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Education
Commission

Background Paper
The Learning Generation

Innovative Financing
Recommendations

Amy Bellinger, Arushi Terway, Nicholas Burnett
Results For Development

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Innovative Financing Recommendations

International Commission on Financing Global Education

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Amy Bellinger

Arushi Terway

Nicholas Burnett



**RESULTS FOR
DEVELOPMENT**



Table of Contents

List of Acronyms..... 2

Acknowledgements..... 4

Executive Summary5

Introduction 8

Why Innovative Financing? 8

Recommended innovative financing mechanisms with immediate potential for education 9

- Global Financing Facility for Education (GFFE) 10
- Outcomes-based financing12
- Education bonds.....12
- Loan buy-down 14
- Student Financing.....15

Recommended innovative financing mechanisms for longer term consideration 16

Next Steps.....17

Appendix A: Innovative financing mechanisms assessed in order of potential..... 19

Appendix B: Concept Notes 27

- Concept Note for a Global Financing Facility for Education (GFFE) 27
- Concept Note for Outcomes-Based Financing..... 30
- Concept Note for Education Bonds..... 34
- Concept Note for Loan Buy-Downs 40
- Concept Note for Innovations in Student Financing 43
- Concept Note for Risk Financing 48
- Concept Note for Social Impact Investment..... 52
- Concept Note for a Global Solidarity Levy for Education 55
- Concept Note for Harnessing Remittances..... 58
- Concept Note for Catalyzing the School/ Provider Financing Market 60

Appendix C: Innovative financing mechanisms assessed against each criterion 62

Appendix D: References 63



List of Acronyms

ADB	Asian Development Bank
AfDB	African Development Bank
AMC	Advanced Market Commitment
ARC	African Risk Capacity
ASff	African Student Financing facility
ATM	Automated Teller Machine
AU	African Union
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CIFF	Children's Investment Fund Foundation
CSR	Corporate Social Responsibility
DCDB	Debt Conversion Development Bonds
DFI	Development Financial Institution
DFID	Department for International Development
DIB	Development Impact Bond
DoH	Department of Health
DSD	Department of Social Development
EAA	Education Above All
ECD	Early Childhood Development
EdTech	Education Technology
EiEPC	Education in Emergencies and Protracted Crises
EYE	Education, Youth, Employment
FTT	Financial Transaction Tax
GDP	Gross Domestic Product
GER	Gross Enrolment Ratio
GFF	Global Financing Facility
GFFE	Global Financing Facility for Education
GIIN	Global Impact Investor Network
GPE	Global Partnership for Education
HECS	Higher Education Contribution Scheme
HIPC	Heavily Indebted Poor Country
HTA	Migrant Hometown Associations
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
ICSL	Income Contingent Student Loans
ICT	Information and Communication Technology
IDA	International Development Association



IFC	International Finance Corporation
IFFIm	International Finance Facility for Immunization
ISA	Income Share Agreement
JICA	Japan International Cooperation Agency
LCPS	Low Cost Private School
LICS	Low Income Countries
LMICS	Lower Middle Income Countries
MDB	Multilateral Development Banks
MFI	Multilateral Financial Institution
MICS	Middle Income Countries
NBFI	Non-Banking Financial Institution
NGO	Non-Governmental Organization
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PPP	Public Private Partnership
R4D	Results for Development Institute
SIB	Social Impact Bond
SII	Social Impact Investment
SME	Small and Medium-sized Enterprises
SYN	Social Yield Notes
TVET	Technical and Vocational Education and Training
UMICS	Upper Middle Income Countries
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development



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Executive Summary

This paper assesses the potential of innovative financing mechanisms to contribute to the financing of global education. It then makes recommendations for the Education Commission to support or encourage the mechanisms with the most potential in order to raise financing, spend funds more effectively and gather further evidence on what works.

By innovative financing, we mean “new or novel ways to generate predictable, additional and sustainable finance” (Filipp, 2014) and “the raising of funds from unconventional sources or mechanisms to make existing funds ‘go further’” (Rose & Steer et al, 2013; interviews with Steer, Gustafsson-Wright, Atinc, March 2014). Innovative financing in development is estimated to have raised nearly \$100 billion between 2000 and 2013 and is expected to grow to \$24 billion per year by 2020 (Dalberg, 2014). However, education has yet to access very much of this. There is potential to tap into new sources of financing for education from foundations, corporates, private domestic funds, private investors and citizen contributions, particularly if more innovative financing mechanisms are used. This is because innovative financing frequently encourages a focus on results, collaboration between the public and private sectors to deliver development outcomes at scale, more effective distribution of delivery and financial risk and addresses market failures and catalyzes political momentum (Dalberg, 2014).

We assessed 18 innovative financing mechanisms against the following criteria: positive impact on educational outcomes (access, equity, learning) globally; potential volume of additional finances; replicability and scalability; cost-effectiveness at scale; sustainability and predictability; and feasibility, ease, speed and transaction cost of implementation. In addition, we interviewed several Finance Panel members and additional experts to obtain their feedback on which mechanisms have the most potential.

We recommend the Education Commission undertakes further due diligence to endorse the following five mechanisms for immediate development and implementation;

A global financing facility for Education (GFFE)

- What is it? An instrument that aims to raise the profile of a particular issue and to crowd in sustainable and scalable funds from donor, domestic government and private sources using both traditional and innovative financing mechanisms, as well as providing technical support to accelerate improvements in the relevant systems at country level.
- What we recommend: a global financing facility ‘to give every child the best start at school through accelerating the provision of quality early childhood education’ OR ‘to give every young person the skills they need to lead a productive life through expanding relevant upper secondary and tertiary education’. These are areas of education which need much greater profile, require significant systems development



and financing, and are likely to attract the private sector given their proven returns to investment or as in the case of skills, the direct impact on preparing the future workforce.

Outcomes-based financing

- What is it? Outcomes-based financing refers to contractual arrangements where a principal (for example, multi or bilateral donor, foundation, etc.) transfers funds to the agent (for example government, NGO etc.) in exchange for the delivery of specified outcomes.
- What we recommend: the Education Outcomes Fund that is proposed by Social Finance. It is aiming to raise \$1 billion, mainly from new funders to education and would provide financing through outcomes-based contracts to achieve improved education outcomes (e.g. improved school attendance, retention or learning outcomes) that directly support government priorities.

Education bond

- What is it? An education bond is a debt investment instrument that links resource mobilization to education development objectives. Investment is used to provide a sizeable amount of initial capital that can be re-paid over time.
- What we recommend: an IFFIm-style donor backed bond to raise infrastructure financing for out of school children and the launch of more multi-lateral finance institution bonds to be invested specifically in education.

Loan buy-down

- What is it? A third party buys down all, or a part of, either or both the interest and the principal of a loan between a country and a lending organization, thereby releasing the borrowing country from all or some of its future repayment obligation. That generates fiscal room for manoeuvre, which can be used to fund development (Results for Development Institute, 2013).
- What we recommend: the inclusion of loan buy-downs as a core instrument of the GFFE in order to have a catalytic effect i.e. blended, primarily with IDA (and possibly other MDB facilities).

Student financing

- What is it? Student financing mechanisms provide funding directly to students or their families to fund educational access, typically for higher or vocational education. Innovative elements include income-share agreements; provision of student financing by non-banking institutions, income-contingent loans
- What we recommend: the African Student Finance facility (ASFF) being developed by D. Capital Partners, a Dalberg company, to combine student financing with advanced market commitments.



We also recommend the Education Commission considers the following for longer-term consideration

- Risk financing in the form of parametric insurance and/ or catastrophe bonds
- Social impact investing
- A micro-levy for education

The Commission should encourage the selection of innovative financing mechanisms to be driven by the education challenge that needs addressing rather than the mechanism itself. It also has an important role to play in facilitating more multi-stakeholder dialogue, research and subsequent action so that the potential of innovative financing for education can start to be harnessed.



Introduction

The purpose of this paper is to outline how innovative financing can contribute to the financing of global education and to recommend mechanisms for encouragement and/or endorsement by the Education Commission so that the potential of innovative financing in education can be harnessed.

By innovative financing, we mean “new or novel ways to generate predictable, additional and sustainable finance” (Filipp, 2014) and “the raising of funds from unconventional sources or mechanisms to make existing funds ‘go further’” (Rose & Steer et al, 2013; interviews with Steer, Gustafsson-Wright, Atinc, March 2014). A range of innovative financing mechanisms has been considered from those that tailor established financial instruments to education, for example education bonds and loan buy-downs; to relatively new financial instruments ready for expansion such as social impact investment and student financing; to new financial instruments such as debt conversion development bonds. We have not included innovative financing mechanisms that focus solely on spending funds more effectively such as results-based financing or public-private partnerships, unless they are coupled with a mechanism to raise funds too.

This paper assesses each innovative financing mechanism against a set of criteria to identify those with the most potential for education in developing countries. This assessment was then discussed with Commission Finance Panel members and further expert interviews were undertaken to inform the recommendations in this paper. A summary of the five most promising mechanisms with immediate potential and a brief summary of those with longer term potential are outlined in the main body of the paper. [Appendix A](#) contains the table with the full assessment of each mechanism, [Appendix B](#) provides more detailed concept notes on each mechanism with potential and [Appendix C](#) shows the rating of each mechanism against each criterion.

Why Innovative Financing?

Given developing countries’ growing education financing needs, the decline in global aid to education (which, despite an upturn in 2014, has still not returned to its 2010 peak) and the decline in Other Official Flows to education, one of the key attractions of innovative financing is its ability to raise additional resources. Innovative financing in development is estimated to have raised nearly \$100 billion between 2000 and 2013 and is expected to grow to \$24 billion per year by 2020 (Dalberg, 2014). However, education has yet to access very much of this. The Global Development Incubator report highlighted that ‘innovative financing has had limited interaction with the...education...sector[s]’ compared to raising \$14 billion for energy and environment and \$7 billion for global health since 2000 (Dalberg, 2014). Between 2000 and 2008, education only received 1.6% of the funds raised by the World Bank for innovative financing, whereas health received 12.2% (Girishankar, 2009).



Education has the potential to tap into new resources from: foundations (the two foundations that give the largest amounts to education in developing countries (Fundacao Bradesco and the Open Society Foundations) (van Fleet, 2011) together give less than a fifth of what the Bill and Melinda Gates Foundation contributes to health (\$1.14 billion in 2014)¹); corporates (only 64% of the 100 largest global companies direct CSR resources to education in developing countries; most contribute less than \$5 million annually) (van Fleet, 2011); private domestic funds (JP Morgan reports that there is roughly \$3 trillion of formalized domestic savings in developing countries (UNESCO, 2011)); private investors (JP Morgan also estimated the potential for impact investments in primary education to be \$10 billion during the next five to ten years, while the potential for other parts of the education sector could be equally high, if not higher) (O'Donohoe et al., 2010) and citizen contributions (crowd-funding platforms raised over \$2.7 billion in 2012 for over 1 million projects) (Leading Group on Innovative Financing for Development, 2014).

There has recently been a shift in the focus of innovative financing from purely resource mobilization to other benefits which include: a focus on results as many of the mechanisms link investment or payment to outcomes; collaboration between the public and private sectors to deliver development outcomes at scale; addressing specific market failures for example access to finance; more effective distribution of delivery and financial risk; and catalyzing political momentum to co-ordinate resources more effectively (Dalberg, 2014).

As we outline the potential of each recommended mechanism, we will highlight which part of the education system or which type of education funding it is most appropriate for. Any decision on the use of an innovative financing mechanism should be driven by the education need rather than the mechanism.

Recommended innovative financing mechanisms with immediate potential for education

We evaluated 18 innovative financing mechanisms for education against the following criteria:

- Positive impact on educational outcomes (access, equity, learning) globally;
- Potential volume of additional finances;
- Replicability and scalability;
- Cost-effectiveness at scale;
- Sustainability and predictability; and
- Feasibility, ease, speed and transaction cost of implementation.

In addition, we interviewed several Finance Panel members and additional experts to obtain their feedback on which mechanisms have the most potential for education.

¹ Bill and Melinda Gates Foundation, Annual Report, 2014



Although we made our assessment based on the mechanism, we would encourage any organization who is deciding whether to undertake innovative financing, to select the mechanism based on the education challenge that they are aiming to address.

We recommend the Commission to undertake further due diligence to endorse the following five mechanisms for development and implementation; a global financing facility for Education (GFFE), outcomes-based financing, education bonds, loan buy-downs and student financing. These combine the need to attract funding from new sources with the ability to raise the profile of education, raise financing for both the public and private education sectors and they support a focus on outcomes. They are listed in order of potential.

Global Financing Facility for Education (GFFE)²

What is it? A global financing facility is an instrument that aims to raise the profile of a particular issue and to crowd in sustainable and scalable funds from donor, domestic government and private sources using both traditional and innovative financing mechanisms, as well as providing technical support to accelerate improvements in the relevant systems at country level.

Potential: It has the potential to raise significant amounts of funding and from new sources given the range of innovative financing mechanisms that can be employed, could focus profile, financing and expertise on catalyzing improvements in a specific part of the education system, could be cost-effective if hosted within the current global education architecture and if it uses existing domestic planning and financing processes, and it could provide sustainable and predictable sources of funding. However it would need very careful design, to demonstrate additionality, fit with the overall education architecture and considerable global and domestic buy-in.

Current Experience: The health Global Financing Facility (GFF) in support of Every Woman Every Child launched with over \$1 billion last year and with pledges to mobilize \$12 billion over the next five years in domestic and international, private and public funding³. It links grants to IDA/IBRD loans, provides technical assistance to mobilize domestic government and private resources and may raise bonds using the World Bank's credit rating. The Leading Group on Education in Emergencies and Protracted Crises (EiEPC) is exploring a Common Platform, which may employ elements of a global financing facility.

Proposal: We recommend a global financing facility 'to give every child the best start at school through accelerating the provision of quality early childhood education' OR 'to give

² A GFF is also proposed in the parallel note on International Financing and Architecture.

³ <http://www.worldbank.org/en/news/press-release/2015/07/13/global-financing-facility-launched-with-billions-already-mobilized-to-end-maternal-and-child-mortality-by-2030>



every young person the skills they need to lead a productive life through expanding relevant upper secondary and tertiary education'. Early childhood development has substantially high rates on investment, particularly when compared to investment in later stages of life (Debissa, et al., 2014); however it has lacked investment in quality and quantity of provision; preschool enrolment in low-income countries is just 17 percent (World Bank, 2013) and 'many of the ECD services in developing countries fall terribly short of providing the quality necessary to ensure that children develop to their full potential' (Gustafsson-Wright & Gardiner, 2016). Financing for skills development at upper secondary and higher education levels is needed to address the gap in skills needed for the 21st century jobs. Currently there is neither adequate access (66% GER in upper secondary, 32% GER in higher education in 2013 (World Bank, 2014)) nor sufficient skills (200 million young people leave secondary school without appropriate skills to contribute in society and find jobs (Winthrop et al., 2013)) for youth to lead a productive life.

