company. This could take several different forms. For example, the third party organization could simply apply its expertise at building actuarial models and mobilize development-related experts to build the requisite projection methodology. After this, the U.S. Government or other sponsoring governments would feed the findings into their respective budgetary and financial management processes. The attractiveness of this option would depend upon its overall cost as well as the U.S. Government's comfort and confidence level in relying on an outside party.<sup>48</sup> Another option is for the third party (i.e., insurance company) to establish an annuity-type instrument for the pool of contingent development program commitments. Under this approach, the insurance company would price the likelihood that development program disbursements would take place over time. In turn, the U.S. Government would provide either a lump sum or stream of payments to pay for the annuity-type instrument. Similar to a standard annuity, these payments would earn interest over time – which, along with the principal, could be used for the underlying development programs.

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<sup>48</sup> Other donor governments may have similar concerns about outsourcing risk management activities.

Assuming that donors can establish or utilize an independent high-quality predictive model(s), a number of budgetary challenges still would remain. For donor governments that require upfront budgetary authority, they still would need to grapple with the need to secure upfront appropriations prior to entering into a legally-binding agreement. As such, they could pursue any of the workaround options listed previously. The predictive model(s) actually could be helpful for determining the appropriate size of the financial guarantee or earmarked reserves. Alternatively, the U.S. Government could seek a general advance appropriation<sup>49</sup> that includes specific budgetary authority spread over a number of years. With this, USAID (or other development agency) would enter into non-legally binding agreements with a number of developing country governments to launch COD aid programs (or similar contingent initiatives). USAID would utilize the predictive models to determine an appropriately conservative volume and time profile structure across the different COD aid program commitments. In contrast to a stand-alone congressional authorization, an advance appropriation (without earmarks) likely would provide sufficient certainty to developing country governments, which would incentivize budget investments in the targeted sector. However, this latter approach is based on the precondition that the U.S. Congress will provide an advance appropriation without earmarks, which is far from certain.

#### **F. Create Congressional Exceptions for Budget Authority Spikes**

Lastly, the U.S. Congress potentially could provide an explicit exception to budget ceiling restrictions for multi-year financial commitments. This would help to address the fundamental opportunity cost problem with respect to current spending programs. For example, the U.S. Congress could appropriate \$500 million in 2011 to support a malaria AMC initiative. Under this initiative, actual outlays would not be expected until at least 2015. As a result, the \$500 million appropriation would be deficit neutral for the current fiscal year. It would only feed into annual deficit calculations once outlays begin in 2015 (or later). This would allow the U.S. Government to make a legally-binding commitment and prevent it from reducing current spending programs to make enough room within its congressional budget ceiling.

In some ways, this would be the cleanest and most straightforward option. However, it does entail some significant potential obstacles. Most importantly, the U.S. Congress may be unwilling to provide the explicit budget ceiling exception. While the approach would be deficit neutral in the immediate term, there still may be optical concerns about large budget approvals. In addition, there are potential concerns about setting broader budget policy precedents.

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<sup>49</sup> In this context, “general” simply refers to an appropriation that does not include any earmarks for specific COD aid programs.



## V. CONCLUSION

Over the last decade, a relatively limited number of donor country governments have financially supported several innovative development finance initiatives. With very few exceptions, these countries have flexible budget scorekeeping systems that allow governments to enter into forward financial commitments without directly affecting budget allocations for the current year. Going forward, expanding the list of sponsoring governments will require, among other things, identifying feasible ways of working within these restrictive budgetary scorekeeping systems. This is especially true for countries like the United States, Japan, and possibly Canada. This paper outlines several potential options that may merit further exploration. Each option entails important financial, political, and bureaucratic challenges and tradeoffs. While there are no silver bullets, a practical solution may be possible with the appropriate political will and financial structuring.

**IFFIm Bond Offerings**

Japan: In March 2010, IFFIm raised South African rand 2.5 billion (\$320.5 million) in a three-year uridashi offering.<sup>50</sup> This was the third issue arranged for IFFIm by the Daiwa Securities Group, and was IFFIm's largest South African Rand denominated issuance to date.

Japan: In June, 2009, a multi-tranche uridashi offering of IFFIm vaccine bonds, arranged by HSBC Securities (Japan), was sold through a group of 19 securities distributors and offered to Japanese investors online. The total offering was roughly \$130 million and composed of three tranches: (1) four-year Australian dollar fixed-rate tranche, (2) four-year South African rand fixed-rate tranche; and (3) 15-year South African rand deep discount tranche.

United Kingdom: In May 2009, the IFFIm issued its first UK Pound denominated bonds. The two tranche transaction raised an aggregate £266 million (roughly \$400 million) and was split between a £250 million fixed rate tranche for institutional investors and a £16,227,290 zero coupon tranche for retail investors. The institutional tranche was managed by HSBC and Royal Bank of Scotland. The retail tranche was packaged into the HSBC Vaccine Investment Plan Individual Savings Account.<sup>51</sup>

Japan: In May 2009, IFFIm completed a multi-tranche uridashi offering in Japan. The offering totaled \$142.9 million consisting of a three-year US dollar denominated tranche and a three-year Australian dollar denominated tranche.

Japan: In February 2009, IFFIm completed an offering to Japanese retail investors totaling \$429 million. Investors had the opportunity to choose between “vaccine bonds” denominated in three currencies: South African rand, New Zealand dollars, and Australian dollars.

Japan: In March 2008, Japanese investors welcomed the launch of the IFFIm’s debut Japanese retail market offering through a South African rand 1.7 billion (\$223 million) two-year uridashi issuance.

United Kingdom: In November 2006, the IFFIm issued its inaugural bonds in London, which raised \$1 billion. Bonds were priced comparably to other sovereign/supranational issuers and were bought by a broad range of investors – both geographically and by investor type – including several central banks, pension funds, fund managers, and insurance companies.

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<sup>50</sup> An uridashi bond is a bond denominated in a foreign currency and sold directly to Japanese household investors. It is normally issued in high-yielding currencies to provide investors with a higher return than the historically low domestic interest rate in Japan.

<sup>51</sup> See <http://www.hsbc.co.uk/1/2/vaccine> for details.

### Pooling of Financial Obligations, Illustrative Example of COD Aid Methodology

