Save the Children

The case for a supplementary IDA budget - a lifeline for children

Save the Children briefing note: December 2020

Executive summary

The World Bank's International Development Association (IDA) the single largest source of donor funding for education, health, social protection and other essential social services in 74 of the world's poorest countries. IDA's grants and concessional lending are enabled by the Bank's ability to raise low interest capital from financial markets and combine it with donor funding, helping to leverage approximately US$3 in funding for every $1 of donor contributions.

To help countries to respond to the COVID crisis, the World Bank has frontloaded spending from the current round of funding (IDA19), with almost half expected to be spent in the first year of its three-year envelope. This has helped to provide timely and much-needed support for countries. However, it also means that funding will face a large deficit in the summer of 2021, falling US$12.7bn less per year than this financial year.

Children will bear the brunt of the resulting funding shortfall, with an estimated US$3.4 billion less likely to be spent on education and US$3.5 billion less on social protection in the final two years of IDA19 than in the current financial year. This would be disastrous at a time when these counties will still be reeling from the global economic crisis and governments' ability to support livelihoods will continue to be constrained through reduced revenue and increasing debt burdens.

To prevent this happening, the World Bank has requested US$10 billion in supplementary IDA grant funding to enable the IDA19 budget to increase by US$25 billion. This would plug the deficit and enable the continuation of enhanced levels of IDA financing at this critical time. Costs of borrowing from capital markets for the World Bank are currently low – an opportunity that should be harnessed for countries that need it most. Moreover, this is affordable. If we assume for illustrative purposes that additional contributions are shared proportional to the original replenishment, the supplement would cost under 5% of the annual aid budget for 15 of IDA's 19 largest donors.

IDA's capacity for leveraging funds from the international markets makes it a smart, cost-effective donor investment during this time of crisis. However, it is imperative that additional funds raised are invested in areas relevant to children – the demographic group that is set to bear the deepest and longest lasting scars from COVID's economic impacts. The original IDA19 replenishment agreement and Country Partnership Frameworks should be reviewed in the light of the COVID crisis, with increased allocations for the social sectors, accompanied by improvements in accountability and transparency to maximise the effectiveness of resources disbursed.

It is also important that IDA replenishment is coordinated with other opportunities to scale up investment in children in the world's poorest countries. In particular, progress must be made on long-term, robust solutions to the debt crisis. Debt distress and defaults risk the sustainability of IDA and reduce its capacity to leverage funds from financial markets.

Concerted, coordinated action on debt and IDA funding in 2021 has the potential to unleash significant funding for education, health, protection from violence and poverty relief – funding that could have a transformative impact on the lives of the world's poorest and most marginalised children, and their hopes for the future.

Introduction

The COVID-19 pandemic is having a devastating impact on children's lives across the world. At its peak, an estimated 1.6 billion children were out of school, with almost 10 million expected never to return.[1] The economic impacts of the pandemic are still sending shockwaves across the world, forcing an estimated 105 million children into monetary poverty in 2020 alone.[2]

Nowhere is the crisis more evident than in the world's poorest countries served by the World Bank's International Development Association (IDA). This is the mechanism providing grants and concessional finance to 74 of the poorest low and lower middle-income countries. Even before the crisis, many of these countries were struggling to maintain progress towards the Sustainable Development Goals. Now many, especially those affected by conflict and fragility, face the prospect of major reversals. For example, already under resourced health care systems have experienced disruptions to supplies and routine interventions, which is set to significantly increase maternal and child mortality[3]. The crisis is also having knock on impacts to food security and nutrition, adding to ongoing challenges of climate change and environmental disasters. All these impacts have led to a spike in household and gender-based violence and threatens to roll back decades of progress on women's economic empowerment, voice and agency.

A crisis of this magnitude and scale for children is unprecedented. And it is coming at a time when public finances in these countries are already at breaking point. Without urgent action, the long-term impact of the crisis on children's futures will be profound, robbing an entire generation of the opportunity to reach their full potential in life. As is often the case, it is the most marginalised children in the greatest poverty that are suffering the most, and who are in the most urgent need of support.

2021 is a pivotal year. It could go down in history as the year that the international community failed to deliver for the so-called 'COVID generation' of children. Or it could be the year that governments, international agencies and the private sector worked together to turn the crisis around, forging new agreements on debt, aid and other issues to unleash the funding that is urgently needed for investment in children's education, health, nutrition, poverty relief and protection from violence and neglect.