These are areas of education which need much greater profile, require significant systems development and financing, and are likely to attract the private sector given their proven returns to investment or as in the case of skills development, the direct impact on preparing the future workforce.

We think that a GFFE for a specific but fairly broad purpose is more likely to succeed than one for education in general. Since the parallel note on International Financing and Architecture recommends that a specialized ECD fund might be set up within GPE to cover underfunded areas such as ECD, the Panel may wish to think more in terms of skills for the GFFE especially given the potential links to the private sector.

It is envisaged that the financing facility would include:

- Support to country governments to develop robust plans to deliver significant improvements in the relevant part of the education system, underpinned by a strong focus on results;
- Loan buy downs and/ or donor funding to leverage IBRD/ IDA funds and soften the terms for country governments to spend on delivering the above improvements;
- A pooled fund for infrastructure funded from public and private sources including Education bonds for example, to fund the construction of the necessary facilities;
- Social impact investing to stimulate innovation in businesses that drive an improvement in learning outcomes through tools and services or provision; and
- The ability to test and rapidly learn from other innovative financing mechanisms that attract financing from new sources, in order to accelerate the quantity and quality of provision.

Next Steps: The following next steps are required for further due diligence:

- Gain agreement to the focus of the GFFE i.e. ECD or skills development or a different education objective;
- Produce a high level design and test and obtain buy-in from key stakeholders;
- Agree hosting organisation;



- Attract and confirm major funders; and
- Undertake detailed design, establish operations and attract further funders.

Outcomes-based financing

What is it? Outcomes-based financing refers to funding mechanisms that involve contractual arrangements where a principal (for example, multi or bilateral donor, foundation, etc.) transfers funds to the agent (for example government, NGO, private organization, etc.) in exchange for the delivery of specified outcomes. We are only considering outcomes-based mechanisms when they also have the potential to raise additional funds for education.

Potential: Outcomes-based financing has the potential to attract new funding, especially from non-traditional sources, strengthening the causal link between education spending and education outcomes. It also has the potential to catalyze innovation from service providers who are rewarded for developing solutions to deliver education outcomes.

Current Experience: There is limited experience with outcomes-based funding from non-traditional actors in education. Most of this experience comes in the form of Social or Development Impact Bonds (SIBs or DIBs). There is, so far, one DIB for girls' education in Rajasthan in India and three SIBs for early childhood development in the Western Cape, South Africa. Several organizations, including Social Finance and the UBS Optimus Foundation, are now considering outcomes funds. These build on the experience of SIBs and DIBs and also on the experience of investing in non-state providers for example through DFID's Girls Education Challenge Fund, and the World Bank Payment for Results program. All these efforts are, however, fairly piecemeal.

Proposal: Social Finance proposes to launch an Education Outcomes Fund. To shift the landscape, it will ideally raise \$1 billion, mainly from new funders to education. This fund would provide financing through outcomes-based contracts to achieve improved learning outcomes. Funding, for non-state⁴ education providers, will be linked to the achievement of independently verified outcomes (e.g. improved school attendance, retention or learning outcomes); the fund will only pay for interventions that have been demonstrated to work in achieving results.

Next Steps:

- Announcement of proposed Fund;
- Discussion with and selection of initial countries; and
- Securing funding from mainly new sources of finance for education.

Education bonds

⁴ Non-state education providers will include non-profits, NGOs, faith-based organizations and for-profit enterprises.



What are they? An education bond is a debt investment instrument that links resource mobilization to education development objectives. The bond investor receives a fixed return on the principal of the underlying security, and the issuer is able raise funds for activities that require sizable initial capital investment whilst re-paying the investor over time.

Potential: It is estimated that emerging market institutional investors have \$4.5 trillion assets under management, with emerging market pension funds accounting for \$2.5 trillion (Inderst & Stewart, 2014), these are looking for long term, low-risk investments such as bonds. Education bonds can leverage these assets for programs that require significant initial capital like school infrastructure development, infrastructure for teacher education institutions, ICT equipment and connectivity. Education is suited to long term bond financing as outcomes take time to be realized. Bonds however require a revenue stream for the issuer to repay the capital and interest, this could be addressed via an IFFIm-style bond whereby long term donor pledges act as collateral for the bond.

Current Experience: IDB launched the Education, Youth, Employment (EYE) Bond that raised over \$600 million from 2014-15, of which 81% was allocated to education projects.⁵ AfDB has several times issued Education Support Bonds directed to Japanese retail investors.⁶

Proposal: We recommend two types of Education Bonds to fund large-scale education infrastructure projects: an IFFIM-style donor backed bond and an MFI Education Bond.

IFFIm-style donor backed bond:

- As bonds are able to raise large amounts of capital, the funds raised could be used to fund infrastructure for out of school children. The bond should have a clear measurable outcome that would attract donors;
- Donors provide pledges to fund out of school children (or another objective) over a long time period;
- The hosting organization (could be the GFFE – see above), issues bonds in various capital markets;
- The funds raised from the sale of the bond are used to fund programs or governments to help out of school children attend school. The funds should be channeled through an organization which oversees the use of these funds and ensures that the clearly defined outcomes are met.

MFI Education Bond:

- MFI issued bond sold on the global market and funds directed to education projects, especially in countries that are not suitable for issuing domestic education bonds;

⁵ <http://www.iadb.org/en/idb-finance/investors/eye-bond-project-list,19297.html>

⁶ <http://www.afdb.org/en/news-and-events/article/afdb-offers-education-support-bond-to-japanese-investors-11547/>



- Target institutional or high net-worth investors who prioritize education or social development investments; has the potential to provide investor with a better diversification option than domestic bonds; and
- MFI would have a clear Education Bond Framework that defines the project selection, reporting and assessment structure, and a pipeline of eligible projects.

Next-Steps: The following next steps are required for further due diligence:

- Hold discussions with MFIs or other donor platforms on their appetite to issue education bonds and the market appetite to invest in them, and identify an organization to lead their development (e.g. World Bank, IADB, AfDB, ADB);
- Assess the feasibility of and appetite for an IFFIm-style education bond, what it should raise funds for and whether to it should be launched separately or part of the GFFE;
- If feasible, identify an organisation to produce a high level design, oversee use of the funds raised and to identify initial donors. Initial conversations could be had with Education Above All which is in the process of developing a primary education bond to fund out of school children; and
- The Commission could encourage governments and donors to continue experimenting with education bonds so they can mature into a new fixed income asset class for thematic bonds.

Loan buy-down

What is it? A third party buys down all, or a part of, either or both the interest and the principal of a loan between a country and a lending organization, thereby releasing the borrowing country from all or some of its future repayment obligation. That generates fiscal room for manoeuvre, which can be used to fund development (Results for Development Institute, 2013). Buy-downs have sometimes been associated with results-based “triggers”, or conditions of release of the grant funds, which extinguish, or at least soften, the loan.

Potential: Loan buy-downs can address the market failure of government willingness to borrow for education as they can induce a country that would not otherwise borrow to do so. They can encourage a focus on results with education outcome based triggers and provide predictable funding as long as outcomes are met. Furthermore, they enable a donor to have an immediate multiplier effect on their own contribution. However, additionality can be challenging to prove and there are already serious volume constraints on concessional loans in IBRD transition countries.

Loan buy-downs have the most potential for the “missing middle” i.e. for those countries transitioning from low to middle-income. At this transitional point, concessional aid is falling off faster than non-concessional and domestic public resources rise (Kharas, Prizzon & Rogerson, 2014) and private investment tends to focus on sectors with clear cash flows. Buy-



downs could help correct this bias for a transitional period, until government revenue and education spending become more robust (ODI, 2016, unpublished).

Current Experience: In education, there has been one buy-down that involved DFID buying down IBRD loan to China to IDA terms in 2003; a \$100 million loan was made and the value of the buy-down was \$34.5 million (Results for Development Institute, 2013). An independent group evaluated the project as satisfactory. Of the 8 buy-downs that R4D evaluated, 7 were very much set in specific historical contexts: significantly higher IBRD interest rates than today; specific policy decisions against borrowing on IBRD terms for non-revenue generating projects and a “weakest link” global public good in order to eradicate polio (ODI, 2016, unpublished). GPE have recently explored a possible set of buy-downs of Islamic Development Bank loans (\$400 million) to (effectively) concessional terms. These discussions have not been conclusive. The GPE board has not so far sanctioned the use of regular GPE funding for buy-downs, but has left open the possibility of raising additional funds for this purpose.

Proposal: ODI has proposed that loan buy-downs form a core element of the GFFE outlined above in order to have a catalytic effect i.e. blended, primarily with IDA (and possibly other MDB facilities).

Next Steps: The following next steps are required for further due diligence:

- Discuss feasibility in more detail with World Bank
- If feasible, include in the design of the GFFE

Student Financing

What is it? Student financing mechanisms provide funding directly to students or their families to fund educational access, typically for higher or vocational education. Three innovations are particularly interesting; 1) Income share agreements (ISAs) that modify traditional student loans by linking the re-payment terms to the borrower’s expected future income rather than existing collateral; 2) student financing by specialized non-banking financial institutions (NBFIs) for whom student financing is a core product, they use technology and innovative financial structures to maximize efficiency and effectiveness and 3) large-scale income-contingent loan schemes that improve default rates and reduce the student hardship inherent in traditional government student loan programs.

Potential: Student financing has the potential to improve equity in higher and vocational education by providing funds to students from low-income families, this can provide an immediate boost to economic growth and increase demand for education at secondary level. It can also attract private sector investment and potentially free up public sector funding that would have otherwise been spent on higher education⁷. It could spur quality

⁷ currently 18% of public sector education spending is on higher education in Lower Income Countries (Table 10, GMR, 2015)



improvement in the skills development or higher education markets by encouraging providers to deliver programs that result in employment. To truly address equity at scale, there is a need to catalyze a market that combines effective government funded (although not necessarily delivered) student financing for those from the lowest income backgrounds (we suggest based on income-contingent loans where possible), as well as private sector innovative student financing for the more professional and vocational courses where the context allows.

Current Experience: Lumni is one of the few student financing providers to use ISAs and has provided 7,000 student loans in Chile, Colombia, Mexico, Peru, and the US, with an average return of 7 to 11% (LaFerrara, 2014), only 2-3% default rate and 5% dropout rate (Bornstein, 2011). Ideal Invest is a good example of a NBFi, in 2015 it gave out 30,000 loans in Brazil and has a long term delinquency rate of 7-8% (CEO interview, April 2016). Australia is the most-widely cited example of an ICL and variations on its model have now been implemented in 8 other countries (Chapman, 2016). To date, the biggest innovative student financing market has been in Latin America.

Proposal: D. Capital Partners, a Dalberg company, is developing the African Student Finance facility (ASFF) to combine student financing with advanced market commitments (AMC). Student financing will use predictive analytics based on student future earnings to evaluate the loan applicants. The AMC will support higher education providers to scale up by ensuring a pool of students guaranteed to pay their education costs and thereby anchoring the demand, and by partnering with employers, so the students become a guaranteed pool of skilled workers. Blended finance will be used to fund the capital. The ASFF will establish operations in South Africa and Kenya in 2016 and plans to expand to Ghana and Rwanda soon after (initial \$30-40 million fund target).

Next Steps:

- Undertake further due diligence and endorse the D. Capital Partners pilot of the African Student Finance Facility. If successful support the establishment of a dedicated student financing facility for development (\$100-200 million plus); and
- Identify other countries with the potential to catalyze or significantly grow the student financing market and explore potential partnerships with governments, investors, lenders and higher or vocational education institutions to implement large scale income-contingent loan schemes (potentially funded by loan buy-downs or education bonds) and other innovative student financing mechanisms such as ISAs.

Recommended innovative financing mechanisms for longer term consideration

Given how nascent innovative financing is in education, the focus should be on piloting the mechanisms with the most potential, rapidly capturing the evidence and their learnings, then



if proven, scaling them up in the most appropriate context to address the most relevant education issues. The following are several other mechanisms we evaluated as having potential for longer-term consideration:

Risk Finance: Risk financing could mobilize funds very quickly to developing countries to enable them to rebuild and maintain their education systems after a shock. It would transfer some risk to the market while increasing resilience planning. It could leverage additional sources of finance, improve efficiency gains, and spending effectiveness.

Potential initiatives: An existing global education institution could take a lead in piloting a risk financing model for education and explore multi-country platforms using mechanisms like parametric insurance and catastrophe bonds.

Social impact investing⁸: Investing with the intention “to create positive impact beyond financial return (O’Donohoe et al., 2010).” Social impact investing has the potential to attract new funding and innovation within education. It can also drive cost-effectiveness in reaching results with the dual goal of social impact and financial sustainability or return. Impact investment can fund businesses that serve low-income customers through innovations in tools, services and delivery of quality education, and private operators in areas where public sector is struggling to deliver. Currently there are few ‘ready to go’ investments of a significant size and businesses may need a lot of support to scale or replicate successfully.

Existing initiative: Caerus Capital is conducting a research project titled “The Business of Education in Africa” to analyse private financing of delivery Pre-K, K-12, higher education, and TVET, as well as products and services that are provided by the private sector to the education sector (public and private) in Sub-Saharan Africa. The study was commissioned by DFID and Yellowwoods Foundation (South Africa).

Global solidarity levies: Aims to “levy global economic activity to pay for global public goods (Task Force on International Transactions and Development, 2010).” Solidarity levies can raise the profile of education and funds can be direct towards any country or issue. Although a global levy has the potential to raise significant funds, it would require considerable lobbying and a multi-country agreement to create a new consumer/user tax.

Potential initiative: Lobbying for a proportion of the proposed European Financial Transaction Tax (FTT) to be spent on international education (O’Hagan & Winthrop, 2013, Douste-Blazy, 2015) or initiating research into opportunities for micro-levies for education with advice from tax experts. One potential idea is a micro-levy on travel accommodation to provide funding for refugee education through the Education Cannot Wait Fund.

