

Proposed Innovative Financial instruments under ADF-14

ADF-14 First Replenishment meeting 17, 18 March 2016
Abidjan, Côte d'Ivoire

Outline

- I. Background
- II. Bridge Loans
- III. Concessional Donor Loans
- IV. Buy-Down Mechanism
- V. Management's Recommendation

I. Background

Big Picture – Economic Outlook of ADF countries

- Resilience in the face of headwinds and heightened uncertainty.
- External debt low on average but varies across countries with risk of debt distress in some countries.
- Need to move from billions to trillions to eliminate poverty in line with the SDGs and FFD agenda.

Big Picture - ADF

Why	How
<ul style="list-style-type: none">• ODA – tight fiscal situation in many donor countries facing competing needs• Sense of urgency to deliver more for the poorest in Africa• ADF has consistently delivered	<ul style="list-style-type: none">• Reforms in the AfDB to deliver more, better, and faster to ADF countries.• Thinking outside the box: Innovative sources finance – ADF Lab.• TYS with a sharper focus around 5 core priorities: light up and power Africa, integrate Africa, feed Africa, industrialize Africa, improve the quality of life of people in Africa.

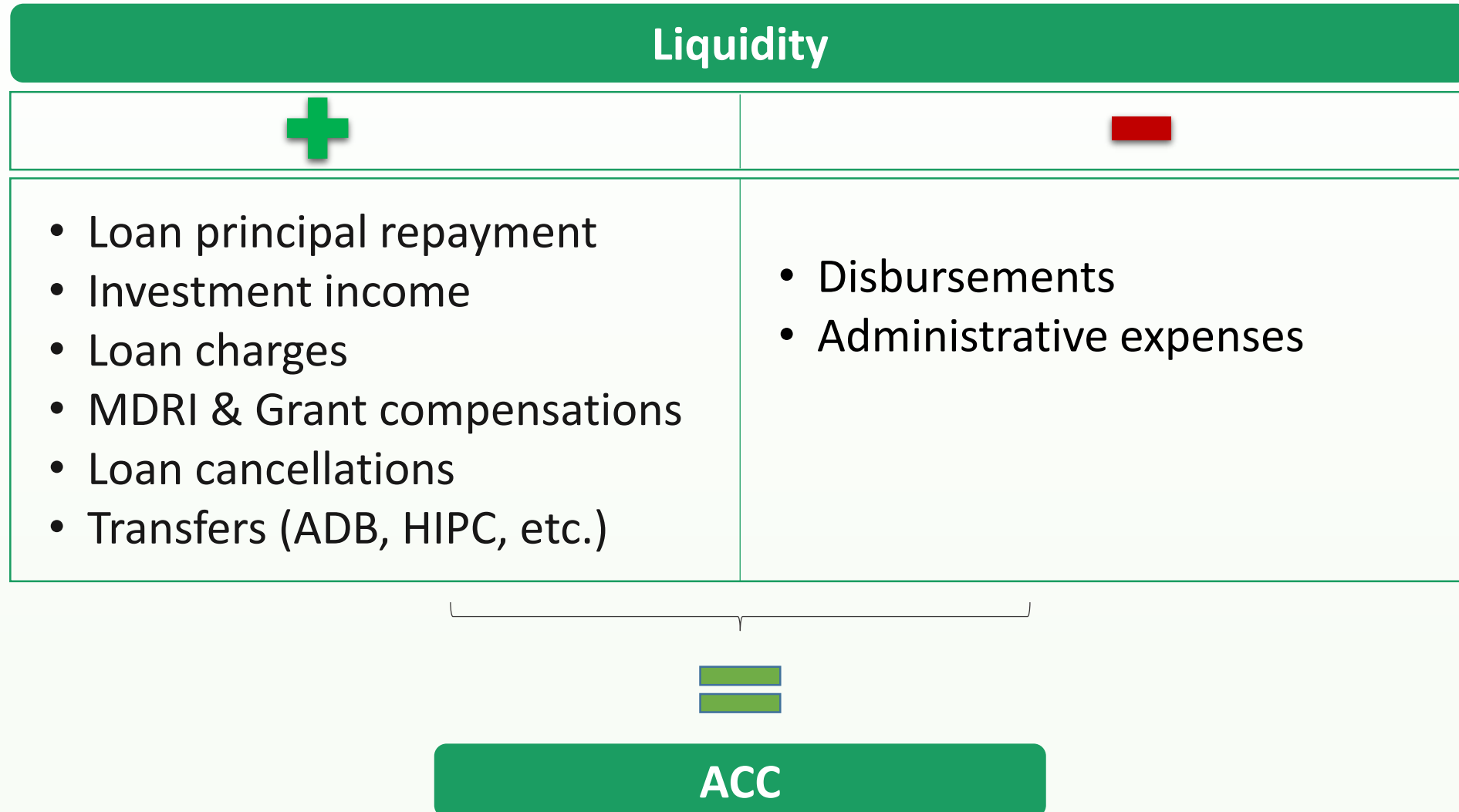
Innovate to stretch concessional resources for more development impact.

