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Topic Guide

# Non-Traditional Financing for Education

Extended Executive Summary

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# Extended executive summary: Non-traditional financing for education<sup>1</sup>

## Introduction and overview

Aid to education is declining, and aid to basic education declined by 20% between 2009 and 2012 (Steer, 2014). Public spending on education is falling short, with only 25% of countries spending the recommended 6% of gross national product (GNP) on delivering quality education (ibid.). A \$38 billion funding gap remains in terms of providing good-quality basic and lower-secondary education for all by 2015 (UNESCO, 2014). Given successes in the health sector, the education sector has started to explore the potential of non-traditional financing to provide additional and alternative sources of finance.

Non-traditional financing includes ways to 'generate public and private funds to provide global public goods' (Doust-Blazy, 2014); 'new or novel ways to generate predictable, additional and sustainable finance' (Filip, 2014); and the raising of funds from unconventional sources or mechanisms to make existing funds 'go further' (Rose and Steer, 2013; author interviews with Steer, Gustafsson-Wright, Atinc, March 2014). The question is not just about private sources of finance, or solely about funding the private sector. There are many types of non-traditional financing instruments that can help the public sector deliver on its responsibilities.

Non-traditional financing is about more than raising additional funds; it is also about spending resources more effectively and finding novel approaches to addressing education issues. We therefore explore instruments that may raise additional funding and mechanisms to spend funds more effectively. Those to raise additional funds include social impact investing, such as Social Impact Bonds (SIBs), Development Impact Bonds (DIBs) and Social Yield Notes (SYNs); access to finance for schools and families; debt swaps; bonds, such as Debt Conversion Development Bonds (DCDBs) and diaspora bonds; debt buy-downs; and global solidarity levies. Mechanisms to spend funds more effectively include cash transfers; vouchers; public-private partnerships (PPPs); and Payments by Results (PbR).

Sources of non-traditional finance include newer players such as business-orientated foundations; corporations (philanthropy and corporate social responsibility (CSR), and commercial investment); private domestic funds; non-Development Assistance Committee (DAC) donors; and citizen contributions. Some multilaterals and bilaterals such as the UK Department for International Development (DFID) are also pioneering non-traditional instruments.

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<sup>1</sup> Note that this extended Executive Summary should be read in conjunction with the full Topic Guide: Non-Traditional Financing and Financial Instruments for Education.

## What is working and what shows potential to work in the future?

Although non-traditional financing in development has grown to an estimated \$50 billion a year (Burnett and Bermingham, 2010), education is not receiving a very large share of this, and, while impact investing in primary education is estimated to grow to \$10 billion per year (O'Donohoe et al., 2010), this is a long way from being realised.

Evidence of what is working is limited. Some non-traditional financing instruments with a longer history in education, for example cash transfers, vouchers and PPPs, have shown signs of success in certain contexts, but there are still many gaps in evidence, especially in Africa. Some instruments have been implemented only recently in education, for example social impact investing and PbR. Some are not yet in developing countries, for example SIBs, and therefore cannot yet demonstrate when and how they work most effectively. Other instruments have yet to be implemented in education at all, for example DCDBs and diaspora bonds.

In order to assess the potential of non-traditional financing instruments, we have undertaken a high-level assessment and evaluated them based on the following criteria: impact on learning outcomes; equity; enabling governments to deliver their responsibilities;<sup>2</sup> potential additional funds; sustainability and predictability of funding; innovation; efficiency; and ease of implementation. Relative to other non-traditional finance instruments, SIBs/DIBs and debt buy-downs may have the most potential. This is driven largely by their ability to link funding to learning outcomes, to support governments to deliver, to provide predictable funding and to enable innovation. Bonds show the potential to raise the most additional funds. The potential for social impact investing and blended finance for the private sector lies in driving innovation and stimulating education markets for the poor, hoping the public sector can adopt some innovations. None of the instruments evaluated looks set to make a significant dent in the financing gap yet. Their potential is most likely to be realised when they can leverage their particular 'value add', such as a focus on learning outcomes or innovation to address a specific education issue. Table 1 lists the non-traditional financing instruments by *relative* potential (high to low). There is insufficient information to give a view on *absolute* potential.

