Engaging the Investment Community in Education

The case for education bonds to raise new resources for Sustainable Development Goal 4

Global Business Coalition For Education

the Education Commission

Discussion Memo 2019

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The memo also benefitted from inputs from individuals at the World Bank and UBS.

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INTRODUCTION
THE URGENT IMPERATIVE

A quarter of a billion of the world's children and young people are out of school, and another 600 million in school are barely learning the basics. Without urgent action, half of the world's children and youth will not achieve basic secondary-level skills needed to thrive in society or even participate in the workforce of 2030.

Addressing this challenge requires a combination of political will, improvements in systems, inclusion and innovation, as well as the necessary finance to achieve Sustainable Development Goal 4 (SDG 4): inclusive and equitable quality education for all. Estimates suggest that even with the best domestic resource mobilization efforts, a large funding gap will remain in low- and middle-income countries, requiring international support.[1] International attention, however, has weakened, despite repeated calls for greater priority and attention to be given to the education crisis.

Yet, other sectors have used new methods to generate resources to finance public goods and social services. For instance, the climate community has used a unique bond scheme to raise significant financing for sustainability projects. With such large-scale success, why not apply this model to education?

This paper puts forward the case for the creation of "Education Bonds" to direct new investments on a much larger scale towards initiatives focused on the achievement of SDG 4.

LABELED BONDS 101: CAN CLIMATE TEACH EDUCATION A LESSON?

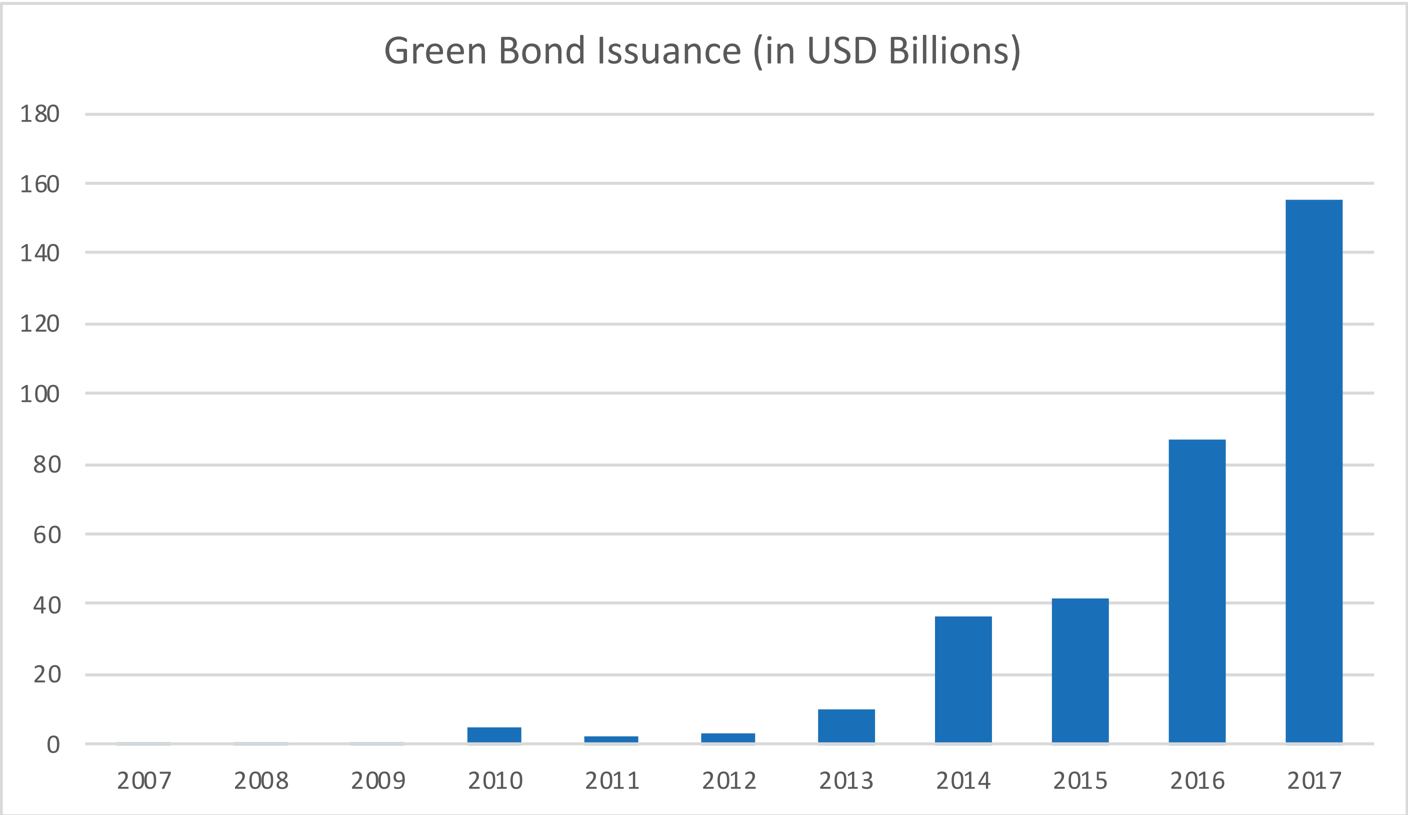
Since 2007, environmentally friendly bonds (commonly referred to as "Green Bonds" or "Climate Awareness Bonds") have raised more than US$500 billion in funding for sustainability projects throughout the world.[2] Initially issued by multilateral development banks ("MDBs"), Green Bonds have become a tool for governments, municipalities, and the private sector to mobilize financing for initiatives ranging from wind farms to eco-friendly facilities.