The Road travelled: ADF-14 Working Group

- Purpose – Identify innovative financial options to increase resources for ADF-14. The working group met 4 times.
- Various options considered; 3 options retained:
 - Concessional Donor Loans (CDLs)
 - Bridge Loans (BLs)
 - Buy-Down Mechanism (BDM)
- Discussions by all Deputies took place during the MTR, and Deputies requested that additional work be done.

II. Bridge Loans (BLs)

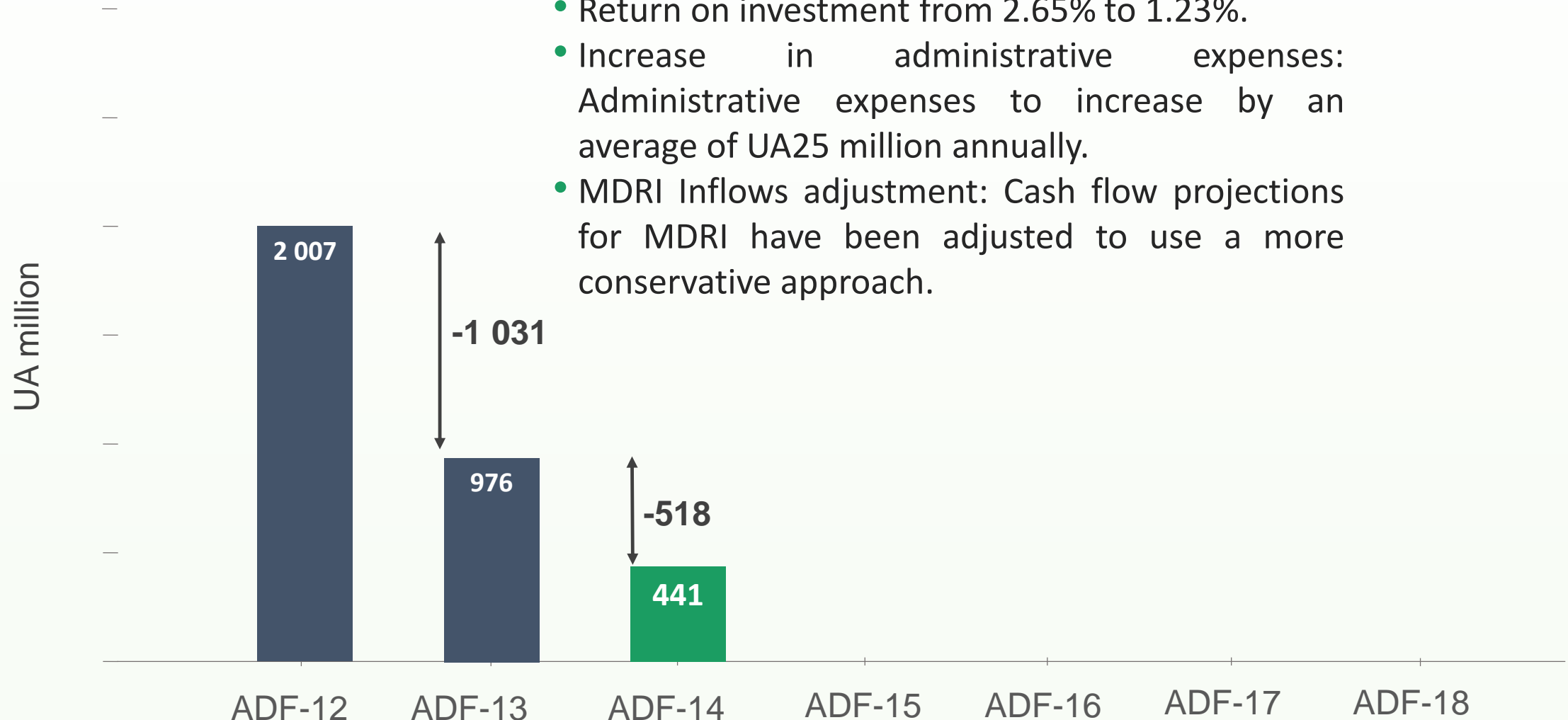
The **mechanics** of Internally Generated Resources



Lower internally generated resources – ADF 12 to 13

Drivers of the lower ACC:

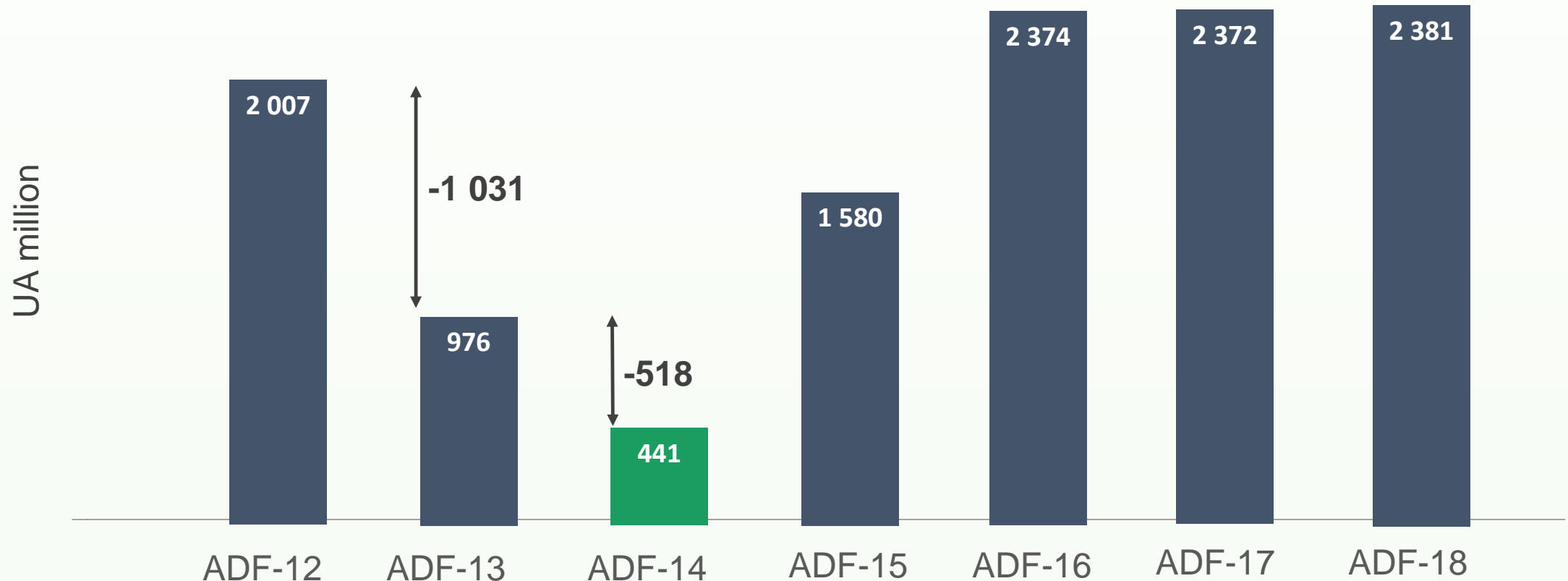
- Return on investment from 2.65% to 1.23%.
- Increase in administrative expenses: Administrative expenses to increase by an average of UA25 million annually.
- MDRI Inflows adjustment: Cash flow projections for MDRI have been adjusted to use a more conservative approach.



Internally generated resources – ADF 12 to ADF 18

Main driver of the higher ACC from ADF 15:

Hardened terms since ADF 13 – see Long-Term Financial Capacity of the ADF produced for ADF 13.