Next Steps

We believe the Commission has a unique opportunity to raise the profile of education, obtain financing from new sources, encourage a strong focus on outcomes, greater collaboration between the private and public sectors and spread risk through facilitating the development

⁸ Note that Social Impact Investment is also included within GFFE proposal above



and implementation of the most promising innovative financing mechanisms. The Commission should:

- Encourage the co-ordination and set up of a GFFE, ensuring that it has a specific focus, the right stakeholders are involved and that innovative financing is a core part of its design;
- Undertake or encourage multi-laterals to undertake further research and due diligence into the feasibility of education bonds;
- Endorse promising pilots for example for the outcomes fund and student financing;
- Encourage governments to implement mechanisms such as education bonds and loan buy-downs where they could add value and collect data to evaluate their effectiveness;
- Encourage donors to fund research, evaluation, technical assistance, scaling up, concessional funding or guarantees for the implementation of innovative financing mechanisms with potential;
- Encourage foundations to also fund research and evaluations, bear the initial risk when piloting new mechanisms and fund or provide incubation of early stage innovative financing ideas;
- Encourage the private sector to help the education sector understand its potential for investment, invest in the outcomes fund and other social impact investment opportunities and collect evidence on what works; and
- Encourage co-ordination of global level financing mechanisms.

The Commission has an important role to play in encouraging more multi-stakeholder dialogue, research and subsequent action so that the potential of innovative financing for education can be harnessed.



Appendix A: Innovative financing mechanisms assessed in order of potential

Mechanism	Definition	Summary Assessment	To be considered when	Education issues	Promising ideas or potential pilots
Global financing facility	An instrument that aims to raise sustainable and scalable funds for a particular issue from a variety of public and private sources using both traditional and innovative financing mechanisms.	<p>Could be focused on a particular education outcome and linked to results, could raise significant additional and sustainable finances at scale, could be cost-effective if hosted within the current global education architecture and if uses existing domestic planning and financing processes.</p> <p>Would need very careful design, proving additionality may be a challenge, could duplicate other financing efforts e.g. GPE if not combined, requires considerable global and domestic buy in and agreement to its design.</p>	Profile is needed for a particular education issue which is likely to be able to attract funding from a variety of sources, global and domestic agreement to a global facility is likely, the financing could support a catalytic improvement in systems.	Education in Emergencies and Protracted Crises; skills development; early childhood education.	<p>The Common Platform being explored for Education in Emergencies and Protracted Conflicts.</p> <p>A Global Financing Facility for Education in areas that could be attractive to the private sector (as that would be a key source) and need improved systems as well as financing for example skills development, early childhood education.</p>
Education Bonds	A bond is an investment in a debt, whereby the investor receives a fixed return on the principal and interest of the underlying security (Filipp et al, 2013). Bonds can be secured on the basis of any future revenue streams. Can be issued by national governments as domestic bonds or by multilateral financial institutions as thematic MFI Bonds.	<p>Potential to leverage the \$4.5 trillion in private assets in developing countries (Inderst & Stewart, 2014) and would provide sustainable and predictable funding. Could raise the profile of the education sector within the finance industry and tap into new sources of financing.</p> <p>Domestic Bonds would need an income stream to repay bondholders so is unlikely to be targeted at most marginalized. Implementation only possible where financial market is sophisticated enough to issue bonds - may need to be guaranteed by a DFI.</p> <p>MFI Bonds would require a strong pipeline of projects for investment and monitoring systems to show investors "results" even in early stages. May not necessarily raise "additional" funds as it could substitute the regular loan funds dedicated to education. The amount of</p>	<ul style="list-style-type: none"> • Ability to generate a future revenue stream • Relatively mature bond market • Credit-worthiness or a guarantor • Need for an upfront capital outlay • Countries willing to raise bonds for education sector projects. 	Development of large infrastructure projects like school buildings, teacher education institutions, ICT equipment and connectivity, etc.	<p>Launch an IFFIm-style donor backed bond to fund out of school children. Initial conversations could be held with Education Above All who are investigating a primary education bond to fund out of school children.</p> <p>Replicate education theme bonds issued by IADB and AfDB.</p> <ul style="list-style-type: none"> • IADB launched the Education, Youth, Employment (EYE) Bond that raised over \$600 million from 2014-15, of which 81% was allocated to education projects. • AfDB has several times issued Education Support Bonds directed to Japanese retail investors.



		bond funds raised is limited by willingness of countries to take education loans. Likely to be competition from other sectors such as climate change.			
Outcomes-Based Financing	Funding mechanisms that involve contractual arrangements where a principal (for example, multi or bilateral donor, foundation, etc.) transfers funds to the agent (for example government, NGO, private organization, etc.) in exchange for the delivery of specified outcomes. These include social and development impact bonds (SIBs and DIBs).	<p>Outcomes-based financing has the potential to attract new funding, especially from non-traditional sources, strengthening the causal link between education spending and education outcomes. It also has the potential to catalyze innovation from service providers who are rewarded for developing solutions to deliver education outcomes.</p> <p>There is currently limited evidence on effectiveness and very little experience of implementing these mechanisms in education. Furthermore SIBs and DIBs currently incur high transaction costs.</p>	There's a clearly defined proposition with clear measurable outcomes	All education issues with clear outcomes	Social Finance has proposed to launch an Education Outcomes Fund of \$1 billion. It will mostly raise funds from new funders to provide financing through outcomes-based contracts to achieve improved learning outcomes in numeracy and literacy. Funding, for non-state education service providers, will be linked to the achievement of independently verified outcomes (e.g. improved school attendance, retention or learning outcomes); the fund will only pay for interventions that have been demonstrated to work in achieving results.
Loan buy-down	A third party buys down all, or a part of, either or both the interest and the principal of a loan between a country and a lending organization, thereby releasing the borrowing country from all or some of its future repayment obligation. Savings can be invested in development projects with agreed	<p>Can encourage governments to take out a loan to improve access, equity and quality of education. Can encourage a focus on results with education outcome based triggers. Provides predictable funding as long as outcomes are met.</p> <p>Risk that countries will increase their indebtedness and may not want to take out a loan for basic education. Only 1 implementation for education known.</p>	<p>Countries are:</p> <ul style="list-style-type: none"> • Reluctant to borrow loans for education. About to graduate from IDA to IBRD but still need to meet major basic education challenges e.g. Angola, Bangladesh, India, Nigeria, Pakistan and Sri Lanka (R4D, 2013). • Not creditworthy if bought-down debt could be provided 	Basic education, upper secondary and tertiary programs for improving access to the most marginalized and improving learning outcomes	<p>GPE and Islamic Development Bank are developing a pilot loan buy-down; Islamic Development Bank has pledged \$400 million for the loan.</p> <p>Including loan buy-downs in the proposed Global Financing Facility for Education</p>

	outcomes (R4D, 2013).		at grant or near-grant terms (R4D, 2013)		
Student financing (loans)	The provision of student financing (loans) using innovative techniques such as crowdfunding, income share agreements, loans by non-traditional lenders or innovative variations of traditional loans such as income-contingent loans.	<p>Can allow equitable access to tertiary education for students from low income families; assumes successful learning outcomes for the students to earn income to re-pay the loans, tools can be replicated, ultimately sustainable (although first few years may make a loss). Government funded income-contingent loans could reach scale. Private sector funding for tertiary education has potential to free up public sector funding for basic education.</p> <p>Can be quite cost intensive marketing and assessing students, the student financing market needs to be stimulated in some countries, this is limited to students who have sufficient education to apply for tertiary education and therefore they are unlikely to be the most marginalized and they may feel over-burdened. Income-contingent loans require an effective tax system.</p>	<p>There is a direct link between the education received and income potential.</p> <p>Higher education/ vocational training is established but is unaffordable for the poorest.</p> <p>There is an effective tax system (income-contingent loans).</p>	Equitable access to higher education/ vocational training	<p>Dalberg, a D. Capital Partners company has developed a concept for an African Student Finance Facility which combines student financing through customized loan products, with advanced market commitments. A pilot is anticipated to take place in Kenya, Rwanda, Ghana and South Africa.</p> <p>Identify countries to implement income-contingent loan schemes and suggest loan buy-downs or Education bonds to fund them.</p>
Risk Financing	Transfer of disaster or political risk to the market in the form of disaster insurance, catastrophe bonds or the catastrophe deferred draw-down option	<p>Risk financing could mobilize funds very quickly to developing countries to enable them to rebuild and maintain their education systems after a shock. It would transfer some risk to the market while increasing resilience planning. It could leverage additional sources of finance, improve efficiency gains, and spending effectiveness. It will require new measurements to calculate the financial impact of disasters on education systems</p>	<p>Natural disasters are highly likely within a particular country.</p> <p>There is an existing risk insurance facility set up in order to keep costs down.</p>	Provision of education immediately following a natural disaster.	<p>Could be explored in countries that are part of African Risk Capacity (ARC) a Specialized Agency of the African Union (AU) and The Caribbean Catastrophe Risk Insurance Facility (CCRIF).</p> <p>Could be set up in conjunction with the GPE or EIEPC platform.</p>

Social impact investing (outside of SIBs and DIBs)	<p>Investing with the intention “to create positive impact beyond financial return” (O’Donohoe et al, 2010).</p> <p>Blended financing in this context is the combination of grant and loan or equity funding to reduce the financial risk of an investment and therefore more attractive to investors at an early stage.</p>	<p>Potential to attract new funding to education. Can foster innovation within the education system and encourage scale up. Potential to drive cost effectiveness due to goal of financial sustainability or return.</p> <p>Although it creates focus on impact, this is not necessarily on education outcomes. Impact is limited to parts of the education sector with a potential revenue stream, e.g. for profit education businesses which may not serve the most vulnerable (although some could be replicated in the public sector). Currently there are few ‘ready to go’ investments of a significant size and businesses may need a lot of support to scale or replicate successfully.</p>	<p>Businesses that serve low-income customers and deliver improvements in education outcomes and some form of financial sustainability or return which need some investment to develop and scale.</p>	<p>Providing tools or services to improve quality or effectiveness across the education system.</p> <p>Delivering education where the public sector is struggling to deliver e.g. ECD, youth training.</p> <p>Enabling access to tertiary education for those with lower incomes.</p>	<p>The Business of Education’ - DFID is currently funding research in Sub-Saharan Africa on what is needed to stimulate investment in private sector delivery and support services for education. This should inform the setting up of social impact funds to invest in these businesses.</p> <p>The above concept could be replicated for other countries and regions, the result of which could potentially be the setting up of regional impact investment funds providing finance for education businesses serving the poor.</p> <p>Map out the funding pathway for social impact investment in a particular country, this could include innovation hubs, angel networks, blended finance and social impact funds (meeting with Nick O’Donohoe, Adviser at the Gates Foundation). This could be used to identify gaps and how the ecosystem could be catalyzed for further education investment.</p>
Global solidarity levies	<p>Aims to ‘levy global economic activity to pay for global public goods’ (Taskforce on International Transactions and Development, 2010)</p>	<p>Can access a high volume of new sources of funds (FTT was estimated to raise €30 billion per year (European Commission, 2014) but has yet to be implemented. Funds can be spent on any area of education need.</p> <p>Education would need to lobby for a percentage of funds. It is unclear whether there could be a direct link to learning outcomes or equity. Gaining multi-country agreement to a global levy is likely to be a challenge.</p>	<p>An end user or consumer is willing to pay a small tax on a high volume product or service</p>	<p>Any issue</p>	<p>Lobbying for a proportion of the FTT to be spent on international education.</p> <p>Exploring the opportunity for a micro-levy for education to be introduced for example on education-related technology or on hotel accommodation to fund refugee education.</p>
Harnessing Remittances	<p>Remittances for education amplified</p>	<p>Provide a source of predictable and sustainable funding, attract greater</p>	<p>Countries have a large volume of</p>	<p>Any issue</p>	<p>Lobbying to reduce remittance transaction fees.</p>

	by government or donor incentives or by labelling as for education	funding for education from diaspora, leverage existing remittances using existing channels, and provide local ownership on how the funding is spent. However the current experience is based on small-scale pilots, scalability needs to be tested, the way remittances are spent is likely to be small scale and piecemeal, and only suitable for countries with a large diaspora.	remittances		Replication and scale up of programs that match remittance funding or encourage its labelling for education.
School/ provider financing	The provision of loans to (predominantly) low cost private schools (LCPSS) or other non-state education providers. Could be supported by credit guarantees.	Can provide additional funds at school level to growing LCPSSs, which may improve learning outcomes or efficiencies if training on improving quality or school management is provided. Could also be used for youth training centers and other education providers. Could be implemented through existing microfinance institutions. Amount relatively small unless the whole market is unlocked. Most vulnerable students unlikely to be catered for if fees need to be paid. Link between finance and improved educational outcomes is unproven. The market will need stimulation as schools are not target customers for lenders.	There is a large low cost private school market that needs access to finance. Microfinance institutions or banks exist.	Improving the sustainability and quality of low cost private or not for profit schools at all stages.	DFID Pakistan have helped to stimulate the market by developing a financial model for lenders to evaluate the risk of lending to LCPSSs and based collateral on fee-related cash flow. DFID also support a guarantee scheme of \$20m for microfinance banks in Pakistan to ensure they have access to capital for onward lending (Haq and Ali, 2014). DFID Nigeria is working to stimulate the school financing market in Lagos. There is potential for pilots to stimulate the market in other countries.
Corporate levies	Taxes that corporates have to pay as part of doing business	Could provide sustainable and predictable funding from new sources. Can be linked to skills and employment. Complex to set up as would need buy-in and ability to set up the regulatory and legal environment to enact. Would need to ensure that funds are spent on educational outcomes and lobby against other sectors.	There is an enabling tax system in place. There are sectors that are being lobbied to make a social contribution.	Any issue but skills for employment could be attractive for the corporates.	South Africa has passed a corporate levy for corporates to spend a percentage of their profits in skills development in society. The education sector has an opportunity to harness this.