> "The climate community has used a unique bond scheme to raise more than $500 billion for sustainability projects."

Although the volume is still small in comparison to the overall size of the bond market (less than 1 percent), Green Bonds have introduced a change in investor behavior for fixed-income products, with more focus on environmental, social, and governance ("ESG") criteria in the investment process.

Green Bonds are very similar to regular bonds. The major difference is how the bond is evaluated in terms of environmental and climate impact.[3] In order to receive the label of "green," the issuer of the bond must prove that proceeds will be used to fund projects in categories such as renewable energy, energy efficiency, pollution prevention and control, and sustainable management of living natural resources, among others.[4] The "greenness" of the bond is evaluated by each investor against the investor's own standards or by reference to certain institutional standards, such as the International Capital Market Association (ICMA)'s Green Bond Principles and the Climate Bond Initiative (CBI)'s Climate Bond Standards.[5]

As companies were beginning to face demands from both consumers and employees to expand their socially responsible investments, Green Bonds served as an avenue to showcase the private sector interest in combating climate change.[6] The expansion of the Green Bond market allowed for the securing of large amounts of capital from business to



Since issuing its first Green Bonds in 2008, the World Bank has raised over $13 billion to support its climate projects throughout the world. In 2017, more than USD$155 billion in Green Bonds were issued by a range of actors - including governments, multilateral development banks, businesses, and other financial institutions.

In 2018, Green Bond issuance surpassed USD$180 billion. Source: OECD expand investments in environmentally friendly initiatives. Since issuing its first Green Bonds in 2008, the World Bank alone has raised over $13 billion to support its climate projects throughout the world.[7] In 2017, more than US$155 billion in Green Bonds was issued by a range of actors – including governments, multilateral development banks, businesses, and other financial institutions. In 2018, Green Bond issuance surpassed US$180 billion.[8]

Capital markets have evolved over the past 10 years from a space where investors knew little about what social purpose their investments might be supporting to one where purpose and impact increasingly matter. Initially sparked by Green Bonds, bond markets now include a number of thematic bonds, including social bonds and ESG bonds; most recently, some investors have also started to use the SDGs as a framework for investment and engagement. All are aligned with the principles of Green Bonds, with a focus on assets that deliver a positive global impact alongside financial returns for investors.

These experiences could be used as models to raise awareness and financing for a salient and immediate problem facing the world today: the global education crisis. Utilizing the Green Bond structure to create "Education Bonds" could enable issuers, whether an MDB, a bilateral financial institution or a private concern, to finance their educational projects and guarantee a system of accountability and transparency that other funding initiatives may not deliver.

Education Bonds would fit into investment strategies designed to contribute towards achievement of the SDGs. Investors in Education Bonds could see a return just as if they were investing in regular bonds; Green Bonds as a whole have performed similarly to "regular bonds" in the sense that green bonds are a reliable and reasonable investment[9] enjoying reasonable liquidity. While it remains an open question whether a critical mass of issuers and investors would be attracted to this one area or even whether this type of single-issue segmentation of the ESG-focused capital markets is advisable, Education Bonds are a topic worthy of further examination to raise the profile of a Sustainable Development Goal which has received limited financial support compared to the 2030 ambition.

THE RATIONALE FOR EDUCATION BONDS

The stark statistics concerning the out-of-school population and the numbers of young people left behind at every critical juncture of inclusion and learning present a serious risk to the health of societies throughout the world. With half of all young people projected to lack the most basic skills to participate in society and the economy of 2030, the impact will be significant on growth, health, and well-being.

Already 40 percent of employers globally are finding it difficult to recruit young people with the skills they need, and as the pace of technological change and innovation accelerates, generations will fall further behind as new higher-order skills are required by labor markets. Education not only enhances the well-being of individuals but also drives the economic and social development of countries.