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<sup>2</sup> Criterion proposed by Samoff and Irving (2014).

Table 1: Assessment of non-traditional financing instruments that may raise additional funding

Instrument	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Sources of finance
<b>SIB/DIBs</b>	Forms of outcome-based contracts whereby the public sector or donor (in a DIB) pays a service provider for the outcomes delivered by a specific intervention or set of interventions (Filipp and Lerer, 2013). Private investment, which can be philanthropic or commercial, is used to fund the intervention with returns made on the basis of improved social outcomes (www.socialfinance.org.uk/).	<p>Strong link to learning outcomes across the education system. Can be targeted to address equity. Can foster innovation as they allow flexibility in delivery. Can encourage efficiency as they focus on outcomes. Can provide upfront and predictable funding from new sources</p> <p>Very limited experience of SIBs. No DIBs have been implemented. Complex and expensive to set up and manage. Uncertain fundraising potential</p>	<p>Prevention could lead to cost savings for the government at a later date.</p> <p>Upfront funding is needed.</p> <p>There is a clearly defined proposition with clear measurable outcomes.</p> <p>Innovation in delivery is needed.</p> <p>Proven model needs to be scaled.</p> <p>The government or a donor will pay for ongoing costs.</p>	<p>Expansion of early childhood education and secondary education.</p> <p>Girls' education.</p>	<p>Private commercial</p> <p>Foundation</p> <p>Government</p> <p>Multi/bilateral</p> <p>Non-governmental organisation (NGO)</p>
<b>Blended finance for the public sector – debt buy-downs</b>	A third party buys down all, or a part of, either or both of the interest and the principal of a loan between a country and a lending organisation, thereby releasing the borrowing country from all or some of its future repayment obligations (R4D, 2013).	<p>Triggers can be based on learning outcomes or equity. Provides sustainable and predictable funding over the term as long as triggers are met. Can enable governments to improve education systems.</p> <p>Risk that countries will increase their indebtedness. Ease of implementation is unknown.</p>	<p>Countries on both sides of the International Development Association (IDA)/International Bank for Reconstruction and Development (IBRD)<sup>3</sup> graduation threshold that still have major basic education challenges and would not otherwise borrow, e.g. Angola, Bangladesh, India, Nigeria, Pakistan, Sri Lanka (R4D, 2013)</p> <p>Low-income countries (LICs) that are not creditworthy if bought-down debt could provide them with increased grant or near-grant funding (ibid.)</p>	<p>Major basic education issues in the public sector with measurable outcomes.</p>	<p>Development banks.</p> <p>Multi/bilateral</p> <p>Government</p>

<sup>3</sup> The IDA and the IBRD are part of the World Bank. The IDA provides concessional loans and grants to LICs whereas the IBRD provides loans and advice to middle-income and credit-worthy poor countries: <http://www.worldbank.org/ida/what-is-ida.html>