One critical piece of the puzzle in supporting government at this time is IDA, which is facing a financing deficit at this moment of unprecedented human need. Quite rightly, the World Bank responded to the COVID crisis by frontloading IDA resources[4] from the current replenishment period (IDA19, covering July 2020 to June 2023) to make them available for pandemic response. That response saved lives and averted an even more serious crisis. However, we estimate that almost half of the IDA19 resource envelope will already have been spent in the first year, equating to around US $35.8bn. This will result in $8.4bn less funding available in the 2022 and 2023 financial years than envisaged pre-COVID-19, and $12.7 bn less per year than this financial year.

With the crisis set to continue into 2021, there is growing concern that governments will continue to need substantial financial support, as reduced economic activity will continue to stifle revenue generation. Given that IDA19 was agreed pre-COVID, and many of its investments thus far have been in immediate response to the crisis, there is an urgent need for replenishment of the fund to ensure that continued support is available throughout the IDA19 timeframe, to June 2023.

In October 2020 the World Bank outlined the need for an additional US$25bn supplement to IDA19, termed as the 'COVID Emergency Financing Package', to enable it to sufficiently support governments until June 2023. This supplement would provide much needed additional resources to aid social and economic recovery in the world's poorest countries at this critical time.

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[1] https://resourcecentre.savethechildren.net/library/save-our-education-protect-every-childs-right-learn-covid-19-response-and-recovery

[2] https://www.savethechildren.org.uk/blogs/2020/coronavirus-invisible-victims-children-in-monetary-poor-househol

[3] http://documents1.worldbank.org/curated/en/404661606955558548/pdf/Building-Back-Better-Pursuing-a-Greener-More-Inclusive-and-Resilient-Recovery.pdf

[4] http://pubdocs.worldbank.org/en/976541595021399817/DSSI-Explanatory-Note.pdf

What is IDA and why is it a critical source of finance during the COVID crisis and recovery period?

The World Bank IDA uses a mix of financial resources to offer concessional finance, primarily in the form of official development assistance (ODA) to 74 of the world's poorest countries, many of which are in sub-Saharan Africa. It relies on donor contributions to provide it with base capital, with replenishment rounds every three years. The current round is referred to as IDA19, running from July 2020 to June 2023. For each round, the policy framework to guide investments is reviewed, which informs country specific versions.

To supplement donor contributions, IDA draws on the World Bank's significant assets and a strong equity position to raise additional resources through capital markets. It then blends these two resources together to offer a mix of concessional lending, with terms based on the income status of recipient countries. However, if a government is at high risk of, or in, debt distress, IDA can only provide support as grants. Pre-COVID, using this approach, as well as reinvesting profits from past lending, IDA was able to commit US$3 of development resources for every US$1 of donor contributions. This leveraging effect makes IDA a particularly effective form of support, provides value for money to donors and increases the resource envelope available for recipient countries.

IDA's finance model has been successful in increasing ODA flows. In real terms it increased from US$10bn in 2010 to almost US$15bn in 2018, when it provided 8% of total ODA[5] - and 16% of sub-Saharan Africa's aid flows. Within sub-Saharan Africa IDA was the largest source of ODA in sectors such as social protection (56% of total), water and sanitation (26%) and education (20%), and the third largest to health. Its importance in providing significant international public financing across these areas, all of which are vital for addressing the impacts of COVID-19, underlines why it is such a critical resource.

In addition, the IDA model is well placed to raise money through capital markets at this time of economic uncertainty, given its high credit rating and low cost of borrowing, offering a means of quickly scaling up concessional resources available to the poorest countries now and in the recovery. In a period marked by record low interest rates and large financing gaps in areas with high social and economic returns, IDA is well placed to support recovery in the poorest countries.

Post-COVID frontloading of IDA programme support up to June 2021

In June, the World Bank Board approved their approach to respond to the COVID-19 pandemic, which included deploying US$50bn of IDA resources in the 15 months from March 2020 to June 2021, focused on responding to the immediate social and economic shocks of the crisis. Figure 1 shows that US$17.2bn of this was committed under IDA18 (which ran to June 2020), meaning that the remaining US$32.8bn will likely be deployed in the first year of IDA19 (running to June 2021). In addition, in October the World Bank board also approved US$12bn of funding for COVID-19 vaccines, US$6bn of which will come from IDA19 resources[6]. If we assume half of this will be committed this financial year, the total amount of IDA19 resources deployed in the first year alone will be US$35.8bn, or 44% of the total three-year envelope. This would reduce the amount available for the final two years by $8.4bn compared to original, pre-COVID plans.