Debt conversion development bonds (DCDB)	This is created when the 'fiscal space' created from the debt swap is used to issue a bond that is sold in local currency on the local capital market, which would then be invested in by investors such as local pension funds (UNESCO, 2011)	Used to fund public sector. Can address equity. Could provide sustainable and predictable funding. Could pave the way for a domestic bond market. Impact is limited to countries with outstanding debt and that have a financial market that is sophisticated enough to issue bonds.	Countries have: · Available debt for conversion · Available creditor(s) ready to cancel debt · Successful legal approval of new type of debt conversion · Sufficient monetary credibility to achieve acceptable rates of interest · Relatively mature bond market (Filipp et al, 2013) · Need for a large capital outlay Would suit LICs i.e. Kenya, Bangladesh and LMICS i.e. India, Ghana, Pakistan (Bond, 2012b).	Major infrastructure development for example for the expansion of early childhood, secondary or primary education where that need has yet to be met.	Jordan and Bangladesh were interested and had suitable projects for the funds but Japan needed high level support to proceed. The Commission could add real weight to move this forward. Could aim to raise \$50-\$100m in a pilot.
Debt swaps	A form of debt relief in which the creditor forgives debt on the condition the debtor makes available a specified amount of local currency to be used for specific developmental purposes (Task Force on Innovative Financing for Education, 2012)	Potential to raise new funding which would be predictable and able to be used for public education systems. 18 debt for education swaps (1998-2008) USD 608.8 m debt into USD 283.2 m local education support (Cassimon, Essers and Renard, 2009) Limited to countries with debt left to swap, the funding may not be additional if donor or domestic governments reduce their spending (there is some evidence to support this), funding not sustainable, high transaction costs if undertaken on a country by country basis, competition from other sectors, would need to ensure funds are used effectively to deliver improved learning outcomes.	Available debt for conversion i.e. in non-HIPC low income and lower middle income countries Available creditor(s) ready to cancel debt - potential countries include Germany, France, Spain, Italy which are estimated to have Euro 730m of debt as potential for debt swaps (Filipp et al, 2013).	Any issue	A multi-creditor swap initiative where debts are pooled and the resulting proceeds are used to create a fund such as a Debt4Education fund.

Advanced market commitments	A public-private partnership between donor countries and private companies. Donors commit funds to guarantee the price of a specific development-related product once it has been developed.	An AMC can be directly linked to educational outcomes if it is for something directly linked to learning. It would provide predictable and guaranteed funding to encourage investment in the product or service. It would need to operate at scale. Not yet happened in education. Time bound. May not necessarily raise additional funds, more make funds go further, unless donors would increase their funding specifically because of the AMC mechanism	A high volume of products or services is needed for the education sector for example teachers, books, technology, public-private-partnership schools.	The AMC could drive demand for a particular product or service and make the funding for that go further	Dalberg and D. Capital Partners have developed a concept for an African Student Finance Facility which combines student financing through customized loan products, with advanced market commitments benefits for education providers and employers who will have a pool of skilled workers. A pilot is anticipated to take place in Kenya, Rwanda, Ghana and South Africa. Possible potential for books.
Diaspora bonds	A debt instrument issued by a country to raise financing from its overseas diaspora (Ketkar and Ratha, 2011)	Potential to access a proportion of the US\$30 billion of diaspora savings from LICs (World Bank, 2011) as well as MICs, could provide sustainable and predictable funding. Needs a revenue stream to make repayments to the bondholders, likely this would need to be guaranteed by donors. No experience in education and not always successful in other sectors, may be difficult to convince diaspora to invest in this way.	Countries have: · A large diaspora community · Relatively mature bond market · A revenue stream to repay the bondholder (Ketkar and Ratha, 2011)	Provision of upper secondary, higher education and youth training	
Crowdfunding	Citizen contributions to a particular project usually via an online platform. Could be set up specifically for diaspora.	Can link funding directly to education projects. Replicable and scalable, cost effective at scale, relatively easy to set up. Could harness diaspora contributions. Individual contributions small but total market is estimated to have raised \$2.7b in 2012 (Leading Group, 2014) - amount raised for education unknown. Predictability of funding uncertain.	Can package the education need in a way that appeals to a consumer/ diaspora.	Any issue	Crowdfunding linked to diaspora
Social Yield Notes	This applies, "structured investment products" to	The model "incentivizes multipartnership (for-profits/not-for-profits, governments, multilaterals, citizen sector, local government) to	For countries that are heavily reliant on grants for education but also have a	Secondary, tertiary and skills development programs that	

	<p>SIBs/DIBs, but with some additional financial innovation married to new legal hybrid company structures that create "social yield notes" (SYNs). SYN is based on an equity framework, where the equity has a value as a function of the delivery of social outcomes.</p>	<p>work in a single collaborative partnership governance structure with goals, governances and incentive aligned, and with social mission hard-wired (Winthrop et al, 2013)", can therefore be drive education outcomes.</p> <p>Likely volumes of additional finance, cost effectiveness, replicability, ease of implementation etc. unknown but the model appears to be fairly complex and advanced for a relatively new social impact investment market.</p>	<p>relatively mature financial market.</p>	<p>may be of high interest to corporate employers.</p>	
<p>Product based consumer contribution</p>	<p>Product sold with a proportion of profits going towards a social purpose.</p>	<p>Could raise new funds, could engage children in supporting other children, potentially replicable and scalable, sustainable.</p> <p>Would need to ensure the funding is spent on delivering education outcomes. The volume of additional funds relatively small. Need to sell 'education' to the consumer.</p>	<p>There is an enabling tax system in place. There are sectors that are being lobbied to make a social contribution. Manufacturers are willing to pass on a percentage of their profits. Products are likely to attract socially conscious consumers. Products are linked to education or children e.g. books</p>	<p>Any issue</p>	<p>An idea is a consumer contribution linked to book purchases in OECD countries.</p>



Appendix B: Concept Notes

Concept Note for a Global Financing Facility for Education (GFFE)

A global financing facility is an instrument that aims to raise the profile of a particular issue and crowd in sustainable funding at scale from private, public and donor sources using both traditional and innovative financing mechanisms. The financing may be provided with technical support to accelerate improvements in the relevant systems at country level. Financing facilities can be set up in a variety of ways. The health sector has established several for example the International Finance Facility for Immunization (IFFIm) uses long-term pledges from donor governments to sell 'vaccine bonds' in the capital markets, making large volumes of funds immediately available for GAVI programs. Since it was set up in 2006, it has raised more than US\$5 billion to date from \$6.5 billion of long-term pledges.⁹

Current Experience

More recently, the Global Financing Facility (GFF) in support of Every Woman Every Child was launched last year. This aims to reduce inefficiencies in the health spending over time to save \$6 billion per year and mobilize \$57 billion of sustainable and scalable funding from domestic governments, donors and the private sector by 2030. It is employing results-based financing and taking a long term (10-15 years) approach. Part of the facility includes the GFF Trust Fund hosted by the World Bank which uses grants in a catalytic way to access IDA/IBRD loans (estimated to be in the ratio of 1:4), may raise bonds using the World Bank's credit rating and is likely to include further innovative financing mechanisms. The GFF Trust Fund has currently received pledges of \$800 million from Canada and Norway (GFF Business Plan, 2015). To minimize overheads, the GFF is fully integrated into the World Bank's processes and works very closely with national governments.

Potential and Limitations

The potential of a global financing facility is that it could:

- Raise the profile of education globally;
- Focus attention on a specific education outcome and link financing to results;
- Provide technical assistance as well as financing to address a particular education need, focusing on improving the education system where possible;
- Raise significant additional and sustainable finances from new sources if designed appropriately;
- Be cost-effective if hosted within the current global education architecture and if it uses existing domestic planning and financing processes; and
- Mix traditional and innovative financing mechanisms, allowing for some piloting and data collection on those that are more innovative.

⁹ <http://www.iffim.org/about/overview/> accessed 16/02/16.



The limitations include:

- Very careful design to ensure global and domestic buy-in, this could take considerable time to achieve;
- Proof of additionality may be challenging;
- Potential duplication depending on how it would be positioned within the current education architecture; and
- Potentially high cost unless co-hosted and leveraging as many fit for purpose existing processes as possible.

Promising Ideas or Pilots

The Leading Group on Education in Emergencies and Protracted Conflicts (EiEPC) is exploring a Common Platform, which may include a global financing facility to mobilize finances for crisis situations.

We recommend a global financing facility 'to give every child the best start at school through accelerating the provision of quality early childhood education' OR 'to give every young person the skills they need to lead a productive life through expanding relevant upper secondary and tertiary education'. Early childhood development has substantially high rates on investment, particularly when compared to investment in later stages of life (Debissa et al., 2014); however it has lacked investment in quality and quantity of provision; preschool enrolment in low-income countries is just 17 percent (World Bank, 2013) and 'many of the ECD services in developing countries fall terribly short of providing the quality necessary to ensure that children develop to their full potential (Gustafsson-Wright & Gardiner, 2016).' Financing for skills development at upper secondary and higher education levels is needed to address the gap in skills needed for the 21st century jobs. Currently there is neither adequate access (66% GER in upper secondary, 32% GER in higher education in 2013 (World Bank, 2014)) nor sufficient skills (200 million young people leave secondary school without appropriate skills to contribute in society and find jobs (Winthrop et al., 2013)) for youth to lead a productive life.

These are areas of education which need much greater profile, require significant systems development and financing, and are likely to attract the private sector given their proven returns to investment or as in the case of skills development, the direct impact on preparing the future workforce.

We think that a GFFE for a specific but fairly broad purpose is more likely to succeed than one for education in general. Since the parallel note on International Financing and Architecture recommends that a specialized ECD fund might be set up within GPE to cover underfunded areas such as ECD, the Panel may wish to think more in terms of skills for the GFFE especially given the potential links to the private sector.

It is envisaged that the financing facility would include:



- Support to country governments to develop robust plans to deliver significant improvements in the relevant part of the education system, underpinned by a strong focus on results;
- Loan buy downs and/ or donor funding to leverage IBRD/ IDA funds and soften the terms for country governments to spend on delivering the above improvements;
- A pooled fund for infrastructure funded from public and private sources to fund the construction of the necessary facilities;
- Social impact investing to stimulate innovation in businesses that drive an improvement in learning outcomes through tools and services or provision; and
- The ability to test and rapidly learn from other innovative financing mechanisms that attract financing from new sources, in order to accelerate the quantity and quality of provision.

Next Steps: The following next steps are required for further due diligence:

- Gain agreement to the focus of the GFFE i.e. ECD or skills development or a different education objective;
- Produce a high level design and test and obtain buy-in from key stakeholders; and
- Undertake detailed design, establish operations and attract initial funders.

Potential action for the Commission:

- Identify an organisation to take the lead in exploring the feasibility of this further with a view to making an announcement of the launch of the GFFE in September

Concept Note for Outcomes-Based Financing

Outcomes-based financing refers to funding mechanisms that involve contractual arrangements where a principal (for example, multi or bilateral donor, foundation, etc.) transfers funds to the agent (for example government, NGO, private organization, etc.) in exchange for the delivery of specified outcomes¹⁰. Many forms of outcomes or results-based financing programs have been implemented in the development sector¹¹, due to greater donor focus on the “managing for results” goal of the aid effectiveness agenda and in turn, the increased emphasis on evidence as a basis for financing. In this research we are only considering outcomes-based mechanisms when they also have the potential to raise additional funds for education.

Current Experience

Impact Bonds, either Social Impact Bonds (SIB) or Development Impact Bonds (DIB)¹² are a form of outcomes-based financing that has engaged the private sector as both the agent or service provider and as an investor within social sector development. An impact bond typically involves four major types of actors, in addition to the population being served. Investors provide capital for a service provider to deliver social services to the target population. The outcome funder (the government or a donor) agrees to repay the investors if the pre-determined program outcomes are achieved. The intermediary entity can play multiple roles, but often has the responsibility of raising the capital and bringing all the stakeholders together to determine and agree upon the contract details. A fifth actor, an evaluator, may also be engaged in outcomes assessment providers (Gustafsson-Wright and Gardiner, 2015).

The business case works when “better [social] outcomes lead to tangible public financial savings” (Mulgan et al., 2011). Note that SIBs or DIB are not technically bonds, as they do not offer a fixed rate of return and cannot be traded (Filipp and Lerer, 2013). The research undertaken by the Brookings Institution considers there to be 4 pre-requisites for an impact bond:

- Meaningful measurable outcomes must exist;
- Outcomes must be achievable within timescales that are appealing for investors and outcome payers;
- Evidence of service provider success in achieving outcomes must match the risk appetite; and
- Legal and political conditions must allow governments (in their role as outcome funders) to pay for outcomes rather than service inputs and make payments beyond the fiscal year in which a contract is made (Gustafsson-Wright and Gardiner, 2015).

¹⁰ Adapted from Pearson, Johnson, & Ellison, 2010.

¹¹ See for example, Perakis & Savedoff, 2015 and Pearson, Johnson, & Ellison, 2010.

¹² SIBs typically have government as the outcome payer, while the term DIBs is used for impact bonds that are implemented in low-and middle-income countries, where a donor agency or a foundation is the outcome payer.



As of 1st October 2015, there were 49 active SIBs and 2 active DIBs; the oldest was only implemented in 2010. Following are some examples of impact bonds that have been developed within the education sector:

- **India: Rajasthan Educate Girls-** In this, Educate Girls, an NGO service provider has received a multi-year grant of \$994,282 through a DIB mechanism where UBS Optimus Foundation is the investor and CIFF is the outcome payer. Istiglio does overall project management while Dalberg Global Development Advisors serve as the process evaluator. The DIB will reach 18,000 children in government primary schools in the Indian state of Rajasthan and the specific impact targets include enrolment of out-of-school girls and improved literacy and numeracy skills; the independent evaluator, IDinsight, will validate outcomes (Instiglio, 2015).
- **Kenya: Nairobi Early Childhood Education-** Nairobi City County in Kenya considered a modified DIB model to fund preschool and catalyze the market for free quality early childhood education provision. Since Kenya's PPP laws prevent County governments from committing to future payments to private entities for outcomes, the County is planning on establishing an arrangement to make salary payments for the preschool staff of private providers and progressively transfer staff from non-state education trust fund to County government, based on outcomes (interview with Wattanga, January, 2016).
- **South Africa: Western Cape Early Childhood intervention –** Three impact bonds have been developed in the Western Cape province of South Africa, with a partnership Department of Health (DoH), Department of Social Development (DSD), Social Finance and Bertha Centre for Social Innovation. It focuses on broad range of early childhood outcomes to test various models and build evidence about the current quality levels of early childhood development programs. The DSD of the Western Cape has committed funding for the outcomes, which will be supplemented by some private funding (Gustafsson-Wright and Gardiner, 2015). The DSD will structure contracts with multiple service providers as an impact bond fund, and outcomes will include a range of indicators approximately 3,000 pregnant women and children in the first 1,000 days (conception to two years) (UCT, 2016).

Potential and Limitations

The potential of outcomes-based financing is that it could:

- Strengthen the causal link between education spending and education outcomes, with an increased focus on outcomes measurement and rewarding for results;
- Promote transparency and accountability in the procurement of social services (Gustafsson-Wright and Gardiner, 2015);
- Can improve the efficiency of spending on aid by focusing on implementation quality and results (CGD and Social Finance, 2013);
- Can attract private sector investment for innovations that might be too risky for



- traditional donors (Ibid); and
- With predictable outcomes-based funding streams, reward effective intervention models and drive a market for new providers.