Instrument	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Sources of finance
<p><b>Blended finance for the low-cost private sector</b></p>	<p>Combination of grant and loan or equity funding to reduce the financial risk of an investment.</p>	<p>Uses traditional funding to leverage additional funds and encourages innovation. Could lead to an indirect improvement in learning outcomes.</p> <p>Impact is limited to parts of education sector with a potential revenue stream, e.g. for-profit education businesses that may not serve the most vulnerable (although could be replicated in the public sector). Limited experience in education. Agreeing who bears the risk could make implementation quite complex.</p>	<p>Education businesses serving low-income customers that need initial subsidisation to reach the scale to attract social impact investment.</p>	<p>Providing tools or services to improve quality or effectiveness across education system.</p> <p>Stimulating education markets for the poor where the public sector is struggling to deliver, e.g. early childhood education, youth training.</p>	<p>Multi/bilateral</p> <p>Private commercial</p> <p>Private impact</p> <p>Foundation</p>
<p><b>Social impact investing (outside of SIBs and DIBs)</b></p>	<p>Investing with the intention 'to create positive impact beyond financial return' (O'Donohoe et al., 2010).</p>	<p>Potential to attract new funding to education. Fosters innovation within the education system. Can drive efficiencies owing to goal of financial sustainability or return.</p> <p>Although it creates focus on impact, this is not necessarily on learning outcomes. Impact is limited to parts of the education sector with a potential revenue stream, e.g. for-profit education businesses that may not serve the most vulnerable (although they could be replicated in the public sector). Currently, there are few 'ready-to-go' investments.</p>	<p>Education businesses serving low-income customers and delivering social impact and some form of financial sustainability or return that need some investment to scale.</p>	<p>Providing tools or services to improve quality or effectiveness of the education system.</p> <p>Stimulating education markets for the poor where the public sector is struggling to deliver, e.g. early childhood education, youth training.</p> <p>Enabling access to higher education for those with lower incomes.</p>	<p>Private commercial</p> <p>Private impact</p> <p>Foundation</p>

Instrument	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Sources of finance
<b>DCDBs</b>	This is created when the 'fiscal space' created from the debt swap is used to issue a bond that is sold in the local currency on the local capital market, which would then be invested in by investors such as local pension funds (UNESCO, 2011).	<p>Potential to leverage the \$6 trillion in private assets in developing countries (Bond, 2013). Used to fund public sector. Can address equity. Implementation costs are low. Could provide sustainable and predictable funding.</p> <p>Impact is limited to countries with outstanding debt and that have a financial market sophisticated enough to issue bonds.</p>	<p>Countries have:</p> <ul style="list-style-type: none"> <li>• Available debt for conversion</li> <li>• Available creditor(s) ready to cancel debt</li> <li>• Successful legal approval of new type of debt conversion</li> <li>• Sufficient monetary credibility to achieve acceptable rates of interest</li> <li>• Relatively mature bond market (Filipp and Lerer, 2013)</li> <li>• Need for a large financial outlay</li> </ul> <p>Would suit LICs, e.g. Kenya, Bangladesh, and middle-income countries (MICs), e.g. India, Ghana, Pakistan (Bond, 2012)</p>	Expansion of early childhood or secondary education, or primary where that need has yet to be met	Multi/bilateral Government National finance institutions
<b>Diaspora bonds</b>	A debt instrument issued by a country to raise financing from its overseas diaspora (Ketkar and Ratha, 2011)	<p>Potential to access the \$30 billion of diaspora savings from LICs (Ratha and Mohapatra, 2011), could provide sustainable and predictable funding.</p> <p>Needs a revenue stream to make repayments to the bondholders, likely this would need to be guaranteed by donors. No experience in education.</p>	<p>Countries have:</p> <ul style="list-style-type: none"> <li>• A large diaspora community</li> <li>• A relatively mature bond market</li> <li>• A revenue stream to repay the bondholder (Ketkar and Ratha, 2011)</li> </ul>	Provision of higher education.	Diaspora Government Multi/bilateral