Figure 1 – IDA funding commitments increased significantly at the end of IDA18

(US$ billions)	**IDA funding commitments**
IDA18 pre-COVID (average/quarter)	5.4
IDA18 post-COVID (2nd quarter 2020)	17.2

Source: World Bank Projects Portal, access October 2020 https://datacatalog.worldbank.org/dataset/world-bank-projects-operations

[5] OECD DAC Credit reporting system

[6] https://www.worldbank.org/en/news/press-release/2020/10/13/world-bank-approves-12-billion-for-covid-19-vaccines

IDA funding scenarios with and without an additional IDA supplement

If there is no supplement to IDA19, this could see investments in social sectors such as education and social protection that are critical to children and COVID-19 recovery fall from US$16.9bn this year, to US$10.9bn in 2021-22 and 2022-23 (based on last year's sectoral allocations, see Figure 3).

The World Bank's proposed IDA supplement of US$25bn would effectively scale support back up to levels of funding this financial year under IDA19.

Given that COVID has resulted in governments having increased debt burdens and reduced opportunity for revenue mobilisation next year and into the medium term, there is a critical need for increased financial support. Costs of borrowing from capital markets for the World Bank itself are currently extremely low, and this opportunity should be harnessed to scale up IDA support for countries that are in urgent need.

Figure 2 – The two scenarios for the future resource envelope of IDA19 in 2021-22 and 2022-23

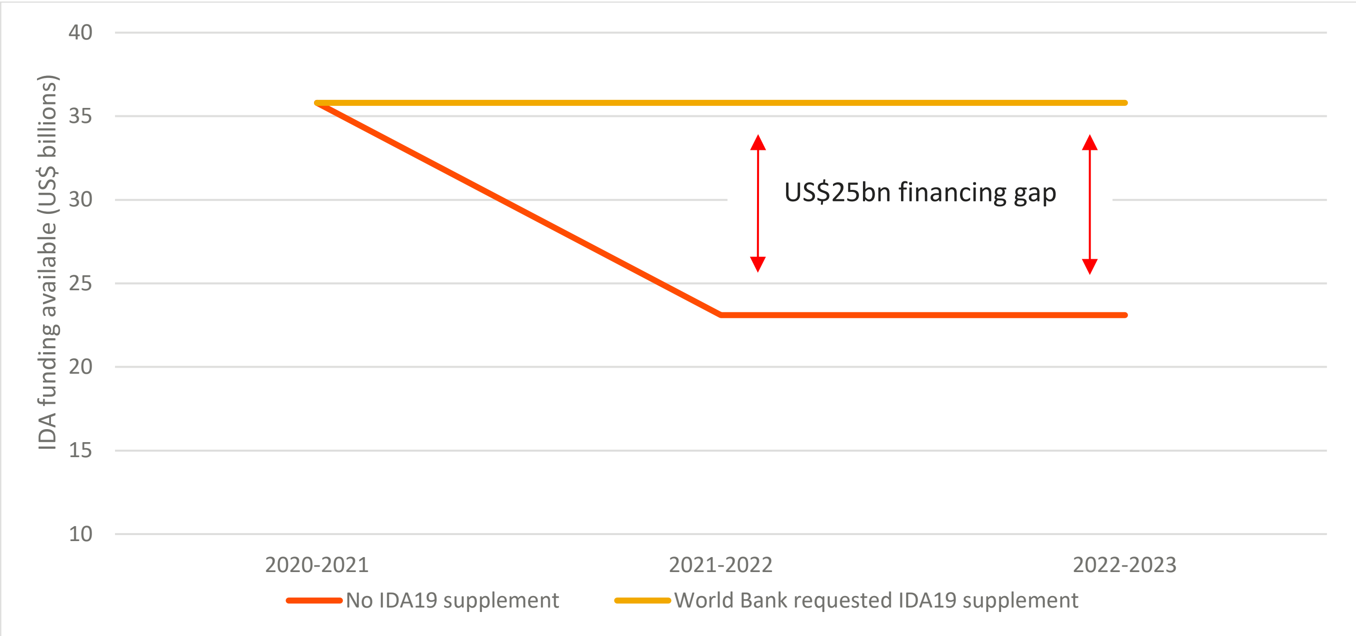

Figure 3 – What IDA19 key sectoral allocations for children could look like in 2021-22 and 2022-23 (combined total)

