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Guaranteeing the future?

The role of guarantees in development and climate finance

By Farwa Sial and C. P. Chandrasekhar • November 2024

Contents

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Abbreviations

ADB	Asian Development Bank
AECID	Spanish Agency for International Development Cooperation
AFD	Agence Française de Développement
AfDB	African Development Bank
AGF	African Guarantee Fund
AIIB	Asian Infrastructure Investment Bank
AILAC	Independent Latin American and Caribbean Association
BGK	Bank Gospodarstwa Krajowego (Polish development bank)
CAF	Development Bank of Latin America and the Caribbean
CBDR-RC	Common but differentiated responsibilities and respective capabilities
CDP	Cassa Depositi e Prestiti (Italian develoment bank)
CGD	Centre for Global Development
CIV	Collective Investment Vehicle
COFIDES	Compañía Española de Financiación del Desarrollo (state-owned enterprise specialised in the management of State funds)
COP29	29th Conference of the Parties to the United Nations Framework Convention on Climate Change
CRDB	Uganda's Centenary Bank for Rural Development
CSOs	Civil Society Organisations
DAC	Development Assistance Committee
DANIDA	Danish International Development Agency
DFC	U.S. International Development Finance Corporation
DFIs	Development Finance Institutions
DG NEAR	Directorate-General for Neighbourhood and Enlargement Negotiations
EAG	External Action Guarantee
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EDFI	Association of European Development Finance Institutions
EFSD+	European Fund for Sustainable Development
EIB	European Investment Bank
ELM	External Lending Mandate
FIT	Forum for Insurance Transition to Net Zero
FMO	Dutch entrepreneurial development bank
GFEA	Guarantee Fund for External Actions
GHGs	Green house gases
IDA	International Development Association
IDB	Inter-American Development Bank
IEEFA	Institute for Energy Economics and Financial Analysis
IFC	International Finance Corporation
IF-CAP	Innovative Finance Facility for Climate in Asia and the Pacific
ILO	International Labour Organisation
IMF	International Monetary Fund
JETPs	Just Energy Transition Partnerships
KfW	Kreditanstalt für Wiederaufbau Development Bank
LDCs	Least Developed Countries
LMICs	Low- and middle-income countries
MDBs	Multilateral Development Banks
MIGA	Multilateral Investment Guarantee Agency
MICI	Independent Consultation and Investigation Mechanism
MSMEs	Micro-, small and medium-sized enterprises
NCQG	New Collective Quantified Goal on Climate Finance
NDF	Nordic Development Fund
NDICI	Neighbourhood, Development and International Cooperation Instrument
NDICI-GE	Neighbourhood, Development and International Cooperation Instrument – Global Europe
NEFCO	Nordic Green Bank
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organization for Economic Cooperation and Development
PBG	Policy-Based Guarantees
PIDG	Partnership for Infrastructure Development
PPP	Public-Private Partnerships
PROPARCO	Société de Promotion et de Participation pour la Coopération Economique
PSI	Private Sector Instruments
PSIL	Private Sector Investment Lab
PSW	Private Sector Window
Sida	Swedish International Development Cooperation Agency
SMEs	Small and medium-sized enterprises
SPV	Special Purpose Vehicles
USAID	United States Agency for International Development
WBG	World Bank Group

Executive summary

Guarantees are legally binding agreements under which guarantors agree to pay part or the entire amount due on a loan, equity or other instrument in the event of non-payment, or a loss of value in the case of an investment. In recent years, their use as a financial instrument in international development and climate finance has been increasing.

This report is the first comprehensive civil society analysis of guarantees in an area that is still largely unexplored. It provides an overview of the current landscape in order to raise awareness of the potential impact of an increased issuance of guarantees for development and climate action. It provides a mapping of the providers of guarantees, introducing three guarantee-issuing organisations: the World Bank Group's Multilateral Investment Guarantee Agency (MIGA); the EU's European Fund for Sustainable Development Plus (EFSD+); and the Swedish International Development Cooperation Agency (Sida).

Based on the existing evidence, the analysis goes on to explore the opportunities and the risks that these instruments pose from a development and climate justice perspective. It finds that there is still a case to be made. More transparency and evidence are needed on the exact nature and role of individual guarantees; the institutional mandate; and their long-term financial and development additionality. This is key to ensuring that guarantees for development and climate do not divert attention from unmet commitments and undermine development and sustainability objectives.

Why use guarantees?

The underlying rationale for using guarantees is that they will attract private finance, lowering the risk of private investors in projects such as capital-intensive energy infrastructure, which otherwise would probably not have been attractive. Guarantees are also being provided with the stated goal of lowering the cost of capital in sovereign borrowing.

Yet, as detailed above, they must be treated with caution. This is especially important in cases when it is not clear who bears the ultimate cost if, and when, guarantees are called upon. Furthermore, the rise of guarantees poses a critical question: In a world potentially awash with guarantees, what are the implications for aid budgets, socioeconomic development and the climate justice agenda, which are so critical for the global south?

The rise of guarantees

In February 2024, World Bank Group President, Ajay Banga, announced the goal of tripling annual guarantee issuance to US$20 billion by 2030. Following this, the World Bank Group launched a new "one-stop guarantee platform" in July 2024. The platform is housed at the MIGA, the arm of the Group that promotes foreign direct investment into developing countries by providing guarantees to investors and lenders and is the world's largest and most significant issuer of guarantees. Junaid Kamal Ahamad, the Vice President for Operations at MIGA, summed up the rise of guarantees at his organisation as an 'inflection point', which is strengthening the transformation of MDB's 'from a lending institution to becoming a leveraging institution'.[1]

Although, in aggregate terms, guarantees are still not a major instrument to mobilise private finance, they are becoming an increasingly attractive instrument of choice of many institutions and rich countries. This is particularly the case in relation to aid budgets and the financing of climate needs (see Box 1).