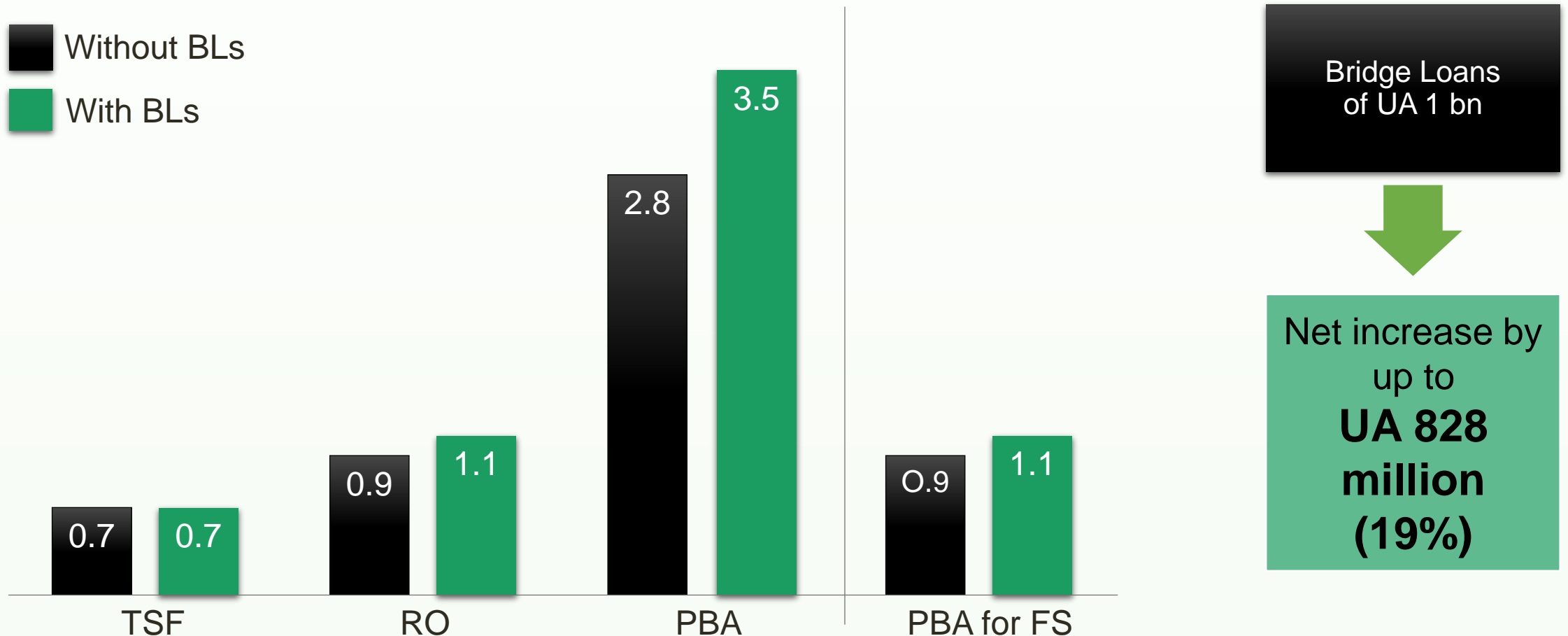


Purpose and principles of bridge loans

- A bridge loan (BL) is a concessional donor loan which allows ADF :
 - Improve its liquidity;
 - Increase the ACC for the next two replenishments when the ACC is projected to be at its lowest.

 **Frontload future commitment capacity to support operations earlier.**

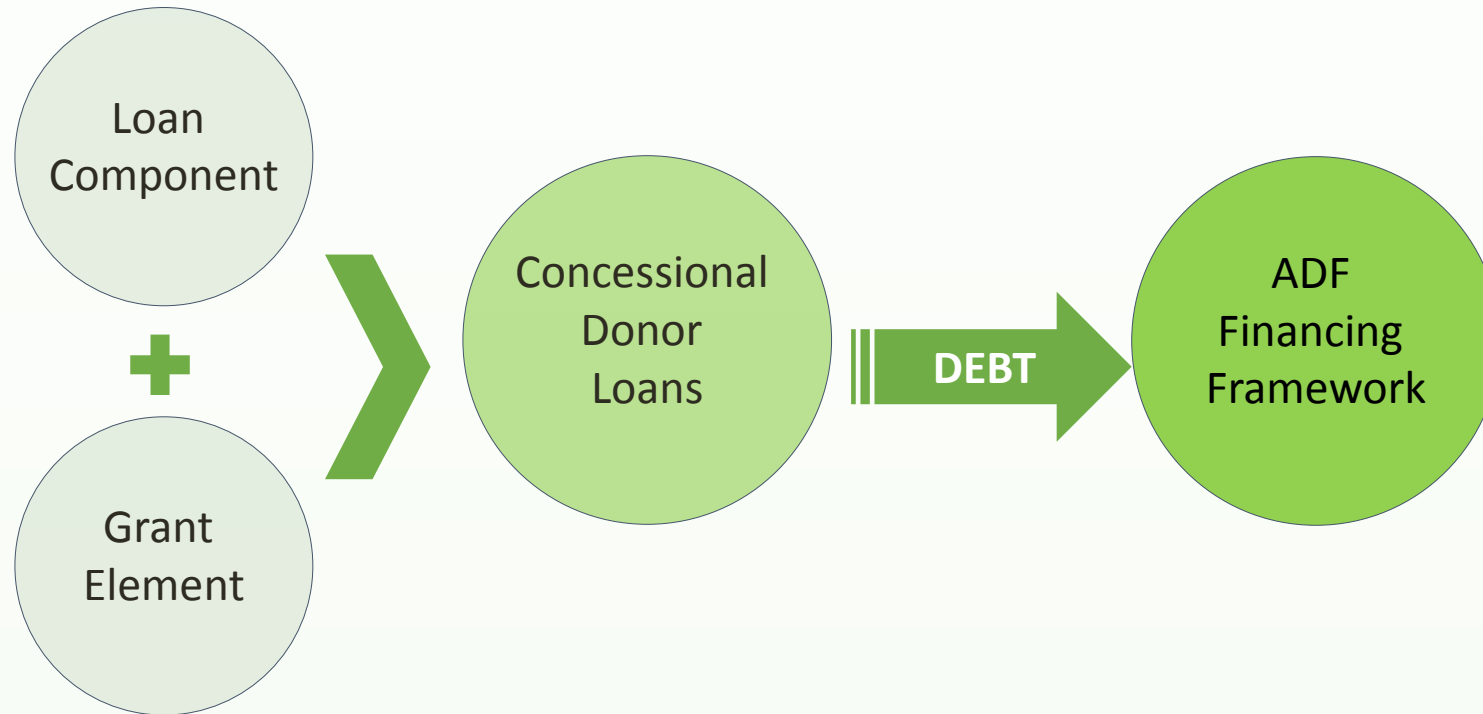
Impact on resource envelopes (UA billion)