Education is both directly and indirectly critical for the achievement of all Sustainable Development Goals, including those related to health, poverty, gender equality, quality of life, and even climate change. Research shows that climbing from the 25th to 75th percentile on the Human Capital Index adds an additional 1.4 percentage points in annual economic growth over 50 years; around one-third of the reductions in adult mortality in the past few decades can be attributed to gains in the education of girls and young women; and every additional year of schooling reduces an adolescent boy's risk of becoming involved in conflict by 20 percent.

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Governments are trying to increase the share of national income going to education from an average of 4 percent to 6 percent between now and 2030. Yet, education's share of international assistance dwindled from 13 percent to 10 percent between 2002 and 2015, even as the health and infrastructure sectors' shares grew. Aid from official donors amounted to just US`12 billion in 2015 – far below current and anticipated need – and only about 70 percent actually reached developing countries.

Meeting this challenge will require greater leveraging of the Multilateral Development Banks (MDBs) as well as other sources of innovative finance to harness new and additional resources in order to move from the billions of dollars in current finance to the trillions of dollars of investment necessary to achieve SDG 4.

IFFEd: AN OPPORTUNITY FOR ISSUING OF EDUCATION BONDS

The International Finance Facility for Education (IFFEd), set to be operational in early 2020, offers a solution to help close the financing gap. As a financial mechanism, it will work through the Multilateral Development Banks (MDBs) to provide lower middle-income countries (LMICs) with scaled-up resources for education. The Facility recognizes that LMICs face structural challenges that make them particularly vulnerable to inadequate financing. Indeed, as these countries graduate from low-income to lower middle-income status, aid falls faster than tax revenues increase. While costs rise, traditional grant aid becomes less available and alternative forms of financing, such as borrowing at market or non-concessional terms, are unattractive for education.

IFFEd will address this challenge by using contingent financial commitments (e.g. guarantees) provided by contributors as a tool to generate additional lending. The Facility will also provide grants to make the terms of loans more attractive to developing countries. IFFEd aims to substantially increase MDB education lending to LMICs, which are home to half of the world's young people and represent the bulk of the funding shortfall.

Despite an estimated financing gap of US$23 billion in LMICs in 2020, current MDB lending in those countries comes to less than US$2 billion annually – and this gap is predicted to grow unless there are drastic interventions. IFFEd aims to double current annual MDB lending in its initial period of financing, with the ultimate goal of establishing a fund for $10 billion of additional lending for education in the short term.

Education Bonds could be issued in this context to generate additional MDB lending and increase the overall momentum of investment in education. Just as Green Bonds have helped to close the environmental funding gap by raising billions of dollars in financing for sustainability projects, so could a potential Education Bond further expand the level of financing for education throughout the world.

Given the increased capacity that will be created by the new Finance Facility, multilateral development banks (MDBs) could potentially issue Education Bonds to mobilize resources for the sector, or simply to raise awareness about what their institutions are doing in the education sector. On the other hand, investors interested in expanding education in emerging economies could be attracted to such bonds. Using the increased funding, MDBs could then lend money to countries that need this financing the most. As part of a concerted effort to increase investment in education and leverage the MDBs, IFFEd could generate the momentum needed to perhaps stimulate a new class of fixed-income instruments focused on investments in education.

BEYOND THE MDBs: GOVERNMENTS, BUSINESS, AND PENSION FUNDS

Education Bonds, like Green Bonds, could be beneficial to entities beyond the multilateral development banks, including governments, business, municipalities, and all other actors seeking to fund projects to close the learning gap.

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Education Bonds could be productive for national governments seeking to strengthen their education systems or the education systems of other countries. In January 2017, France issued EUR7.5 billion in Green Bonds to support its commitment toward the Paris Climate Agreement.[10] A country like France could issue an Education Bond to fund training programs, workforce development, and other initiatives to help close the youth skills and talent gap.

For businesses that are interested in funding workforce training programs, Education Bonds are a potential low-risk mechanism that could multiply current funding of education. In addition, pension funds and insurance funds can play a critical role in driving awareness around education through Education Bonds; when Green Bonds were first issued, they were partly a response to pension funds' desire to invest in more climate-focused projects.[11]

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An Education Bond would potentially be an appealing option for large-scale funds that might want to prioritize their resources on educating today's children and youth and show their support for the SDGs. Teacher pension funds could be a natural investment source for Education Bonds.

An expanded choice of financial instruments with different risk/return characteristics in financial and impact terms could also be explored in later stages of this initiative. This could allow more private capital to participate and Education Bonds themselves could then evolve into lower-risk instruments with even greater transparency and ease of implementation.