The limitations include:

- Need for very robust evidence to accurately estimate outcomes and returns;
- Need for careful selection of outcomes metrics to ensure that the chosen metrics create the right incentives for service providers to deliver the desired impact while avoiding perverse incentives;
- High cost of monitoring and evaluation (given challenges such as disentangling the impact of interventions on outcomes from other influences within the ecosystem);
- In the case of impact bonds, high overall transaction costs due to complex arrangements involving intermediaries (especially when the cost of borrowing for governments is usually relatively low) (Hughes and Scherer, 2014; Social Finance, 2016; Mulgan et al., 2011; Disley et al., 2011);
- Operating at significant scale given the amount of funding that would be required and the delivery capacity of service providers (Gustafsson-Wright and Gardiner, 2015).

Promising Ideas or Pilots

Social Finance proposes to launch an Education Outcomes Fund of up to \$1 billion to make payment-by-results grants to non-state education providers for improving education outcomes. The aim of the Education Outcomes Fund is to collect and disseminate data on effective interventions, increasing the effectiveness of existing funding for education and building the investment case for new sources of funding.

The Fund aims to attract new funding commitments to education by strengthening the causal link between education spending and education outcomes, while stimulating local innovation and maximizing the efficiency for existing education funding streams. This pay-for-success nature of the Fund is expected to crowd-in new education funding and investment from traditional and non-traditional donors, and provides a business case for corporates to invest in education that results in a skilled workforce through CSR programs.

The Fund would support intermediate level programs – beyond small-scale pilots, but below national roll-out – with a focus on improving outcomes for the most vulnerable groups. Target outcomes will be set and measured at a fund and project level, balancing standardization and pragmatism with the need to adapt to the local context.

Country governments will play a crucial role in the Fund: identifying priority target populations and education issue areas; setting curriculum and regulating providers; playing a role in the Advisory Committee; potentially co-funding interventions; and ensuring sustainability. A portion of the fund could be allotted to supporting governments to play this role and to replicate and scale up successful programs.



As a single legal entity – a wholesale, open ended vehicle - the Fund will be able to deliver impact at scale by providing a simple, cost-effective way to commission multiple outcomes-based contracts, reducing the transaction costs of individual projects. It will occupy a unique place in the global education funding space by focusing on harnessing the skills and innovation of private sector providers and investors to create a market for improved education outcomes. At scale, the Fund would also become a center of expertise for developing outcomes metrics, pricing, and monitoring results to improve education.

The Fund would receive commitments from official donors, private donors such as philanthropic foundations, CSR and corporate funding, and potentially also high-net-worth individuals. It would pool donor funds to pay non-state education providers (including non-profits, NGOs, faith-based organizations and for-profit enterprises) for improved education outcomes for priority populations in low and middle-income countries.

The Education Outcomes Fund would also play a catalytic role in seeding the investor market for education by sharing due diligence and sector learning, and potentially also by providing guarantees and / or first loss investments into specialist investment funds.¹³ The aim of such activities would be to attract private sector investors into the space by enabling portfolio diversification and scale. The specialist investment fund model would meet the pre-financing needs of private sector education providers to deliver on contractual outcomes.

Key to the Fund’s success will be its ability to:

- Unlock private sector innovation: providers that successfully develop and adapt interventions to meet local needs will be rewarded;
- Stimulate investment: the clear link between funding and results creates a rational investment market enabling working capital loans, risk-sharing through equity and Impact Bonds;
- Require rigorous measurement and adaptation: evidence of what works and where will accumulate rapidly strengthening market confidence.

Next Steps for the Outcomes Fund:

- Announcement of proposed Fund;
- Securing funding from mainly new sources of finance for education;
- Discussion with and selection of initial countries to develop the proposition and pipeline. Country selection criteria would consider the following:
 - A strong existing private education provider market that could absorb capital;
 - Government willingness to involve the private sector in the delivery of quality education – ideally within an appropriate policy and regulatory framework; and
 - Identification of target population and education issues to be addressed.

Potential Action for the Commission:

- Undertake due diligence and endorse the Education Outcomes Fund

¹³ To avoid conflicts of interest, the Fund’s investment stimulating activities would be managed independently of its contracting activities with specific service providers.

Concept Note for Education Bonds

Bonds are used as a way of raising long-term capital by public authorities, companies, and other institutions. The bond investor receives a fixed return on the principal of the underlying security, and the issuer is able to raise funds for activities that require sizable initial capital investment while re-paying the investor over time. Bonds can be secured on the basis of any future revenue streams. Bonds provide a long-term and low-risk investment opportunity to investors and are considered one of the safest investment options. We are considering bonds as innovative when they are raised specifically to fund education.

Current Experience

In the development sector, bonds are often raised by multi-lateral financial institutions such as the World Bank and the African Development Bank which both have AAA ratings. Bonds have been used in education to fund higher education. The IFC has supported bonds issued by universities based on future tuition payments and securitised by student loans. This assumes students (or their parents) will be able to fund some of their higher education, and graduates will repay their student loans with their future earnings (UNESCO, 2011). These bonds could be backed by a partial credit guarantee by a development finance institution. Sovereign governments also issue bonds in both the international or domestic market to raise funds for general budget support or to support specific development projects.

Education bonds have the potential to leverage funds from institutional investors interested in low-risk and long-term investment opportunities. Emerging market institutional investors are estimated to have \$4.5 trillion in assets under management, with emerging market pension funds accounting for \$2.5 trillion (Inderst & Stewart, 2014) and so are looking for new investment opportunities.

Some countries have issued diaspora bonds, specifically targeting the diaspora population, which may be more inclined to purchase local currency bonds and accept a lower interest rate than typical bonds due to their ties to the country (Ketkar & Ratha, 2011). Through diaspora bonds India and Israel have raised \$32 billion and \$11.3 billion, respectively (ibid.). India used the funds to support its balance payment at times when it could not access sufficient funds on the capital market; whereas, Israel raised the money to support projects in various sectors like transportation, energy and water.

There is an appetite for sector specific or earmarked bonds as demonstrated in the environment and health sector. Green bonds grew rapidly in 2014, with \$35 billion issued (triple the amount in 2013), and were expected to grow to \$100 billion in 2015¹⁴. The International Finance Facility for Immunisation (IFFIm) has raised \$5 billion from vaccine bonds since 2006 secured through long term donor pledges for vaccines.¹⁵ The advantage of an IFFIm style bond is that the donor pledges are then used to re-pay the bond.

¹⁴ <http://www.climatebonds.net/2015/01/final-2014-green-bond-total-366bn-%E2%80%93-that%E2%80%99s-more-x3-last-year%E2%80%99s-total-biggest-year-ever-green>

¹⁵ <http://www.iffim.org/About/Overview/>

Selected examples of education bond initiatives:

Inter-American Development Bank - Education, Youth, and Employment (EYE) Bond

The IADB launched the EYE Bond that raised over \$600 million since 2014, of which 81% was allocated to education projects. The EYE Bond provides loan funding to eligible projects in the Latin American and Caribbean countries. This bond program has a “‘life-cycle’ approach to building human capital from early childhood care and education, through formal primary and secondary education, as well as programs that facilitate labor market placement by improving the transition from school to work through vocational training. The IADB supervision and monitoring activities for the lending projects include disbursement, financial management, procurement procedures, risk management and/or safeguards compliance policy.¹⁶ With AAA rating and a reputation for results-driven project management, the IADB has experienced considerable success in investor interest in these bonds as a sustainable investment option and is continuing to issue more EYE bonds in targeted markets.¹⁷

African Development Bank- Education Support Bonds

AfDB has several times issued Education Support Bonds directed to Japanese retail investors. The proceeds from the Education Support Bonds are directed to AfDB projects in the education sector within Africa focusing on (i) higher education, science, and technology with the aim of producing the human capital (scientists, engineers, researchers, doctors, etc.), who will serve in the countries’ centers of excellence, and (ii) Technical and Vocational Education and Training to address the skilled labor requirements of the productive sectors.¹⁸

Potential initiatives

Education Above All – Primary Education Bond

Education Above All (EAA) is exploring a primary education bond to be issued by a sovereign state or municipality. A donor or donors would guarantee the bond, impact investors would purchase the bond on the global market, the funds would be used to implement programs to educate out of school children and EAA would review the results. If out of school targets are met, funds would be released from the donors to the sovereign body who would repay the impact investors. Education Above All would facilitate of the process and underwrite some of the costs such as marketing. Next steps for EAA;

- Approach financial institutions and aid agencies to gauge interest;
- Create prototype bond based on single market as test of concept; and
- Roll out EAA bond concept country by country.

¹⁶ <http://www.iadb.org/en/idb-finance/investors/eye-bond-project-list,19297.html>

¹⁷ Interview with IADB Finance Department and Social Sector Department staff.

¹⁸ <http://www.afdb.org/en/news-and-events/article/afdb-offers-education-support-bond-to-japanese-investors-11547/>



Affinity Macrofinance – Debt Conversion Development Bond

A variation of domestic education bonds, Debt Conversion Development Bond (DCDB) has also been explored. A DCDB can be developed when the ‘fiscal space’ created from the debt swap¹⁹ is used to issue a bond that is sold in local currency on the local capital market, which would then be invested in by local institutional investors. In 2012, UNESCO commissioned Affinity Macrofinance to explore a pilot. Affinity Macrofinance selected Jordan, Bangladesh and Kenya as potential recipient countries based on data and stakeholder consultations. They visited Ministry of Finance officials in Jordan and Bangladesh²⁰ where the Finance officials expressed interest in obtaining more information about how a DCDB would be carried out and a willingness and ability to issue the necessary domestic bonds. Education officials identified specific education programs that were ready to be implemented but needed additional funding (Bond, 2012a).

The debt data provided by Bangladesh and Jordan revealed that 75% and 61% respectively of these countries’ official bilateral debts were owed to Japan. Thus, Affinity Macrofinance visited Japan and had encouraging discussions with mid-level civil servants and JICA, who said the DCDB could involve the conversion of \$50m of JICA loans with Bangladesh. However, Japan subsequently decided that it was not the right time to take this approach further and the pilot stalled (Bond, 2012).

DCDB have the potential when there is sufficient debt left to swap, for example middle income countries such as e.g. India, Ghana, Pakistan, Philippines, Indonesia and Egypt, and non-HIPC low income countries e.g. Kenya and Bangladesh (Bond, 2012b). However, it has limited scope for use in the very low-income countries that have the potential for their external debt to be forgiven (as witnessed in the recent past).

Potential and Limitations

The potential of education bonds is that they could:

- Raise long-term capital from the bond market to be dedicated specifically to education for countries willing to take loans for the education sector;
- Leverage the appetite for socially responsible investing by institutional investors and high-net-worth individuals who are interested in low-risk products with institutions that have a track record of successful implementation;
- When issued in the domestic market, education bonds could provide local institutional investors (e.g. pension funds, insurance companies, mutual funds, etc.) safe, long-term assets to invest in and therefore help build the capital market (UNESCO, 2011);
- Target diaspora, if issued as a diaspora bond, and have the potential to access a proportion of the US\$30 billion of diaspora savings from LICs (Ratha & Mohapatra, 2011) as well as MICs, and could provide sustainable and predictable funding. However, not all countries have been successful with raising funds through diaspora bond as the

¹⁹ A form of debt relief in which the creditor forgives debt on the condition the debtor makes available a specified amount of local currency to be used for specific developmental purposes (Task Force on Innovative Financing for Education, 2012).

²⁰ Kenya did not issue an invitation.



expatriate population may not always have high level of confidence in the government to manage the funds appropriately;

- Reduce the demand on the country's foreign exchange reserves when the bond is issued in local currency (UNESCO, 2011);
- Raise the profile of education within the finance industry and tap into new financing sources for the sector
- Draw on the experience from Green Bonds and engage with existing global efforts to set up guiding principles for "Social Development Bonds;"²¹ and
- Catalyze a larger social sector bond market and increase overall private asset investment in the area.

The limitations are however that:

- The interest and principal on bonds need to be repaid to the bondholder. This needs some form of revenue stream generated by a financial return or the government. If the government has to pay, there is the potential that spending on education could be reduced elsewhere (Samoff & Irving, 2014);
- There is likely to be competition for raising bonds from other sectors with an overall increased investor interest in sustainable investment options (Samoff & Irving, 2014);
- Countries need to have sufficient credit worthiness and access to capital markets to issue domestic bonds, which the poorest countries are unlikely to have;
- Countries could be reluctant to incur more debt and increase their general debt obligation and negatively impact their credit rating;
- Investors would be reluctant to purchase bonds issued by governments with a weak economy, high debt burden, weak or volatile currency, weak tax collection systems and political instability;
- Sector specific bonds issued by multilateral financial institution may not necessarily raise "additional" funds as it could substitute the regular loan funds dedicated to education. The amount of bond funds raised is linked to existing number of projects (approved loans) or loans requests; and
- Bonds issued by multilateral financial institutions or governments would require a strong pipeline of projects for investment and monitoring systems to show investors "results" even in early stages.

Promising Ideas or Pilots

We recommend two types of Education Bonds to fund large-scale education projects with clearly defined results measurement: an IFFIm-style donor backed bond and a Multilateral Financial Institution (MFI) Education Bond. A Domestic Education Bond should be considered for the longer term.

²¹ <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-bonds/green-bond-principles/>



IFFIm-style donor backed bond:

- As bonds are able to raise large amounts of capital, the funds raised could be used to fund infrastructure for out of school children. The bond should have a clear measurable outcome that would attract donors;
- Donors provide pledges to fund out of school children (or another objective which is chosen) over a long time period;
- The hosting organization (could be the GFFE), issues bonds in various capital markets which investors purchase;
- The funds raised from the sale of the bond are used to fund programs or governments to help out of school children attend school. The funds should be channeled through an organization which oversees the use of these funds and ensures that the clearly defined outcomes are met; and
- The donor pledges then re-pay the bonds to investors at maturity.

MFI Education Bond:

- Sold on the global market and funds directed to education projects;
- MFI bonds could be targeted specifically for at countries with lower potential for domestic education bonds (low credit rating, weak domestic capital market, etc.). MFI bond funds could support projects with potential for successful investment in untested frontier markets by using the MFI's standard supervision and monitoring procedures and building investor confidence (Inderst & Stewart, 2014);
- Target institutional or high-net-worth investors who prioritize education or social development investments;
- Would have a clear Education Bond Framework that defines the project selection, reporting and assessment structure, and a pipeline of eligible projects; and
- Could provide investors with better diversification as they can be used for multiple projects across different countries (Inderst & Stewart, 2014).