Box 1: Examples of the recent rise in guarantees

Bridgetown Initiative: The Bridgetown initiative includes a proposal for the International Monetary Fund (IMF) and multilateral development banks to offer $100 billion a year in currency risk guarantees. These guarantees are intended to drive private sector investment in projects focusing on green energy transitions.

Multilateral Development Bank climate sovereign guarantees: Just ahead of the COP29, the Asian Development Bank announced an increase in its climate finance by $7.2 billion after the United States and Japan agreed to underwrite risk for some existing loans.

European Fund for Sustainable Development Plus (EFSD+): The European Union's developmental mandate, delivered through the European Fund for Sustainable Development Plus (EFSD+) has expanded its use of guarantees. Between 2017 and 2021, 16 guarantees worth approximately EUR 1.75 billion guarantees were signed under the old EFSD with the expectation of mobilising investment worth EUR 11 billion.

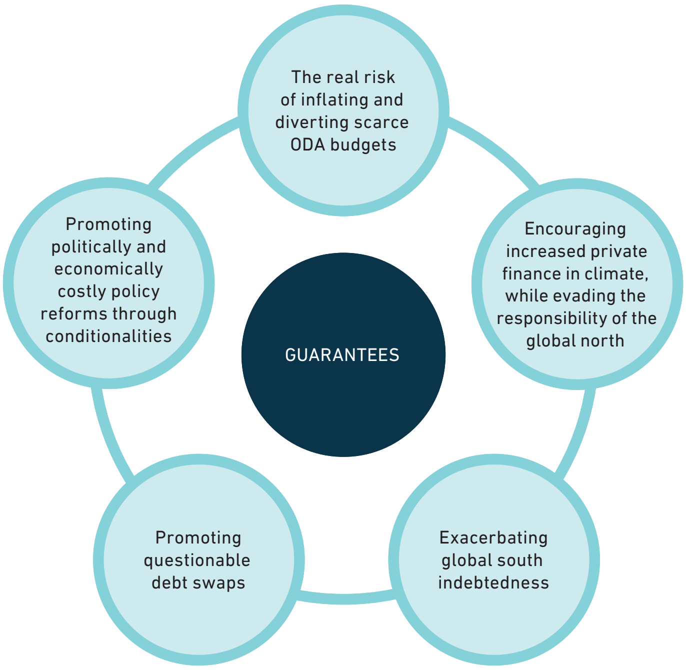
Official Development Assistance (ODA): The 2023 rules on aid reporting allow rich countries to report the grant equivalent of guarantees in their ODA statistics. The adoption of these rules follows the rise of initiatives aimed at using aid to leverage private finance. Sweden's development agency, Sida, is one of the earliest providers of credit guarantees on the back of their aid budget. Sida's guarantees have been increasing from under $400 million in 2012 to $1.4 billion in 2022. Following this model, in 2021 the Danish government approved a four-year pilot phase to develop a guarantee facility in close cooperation with Sida and the Swedish National Debt Office. In 2023, Norway announced a new guarantee scheme worth NOK 5 billion (€430 million), for investments in green infrastructure projects in the global south.

In future, in conjunction with major developments such as the MDB reform agenda, the rise of guarantees in development and climate will likely accelerate, as yet another approach to de-risking private investment. However, the success of such guarantees has been mixed both in terms of the ability to kickstart private investment and in terms of realising the social outcomes which justify their use.

Opportunities and risks

This report recognises that if designed and deployed appropriately, guarantees can be a major opportunity for mobilising both public and private finance. They can help lower the interest rate on debt and reduce the cost of capital for socially desirable projects that are expected to yield less profits than other competing opportunities.

However, when focusing on the future trajectory of guarantees, it is important to consider also the five main risks that they might pose. This report identifies the following risks:



This report concludes that to understand the evolving role of guarantees, it is essential to go beyond a technocratic rationale and an analysis focused on the amount of money mobilised. It is necessary to also contextualise the necessity to issue them and assess their long-term impact on development and climate policy. While guarantees may play a major role in catalysing or accelerating private investment around the world in the future, questions around the precise role, nature and relevance of guarantees for sovereign global south states and the socio-economic structural transformation of those countries, must first be answered.

1. Introduction

A guarantee is a legally binding agreement under which a guarantor agrees to pay part or the entire amount due on a loan, equity or other instrument in the event of non-payment, or a loss of value in the case of an investment. Guarantees have become increasingly popular in recent decades, both in development finance and in climate action.

The underlying rationale for using guarantees is that they will attract more private finance into development and climate action. This transfers the risk from a party that is unable to bear that risk (usually a private investor) to another that is able to support the risk (such as a public sector entity). Guarantees are therefore a financing instrument promoted to attract private investors in projects such as capital-intensive energy infrastructure, which otherwise would not have received investment.

Guarantees have the advantage that, unlike equity investments or direct lending, they may never be triggered. The resources backing them may only be 'called in' if the payments due to financial investors cannot be met by the revenue generated by a supported project. Since that is not expected to be the norm, many see guarantees as an alternative to borrowing – a win-win option that does not require resources to be delivered up-front and can unlock development and climate action projects.

However, guarantees must be treated with caution, especially in cases when guarantees are called upon and it is not clear who bears the ultimate cost. Furthermore, the rise of guarantees poses a critical question: In a world potentially awash with guarantees, what are the implications for aid budgets, socioeconomic development and the climate justice agenda, which are so critical for the Global South?