(US$ billions)	**No supplement**	**World Bank requested IDA19 supplement**
	FY 2022 and 2023	**FY 2022 and 2023**
Education	6.1	9.5
Health	6.5	10.1
Social Protection	6.4	9.9
Water, Sanitation, and Waste Management	2.8	4.3
Total	**21.8**	**33.8**

Source: Based on scenarios in Figure 2 and on proportions of sectoral allocations in the World Bank Financial year detailed within the 2020 Annual Report.

How much would an IDA19 supplement cost and how would it be financed?

We estimate that World Bank's US$25bn IDA19 supplement would require additional grant financing of US$10bn, a scale up ratio of US$1 to US$2.5 rather than the previous US$1 to US$3 under IDA19's original budget. This is because growing debt burdens of eligible country governments and lower economic output will likely require larger disbursements in grant form or higher concessional lending, meaning reduced leveraging of grant resources. Funding for this could come in three possible ways.

i) **Donor grant contributions**

Like the original IDA19 replenishment, donor contributions could top-up the IDA resource envelope, with disbursements potentially being spread over two years. If additional contributions are shared proportional to the original replenishment, none of the 19 largest donors would have to commit more than 10% of their 2019 aid budget each year. For fifteen of these countries, the required contribution would be under 5% of their aid budget (see figure 4). These calculations are illustrative, and suggest that the supplement is generally affordable. Contributions of course could be shared in different ways.

Figure 4 – Illustrative donor grant contributions to a supplemental IDA19 replenishment, proportional to the original contribution

(Largest 19 contributors to IDA19)	**Proportional share of IDA19 US$10bn supplemental grant financing (per year for FY 2022 and 2023)**	**% of 2019 official development assistance**
United Kingdom	US$0.83 bn	4.3%
Japan	US$0.69 bn	5.9%
United States	US$0.64 bn	1.9%
Germany	US$0.39 bn	1.6%
France	US$0.35 bn	2.9%
China	US$0.26 bn	no data
Canada	US$0.24 bn	5.3%
Sweden	US$0.21 bn	3.9%
Netherlands	US$0.20 bn	3.8%
Switzerland	US$0.15 bn	4.7%
Italy	US$0.14 bn	3.0%
Belgium	US$0.11 bn	4.9%
Austria	US$0.10 bn	8.7%
Korea	US$0.10 bn	3.8%
Saudi Arabia	US$0.09 bn	1.8%
Norway	US$0.08 bn	1.8%
Denmark	US$0.07 bn	2.9%
Australia	US$0.07 bn	2.5%
Spain	US$0.07 bn	2.6%

Source: OECD DAC CRS, World Bank IDA-19 replenishment document

ii) **Using existing World Bank IDA assets**

As part of the IDA financing model the World Bank holds a certain amount of assets, used to mitigate against risks (such as non-payment of loans and currency fluctuations) and maintain its triple A credit rating, allowing it to access capital markets to support its lending activities. Part of this is held in an investment portfolio, and invested in high rated sovereign and non-sovereign debt. As shown in Figure 5 the amount of assets held in portfolio investments has grown over time from US$29.6bn in 2017 to US$35.6bn in 2020. Therefore, one policy option

available to the Bank is to utilise these assets to support a supplemental IDA budget. However, there could be several issues associated with this approach:

Portfolio investments support longer term income for IDA operations – The utilisation of assets now to fund operation activities would likely be focused on grant support or highly concessional lending to countries. Therefore, the rate of return received would not be as high as if the assets were maintained in the current portfolio. Whilst this would support short term financing needs, in the longer term this would lead to less income to finance future IDA operations.

There are risks associated with reducing IDA's assets – Given the uncertain economic climate, reducing IDA's capital adequacy ratio may risk operations activities in several ways. It could risk a credit rating downgrade that would reduce its access to market borrowing on the current terms if deemed a less sustainable operation. This would lead to a greater need for a larger proportion of grant contributions to continue to fulfil lending criteria to countries on concessional terms. In addition, with increasing debt sustainability issues and risk of non-payment of loans, there is a case for IDA to become more prudent and hold greater assets to further mitigate against the risks.

