Testimony

U.S. Development Finance Corporation

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George Ingram, Center for Sustainable Development, Brookings Institution[1]

DFC's role in expanding development finance

A key objective in the lead up to and reauthorization of the BUILD Act in 2025 is empowering the DFC to fulfill its role in the expansion of development finance.

Background

Building on the effort to revitalize the World Bank and other MDBs/DFIs, catalyzed by U.S. Treasury Secretary Janet Yellen, the administration and Congress should begin now to provide the capabilities for the DFC to fulfill its role in galvanizing a significantly higher level of private financial flows to developing countries.

The 2022 report *Financing a big Investment push in emerging markets and developing countries for sustainable, resilient, and inclusive recovery and growth* calls for a doubling of private lending to development countries by 2025. *The Triple Agenda* report (in 2 volumes[2]) of the Independent Expert Group commissioned by the Indian G20 Presidency outlines a path to enhancing financing for development. Its findings identify a need for incremental investment in climate action and SDG financing of $3 trillion annually by 2030, of which $2 trillion would be from domestic finance and $1 trillion in international finance. The international finance would be comprised of $500 billion each of official development finance and private capital. The report was discussed at the October meeting of G20 Finance Ministers and recommended for further consideration in the final declaration.

Recommendations

Contingent liability: The BUILD Act sets a maximum contingent liability for the DFC of $60 billion. Total current exposure is $41 billion. Projecting from the level of commitments of $ 7.4 billion in 2022 and $9.3 billion for 2023, the DFC will broach the $60 billion ceiling in 2025.

[1] This testimony represents the views of the author and does not reflect the views of Brookings, its other scholars, employees, officers, or trustees.

[2] The Triple Agenda: Mandates, Finance, Mechanisms; volume 1.

- Recommendation: assuming a five-year authorization, the DFC contingent liability should be tripled from $60 to 180 billion[3] and take additional steps as outline below so the DFC has the ability to function at the increased level of activity.

Equity scoring: Contrary to the intent of the authors of the Build Act, DFC equity financing is scored on a dollar-for-dollar basis – as if every dollar invested is a grant that would never be recouped. However, in most cases, equity investment is paid back along with a financial return. By failing to take this reality into account, the current dollar-for-dollar scoring (1) puts unnecessary pressure on the DFC's budget and on the International Affairs Budget and (2) limits the activity of the DFC by both restricting available finance and making the DFC a less desirable partner for other DFIs.

- Recommendation: take immediate action, the next opportunity being the legislative vehicle to fund the FY 2024 budget, to set scoring of equity investments at "net present value" with a reserve fund to cover any project risk.

Partnering: Reaching scale, such as for large infrastructure and any of the eight global challenges[4] identified in the recent World Bank/IMF report *Ending Poverty on a Livable Planet*, requires collaboration and joint project support among DFIs. But DFIs have a "competitive spirit" for a limited supply of qualifying projects; each typically develops potential transactions solo, such as undertaking its own separate due diligence which when a project ends up being co-funded adds to costs time and money when other DFIs repeat pre-investment processes.

The DFC and IDB Invest have taken an important step with the recent creation of the Americas Partnership Platform (announced at President Biden's inaugural America's Partnership for Economic Prosperity Leader's Summit) for joint collaboration on infrastructure and other strategic investments.

Effective partnering is not simply joining together once a deal is ready to be launched. It comes from a level of trust and understanding that is developed through a pattern of working together – jointly originating deals, sharing pipeline information and market intelligence, and pooling resources. Country platforms offer a venue for facilitating DFI partnering.

- Recommendation: the BUILD Act reauthorization, along with guidance from the DFC board, should emphasize the role of collaboration in fulfilling the DFC mission, specifically with regard to

[3] Or, increase the contingent liability by at least $30 billion/year for the number of years of the reauthorization.
[4] (i) Climate Change Adaptation and Mitigation; (ii) Fragility and Conflict; (iii) Pandemic Prevention and Preparedness; (iv) Energy Access; (v) Food and Nutrition Security; (vi) Water Security and Access; (vii) Enabling Digitalization; and (viii) Protecting Biodiversity and Nature.

- Making real the Americas Partnership Platform and replicating that collaboration with other DFIs, preferable on a multi-DFI basis.
- Facilitate sharing due diligence among DFIs to speed up the process of collaborating on investment projects and reducing the origination costs by developing a common set of criteria so DFIs can accept the due diligence of the originating project sponsor.
- DFI collaboration to build project pipelines.

Fees: The BUILD Act does not provide the DFC with the statutory authority OPIC had to use fees collected for services and transaction costs. This was an important means for sharing costs with private investments and covering OPIC's operating expenses.

- Recommendation: amend the BUILD Act by adding the authority that was in section 105 of the Foreign Assistance Act authorizing the reuse of fees for services and pre-investment transaction costs.

Risk appetite: As with most DFIs, the DFC has a risk culture that prioritizes avoiding financial risk over the upside of supporting innovative but commercially unproven investment projects, and favoring stable middle income country over less stable, fragile poor country environments where solid investment possibilities are more difficult to find. Section 1412(c) of the BUILD Act gives priority to "less developed countries with a low-income economy or a lower-middle-income economy".

- Recommendations:
    - Continue priority for projects in poor and fragile countries, and limit projects in upper middle-income countries to those that have a clear impact on underserved communities.
    - Move the approval process for exceptions being determined by the President to the more appropriate collective decision of the DFC board that can weigh the considerations of commercial viability, impact on underserved communities, and U.S. foreign policy interests.
  - Make better use of de-risking mechanisms that share risk with private investors, such as:
    - small grants and technical assistance
    - concessional finance
    - blended finance
    - joint projects with USAID, USDTA, and MCC to share respective capabilities
    - collaborate more frequently with other DFIs and MDBs
    - transparent investment data to allow the private sector to assess potential risk and return

Building a pipeline: With enhanced resources and need to attract greater private finance, the DFC needs to be proactive in building a pipeline of projects. A new vehicle that offers this opportunity is the Global Infrastructure Facility.

- Recommendations:
    - Build on current USAID-DFC collaboration and review the extent to which USAID can better engage in originating deals and the need for the DFC to have representation abroad.
    - Collaboration with other DFIs in building project pipelines.