III. Concessional Donor Loans (CDLs)

Purpose and mechanics of CDLs

- Donors provide concessional debt in addition to grants.
- Positive effect of grants on amount of CDLs which ADF can absorb.



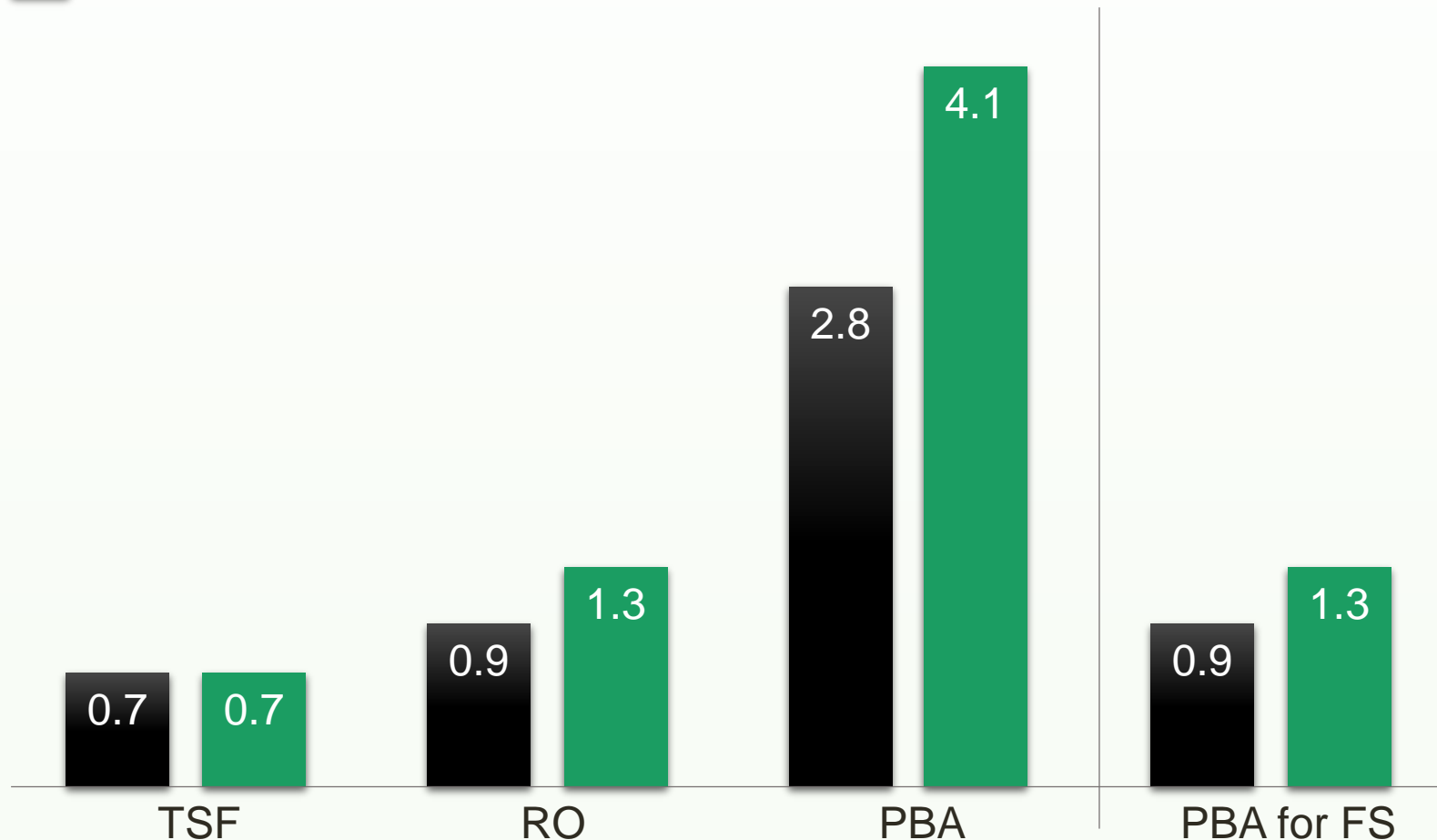
- **Simple CDLs:** To support public sector operations.
- **Enhanced CDLs:** To support private sector development.