Instrument	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Sources of finance
<b>National bonds</b>	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 and Lerer, 2013). Bonds can be secured on the basis of any future revenue streams.	<p>Potential to leverage the \$6 trillion (Bond, 2013) in private assets in developing countries and would provide sustainable and predictable funding.</p> <p>Would need an income stream to repay bondholders so is unlikely to be targeted at the most marginalised.</p> <p>Implementation possible only where the financial market is sophisticated enough to issue bonds – may need to be guaranteed by a development finance institution (DFI).</p>	<p>Countries have:</p> <ul style="list-style-type: none"> <li>• Ability to generate a future revenue stream</li> <li>• A relatively mature bond market</li> <li>• Creditworthiness or a guarantor</li> <li>• Upfront capital outlay</li> </ul>	Provision of higher education.	<p>Private domestic</p> <p>Government</p> <p>Private commercial</p>
<b>Access to finance for schools</b>	The provision of loans to (predominantly) low-cost private schools (LCPSs)	<p>Can provide additional funds at school level to growing LCPSs, which could improve learning outcomes or efficiencies if training on improving quality or school management is provided. Could be implemented through existing microfinance institutions.</p> <p>Amount relatively small. Most vulnerable students unlikely to be catered for.</p>	<p>There is a large LCPS market that needs access to finance.</p> <p>Microfinance institutions exist.</p>	Improving the sustainability and quality of LCPSs.	<p>Private commercial</p> <p>Private impact</p> <p>Foundation</p> <p>NGO</p>
<b>Global solidarity levies</b>	Aims to 'levy global economic activity to pay for global public goods' (Taskforce on International Transactions and Development, 2010).	<p>Can access new sources of funds for the education ecosystem (the Financial Transaction Tax (FTT) is estimated to raise €30 billion per year, but has yet to be implemented.</p> <p>Uncertain what proportion may be available for education, how it would be used and whether there could be a direct link to learning outcomes or equity.</p>	An end-user or consumer is willing to pay a small tax on a high-volume product or service.	Any issue.	<p>Citizen contributions</p> <p>Private commercial</p>



Instrument	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Sources of finance
<b>Debt swaps</b>	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).	<p>Potential to raise new funding that would be predictable and able to be used for public education systems.</p> <p>Limited to countries with debt left to swap, would need to ensure funds are used effectively to deliver improved learning outcomes.</p>	<p>Available debt for conversion.</p> <p>Available creditor(s) ready to cancel debt.</p>	Any issue.	<p>Multi/bilateral</p> <p>Government</p>
<b>Access to finance for parents/ students</b>	Provision of loans or insurance specifically for education, to parents or students.	<p>Relatively straightforward to implement through existing loan companies.</p> <p>Will raise only small amounts of funding and there is an ethical issue with lending parents money to pay for education when it should be free.</p>	<p>Higher education is available but unaffordable.</p> <p>Parents are struggling to meet education costs.</p>	Equitable access to higher education.	<p>Private commercial</p> <p>NGOs</p> <p>Students</p> <p>Parents</p>

Source: Authors' own assessment

In order to assess the potential of mechanisms to spend funding more efficiently and effectively, we have undertaken a high-level assessment based on the following criteria: impact on learning outcomes; equity; enabling governments to deliver on their responsibilities; innovation; efficiency and ease of implementation. PbR and PPPs show the most potential. PbR's potential stems from its ability to focus programmes on improving educational outcomes, working systemically across education and providing value for money. PPPs have potential, as, if designed and implemented well, they can open up the education system so children can access free, quality education regardless of who delivers it. Evidence is currently inconclusive as to whether either works, so piloting or implementation must take a learning approach. Table 2 lists the non-traditional financing mechanisms by *relative* potential (high to low). There is insufficient information to give a view on *absolute* potential.

Table 2: Assessment of non-traditional financing mechanisms to make funding go further