In addition, the World Bank could also look at opportunities to repurpose existing lending operations, such as through the cancellation or scaling back of ongoing projects. Although this could support the supplementation of IDA19 resources, this should only be done in cases where current projects are no longer viable in their current form, jointly agreed by recipients and where possible reinvested back into the same country.

Figure 5 – Key statistics from the World Bank current IDA balance sheet

(US$mn unless stated)	2017	2018	2019	2020
Total assets	173,357	184,666	188,553	199,472
Net investment portfolio	29,673	33,735	32,443	35,571
Capital Adequacy ratio	37.2%	37.4%	35.3%	35.8%

Source: International Development Association - Management's Discussion & Analysis and Financial Statements June 30, 2020

iii) A hybrid approach is possible

While both of these financing options are technically feasible on their own to support a supplementary IDA replenishment, there are challenges with each. For example, although IDA presents a good opportunity for donor members to catalyse their aid spending, they are facing their own fiscal pressures and therefore potential constraints on their aid spending. Conversely, with significant uncertainty at this point in time, it may feel unwise for the World Bank to utilise assets that may make its IDA operations less viable. There may therefore be a case for a hybrid approach, where donors provide a guarantee of the full supplement, but with the potential for some proportion of IDA assets to be used instead once there is greater medium-term certainty about the global economy. Having this certainty could be expediated through treasury guarantees from certain donor contributing countries to underpin IDA operations. This hybrid approach would need to be based on an agreed set of conditions with donors and the World Bank (such as asset levels and borrower default risk assessment), ensuring there is little or no impact on funding available for IDA20 replenishment and beyond.

The case for an IDA19 supplement to be focused on human capital investments in children and the need for continued progress on accountability.

From the outset of the pandemic IDA has seen a significant increase in allocations to human development, largely driven by healthcare. As shown by Figure 6, financial years affected by COVID-19 have seen a large increase in healthcare allocations and maintenance of education. Considering the impact on livelihoods and demand from recipient governments, this is welcome, as education, health and social protection are critical sectors for COVID response and recovery, together with strong child protection systems and investments in child nutrition.

It is imperative that IDA's investments in human capital continue to be prioritised throughout the IDA19 round, with a focus on investment in children - the largest demographic group in low and lower-middle income countries, which has been severely impacted by the crisis, and upon which countries will depend in the long term for economic development.

To enable this continued prioritisation of human capital investment within IDA, the supplement should also look to revise the IDA19 replenishment document, agreed pre-COVID, to make specific reference to the current crisis and outlining the key areas of focus up to June 2023. These should include the established IDA sectors of education, social protection and health, as well as child protection systems to address the increased risk of violence, abuse and neglect posed by the pandemic, including gender-based violence. In addition, where needed, Country Partnership Frameworks should also be adapted to ensure they are in alignment with a shift in emphasis towards human capital, and so that governments and citizens have certainty about the World Bank's operations within their respective countries under IDA19.

Figure 6 – Selected average budgetary allocations under IDA

(% of IDA budget allocation)	**Average FY 2018 and 2019**	**Average FY 2020, 21, 22 and 23**
Education	8.9%	8.9%
Health	7.4%	11.9%
Transport and storage	20.0%	14.2%

Source: World Bank IATI data registry, assessed October 2020

It is also essential that IDA resources are used in the most efficient and effective ways. One way to help support this is to ensure the World Bank and governments are accountable for project selections to the citizens where investments are made. Over the last few years, the World Bank has made reforms to its review panel, with a new independent accountability mechanism announced in March 2020 and reforms currently being operationalised[7]. However, given the rise in remote working there has been concern that accountability and transparency mechanisms have fallen short[8], an issue that was acknowledged by World Bank directors at a CSO roundtable event during the 2020 annual meetings. Therefore, alongside the ongoing reforms, it will be essential to assess that they are fit for purpose at this time of crisis and beyond, and adapt them as necessary, to ensure IDA operations as effective and efficient as possible.