Why this report now?

Historically, guarantees were used to support private investment in sectors crucial for development. Today, their use in international development and climate action looks set to play a more central role. In the field of Official Development Assistance (ODA or aid), for example, this can be seen in the new rules for what rich countries can report as aid. As part of the so-called 'ODA modernisation process' adopted in late 2023, rich countries can report the grant equivalent of guarantees. In climate finance discussions, the use of guarantees is also on the rise as they are promoted as a way of increasing private finance for climate purposes. An agreement on the New Collective Quantified Goal (NCQG) on climate finance might lead to an increased focus on private finance as a way of meeting climate finance needs.[2]

Additionally, the World Bank Group (WBG)'s Evolution Roadmap, which is currently being implemented,[3] was explicit in emphasising the role of guarantees for mobilising private finance for development and climate action.[4] As part of this, the World Bank's Multilateral Investment Guarantee Agency (MIGA), the arm of the World Bank that offers political risk insurance and credit enhancement guarantees, plans to increase its guarantees from US$6.5 billion annually to at least US$20 billion per year by 2030.

Guarantees also featured in different versions of the Bridgetown Initiative – a political agenda for reform of the global financial architecture proposed by the Prime Minister of Barbados, Mia Mottley, ahead of COP27 in 2022. Bridgetown 3.0, published in 2024,[5] refers to the MIGA Platform as a positive development, and includes a proposal for the International Monetary Fund (IMF) and multilateral development banks (MDBs) to offer US$100 billion a year in currency risk guarantees.

About this report

This is the first comprehensive civil society analysis on guarantees. It builds on Eurodad's existing research on the role of financial instruments in development and climate finance, such as blended finance, public-private partnerships (PPPs) and the growing role of private sector instruments and their manifestations at the European and global levels. It provides an overview of the guarantees landscape with a view to raising awareness of the potential impact of an increased issuance of guarantees for development and climate action. In addition, it explores the aggregate levels, sectoral and geographical focus of guarantees, and provides a mapping of the providers of guarantees. This includes a brief introduction to three guarantee-issuing organisations: the World Bank Group's MIGA; the European Union (EU)'s European Fund for Sustainable Development Plus (EFSD+); and the Swedish International Development Cooperation Agency (Sida).

The report is based on a combination of primary and secondary research tools, including interviews with key stakeholders, policy makers and researchers (see Acknowledgements) as well as a desk review.

A key contribution of this report, from a public interest perspective, is to make the case that guarantees in international development and climate finance should not simply be analysed in relation to the amount of private finance being mobilised, but they should also be seen through the lens of the concrete evidence of development and financial additionality. Unlike commercial finance, guarantees in international development and climate finance are issued with the aim of delivering on developmental impact and the much-needed finance to support the fight against climate change. Guarantees provided by development institutions use public resources, and should therefore not be used to subsidise commercially viable investments to increase their profit-making nature.

The report is organised into five sections following this introduction:

- Chapter 2 presents the recent rise and drivers of guarantees in development and climate action.
- Chapter 3 provides an overview of the guarantee landscape focusing on stakeholders, typologies, aggregate financing trends and key areas of focus, such as aid, debt-for-nature swaps and climate.
- Chapter 4 covers three examples of guarantee-issuing organisations and the embedded concept of development additionality.
- Chapter 5 describes the opportunities and risks of guarantees in development and climate action, and Chapter 6 concludes with reflections for the way forward.

2. The rise of guarantees in the field of development and climate action

Guarantees have grown in importance with the transformation of Multilateral Development Banks (MDBs) from providers of concessional finance to institutions that mostly aim to mobilise private finance. The World Bank Group (WBG)'s former 'cascade approach' to increase the flow of private finance into international development illustrates this. More generally, the rise of guarantees is also connected with the increased use of aid at the regional and bilateral level to catalyse private finance for development. The global challenge of delivering on climate finance has further accelerated this trend.

The expansion of guarantees provided by the WBG's Multilateral Investment Guarantee Agency (MIGA) has taken place in the context of this changing role of MDBs. This is further exemplified by the Bank's Evolution Roadmap, launched in 2023.[6] The Roadmap responds to pressure from stakeholders to reform its mandate, to serve rising challenges including climate change, without costing them too much.

The emphasis on guarantees was also included in the G20 Independent Expert Group report on Strengthening Multilateral Development Banks,[7] which called for an expanded use of guarantees to mitigate different type of political, commercial and currency risks and catalyse private finance.[8] To achieve this, the WBG needs to enhance its capital base and create new financial tools to serve its expanded mandate.

Following on from this, in July 2023, WBG President Ajay Banga established the Private Sector Investment Lab (PSIL) to attract more private sector investments.[9] PSIL's 15 CEO members are heads of some of the world's largest private asset managers and commercial banks with diverse portfolios.[10] The PSIL identifies barriers to private sector investment in emerging markets as well as offering guidance on the nature of investment including the role of financial tools such as guarantees in investment.

Implementing one of the recommendations of the PSIL, in February 2024 President Banga announced the goal of tripling MIGA's size, increasing annual guarantee issuance to US$20 billion by 2030.[11] As part of this, on 1 July 2024, the WBG launched a new 'one-stop guarantee platform'.[12] Housed at the MIGA, this platform brings together products and experts from the World Bank, International Finance Corporation (IFC) and MIGA – which, according to the WBG – works "for simplicity, efficiency, and speed". This is explored further in section 4.1.