Mechanism	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Source of finance
<b>PbR</b>	Payment for a programme or service based on predefined and independently verified results.	Drives a focus on outcomes that could be for learning or equity. Can be applied to government or non-state implementers. Can lead to innovation given flexibility in delivery and efficiencies if structured effectively.  Complex and time consuming to implement effectively.	Indicators can be defined and independently measured  Context/environment already open to PbR principles.  Focus on outcomes would improve results.  Good relationship between partners. Implementer has capacity for PbR.	Issues where results can be measured within a practical timescale, e.g. early grade reading, progress improvements within primary, secondary schooling.	Multi/bilateral  Foundation  Private commercial  Private impact
<b>PPPs</b>	Government funded but privately delivered education (Patrinos et al., 2009).	Can provide access that is free at the point of use. Can drive innovation and efficiencies through autonomy, management effectiveness and competition (Patrinos et al., 2009). Enables government to still be <i>responsible</i> for education delivery.  Evidence mixed on ability to improve learning outcomes and address equity - have to be regulated and incentivised effectively (Patrinos et al., 2009).	Rapid expansion in access required but public delivery constraints. There is a low-cost private sector that can deliver quality education on behalf of government.  Government able to regulate PPPs effectively.  Different approach needed for certain groups.	Issues where the public sector needs support in delivery, e.g. early childhood, post-primary.	Multi/bilateral  Foundation  NGO  Government  Private commercial  Private impact
<b>Vouchers</b>	Provide parents greater choice on where to send their child to school and access to school to those children who might not be able to otherwise afford it.	Can improve access when implemented effectively. Can lead to an improvement in learning outcomes (but not always) (Agrist et al., 2002; 2006). Can be cost effective (Morgan et al, 2013; Muralidharan and Sundararaman, 2013).  Not always equitable. Can lead to 'cream skimming' <sup>4</sup> and segregation (Morgan et al., 2013). Rely on availability of sufficient LCPSS.	Public sector does not have enough school places for number of students. There are private schools that can deliver appropriate quality in a location that can offer choice (vouchers can also be used in public sector to encourage choice).  Certain socioeconomic groups need to be targeted.	Locations with public school supply constraints and a large supply of LCPSS.	Multi/bilateral  Foundation  NGO  Government

<sup>4</sup> Selection of the most able pupils.

Mechanism	Definition	Summary assessment of potential	To be considered when	Example education issues that could be addressed	Source of finance
<b>Cash transfers</b>	Give cash to poor households. Unconditional cash transfers (UCTs) provide cash with no strings attached. Conditional cash transfers (CCTs) provide cash if certain conditions are fulfilled (Baird et al., 2013).	When conditional, can significantly improve access and equity (Baird et al., 2013). Relatively straightforward to implement.  Have a small (at best) impact on learning outcomes (Baird et al., 2013). Rely on a sufficient supply of schools. Do not drive innovation or efficiency.	Sufficient schools for children to attend, but low enrolment and attendance owing to financial constraints.  No choice of schools.  Certain socioeconomic groups need to be targeted.	To provide access to most marginalised.	Multi/bilateral NGO Government

Source: Authors' own assessment.

## Key issues to be addressed

Key issues that cut across non-traditional financing need to be addressed:

- **Clarity of communication on what non-traditional financing is, and the role of the private sector:** there is some confusion, and discussion about non-traditional financing often gets caught up in an ideological debate about the role of the private sector in education, rather than in one about how non-traditional financing can address key education issues. Non-traditional financing can involve both public and private funding, and can support the whole education system.
- **Evidence and learning about what works:** although some organisations (e.g. the Open Society Foundation) have played an important role in funding research and driving thinking forward in education, and others (e.g. Social Finance) are building expertise in, or forming networks around, specific instruments, learning is hampered by a lack of evidence on the effectiveness of non-traditional instruments in education, as so few have yet been implemented.
- **More involvement and ownership by developing countries:** many discussions about non-traditional financing happen in the US/Europe without sufficient involvement of developing countries, although experience shows there is often enthusiasm at country level to try new approaches – from both government and financial institutions. Ministries of finance may have experience implementing non-traditional approaches in other sectors, and the expertise to advise ministries of education, but these discussions need to be brokered and civil society and other stakeholders involved.
- **Clarity on the investment opportunity:** certain characteristics mean the education sector's investment market is still nascent. Many potential investors are unclear what the investment opportunity is, and even those who have explored it have not found many 'ready-to-go' investment opportunities with a financial return that serve the 'bottom of the pyramid'. This is because of the trade-off between social and financial investment objectives. It is clear education does not offer quick financial returns while reaching the most vulnerable; however, there are some investment opportunities that can either directly or indirectly deliver impact over the long term, for example:
  - Higher-cost private delivery, with a focus on access for lower-income students, e.g. the higher education sector and student finance
  - Low-cost private delivery at scale in areas with unmet need, e.g. early childhood education
  - Tools and services for the public or private education system, e.g. finance products for schools; technology devices; school management systems; school rating systems; curricula; and low-cost school infrastructure

The question remains as to whether any of these can be scaled up to have maximum impact.