Principles of CDLs

- Donors providing CDLs fairly recognized;
- CDLs must be self-sustaining;
- ADF grant-component protected and substitution risk mitigated;
- A prudential debt limit:
Debt **fully** repaid through reflows from the additional lending;
- Proceeds of CDLs go into the general replenishment pool.

Simple **CDLs**: Impact on resource envelopes (UA billion)

- Without CDLs
- With CDLs (interest rate between 0% and 0.5%)



A CDL of UA 1.27
bn



Net Increase by
up to
**UA 1,617
million
(37%)**

Enhanced CDLs: A win-win proposal

- Africa's private enterprises hampered by insufficient long-term finance.
- An anemic private sector means that countries cannot expand their taxable base.
- Harnessing more donor resources to support private sector development, fits within the broader context of better and smarter development financing to achieve the SDGs.
- ADF can absorb more CDLs if they are used for private sector operations.
- In addition, as lending to the private sector would be on harder terms, ADF would be more sustainable over time.

Enhanced CDLs: Principles

- In 2013 MDBs spelt out principles for deploying concessional financing through the private sector. Attention was paid to the subsidy element.
- Three principles:
 - market failure such that the subsidy element is additional;
 - the subsidy element accrues to the public good that is achieved;
 - the subsidy is minimized both in amount and over time to achieve bankability without creating market distortions.
- These principles guide our proposal.
- Build on the agreements establishing the ADF.

Enhanced CDLs: Operationalization

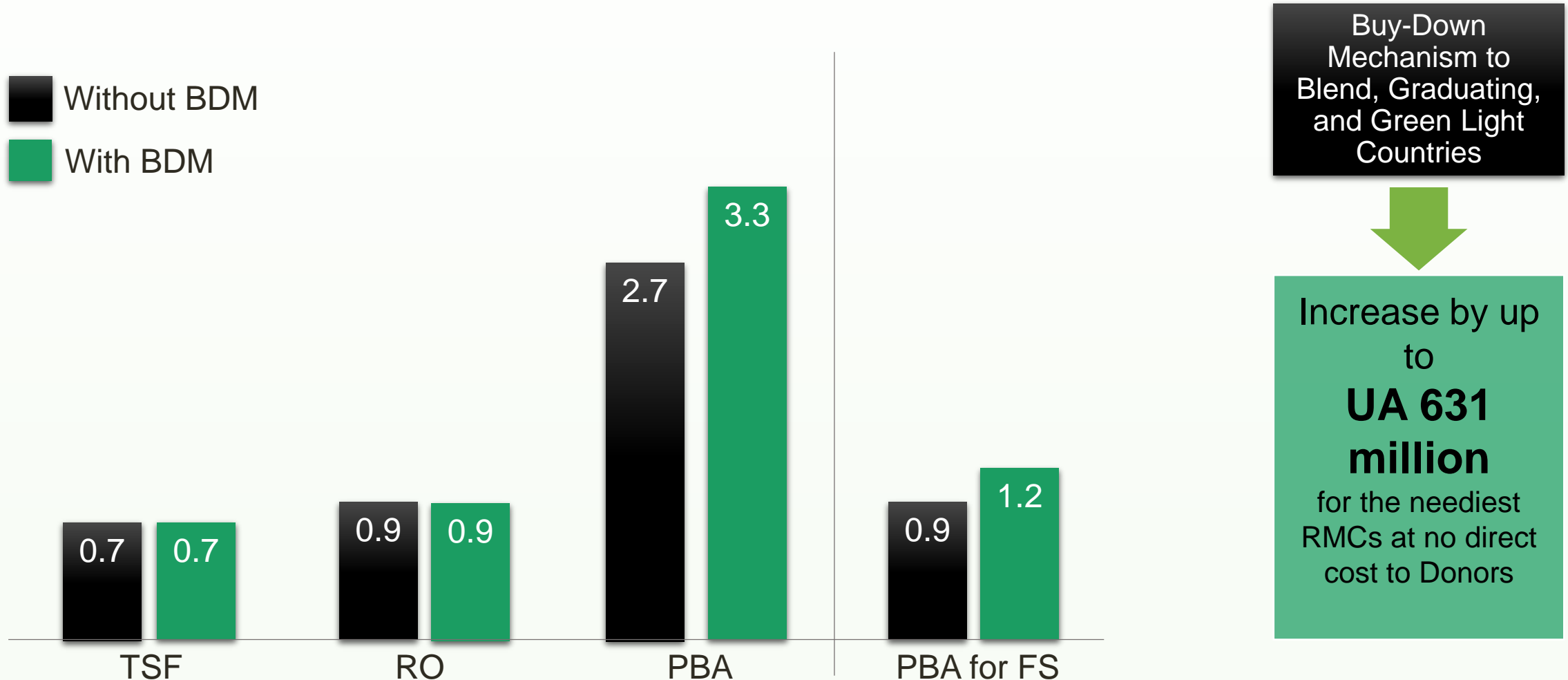
- Direct support to private sector operations.
 - CDLs, over and above to support sovereign operations and the bridge loan set aside to directly fund private sector operations.
- Scaling up the PSF. CDLs could be channeled through the PSF to:
 - provide blending solutions and/or
 - enhance the PSF's risk participation capacity.
- Ongoing work