An expanded use of guarantees is also present in the EU's developmental mandate, currently delivered through the European Fund for Sustainable Development Plus (EFSD+).[13] Between 2017 and 2021, 16 guarantees worth approximately €1.75 billion were signed under the old EFSD with the expectation of mobilising investment worth €11 billion. As a financing tool of the EU's new development strategy known as the Global Gateway, EFSD+ guarantees will play a key role in mobilising investment. This is explored further in section 4.2.

Furthermore, guarantees have appeared in the latest version of the Barbados-led Bridgetown Initiative.[14] It proposes the creation of new instruments and the reform of existing institutions to finance climate resilience and the Sustainable Development Goals (SDGs). The initiative also includes a proposal for the International Monetary Fund (IMF) and MDBs to offer US$100 billion a year in currency risk guarantees. These guarantees are intended to drive private sector investment in projects focusing on green energy transitions.

The climate finance landscape following the latest COP29 in November 2024 will also provide another avenue for a concerted push of guarantees on a multilateral level. Just ahead of COP29, the Asian Development Bank (ADB) announced an increase in its climate finance of US$7.2 billion after the United States and Japan agreed to underwrite risk for some existing loans.[15] This example is being reported as a first of its kind sovereign guarantee for climate finance and a potential role model for other development banks.[16]

Guarantees are also playing an important role in the landscape of ODA, especially following the new OECD-Development Assistance Committee (DAC) rules (see section 3.5). For example, Sweden's development agency, Sida, has been using credit guarantees in its ODA model since the early 2000s. However, this has increased in recent years, from under US$400 million in 2012 to US$1.4 billion in 2022[17] (see section 4.3 for more details).

Globally, three factors have played a role in increasing the interest in using guarantees.

The first is the recognition that there is a need for substantially enhanced cross-border flows of capital to low- and middle-income countries (LMICs) to meet the demands of the SDGs and climate financing. This is seen as requiring substantial flows of private finance that have previously been kept away from these markets and projects. The argument was that developing country markets are not profitable because of their poor economic performance, balance of payments imbalances and currency depreciation risks. In short, the structural constraints that define developing countries were considered too high risk for private capital investment and needed a subsidy or derisking.

The rise of guarantees is connected with the increased use of aid at the regional and bilateral level to catalyse private finance for development.

The second is evidence of a policy-driven overshadowing of large volumes of yield-hungry private capital that, it is believed, can be transformed through suitable interventions into capital for social good, especially investments in the provision of global public goods.[18] The policy underlying that overhang were large infusions of liquidity by advanced economy central banks into the banking system starting after the 2008 financial crisis, and significantly enhanced during and after the Covid-19 pandemic.

And third is the intensification of 'aid fatigue' or the shrinking of already inadequate public financial flows from rich countries because of domestic preoccupations, geopolitical tensions and fiscal conservatism. This has led to heightened interest in guarantees as a means of raising 'additional' resources. As mentioned above, there has been an emerging new multilateral consensus emphasising an expanded role for guarantees, manifested in various policy documents and initiatives. The PSI agreement for the reporting of ODA would also increase the role of guarantees in aid, while the current discussions of the New Collective Quantified Goal (NCQG) may also lead to an expansive use of guarantees to catalyse other finance flows. Currently, several institutions – varying from MDBs and global north countries' development agencies to specialised financial institutions and governments – are issuing guarantees to support investments. This is discussed in more detail in the next sections.

3. Mapping guarantees in the development and climate finance architecture

3.1 Who provides guarantees and why?

Guarantees for development and climate are provided by a diverse group of development finance institutions. These institutions focus on addressing a series of risks that can broadly be categorised as political, commercial and currency risks (see Box 1).

Box 1: Types of risks covered by guarantees in development and climate

The types of risks covered by guarantees generally fall under one of three broad categories, although guarantor and insurers can offer tailor-made guarantee coverage.

Political risk is where the investment's returns could suffer as a result of political changes or instability in a country, such as war and terrorism. Instability affecting investment returns could stem from a change in government, legislative bodies, other foreign policymakers or military control. For example, a situation of political instability may lead to expropriation of national assets by the government from private sector companies.

Commercial/credit risk is where the borrower's inability to meet its financial obligations is due to non-performance of the investment or asset. Some examples include: economic risks, tied to the fluctuation of the economic landscape, and operational risks, which include accidents, natural disasters, and other unforeseen events that halt business operations.

Currency risk is commonly defined as exchange-rate risk. It is focused narrowly on the possibility that local currency depreciation makes debt denominated in foreign currency more difficult to service when revenues are denominated in local currency, and equity investments by foreign investors lose value due to currency depreciation or the availability or convertibility of foreign currency risks. For example, when exporting or importing from more than one currency zone, the investors can secure against risk that the zones do not move all together.

Guarantees are not simply driven by the creditworthiness of the borrower but the perceived risk-return combination characterising particular projects. For example, many climate-related projects may be characterised by high social returns but relatively low financial returns for private investors. They may also be considered risky. Guarantees may be deployed to dilute risk and attract finance at rates that can feasibly be borne by such projects.