The critical role of debt sustainability to support IDA19 operations

Our calculations of financing need for a supplemental IDA19 replenishment are grounded on the assumption that debt positions in eligible countries do not worsen in the period up to June 2023. However, there is a significant risk that, with prolonged crisis, an increasing number of countries' positions will worsen. Given the level of liabilities the World Bank has, the threat of defaults will risk the sustainability of IDA operations overall. Therefore, it is critical that the international community focuses on finding solutions to address growing debt issues.

At present, although governments are receiving some liquidity support through the G20's Debt Service Suspension Initiative (DSSI) from selected official bilateral creditors, this is just a stop gap measure that will not solve the issue of unsustainable debt burdens, especially if further borrowing is required sustain public spending in 2021 and beyond. In addition, the IMF's Catastrophic Containment Relief Trust (CCRT) is providing debt relief through donor

[7] https://www.worldbank.org/en/news/factsheet/2020/03/06/conclusion-of-the-inspection-panel-toolkit-review

[8] https://d3n8a8pro7vhmx.cloudfront.net/eurodad/pages/1101/attachments/original/1602585821/WBG_covid_funding_FINAL.pdf?1602585821

contributions in 28 of the world's poorest countries up to April 2021. Whilst there has been agreement in principle for a Common Framework for Debt Treatments[9], both this and the current measures are not sufficient. As the IMF has highlighted[10], further support is needed to ensure debt positions do not worsen, impacting IDA operations.

Within the context of the IDA replenishment, it is essential that debt sustainability is discussed, especially as major contributors to IDA are also some of the largest official bilateral creditors. The Common Framework states that the World Bank should review options to provide debt relief alongside other policy measures. Whilst the World Bank has concerns about participating in the Common Framework, where requested by governments, it should actively review potential benefits of debt relief against risks, and develop proposals for debt restructuring in cases where it has clear advantages over further programme support.

Finally, all actors with a vested interest in IDA need to work to ensure the constructive participation of private sector creditors in debt relief processes. They must also work to mitigate the impact that the actual or perceived threat of rating downgrades by credit rating agencies are having on governments and multilateral institutions and their efforts protect the poorest and most marginalised children at a time of crisis.

Conclusions

This paper has shown how the World Bank's frontloading of IDA19 operations has helped to provide critical support to low and lower-middle income countries at a time when access to concessional financing is in short supply to ensure the provision of key social services is maintained. The growing number of countries in or at risk of debt distress means that a higher proportion of IDA resources than expected will likely be disbursed as grants, decreasing the amount that donor contributions can leverage from capital markets. This could mean that support from IDA will be at least US$8.4bn less than originally planned from July 2021 to June 2023, at a time when need is higher than ever due to the COVID crisis. This makes the case for a supplemental IDA replenishment clear, and the risk of doing nothing is too great, given governments in IDA eligible countries will be struggling to maintain social spending with constrained revenue generation and significant challenges with debt sustainability.

A $10bn IDA supplement would enable countries to continue to receive the same amount of scaled-up funding in FY2021-22 and 2022-23 as in the current financial year, helping to provide much needed resources during the crisis and its aftermath. This will need to come at least initially from donor contributions, with potential for the World Bank to use its assets to contribute where possible, whilst ensuring sustainability of IDA operations and not significantly impacting on ongoing operations or the IDA20 resource envelope.

In addition to the supplement there is a need to revisit the priority areas under IDA19 to ensure that they are still fit for purpose and meet critical financing gaps in human capital to support the poorest and most marginalised children. In addition, it is vital these resources are used effectively, so the World Bank needs to continue strengthening its transparency and accountability mechanisms.

Finally, it is critical that IDA is not treated in a vacuum. Debt sustainability for governments in IDA eligible countries is a major risk factor in the IDA operating model, both for the World Banks's risk of non-payment of loans by countries, but also for overall IDA resources available if more countries move to higher risk of debt distress, thereby requiring disbursements of grant funding rather than loans. Therefore, it is critical that significant progress is made beyond current initiatives such the G20's DSSI and the IMF's CCRT. There is an urgent need for the implementation of clear framework for debt restructuring, with active participation in the process from all actors, including the World Bank.

[9] https://g20.org/en/media/Documents/English_Extraordinary%20G20%20FMCBG%20Statement_November%2013.pdf
[10] https://www.imf.org/en/News/Articles/2020/11/13/sp-g20-finance-ministers-and-central-bank-governors-meeting