- **How the most marginalised can be reached:** given that some non-traditional financing instruments and sources are best suited for those parts of the education sector that produce a financial return, some argue they may not serve the most marginalised. However, this does not always need to be the case:
  - Many types of non-traditional financing instruments do not need a financial return, and can therefore be targeted at the most marginalised, e.g. SIBs and DIBs; debt swaps; DCDBs; solidarity levies; and debt buy-downs.
  - Non-traditional financing mechanisms that involve PbR can actually enhance the outcomes delivered for the most marginalised by clearly linking funding to outcomes.
  - Instruments more suited to sectors with a financial return could either cross-subsidise or free up traditional financing to focus on those that still need funding.
- **A clear and measurable issue to rally round:** this is one of the reasons health has been so successful in raising funds from non-traditional financing. The education sector needs to spotlight its key issues for champions to rally around. Even the focus on learning outcomes does not have the same clarity on what needs to be done. The lack of consistency in measuring education impact has hampered this further. Although education has high-profile names as political champions, it lacks the sole focus of a high net worth individual or major foundation to crowd in funding and drive innovation through non-traditional financing mechanisms.
- **A number of implementation challenges:** these include sometimes high transaction costs, an unfavourable economic climate and competition with other sectors.

## Moving forward

Non-traditional financing remains at an early stage, but needs to move from theory into practice. This guide suggests two initial phases to make instruments work better, or to be adopted more widely:

- **Phase 1:** focusing on one or two specific education issues; developing better understanding of the instruments and the contexts in which they may work to understand what the most promising instruments may be; forming multiple stakeholder collaborations around specific opportunities that address those issues; piloting; and capturing learning and evidence.
- **Phase 2:** profile raising; greater coordination; and ultimately scaling of instruments that work.

This needs to be enabled by key stakeholders playing important roles:

- **Donors:** work with governments to pilot non-traditional approaches where appropriate; provide technical assistance; fund research, pilots, impact evaluations, knowledge sharing and scaling; provide concessionary funding/guarantees; and support improvement of education data and metrics.

- **Governments:** encourage multi-stakeholder dialogue; pilot new approaches; invest in sound education management information systems; and adopt mechanisms or innovations that have been proven, at scale.
- **NGOs:** encourage multi-stakeholder dialogue; monitor the needs of the most marginalised; pilot and implement; and become more outcome orientated.
- **Foundations:** bear initial risk when piloting new instruments and making social impact investments; and collaborate to fund pilots, rigorous evaluations and incubation.
- **Civil society:** contribute to multi-stakeholder discussions; monitor the needs of the most marginalised; and advocate for transparency and accountability.
- **Private sector:** take part in multi-stakeholder discussions; collaborate to implement pilots and collect evidence; invest in education not just for profit, and, when for profit, in education businesses that serve the poor and have educational impact; and raise the profile of education.
- **Think-tanks:** drive one or two key issues; convene multi-stakeholder discussions; conduct thought leadership; undertake research; facilitate knowledge sharing; and attract high-level support.

## Conclusions

Non-traditional financing is not a quick win, and will take time to test and evaluate, but, as outlined above, opportunities to do this will start to provide more evidence on what works and what has potential. If non-traditional financing focuses on areas where it can add most value, such as in girls' education, it could free up traditional financing to focus on the most marginalised and issues that cannot otherwise be addressed.

Given that non-traditional financing is unlikely to fill the entire funding gap, or address all education issues, the education sector must continue to advocate for traditional finance to be raised through domestic revenue via an increased allocation to education and the strengthening of tax systems (UNESCO, 2014); this will be the most sustainable source of education funding and will enable developing countries to have greater ownership of their education systems (Samoff and Irving, 2014). Despite the reversing trend, the education sector must also advocate for countries to meet their overseas aid commitments and reach the target of 0.7% of gross national product (GNP) so the global commitment to education for all can be supported by a global commitment for funding (ibid.).