Table 1: Examples of major guarantee providers in development and climate

MDBs World Bank, ADB, AfDB, IDB, CAF, AIIB	All major multilateral development banks issue guarantees. The World Bank provides guarantees to various development projects through its different organisational arms, including the International Finance Corporation (IFC), International Development Association (IDA), Private Sector Window (PSW) and the Multilateral Investment Guarantee Agency (MIGA). In addition to MIGA, regional development banks such as the Asian Development Bank (ADB), African Development Bank (AfDB), Inter-American Development Bank (IDB), Development Bank of Latin America and the Caribbean (CAF) and the Asian Infrastructure Investment Bank (AIIB) are also enhancing their focus on guarantees. In 2023, the ADB launched a new large-scale climate finance mechanism, the Innovative Finance Facility for Climate in Asia and the Pacific (IF-CAP). IF-CAP is a donor-backed guarantee facility, where public, private and philanthropic financing partners take risk off the ADB's balance sheet by guaranteeing to backstop repayments for a subset of its loans.[19] In 2024, ADB announced an increase to its lending, following sovereign guarantees by the US and Japan to its existing loans.[20]
Regional institutions European Union	The EU provides guarantees through the European Fund for Sustainable Development Plus (EFSD+) and the European Investment Bank (EIB) as well as channelling guarantees through DFIs.
DFIs and global north development Agencies Guarantees and ODA	Bilateral development finance institutions (DFIs) and global north development agencies provide guarantees in different forms. Sida was one of the first development agencies to use credit guarantees (see section 4.3).
Specialised guarantee vehicles	Specialised providers, such as GuarantCo, InfraCredit and the African Guarantee Fund (AGF), combine development impact with financial returns and often funded/supported bilateral and multilateral development-oriented institutions. **GuarantCo** was established in 2006 under the aegis of the Partnership for Infrastructure Development (PIDG), a multi-donor organisation working to mobilise private sector investment in infrastructure in the developing world. PIDG is an infrastructure development and finance organisation funded by seven governments and the IFC.[21] **Africa Guarantee Fund (AGF)** was established in 2011 by the Government of Denmark (represented by DANIDA), the Government of Spain (represented by AECID) and the African Development Bank (AfDB), with a mandate of facilitating access to finance for small- and medium-sized enterprises (SMEs). In 2015 and 2016, the French Development Agency (AFD) and Nordic Development Fund (NDF) became AGF's fourth and fifth shareholders.[22] **InfraCredit** is a private company and was established by GuarantCo and the Nigerian Sovereign Investment Authority. It provides local currency guarantees to enhance the quality of debt instruments issued to finance infrastructure projects in Nigeria.[23]

As Table 1 shows, the providers of guarantees for development and climate actions come in four different categories. They can be either multilateral, regional, bilateral or specialised entities supported by bilateral and multilateral development-oriented institutions.

3.2 Typology of guarantees in development and climate finance

Guarantees can be of different types and defined differently by guarantee-issuing institutions. As Table 2 (overleaf) shows, guarantees can be classified based on:

(a) their coverage, resulting in whether they are partial or full

(b) the nature of the exposure they result in (guarantees can be either funded or non-funded)

(c) the objectives they are intended to serve.

Table 2: Typology of guarantees

i) Typology by extent	*Partial guarantees* These are guarantees set to cover part of a default on interest or principal payments on a debt, with cover being restricted to either first loss, or losses beyond some specified level. First loss is a type of guarantee in which the guarantee provider agrees to bear losses incurred up to an agreed percentage in the event of default by the borrower. In the case of equity, a guarantee may specify that a part of any shortfall in dividend payments relative to a guaranteed minimum is covered. *Full guarantees* Full guarantees promise to make good any shortfall in payments on a liability specified in a debt contract and/or terms of equity sale.
ii) Exposure-based typology	*Funded guarantees* A funded guarantee is when the resources to cover the guarantee are set aside and held in relatively liquid form to be released if called upon because of a default. *Non-funded guarantees* A non-funded guarantee is one in which the resources have not been pre-committed and the value of which appears as a contingent liability in the books of the guarantor. There are some common instruments that are in the nature of non-funded guarantees, such as letters of credit backing trade transactions or bank guarantees against payments liabilities.
iii) Objective-based typology	Guarantees provide a combination of overlapping goals, which can be categorised for ease of understanding. *Guarantees to increase borrower access, improve debt terms and leverage private capital* Guarantees are often used to realise an objective that goes beyond the fee that accrues to the provider. A typical example is the use of guarantees to reduce the cost of credit and/or ease the access of a borrower to credit markets. A first loss guarantee incentivises lenders to accommodate more 'risky' borrowers, since they are protected from loss due to default up to some threshold that may be the maximum expected extent of default. An example is a credit enhancement guarantee, which is a third-party agreement to fulfil a borrower's debt obligations to a lender. Credit enhancements are risk mitigation mechanisms that help borrowers take on debt by reassuring lenders that they will honour their obligations. Guarantees are also not simply driven by the creditworthiness of the borrower but the perceived risk-return combination characterising particular projects. For example, many climate-related projects may be characterised by high social returns but relatively low financial returns for private investors. They may also be considered risky. Guarantees may be deployed to dilute risk and attract finance at rates that can feasibly be borne by such projects. The primary aim here is to leverage guarantees to mobilise private finance in areas where 'available' public finance is considered insufficient. *Guarantees aimed at ensuring policy change* While all guarantees may have an element of embedded conditionality, the World Bank's Policy-Based Guarantees (PBGs) are explicitly focused on conditioning for finance. PBGs cover private lenders against the risk of debt service default by the sovereign government. While structurally similar to Partial Credit Guarantees (PCGs) used in project financing instruments, PBGs facilitate balance of payments and general budget support.[24] PBGs were expressly designed to leverage the World Bank's resources to attract more private financing to "countries with a strong track record of performance, a satisfactory structural and macroeconomic framework, and a coherent strategy for gaining access to international financial markets".[25]

3.3 Aggregate financing trends: How much private finance do guarantees mobilise?

Guarantees have been used as a financing instrument for attracting private investment into development-oriented projects since the 1990s, mainly led by MDBs such as the World Bank, as well as regional banks such as the ADB and AfDB. Updated data on guarantees is limited to figures reported by the Organisation for Economic Co-operation and Development (OECD) for 2020 (Figure 2).