IV. Buy-Down Mechanism (BDM)

Mechanics of the Buy-Down

- Builds on the AfDB credit policy:
 - Eligible RMCs borrow from the AfDB an amount equivalent to their Performance-Based Allocation.
- Extra grants provided to eligible countries as compensation for the differential between ADF and AfDB lending terms.
- Eligible countries no longer ‘use’ their ADF allocations
 - Resources unlocked for remaining ADF countries.
- Eligible countries to get more resources:
 - PBA (on AfDB terms) + extra grants.

BDM: Impact on resource envelopes (UA billion)

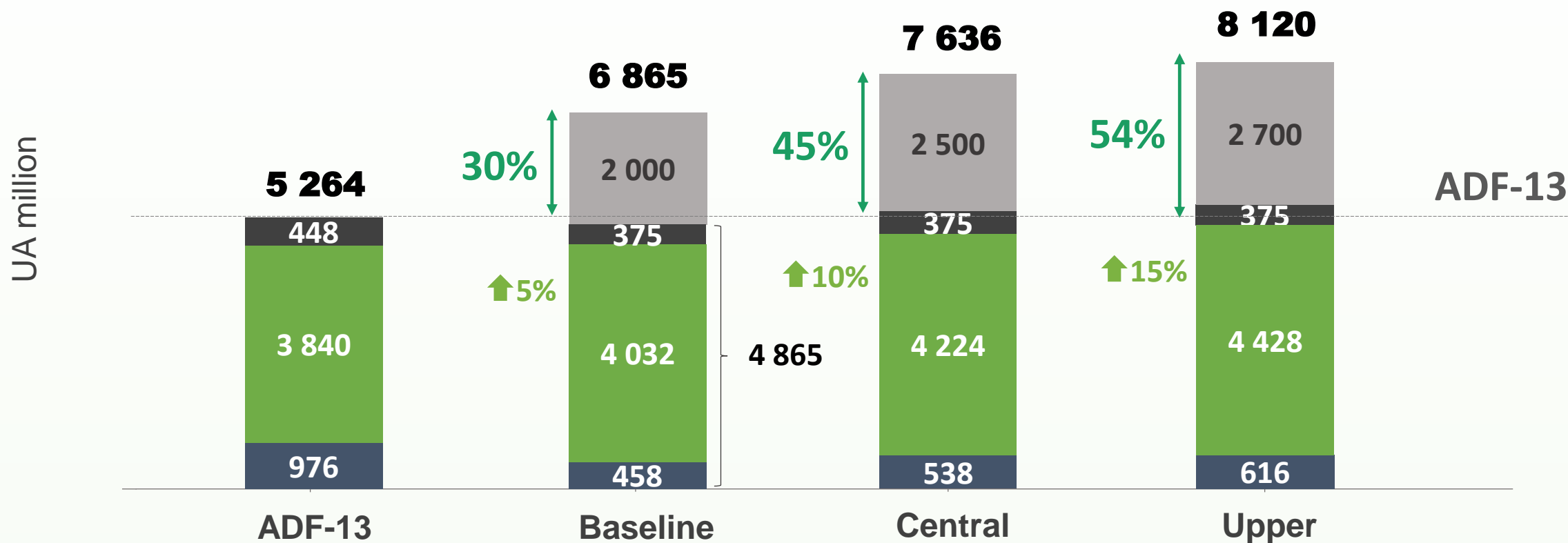


Downside of the Buy-Down Mechanism

- Competition with CDLs
 - ADF countries must be split between the 2 instruments
- Introduction of complexity in the framework for assistance to countries.
- Negative impact on the ACC.
- Negative impact on the Grant Compensation Scheme in the longer term.