For example, in more complex, asset-backed education programs private sector capital could take "first-loss" equity stakes, with education bonds funding the remainder of these de-risked projects in underserved markets with high potential financial and impact risk/reward, bringing additional capital into education funding while transforming Education Bonds into lower-risk, more transparent instruments that are investible for a wider group of potential investors.

This private equity capital could be sourced through pooled and/or mainstream investment vehicles, or via an identified collection of mainstream-impact investment managers being awarded first refusal rights on specific co-investments with the World Bank and other MDBs and development finance institutions.

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TAKING THE PROPOSAL FORWARD

Overall, Education Bonds have the potential to transform education financing by mobilizing funding from capital markets that are otherwise difficult to access. But there are several steps that would need to take place to make such a proposition viable:

1. Set standards

Moving forward, the international community would need to set standards for what qualifies as an Education Bond; the standards would need to be based on what projects merit the "education" label, in addition to determining what kind of impact would be needed. Addressing the targets of SDG4 would be a baseline requirement, but a more detailed set of criteria will be necessary.

In the climate sector, the Center of International Climate and Environment Research at the University of Oslo (CICERO) provided guidance on project eligibility criteria and ultimately wrote a second opinion on the World Bank's Green Bond framework. This investment in issuance frameworks and impact reporting was critical to giving credibility to the Green Bond movement. These efforts have been helpful in setting expectations, creating familiarity, and establishing standards.

2. Ensure measurable impact

An Education Bond would allow investors to fund educational projects with a greater awareness of evaluation and impact. Ensuring that impact is measurable and quantifiable will be essential for investors who are purchasing the bond. One of the main attractions of Green Bonds is their clear accountability in the projects they are funding.

Just as Green Bonds are evaluated and monitored, an Education Bond issuer following the model of the Green Bond market and Green Bond Principles would need to provide detailed and annual reporting of where the money is being directed, what projects are being funded, and how successful those projects are in ensuring quality education for the targeted community or country.

3. Identify potential tax incentives

It will also be essential to determine how Education Bonds may fit in an overall tax structure (i.e. to identify tax incentives). Various incentives could help persuade investors to direct funding to portfolios focused on supporting SDG 4 as opposed to other areas of investment.

BENEFITS OF EDUCATION BONDS

Increasing awareness

Issuing specific bonds for education would have important effects also found in other labeled bonds. In the same way that Green Bonds have helped raise awareness about climate risk, Education Bonds would raise awareness about much-needed investment in education and engage actors to address those challenges. Indeed, the simple structure and story of labeled bonds give a straightforward and compelling option to change the way investors engage and measure their impact.

Generating large-scale funding

Education Bonds could attract capital market funding from a more diverse set of investors by increasing awareness around the issue of the education gap.

Driving greater accountability and monitoring

For investors, Education Bonds could be a more reliable investment as the proceeds would be tracked throughout their allocation process. For example, a business that issues a Climate Bond currently needs to inform investors how much of its proceeds are being directed toward an environmentally sustainable project, how much has been allocated, etc. Monitoring practices related to Green Bonds have promoted greater transparency from issuers due to reporting requirements – particularly external and third-party evaluations – and a focus on impact, which helps strengthen investors' assessment of risk and return. The credibility of the MDBs will play a critical role in reassuring markets of the seriousness of the investments and the quality of their preparation. The same would be true for Education Bonds.

Enabling personalized investment opportunities in education

Dedicated Education Bonds make it easier for private investors with a particular affinity for education sustainability to make a contribution towards this and the wider goals of SDG 4. Such bonds enable companies and investors to signal to markets and consumers their commitment to sustainability and social issues. Issuers can further cement credibility by committing themselves to a greater degree of scrutiny through disclosure and reporting.

CONCLUSIONS

As the experience of Green Bonds shows, it is possible to create a new dimension for investment decisions with large-scale impact. In particular, Education Bonds would raise global awareness around Sustainable Development Goal 4 and education by connecting investors with social impact. Labeled bonds (e.g. green, social and sustainability bonds)[12] are structurally no different from traditional bonds, but the focus on results provides impetus to boost efforts in impact investing and create momentum in socially minded fixed-income markets.

Education Bonds would help the wider investment community become an active participant in creating positive social change. While a "sustainability revolution" is now underway, thanks in part to the Green Bond market, the social bond market is still in its early stages and Education Bonds would help to raise visibility for such transformative investments.

Education needs to be part of a global effort where investors ask for every investment "How is this making a positive impact on society?" And the creation of education bonds as part of the broader set of social investment options should become the "new normal" for bond holders.

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