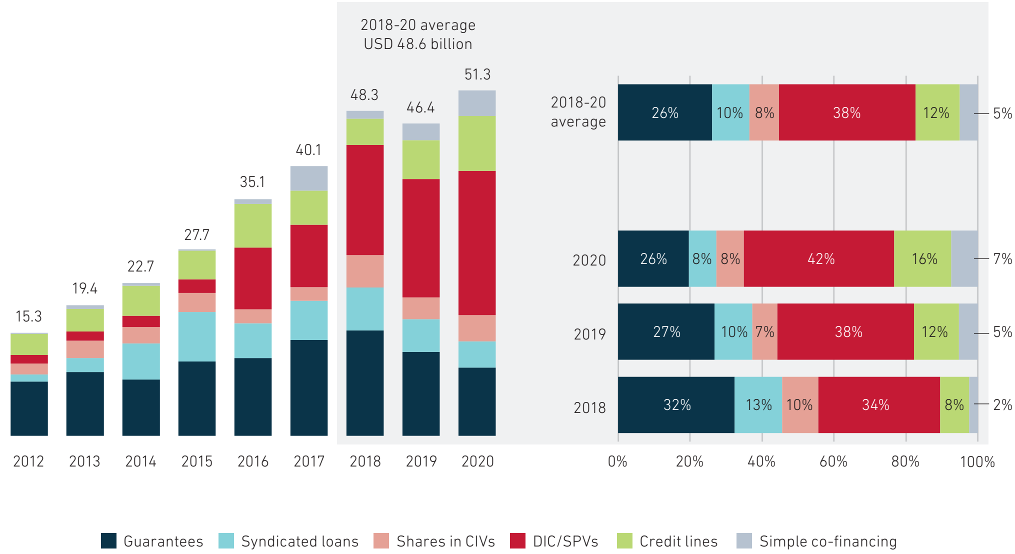
OECD estimates show that the uptake of guarantees was limited until 2017. But, by 2018, guarantees, special purpose vehicles (SPVs) – i.e. separate legal entity created for a specific objective, often to isolate financial risk – and direct investment in companies were the highest financing instruments of mobilised private finance. In 2019, this trend shifted in favour of direct financing.

OECD estimates show that in 2020, the total amount of private finance mobilised was US$51.3 billion, with guarantees accounting for 20 per cent of this amount, following direct investment in companies and project finance (42 per cent). This was followed by credit lines (16 per cent), syndicated loans (8 per cent), shares in a Collective Investment Vehicle (CIV), i.e. a form of investment fund that enables a number of investors to pool their assets and invest in a professionally managed portfolio of investments often gilts, bonds and quoted equities (8 per cent), and simple co-financing (5 per cent).

On average, as a share of total mobilised private finance, guarantees underwent a decline from 32 per cent in 2018 to 26 per cent in 2020. This decline was aligned with the global economic depression with the onset of the Covid-19 pandemic (see Figure 1).

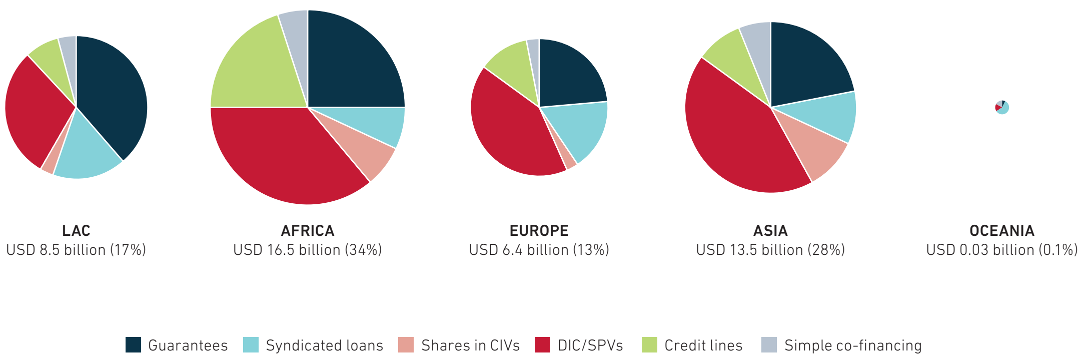
While these statistics are based on OECD reporting, section 3.4 raises some questions about mobilising ratios, which are important when considering the precision of reporting mobilised finance.