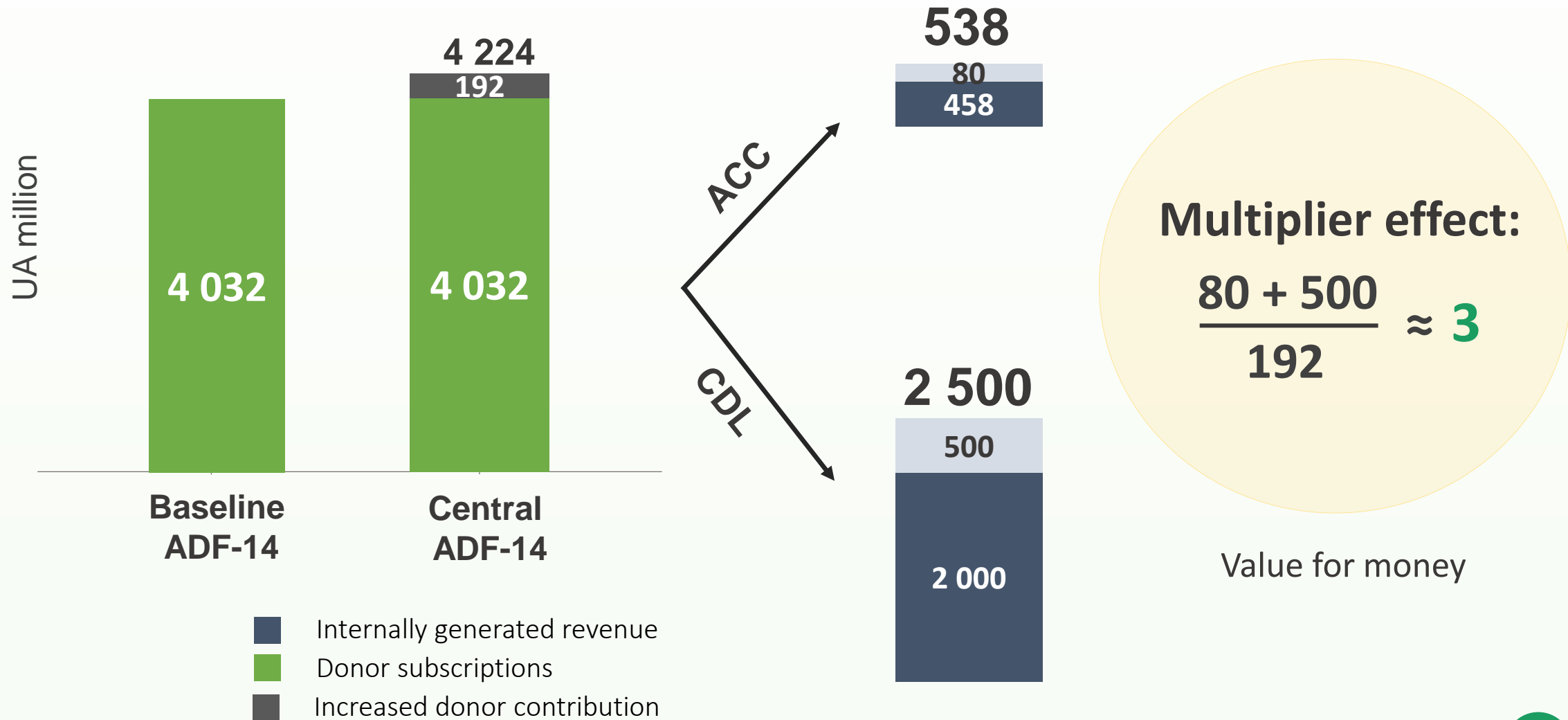
V. Management's Recommendation

ADF-14 Replenishment Scenarios



- Internally generated revenue
- Donor subscriptions
- Carry-over + Additional contributions + Initial Subscriptions
- Additional Debt Resources

Multiplier effect of donor contributions



ADF-14 Ask – for public sector operations

1. Support the upper ADF 14 replenishment scenario:

UA 8.1 billion: donor subscriptions of UA 4.4 billion + donor loans of UA 2.7 billion.

Donor loans as follows:

- UA 1 billion of bridge loans to boost ADF internally generated revenue : interest rate of up to 1%, maturity 20 years and grace period 10 years.
- UA 1.7 billion simple concessional donor loans: 0% interest rate, maturity of 40 years, and grace period of 10 years.

ADF-14 Ask – for private sector operations

- 2. Additional CDLs to scale up assistance to the private sector either through direct support or the private sector facility.**
- Supporting private sector will improve the financial sustainability of ADF.
 - CDLs for PSO is good value for money.
 - A strong private sector is aligned with ADF countries strategies and will help their economies diversify.