Domestic Education Bond:

- Sovereign bonds sold on the local and/or global bond markets to fund education projects that can achieve measurable results and require significant initial capital like school infrastructure; development, infrastructure for teacher education institutions, ICT equipment and connectivity, etc.
- Bonds could be targeted to domestic and international institutional investors who are interested in socially responsible long-term, low-risk investments. For countries with large diaspora population, diaspora bonds can be issued to target the specific population abroad that may have a higher interest in purchasing local currency bonds at a lower interest rate;
- For countries with low credit ratings, a donor institution (multi/bi-lateral donors or foundations) could provide a guarantee and extend their AAA credit rating. This could improve the confidence of investors to enter new markets that may pose a higher risk;
- Bonds issued in local currency to reduce demand on foreign exchange reserve (UNESCO, 2011);
- Bond re-payment could be linked to GDP, where the country would re-pay more during high GDP growth period and pay less when the economy is underperforming



(Griffith-Jones & Sharma, 2006).²²Historically, high levels and quality of education have been linked to positive GDP growth, which provides a strong argument for expecting investment in education to result in long-term growth in GDP (See for example, Hanushek & Woessmann, 2015). However, careful bond structuring would be required to mitigate for inaccurate GDP data and weakened incentives for governments to implement growth-promoting policies.

Potential immediate action for the Commission:

- Hold discussions with MFIs or other donor platforms on their appetite to issue education bonds and the market appetite to invest in them, and identify an organization to lead their development (e.g. World Bank, IADB, AfDB, ADB);
- Develop bond structure and management plan;
- Develop criteria for selection of projects to be funded;
- Assess the feasibility of and appetite for an IFFIm-style education bond, what it should raise funds for and whether to it should be launched separately or part of the GFFE;
- If feasible, identify an organisation to produce a high level design, oversee use of the funds raised and to identify initial donors. Initial conversations could be had with Education Above All who is in the process of developing a primary education bond to fund out of school children; and
- The Commission could encourage governments and donors to continue experimenting with education bonds so they can mature into a new fixed income asset class for thematic bonds.

²² There is strong evidence higher education attainment and quality is linked to increase in GDP, therefore bond repayment structure linked to GDP lends itself to monetize the success from investing in education to economic growth.



Concept Note for Loan Buy-Downs

A loan buy-down is an arrangement where a third party buys down all, or a part of, either or both the interest and the principal of a loan between a country and a lending organization, thereby releasing the borrowing country from all or some of its future repayment obligation. The funding that would have been used to repay or service the loan must then be invested in earmarked development projects with agreed outcomes (R4D, 2013). Buy-downs have sometimes been associated with results-based triggers or conditions of release of the grant funds which extinguish, or at least soften, the loan.

Current Experience

There is limited experience to date on loan buy-downs, those that have been implemented have been mainly in the health sector, with bilateral agencies or the Bill and Melinda Gates Foundation buying down loans from multilateral banks. Of the 8 buy-downs that R4D evaluated, 7 were very much set in specific historical contexts: significantly higher IBRD interest rates than today; specific policy decisions against borrowing on IBRD terms for non-revenue generating projects and a “weakest link” global public good in order to eradicate polio (ODI, 2016, unpublished).

In education, there has been one buy-down so far that involved DFID buying down IBRD loan to China to IDA term in 2003; a \$100 million loan was made and the value of the buy-down was \$34.5 million. An independent group evaluated the project as satisfactory (R4D, 2013).

Potential and Limitations

The potential for using loan buy-downs in the education sector are that they:

- Encourage a focus on results as buy-downs can be triggered based on education outcomes achieved;
- Encourage governments that would otherwise not borrow to take out a loan to invest in education;
- Have greatest potential for countries that are on the both sides of the IDA/IBRD graduation threshold with major basic education challenges for example Angola, Bangladesh, India, Nigeria, Pakistan and Sri Lanka (R4D, 2013) (at this point, concessional aid is falling off faster than non-concessional and domestic resources rise and private sector tends to focus on sectors with clear cashflows (ODI, 2016, unpublished));
- Also have potential for low-income countries unable to take on more debt but in serious need of external support for basic education, such as Afghanistan, Burundi, Chad, Democratic Republic of Congo and Tajikistan. As these countries are not creditworthy, any buy-downs for them would have to be to grant or near-grant terms (R4D, 2013). In this case the multiplier would be far lower than in the case of buying down from e.g. IBRD to IDA terms; and



- Are deemed to be most appropriate for higher and vocational education (ODI, 2016, unpublished).

The limitations however are that they:

- Risk increasing a country's indebtedness;
- Triggers need to be chosen carefully to ensure 1) their relevance to project outcomes; and 2) that they can be easily monitored;
- May not be sufficiently attractive to countries given they may have received grant funding in the past;
- May not be demanded by countries given 1) other national development priorities; 2) strong competition from other sectors for scarce IDA/IBRD resources; (3) returns to increased national education spending are not clear enough; (4) sufficient availability of grants for education from other sources; and (5) concerns with education recurrent costs, via an ever-expanding teacher wage bill (ODI, 2016, unpublished); and
- Buy-downs could encourage an increase in lending and run the risk of discouraging grants, reversing the recent trend of more grant funding of basic education.

Promising Ideas or Pilots

In 2014, the Islamic Development Bank pledged \$400 million for a pilot loan buy down with the Global Partnership for Education (GPE). GPE would buy down Islamic Development Bank non-concessional loan to concessional loan terms for countries that implement programs that meet GPE quality and monitoring requirements. Unfortunately, the funding set aside by the GPE to buy down the loan was re-prioritized and until December 2015, the GPE was unable to receive targeted funding for the buy down element (interview with GPE staff, February 2016).

Next steps for the GPE

- The GPE's strategy meeting in December 2015 has now given the Secretariat the mandate to explore targeted funding, however the GPE is also broadening its assessment of strategic financing options of which the loan buy down is one;
- Explore potential targeted funding for the loan buy down from a Middle Eastern funder; and
- Recommendations for strategic financing options for eligible countries will be made in June 2016 and a final decision in December 2016.

The ODI is also reviewing the potential benefits of loan buy downs (whether structured as a formal blend or looser co-financing arrangement) to help "crowd in" concessional and semi-concessional loans for education. This work starts from factors that constrain effective demand for such loans from potential borrowers and prospects for additional finance, as well as additional education development benefits, derived from such designs. They are proposing to include loan buy-downs in the Global Financing Facility for Education which has been outlined in more detail above. The idea would be to use the loan buy-downs could be used for a catalytic effect, i.e. blended, primarily with IDA (and possibly other MDB facilities) (ODI, 2016, unpublished).



Next steps: The following next steps are required for further due diligence:

- Discuss feasibility in more detail with World Bank
- If feasible, include in the design of the GFFE

Potential action for the Commission

- Review the GPE's analysis and assess whether suitable for endorsement. If so, encourage donors to provide targeted funding and governments from eligible developing countries to borrow where a loan buy down would provide the financing they need
- Endorse loan buy-downs as part of the GFFE



Concept Note for Innovations in Student Financing

Student financing mechanisms provide funding directly to students or their families to fund education access. The most common forms of demand-side funding mechanisms are scholarships / grants, student loans, and vouchers. We are focusing on student loans as they are the most sustainable of the three assuming an effective repayment system is in place. Traditional (mortgage-like) student loan models require students to repay the principal and interest in full, which could be prohibitive for students not wanting to take a risk based on future earnings. Traditional student loans have seen high default rates of 11.8% in the US (U.S. Department of Education, 2015), 36% in Chile and 17% in Colombia (Salmi, 2013). These loans have a fixed amount a student must repay but offer no guarantee of affordability with variable future income.

Innovative student financing mechanisms include techniques such as income share agreements, crowdfunding or peer-to-peer lending; they are provided by non-banking financial institutions (NBFIs); or are an innovative variation of the more traditional loans such as income-contingent loans.

In terms of scale, income-contingent loans have the most potential provided an effective and comprehensive tax system is in place. If that is not present, we think that income share agreements hold promise in terms of addressing equity in careers where the future salary is predictable e.g. teachers, vocational training, business and commerce and engineering, and in locations where the data is available and the market allows it. However, to truly address equity at scale, there is a need to catalyze a market that combines effective government funded (although not necessarily delivered) student financing for those from the lowest income backgrounds (based on income-contingent loans where possible), as well as private sector innovative student financing for students undertaking professional or vocational courses and where the context allows.

Current Experience

Income Share Agreements (ISAs)

In Income Share Agreements (also known as human capital agreements), the investor (government, private institution, bank, non-profit) lends capital to the student to pay for a degree as an investment in their future earnings. The borrower commits to pay the investor a fixed percentage of their future income for a fixed period, regardless of whether the full amount is paid back. This is an investment in human capital, rather than a traditional loan that earns interest. An investor manages risk through calculating the financial rate of returns on different degree courses, assessing the individual's potential income and through a diverse pool of student borrowers. A low-income student benefits from not having to provide collateral for the loan and making affordable repayments.

ISAs are being implemented in several Latin American countries and the US for higher education financing. Lumni for example is one of the pioneers of this approach:



- Since 2002, 7,000 students have been funded in Chile, Colombia, Mexico, Peru, and the US, mostly from low and very low-income families;
- It has realized an average return of 7 to 11% in Chile, Colombia, Mexico and Peru (LaFerrara, 2014);
- 2011 data showed only 2-3% default rate and 5% dropout rate (Bornstein, 2011);
- It currently manages \$38 million in assets under management from both corporate and individual investors (Lumni interview, 2016); and
- Key factors to its success include; corporate financing; selection of students based on their future income potential rather than their families' wealth; highly tailored support to students; development of a culture of re-payment through small contributions by students throughout their higher education until employment; minimization of risk through a diversified student pool as well as only supporting students from year 2 (ibid.).

Other organizations using this ISA approach also include Prodigy Finance (loans to international postgraduate students attending leading business schools).

Non-banking financial institutions (NBFIs)

One of the innovations in student financing is that non-banking financial institutions (NBFIs) have begun to deliver student loans. The advantage of these is that when student loans are given a central focus, they can increase efficiency and responsiveness to student needs (IFC, 2015) and they typically innovate in the selection of students as well as in their approach to raising capital. An interesting example is Ideal Invest:

- A private student lending company in Brazil which has raised its capital from investors (including the IFC) through a securitization vehicle (it has loaned over \$240m since 2006 (IFC, 2015));
- Since 2006 it funded approximately 80,000 students and plans to grow to 500,000 students in 5 years; it targets low income students (interview with Ideal Invest, April 2016);
- It works with approximately 400 universities and since 2010 has shared the risk, with universities subsidizing some or all of the loan interest and marketing the loans – they do this as Ideal Invest students have a 40% lower dropout rate (ibid.);
- Ideal Invest has a long term delinquency rate of 7-8%, and past due loans over 90 days is 5% (ibid.); and
- Key factors in its success; its simple loan structure (IFC, 2015), very close working relationship and risk sharing with universities, a very competitive higher education market with private student base accounting for 75% of all higher education students and changes to the government's flagship student loan program (FIES) making it harder for students to get government loans (interview with Ideal Invest, April 2016).

Another interesting scheme that has a strong link between education and employability is a student financing facility set up by Duoc UC, a non-profit private tertiary vocational institution in Chile (serving 88,000 students), together with the IFC and Banco de Crédito e



Inversiones (IFC, 2015). This aimed to provide student loans to students from the lowest quintiles (ibid.) and had a strong track record for employability.

Income contingent student loans (ICLs)

Income contingent student loans are structured so that the loan repayments to the government are a fixed proportion of a graduate's annual income (Salmi, 2003) and are typically collected through the tax system. They have a minimum threshold so repayments are only made once the student's income reaches a certain level. Chapman (2016) states that evidence suggests that the economic, administrative and equity case for ICLs is very strong, although it depends on their design and implementation. The key benefits include lower default rates, more efficient re-payment and collection, and greater equity as they remove repayment hardship. In addition, they can have the ISA principals applied so can be based on future earnings rather than family collateral.

Australia's Higher Education Contribution Scheme (HECS) is often cited as a good example of an income-contingent loan scheme as it has enabled Australia to introduce cost-sharing in public higher education which has meant a 30% expansion in enrolment without a significant increase in government spending (Salmi, 2003). Government loans were provided with repayments set at a maximum of between 4% and 8% of annual personal income above a certain threshold and collected through the Australian tax system (Chapman, 2016). This scheme has been adapted by 8 countries including Ethiopia and South Africa often with interest rate subsidies to improve equity and efficiency (Chapman, 2015).

However, the main disadvantage of this approach for developing countries is the need for effective personal identification and collection mechanisms which would usually be a reliable tax or social security collection system to collect the repayments, as well as a functioning judicial system (Chapman, 2016) as this obviously may not always exist. Income-contingent loans are therefore best explored in tandem with broader tax system reform in countries.

Potential and Limitations

The potential for innovative student financing mechanisms are that they:

- Increase equity in access to and success in higher education and potentially vocational training for low-income and very-low income students;
- Increase funding from the private sector for higher education with relatively high return on investment and low repayment default rates (subject to initial subsidies) – this is enhanced by the clear link between higher education and employment and economic growth;
- Potentially free up public sector funding that would have otherwise been spent on higher education²³ for pre-primary, primary and secondary education;
- Create a demand for education downstream;

²³ currently 18% of public sector education spending is on higher education in Lower Income Countries (Table 10, GMR, 2015)



- Potentially encourage higher education institutions to reduce tuition inflation and price programs relative to the labor market return; and
- ISAs have potential where future salary is predictable e.g. teachers, vocational training, business and commerce, engineering and encourage the linking of financing to higher education supply and to employability (risk sharing financing across these where possible).

However, there are some limitations to pursuing the expansion of these:

- Legislation and regulations may not allow for private provision of student financing or specific types such as ISAs;
- For ISAs, there are quite high transaction and administrative costs related to beneficiary selection and support;
- For ISAs, future earnings are difficult to predict in countries with high unemployment, or informal employment or where there is limited data on the financial rate of return for specific programs of study;
- In countries where higher education is highly subsidized by the government, there may be some reluctance by students to pursue private financing;
- In the first few years, private student financing schemes are likely to require some form of subsidy or blended finance until they reach scale;
- For large scale income-contingent loans, an effective personal identification and tax or social security collection systems as well as robust judicial systems would be needed;
- It is uncertain how the repayment is collected if the student emigrates; and
- There may not be a sufficient supply of quality higher education institutions.

Promising Ideas or Pilots

D. Capital Partners (a Dalberg company) is developing the African Student Finance facility (ASFf), which combines student financing with advanced market commitment (AMC) benefits in order to enable African students to reach employment.