Figure 1: Mobilised private finance by leveraging mechanism, US$ billion



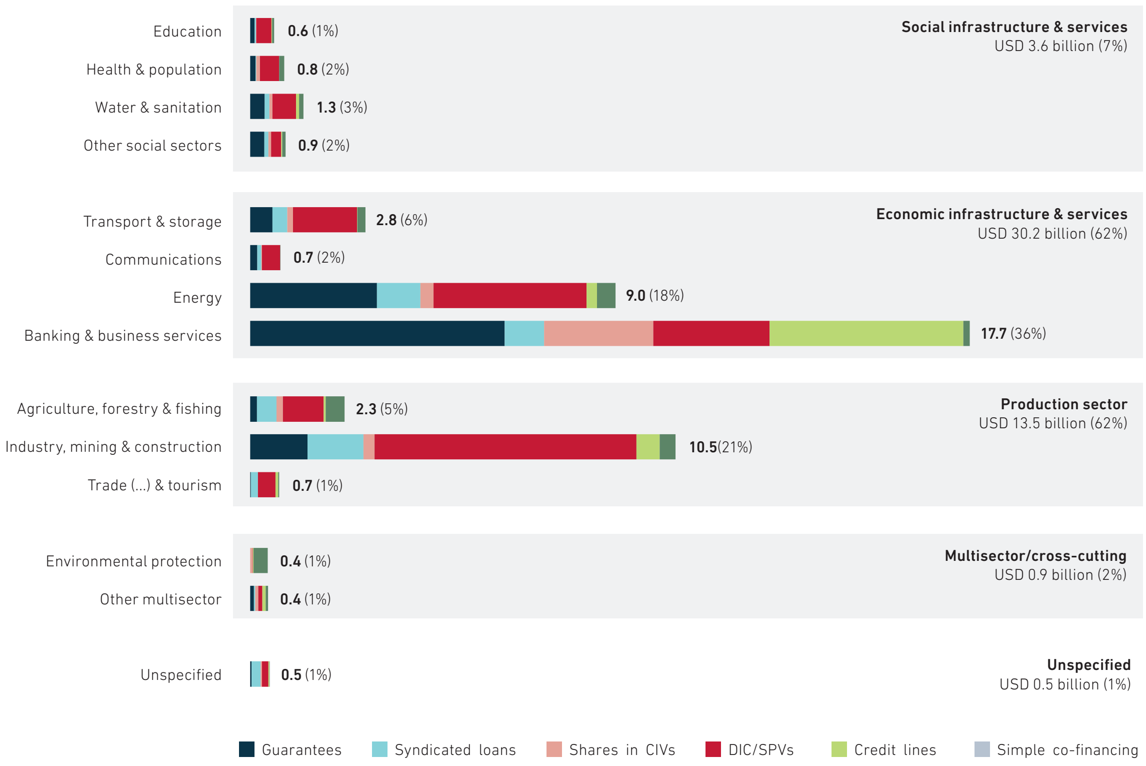
Note: DIC/SPV stands for direct investment in companies and project finance special purpose vehicles (SPVs).
Source: OECD 2023[26]

Figure 2: Average geographic distribution of mobilised private finance, 2018-20, US$ billion



Source: OECD 2023[28]

Figure 3: Mobilised private finance by sector, 2018-20 average, US$ billion



Source: OECD 2023[29]

A breakdown of guarantees by organisation shows the dominance of guarantees issued by MDBs. According to a report by the Centre for Strategic and International Studies (2019):

> "In 2018, guarantees constituted 8 per cent of EBRD commitments, almost 4 percent of IFC commitments, and 2.9 percent of IBRD commitments. Moreover, only 13 of the 30 members of the OECD's Development Assistance Committee structure guarantees for international development. Official Development Assistance (ODA) still exceeds the amount of private capital mobilized by guarantees."[27]

The OECD's geographical breakdown shows that, in 2018-20, the largest share of mobilised private finance was in Africa. Within this share, guarantees mobilised the highest amounts in Eastern Africa (US$1.2 billion) and Western Africa (US$1.1 billion) (see Figure 2). This trend was followed by Asia – with guarantees mobilising between 20-30 per cent in each of the Asian sub-regions). In Latin America and the Caribbean, guarantees mobilised around 38 per cent of the total mobilised private finance.

In terms of sectoral distribution, guarantees as a share of mobilised private finance were dominant in the financial industry sector (banking and business services), energy, industry, mining and construction as well as transport and storage sectors (see Figure 3). Overall, social infrastructure and service sectors such as education and health took a back seat in comparison to guarantees for economic infrastructure.

3.4 What 'additionality' do guarantees bring?

The value of guarantees in leveraging finance into development and climate-related projects is based on the concept of 'additionality'. While the concept does not have an internationally agreed definition, it can be loosely conceptualised as the likelihood that the effects observed (either financial or development) would not have emerged in the absence of the intervention, in this case the issuance of the guarantee.

A cursory overview of guarantees issued by MDBs and DFIs shows that there is a lack of agreement on operational definitions of the types and dimensions of financial and development additionality of guarantees. This is not particular to the instrument of guarantees but a shared problem with other so-called tools of innovative finance including blended finance. To fully comprehend the discussion of additionality in guarantees, the following discussion focuses on the meaning and evidence of financial and development additionality of guarantees.

Financial additionality

The OECD defines financial additionality of guarantees as follows:

> "a transaction is financially additional if it is extended to an entity which cannot obtain finance from the private capital markets (local or international) with similar terms or quantities and for similar developmental purposes without official support, or if it mobilises investment from the private sector that would not have otherwise invested."[30]

Determining the financial additionality of guarantees is challenging because it requires understanding the counterfactual – essentially, estimating what would have happened in the absence of the guarantees – which is inherently difficult to ascertain. The private sector may invest in highly risky situations if there are expectations of high profitability, making it challenging to measure whether a development or climate guarantee was truly essential for mobilising that capital. As a detailed analysis by the ODI shows, mobilising ratios and scale of private finance mobilised by different DFIs varies hugely and is subject to different factors.[31] For example, financial intermediaries that are a part of most mobilising efforts have different reporting rating standards. Moreover, the banks of recipient countries that benefit from guarantees also use different systems of risk rating. They also have different disclosure rules – making it difficult to provide a comprehensive account of how much capital was mobilised through guarantees.[32]

The quantification of guarantees to affirm that x number of guarantees have mobilised x amount of capital should therefore be analysed with this background in mind. As noted by the transparency focused organisation Publish What You Pay:

> "The reliance on additionality is problematic for stakeholders who query the additionality of some DFI investments as it arguably includes activities that are not mobilising."[33]

Development additionality

The development additionality of guarantees is a much more complicated concept and it lacks a comprehensive definition. Additional finance mobilised by guarantees may be developmental if it gives way to a series of context-based development outcomes – such as catalysing knowledge and expertise, promoting social or environmental standards or fostering good corporate governance, which would not have occurred without the partnership between the official and the private sector. The development impact mandate of MIGA guarantees, discussed further in section 4.1, corresponds to the concept of development additionality.