The student financing element includes loans that will be customized using predictive analytics based on student future earnings, and outperformance incentives such as performance-based loan forgiveness. The AMC element supports higher education providers to scale up by partnering with providers to lend loans to students, so the provider has a pool of students guaranteed to pay their education costs and thereby anchors the demand, and by partnering with employers, so the students become a guaranteed a pool of skilled workers. The risk will be shared between the higher education providers and employers. ASFf will raise capital from a wide range of investors using a blended finance model. Foundations and donors are likely to provide the initial first loss funding and grants for performance-based loan forgiveness; and impact investors and commercial investors will provide the capital with the expectation of a financial return.

ASFf aims to differentiate itself from previously tested education loan schemes by its deliberate recognition of the motivations of each player in the system and upfront strategies



to minimize the portfolio risk by integrating mitigation strategies within its design. The ASFF will establish operations in South Africa and Kenya in 2016 and plans to expand to Ghana and Rwanda soon after (initial \$30-40 million fund target).

Next steps for the ASFF

- D. Capital Partners is currently seeking financial and technical support to design and pilot the ASFF; and
- Work would need to be undertaken at a country level to line up partners.

Potential action for the Commission

- Undertake further due diligence and if appropriate, endorse the D. Capital Partners pilot of the African Student Finance Facility. Ultimately, if successful, support the establishment of a dedicated regional financing facility for development (\$100-200 million plus) in Africa, Central America or South Asia;
- Identify countries to implement income-contingent loan schemes; countries with sufficiently effective and reliable tax systems (or those going through reform) in need of increased higher education funding and with potential employment opportunities, assess government appetite for an income-contingent loan scheme and explore opportunities to raise the capital for implementation, for example through education bonds or loan buy-downs; and
- Identify countries that would be suitable for private sector student financing with: the necessary legal and finance environment; high secondary education completion but a low transition to higher or vocational education; effective higher education and vocational training programs but few students from low income families; and sufficient data on education level and expected income are available. Explore potential partnerships with governments, investors, lenders and higher or vocational education institutions.



Concept Note for Risk Financing

Risk financing could mobilize funds very quickly to developing countries to enable them to rebuild and maintain their education systems after a shock. It would transfer some risk to the market while increasing resilience planning. It could leverage additional sources of finance, improve efficiency gains, and spending effectiveness.

Education systems are subject to shocks such as earthquakes, drought, armed conflict, commodity price fluctuations, financial crises and civil unrest that disrupt the delivery of education and undermine the ability of the system to sustain gains. Education infrastructure is lost either by damage or destruction of schools and equipment, or due to the use of schools for long-term shelters. Students and teachers lose the ability to reach schools due to road or other lifeline damage or security concerns. Hunger, malnutrition, and other child health issues prevent school attendance and contribute to teacher absenteeism. General negative economic impacts also carry through to the education sector.

Liquidity for early response is challenging, ex-post financing is unpredictable and education is often deprioritized in humanitarian crises. There is also a compounding effect of children missing school. There is a multiplier effect through pre-planning activities such that early and targeted financing could be leveraged. Overall, expanding the capacity for proactive risk management, mitigating risk through practical measures and including risk assessment in project preparation could reduce risk.

Risk markets have shown an increased willingness to underwrite specified perils that impact physical and social infrastructure in developing countries including cyclones, excess rainfall, earthquakes and drought. There is strong interest in these markets to take on risk quantified using index-based models where the insured loss is based on pre-agreed independently verifiable data-metrics and payout amounts tied to the severity or magnitude of the particular event and its ultimate impact. With an insurance scheme, risk can be transferred to the international market (including both traditional reinsurance markets and the broader capital markets through instruments such as catastrophe bonds), unlocking a new source of contingent financing for the sector and securing efficiency gains for spending.

Current Experience

Disaster Insurance: There is considerable – but very modest – experience with natural disaster insurance, in both the Caribbean and in Africa. The following are two large sovereign risk pools currently in operation, which were initially funded with various financial instruments by the donor community.

- The Caribbean Catastrophe Risk Insurance Facility (CCRIF) was founded in 2007 as the first multi-country risk pool in the world designed as a regional catastrophe fund for Caribbean governments to limit the financial impact of devastating hurricanes and earthquakes.



- The African Risk Capacity (ARC) a Specialized Agency of the African Union (AU) was established to help the member states improve their capacities to better plan, prepare and respond to extreme weather events and natural disasters.

Catastrophe Bonds: Catastrophe bonds (or cat bonds) transfer the risk of catastrophic event to investors by allowing the issuer to not repay the bond principal if a catastrophe occurs. The World Bank has developed a cat bond insurance platform – the MultiCat Program – which allows governments to use a standard framework to buy insurance on affordable terms by issuing cat bonds. In 2014, the World Bank (IBRD) issued a \$30 million, 3-year cat bond linked to earthquake and tropical cyclone risk in sixteen Caribbean countries²⁴. This bond provides re-insurance to the CCRIF.

Potential and Limitations

The potential of risk financing is that it could:

- Provide immediate financing to governments for early responses to the education sector after a shock;
- Support some continuity in provision of education and sustain gains during and immediately after a shock;
- Partially transfer some of the risk burden from governments (and donors) to financial markets, who are better able to manage them;
- Leverage new sources of contingent financing from the international market (including both traditional reinsurance markets and the broader capital markets through instruments such as catastrophe bonds);
- Leverage the increasing willingness of insurance markets to underwrite specified perils that affect physical and social infrastructure in developing countries.
- Use easily measurable, pre-agreed, and independently verifiable data metrics as triggers for an index-based or parametric insurance for rapid claim payout; and
- Incentivize governments to include emergency and resilience planning within education sector plans. A proactive approach by countries may improve humanitarian response in general and give greater confidence to emergency humanitarian funders.

The limitations are however that:

- It will require improvement of education data to calculate the financial impact of disasters on education systems;
- While some models for parametric insurance exist for natural disasters, models for index-based insurance products for political risk are less widely known;
- Coordination between donors and recipient country would be needed to negotiate premium payment arrangements which may be too high to be considered value for money if developed for individual countries; a multi-country platform would be more efficient; and

²⁴ <http://treasury.worldbank.org/cmd/htm/FirstCatBondLinkedToNaturalHazards.html>



- It is only suited to those parts of the world with a high likelihood of natural or political disaster.

Promising Ideas or Pilots

Existing global education institutions could take a lead in piloting a risk financing model for education. To participate, countries would be required to demonstrate that they had in place an adequate risk management and resiliency in their education sector plans. The mechanism could either insure each country individually or a group of countries at the global or regional level to provide some diversification.

Parametric Insurance

For parametric insurance, the cost of recovery/reconstruction is financed through regular premium payments. The donor community pays the premium to the insurance company to purchase coverage against specified perils. When a qualifying event occurs, it triggers a payout to developing countries to meet the immediate financing needs of the sector, which may be disbursed as general budget support or to fund pre-agreed government prioritized education activities such as restoring infrastructure, keeping schools open, paying teacher salaries or funding school feeding. The insured loss is based on pre-agreed independently verifiable data-metrics, and payout amounts are tied to the severity or magnitude of the particular event and the scale of its ultimate impact. This removes the need for costly and uncertain loss adjustment and would make the payout in the case of a covered event automatic.

Catastrophe bonds

Catastrophe bonds are risk-linked securities that transfer a specified set of risks from an insurer or reinsurer to an investor. In much the same way as a premium based insurance mechanism, the payout would be parametric trigger. An issuing vehicle would be set up to issue a bond on the capital markets and finance the coupon of the bond. At maturity of the bond the principal would be returned to the bondholder if there has been no event. If there has been an event, then a part of the principal needed to remediate the costs would be transferred to the country and paid out according to a qualified plan. The remainder of the principal would be paid back to the bondholder. In both cases returns would be paid periodically.

Next steps: The following next steps are required for further due diligence:

- Identify and quantify the causes of disruption to education system delivery, including the long-term impacts on economic development in future generations;
- Calculate the event risk of the shocks that disrupt education systems;
- Identify the appropriate potential financial solution(s);
- Discuss feasibility in more detail with global education institutions and identify a lead;
- Explore whether an existing risk facility could be expanded to incorporate education risk;



- Explore if risks could be packaged in such a way that countries could access the risk financing markets (in terms of affordability too);
- Assess how all low-income and lower-middle income countries could integrate risk management and resiliency planning; and
- Undertake detailed design and establish operations.

Potential action for the Commission

Identify an organization to take the lead in exploring various risk financing mechanism and support further due diligence.



Concept Note for Social Impact Investment

Social Impact Investments (SII) are investments intended to achieve positive social outcomes beyond financial return. Investors in the SII market include philanthropic foundations, high-net-worth individuals, financial institutions, companies and development finance institutions. The majority of SII use private debt and equity structure, but some also use equity-like debt and pay-for-performance type instruments. Blended finance in the context of social impact investment combines grants with debt or equity and is often used to reduce the risk of the investment at an early stage.

Investors vary in their appetite for risk from impact first to finance first investors. The Acumen Fund is an example of an investor that undertakes impact-first investments in education, providing long-term capital in early stage companies for an eventual 'below market rate' financial return. Financial-first investors like the International Finance Corporation (IFC) focus on upper-middle-income countries (UMICs), and typically invest in private tertiary institutions or high-end private school networks (Bellinger & Fletcher, 2014).

Current Experience

Most social impact investments in education are in school infrastructure. Investments in people typically include student loans, vocational training and teacher training; investments in tools and services are largely focused on technology, whether for education delivery or for managing the back office. There are very few transactions to build the education ecosystem. Investees are playing a range of roles: filling the gap through direct service provision, building capacity and the broader education ecosystem and supporting public delivery (Dalberg Research, 2013).

There is a growing interest from investors in Social Impact Investment, in general, and is being considered a new investment asset class (O'Donohoe et al, 2010). The findings of the 2015 survey of 146 impact investors within the Global Impact Investor Network demonstrate the potential for an increase in the SII market for education (Saltuk et al, 2015):

- Investors committed \$10.6 billion to impact investment in 2014 and expressed intentions to invest up to \$12.2 billion in 2015.
- A total of \$60 billion of impact investment assets were under management by 2015, and approximately half of this was in emerging markets; majority of the investors plan to increase investments in Sub-Saharan Africa, East and South East Asia and the Latin America and Caribbean region; and
- 2% of the investment assets under management were in the education sector, although in both developed and developing countries; 22% of the responded planned to increase education sector investments.

Education specific social impact investment funds could bring more attention to the sector and increase overall impact investment funding for education. Several investment funds focusing on the education sector are being set-up in emerging markets (For example,



Pearson Affordable Learning Fund²⁵, Lok Capital²⁶ in India, EdTech Funding Forum for start-ups in India²⁷, Intellectap²⁸ in Africa and South Asia, the Regional Education Finance Fund for Africa²⁹ to encourage innovation in education and to improve access to educational services. However, there is a lack of large funds dedicated to education sector SII.

Potential and Limitations

The potential for SII specific to education is that they:

- Attract new funding into education in low and middle-income countries from mainly new funders (possibly over \$122 million per year at a 2% rate on approximately \$6.1 billion SII investment that was estimated for emerging market by GIIN in 2015 (Saltuk et al, 2015));
- Often bear more risk (than governments and solely commercial investors), and so fund experimentation and catalyze innovation (Dalberg Research, 2013; van Fleet, 2012);
- Can encourage the scaling-up of successful education models, these could improve education quality and effectiveness in both public and non-state sectors;
- Beyond just investment funds, often provide support to small and medium enterprises in education with financial and management capacity building;
- Drive cost-effectiveness with a focus on financial return and sustainability; and
- Encourage the measurement of impact.

There are several limitations to expanding Social Impact Investment in the education sector:

- Few education-related enterprises in developing countries have developed a track record of social and financial return (Dalberg Research, 2013), demonstrated cost-effectiveness at scale or clear exit routes;
- Recipient organizations are potentially in need of support in absorbing and using investment capital effectively - investors need to spend a substantial amount of resources "hand holding" the institutions through the adoption phase;
- Substantial scale-up of EdTech and other educational products or services to the public sector is difficult due to the lack of government human and system capacity to implement the model into the larger system. Considerable knowledge and skills development within the public sector needs to take place for before adoption;
- International Social Impact Investors use standard indicators for performance metrics like IRIS and GIINS; however, these are currently not fully aligned with SDG education indicators; and
- There is the perception from some of the education community that social impact investing may be about making money from the poor (interview with Peeters, February 2014).

²⁵ <https://www.affordable-learning.com/content/corporate/global/palf/en/home.html>

²⁶ <http://www.microcapital.org/microfinanceuniverse/tiki-index.php?page=Lok+Capital+LLC>

²⁷ <http://edtech.applyifi.com/>

²⁸ <http://www.intellecap.com/>

²⁹ <http://www.reffa.org/reffa/the-fund>



Promising Ideas or Pilots

The 'Business of Education'

DFID and Yellowwoods Foundation (South Africa) have commissioned a research project titled "The Business of Education in Africa." The study is expected also to attract funding from USAID and the ELMA Foundation, and possibly from other similarly reputable organizations. The project was conceived of and initiated by Caerus Capital and is supported by Oxford Analytica, a macro-advisory firm, and Parthenon-EY, a consulting firm specializing in the education sector in emerging markets. They aim to research private financing of delivery in Pre-K, K-12, higher education, and TVET, as well as products and services that are provided by the private sector to the education sector (public and private) in Sub-Saharan Africa. The project is being delivered in two phases: Phase 1 (due June 2016), relies largely on desktop and survey work; and Phase 2, will rely largely on on-the-ground work in around six African countries.

Caerus Capital has two objectives for this work: (i) to develop a fund dedicated to investing in the education sector in Africa, and (ii) to create a "public good" that they hope will encourage investors, operators, policy-makers, and development institutions to think about how the private sector can help improve educational outcomes in Africa. The sponsor organizations supporting the project share these objectives.

Potential action for the Commission:

- Review Caerus Capital research report; increase visibility of the Phase 1 report to encourage donors to meet the funding gap for the Phase 2 of the study to conduct on-the-ground research;
- Potentially encourage similar research or commission research in other countries or regions where there is potential for greater private financing of education and better integration of the private sector in the overall education system;
- Understand areas of opportunity for potential commercial investors and impact investors, taking into account needs of the education system overall;
- Identify where Commission could most add value, for example through encouraging donors to help catalyze the private financing ecosystem in one or more countries; working with donors and governments to adopt and successfully implement policy, regulatory and financing approaches that lead to greater integration of the public and private sectors in education systems;
- Encourage support for existing fund managers in launching relevant investment funds; exploring financing options for the adoption and scaling up of successful products or services to public education systems;
- An interesting idea which will likely not be included in Caerus Capital's research would be to map out the funding pathway for social impact investment in a particular country, this could include innovation hubs, angel networks, blended finance and social impact funds (ref. meeting with Nick O'Donohoe, Adviser at the Gates Foundation). This could be used to identify gaps and how the ecosystem could be catalyzed for further education investment.

Concept Note for a Global Solidarity Levy for Education

A global solidarity levy aims to “levy global economic activity to pay for global public goods (Task Force on International Transactions and Development, 2010).” It is based on the principle that those sectors of the global economy that are doing well or which are contributing to a ‘global public bad’ should help pay for the funding crisis of global public goods (The Leading Group, 2010). A global levy involves ‘a set of identical or convergent national tax mechanisms, implemented jointly by the countries [involved] within a common, agreed framework, encompassing the utilization of the funds levied by each of these states’ (the Landau Report, 2014).

Current Experience

The air ticket levy used to fund over 50% of UNITAID during the last 5 years³⁰ is the most widely quoted example of a successful global solidarity levy. The air ticket levy has been implemented in ten countries in both Northern and Southern hemispheres. A small levy is charged on each flight leaving the country, the country decides on the amounts and the levy is implemented through the adoption of a law or decree and simply added to an existing airport tax. Since 2006, the levy has raised US\$2 billion (Douste-Blazy, 2015) and its funding remained stable throughout the economic crisis. UNITAID’s 5-year evaluation (ITAD, 2012) stated “the airline ticket levy can be considered a success and an important ‘proof of concept’.

Key factors for its success:

- Very simple structure and low cost as it was built on existing systems for collecting air tax;
- A connection between a global service with some adverse effects such as pollution, funding a global health need;
- Strong leadership from France and early support from partners including the UK;
- African countries have implemented the levy to raise funds for their own populations;
- The amounts levied are so small (in France 1 Euro per Economy flight) that there is no evidence that it has caused any negative effects on air traffic (French National Assembly, 2011)³¹; and
- Providing recurrent funding for HIV/ AIDS, tuberculosis and malaria which have high recurrent costs but that are easily trackable.

In September 2015, UNITLIFE was launched to fight chronic malnutrition in sub-Saharan Africa. Under UNITLIFE, countries with abundant natural resources such as Republic of Congo, Guinea, Mali and Niger will invest a small portion of revenues derived from the sale of oil, gas and mining towards a UNICEF-hosted fund dedicated to improving child nutrition. The levies are expected to initially generate between \$100-\$200 million a year³².

³⁰ <http://www.unitaid.eu/en/how/innovative-financing>

³¹ Ibid.

³² http://www.unicef.org/media/media_85667.html



In July 2013, the European Parliament approved the introduction of a Financial Transaction Tax (FTT) to be applied to certain financial transactions between institutions. 10 countries have signed up, it was originally expected to raise €30-35 billion per year³³ if implemented in all countries, however the amount is now expected to be much less, however delays continue to its implementation and no final agreement has been made on what proportion can be allocated to development, let alone to education. Other taxes that have been considered but not yet implemented include a global currency transaction tax; a global carbon tax; and solidarity tobacco contributions (Carter, 2015) and a road safety tax on used vehicles (Badré interview, May 2016).

The only levy that we are aware of that was proposed for Education was by UNESCO in 2009 when it launched an appeal to Fifa and five major European football leagues for a sports levy on football broadcast and sponsorship revenues however it has not been implemented (Samoff and Irving, 2014).

Principles for an effective international tax as stated in the Landau Report:

- Universal consensus on goals, which should be seen as absolutely legitimate by the whole international community;
- Programs with high visibility, and whose impact must be proven and easily measurable;
- Economic efficiency, which leads to either corrective taxes or taxes at very low rates and broad bases;
- Equity in burden sharing; and
- Total transparency in governance and management, both from the point of view of recipients and the international community (Landau Report, 2004).

Potential and Limitations

The potential of international solidarity taxes is that they:

- Provide stable and predictable funding (The Landau Report, 2004) and are therefore most suitable for a recurring need (Badre, interview, May 2016);
- Can potentially access a high volume of new sources of funds from the private sector (FTT is estimated to raise €30 billion per year (European Commission, 2014));
- Can be spent on any area of Education need;
- Can raise the profile of a specific issue within the Education sector for example education for refugees;
- They are relatively efficient to manage;
- Promote South-South cooperation by allowing new actors from Africa and Latin America to participate in financing international development (Carter, 2015); and
- Are relatively painless for the consumer (Douste-Blazy, 2015).

The limitations are however that:

³³ http://ec.europa.eu/taxation_customs/taxation/other_taxes/financia_sector/index_en.htm



- Gaining multi-country agreement to a new tax on education given current domestic economic pressures, is likely to be a considerable challenge;
- Some argue that it is more sustainable and less donor reliant to make the case for investing in greater international cooperation for direct tax collection (Carter, 2015);
- The Education sector is likely to be in competition with other sectors for example for the European Financial Transaction Tax;
- It would face opposition from the private sector and other contributors if it is perceived to create additional bureaucracy (Badre interview, May 2016); and
- Clear additionality, accountability and link between financing and results would have to be demonstrated.

Promising Ideas or Pilots

Douste-Blazy, President of UNITAID and Under-Secretary-General, Special Adviser on Innovative Financing for Development at the United Nations has called for the ten countries implementing the European Financial Transaction Tax to allocate 30% of funds for development as France has done (Douste-Blazy, 2015). Lobbying could be undertaken for the Education sector to receive a good proportion of that.

Potential action for the Commission

- Lobby for a proportion of the proposed European Financial Transaction Tax (FTT) to be spent on international education (O'Hagan & Winthrop, 2013; Douste-Blazy, 2015);
- Speak to international tax experts to identify existing consumer taxes that have the potential for a micro-levy to be added at no/ low cost and where there might be some appetite. Ideally, there should be a link between the item or service taxed and education;
- Identify sectors that need to offset their 'global public bad' and gauge their appetite;
- Develop one or two illustrative examples to test; and
- Identify a champion to take this forward.



Concept Note for Harnessing Remittances

Remittances, or funds transferred from migrant workers to their relatives in the home country, are a significant part of international capital flow. In 2014, remittances totaled \$582 billion worldwide, out of which \$435 billion went to developing countries. Remittances in developing countries are significantly larger than both Official Development Aid and Foreign Direct Investment, and have the potential to be a stable source of development finance. Funding schooling of migrant's children or that of relatives in the home country is one of the major uses of remittance funds and several studies have linked an increase in schooling with increasing remittances (Theoharides, 2014).

Current Experience

Several experiments have attempted to further increase remittance funding for education: labeling remittance transfers for education (De Arcangelis et al, 2014); direct payments to education institutions (for example EduPay for the Philippines (USAID, 2013)); matching funds (for example EduRemesa in El Salvador (Ambler et al, 2015)); and subsidizing transaction fees for education related transfers. Some more detail on these is outlined below:

- An experiment with Salvadorian migrants in the Washington, DC area using EduRemesa showed that migrants are willing to increase remittances for education to relatives in El Salvador if they are subsidized through matching funds (3:1 and 1:1 matching provided by IADB); (for each \$1 received by beneficiaries, educational expenditures rose by \$3.72), furthermore, when the funds are targeted to a specific student through an ATM card, it has a crowd-in effect with the family in the home country increasing their expenditure on the student (Ambler et al, 2015).
- Migrant hometown associations (HTAs) are mobilizing collective remittances to improve social welfare in their countries of origin (Duquette-Rury 2014). Ratha (2016) states that 'Beauchemin and Schoumaker (2009) find that villages in Burkina Faso with hometown associations were 2.8 times more likely than others to have a primary school, while Chauvet et al (2013) find evidence that Malian HTAs have helped improve schools'. In the Mexican 3x1 Program for Migrants, the Mexican local, state, and federal government matches funding raised by HTAs to improve public services. Duquette-Rury (2014) has found that this program has been effective in infrastructure construction (2014) but Ratha (2016) points out that this best serves the richer communities as they tend to be more organized and selection can be political. It has been copied by other countries in Central America and the Caribbean though (Newland 2004).
- De Arcangelis et al, 2014, in a lab-in-field experiment, found that Filipino migrants in Rome were willing to increase remittances by 15% if they were allowed to label them specifically for education and 17.2% if the remittances could be paid directly to the educational institutions (as in EduPay instrument by the Bank of Philippines).



Potential and Limitations

Multiplying remittances in this way has the following potential, it can:

- Provide a source of predictable and sustainable funding;
- Attract greater funding for education from diaspora;
- Amplify existing remittances using existing channels; and
- Provide local ownership on how the funding is spent and so addresses local need.

Some limitations include:

- The current experience is based on small-scale pilots, scalability needs to be tested;
- The way remittances are spent is likely to be small scale and piecemeal;
- Only suitable for countries with a large diaspora; and
- Would need a cost effective way of measuring how the funding was spent.

Promising Ideas or Pilots

Potential action for the Commission

- Lobby at the highest level for a reduction in remittance transaction fees;
- Identify suitable country/ countries (other developing countries with high remittance in-flows are India, Philippines, Mexico, Nigeria, Egypt, Pakistan, Bangladesh, Vietnam, Ukraine)
- Assess scalability, replicability and feasibility of these programs;
- If feasible, identify organizations with potential to scale them up for example bilaterals (e.g. USAID as they launched EduPay) and regional (e.g. IADB) donors or domestic governments to fund matching programs to subsidize remittances being used specifically for education.



Concept Note for Catalyzing the School/ Provider Financing Market

As various studies have shown, many low-income parents are sending their children to low-cost private schools (LCPSs). These LCPSs are typically owner-operators with limited access to capital to expand their infrastructure, or working capital to manage the higher operating costs associated with greater pupil numbers (Wheeler and Egerton-Warburton, 2012a). LCPSs fall outside the market for microfinance (as the loans they need are too big) and SME finance (as the loans they need are too small) (Wheeler and Egerton-Warburton, 2012a). They do have positive characteristics for lending though, for example assets in the form of school buildings, operating plans and comparable costs (Ibid.).

Some financing companies have therefore started to offer loans specifically to these LCPSs to invest in infrastructure and improve the quality of education they deliver, for example the Indian School Finance Company has provided over 2,000 secured and unsecured loans to LCPSs in India since 2009³⁴. Foundations such as Edify, IDP Foundation, Kashf Foundation and Opportunity International, donors such as DFID and the IFC have been trying to catalyse the market by providing an initial credit guarantee to an existing microfinance institution to start lending to schools to prove the market, plus training in school management or quality interventions to improve learning. DFID's programme in Pakistan also developed a lending tool to enable lending officers at existing microfinance institutions to assess a school's capacity to absorb credit and repay loans easily.

Potential and Limitations

The potential of school/ provider financing through loans is that:

- It provides access to capital that LCPSs would otherwise be unlikely to obtain so they can grow, be sustainable and improve the quality of education they deliver;
- Financing is sometimes provided with access to training on school management and interventions to improve quality so the schools can be run more effectively; and
- School financing companies that have the potential to reach a scale where they can be invested in themselves, which can help further scale the LCPSs.

The limitations are however that:

- Finance is often used to improve elements of the school that do not have a big impact on learning outcomes, for example infrastructure and even where training on school improvement is provided, there is little evidence of its impact on learning outcomes;
- High interest rates could mean some schools serving the poorest communities may not be able to afford the loans; and
- There is ideological opposition from some quarters to the proliferation of LCPSs given that education should be free. However, some countries accept the idea that LCPSs are a good supplement to whatever governments can afford as they expand and attempt to improve learning at all levels of education.

³⁴ www.isfc.in/



Promising Ideas or Pilots

There has been some growth in finance companies offering school financing loans to LCPSs in some countries, like India, Rwanda and Ghana, but the market is still relatively unserved and, given the large number of LCPSs, the opportunity exists to catalyse a relatively new market. In Pakistan for example, the credit needs of LCPSs is estimated to be £440m (ILM Ideas, 2014).

Potential action for the Commission

If this is considered to have potential, the Commission could identify donors who would be interested in opening up this market and encourage them to:

- Identify countries with the greatest need and undertake due diligence on the current market opportunities, barriers and potential;
- Identify potential partners and key stakeholders and the role of the donor; and
- Design programs which could:
 - Understand the type and scale of need of financing for schools and other education providers;
 - Identify and influence the creation of the enabling environment required to meet that need;
 - Encourage existing lending institutions to offer school/ provider financing products through making the process of risk assessment more efficient and effective and providing initial loan guarantees;
 - Provide technical assistance to link loan provision to better education outcomes;
 - Encourage the development of other financial products for schools, for example asset financing;
 - Encourage impact investing in school financing companies to help them deliver to the scale of the LCPSs; and
 - Collect and share evidence on what works.

The aim should be to catalyse the market so it can operate sustainably by itself in the future.

Appendix C: Innovative financing mechanisms assessed against each criterion

Mechanism	Positive impact on educational outcomes	Potential volume of funds	Replicability and scalability	Cost-effectiveness at scale	Sustainability and predictability	Feasibility, ease, speed and cost of implementation
Global financing facility	High	Medium-High	Medium	Low - Medium	Medium	Low
Education Bonds	Medium	Medium	Medium	Medium	High	Low-Medium
Outcomes-Based Financing	High	Medium	Low-Medium	Medium	Low-Medium	Low
Loan buy-down	Medium-High	Medium	Low-Medium	Medium	Low-Medium	Medium
Student financing	Medium-High	Medium	Low	Low-Medium	Medium	Low-Medium
Risk Financing	Medium-High	Low	Low-Medium	Low	Low	Low
Social impact investing (outside of SIBs and DIBs)	Low-Medium	High	Low-Medium	Medium	Medium	Very low
Global solidarity levies	Medium	Medium	Medium	Medium	Low-Medium	Low
Harnessing remittances	Low-Medium	Low-Medium	Low-Medium	Medium	Medium	Low-Medium
School/provider financing	Low-Medium	Low	Medium	Medium	Low-Medium	Low-Medium
Corporate levies	Low-Medium	Medium	Low	Low-Medium	Medium	Low
Debt Conversion Development Bonds (DCDBs)	Medium	Medium	Low	Medium	Low	Low
Debt swaps	Medium	Medium	Low	Low	Low-Medium	Low
Advanced market commitments	Low-Medium	Medium	Medium	Low	Low-Medium	Low
Diaspora bonds	Medium	Low	Low	Medium	Low-Medium	Low
Crowdfunding	Low	Very-Low	Medium-High	Medium-High	Low	Medium
Social Yield Notes	Medium	Low	Low	Low	Low	Low
Product based consumer contribution	Low	-	Low	Low	Medium	Very low



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