In short, it is a step further than the mobilisation of finance, and is at the heart of how development cooperation can be beneficial for socio-economic growth and poverty reduction. An OECD review of various academic and policy studies on the development impact of guarantees shows mixed results based on different contexts.[34] While the literature shows that guarantees can have a positive impact on development additionality in certain contexts, there is a need for a harmonised reporting approach as well as more evidence on the long-term impact of guarantees.

3.5 Key areas in which guarantees are provided

A breakdown of guarantees according to different areas of emphasis such as climate finance, ODA and debt swaps shows that their issuance is diverse, expanding and is part of the transforming landscape of international development.

a) Climate finance

MDBs like the World Bank and bilateral development agencies, such as the Norwegian Agency for Development Cooperation (Norad) and Sweden's Sida already offer – or are in the process of developing and implementing – the use of guarantees to boost climate finance. Their contribution to climate finance stems from the legal obligation of developed countries towards using financial resources as a way of mitigating against climate change (see Box 2).

Box 2: The New Collective Quantified Goal (NCQG) on climate finance and implications for the use of guarantees

The United Nations (UN) Framework Convention on Climate Change (UNFCCC), which came into force on 21 March 1994, is a convention that prevents "dangerous" human interference with the climate system. It has a near-universal membership of 198 countries that are party to the convention. In 2015, at COP21, the UN delivered a universal, legally binding climate change deal called the Paris Agreement.[35] Article 9 of this agreement affirms that "developed country parties shall provide financial resources to assist developing country parties with respect to both mitigation and adaption". The agreement also declared that a new collective quantified goal (NCQG) on climate finance shall be set prior to 2024, from a floor of US$100 billion per year, accounting for the needs and priorities of developing countries.[36] The NCQG was the focus of negotiations at the COP29 in Azerbaijan.[37]

A consensus on the amount of NCQG is subject to technical and political considerations. While the US$100 billion was an arbitrary number proposed by the leadership of global north countries,[38] assessments on investment needs by developing countries are significantly higher and very varied, especially as climate conditions deteriorate. The Independent High-Level Expert Group on Climate Finance has identified the goal of US$2.4 trillion annually by 2030. On the other hand, developing countries themselves are not in agreement when it comes to the exact amount. Pakistan has proposed the highest figure of a minimum of US$2 trillion,[39] while the Arab and African groups have estimated US$1-1.3 trillion a year.[40]

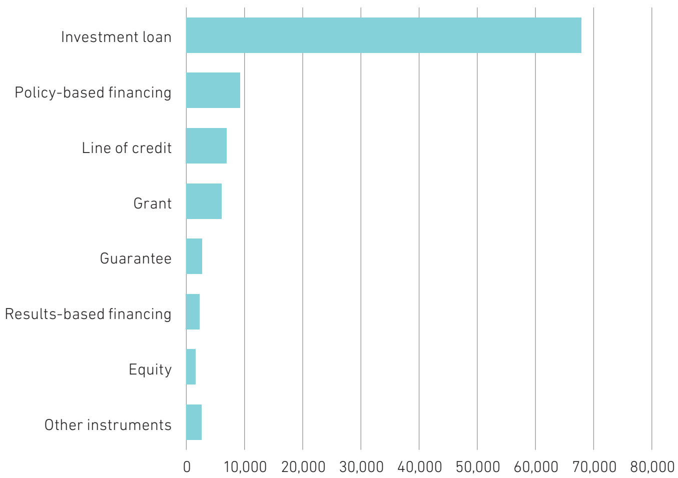
As evident in the Paris Agreement's principles of equity, the polluter pays principle, and common but differentiated responsibilities and respective capabilities (CBDR-RC) as well as Article 9 of the agreement, the burden of financing climate action in developing countries is firmly on developed countries. However, in negotiations, developed countries are keen to introduce provisions that move away from these commitments by asserting that additional countries (such as India, China and Gulf countries) can contribute towards meeting the global goal. However, developing countries oppose this, citing the binding convention signed by developed countries and highlighting that it disregards the historic responsibility of developed nations, whose actions have been the primary drivers of global climate change.

As noted by the UN Trade and Development, private finance mobilisation in relation to the US$100 billion goal has fallen short of expectations, with a 60-percentage point gap in 2020 compared to the 2016 Roadmap to US$100 billion.[41] Moreover, the OECD's latest figures also show that private financing for climate has been stagnant at about US$14 billion per year from 2013 to 2020.[42]

The emphasis on climate insurance at COP29 – with the launch of the first-ever global guide on transition plans for insurance companies, published by the UN-convened Forum for Insurance Transition to Net Zero (FIT) – is also an important development in relation to guarantees and private finance.[43] The FIT has published its inaugural report 'Closing the Gap: The emerging global agenda of transition plans and the need for insurance-specific guidance'.[44] This report centres the role of the insurance industry as risk managers, risk carriers and investors in supporting a just transition to a resilient net-zero economy. In short, there is enough evidence to suggest that guarantees would likely become integrated with the NCQG narrative, especially led by global north countries and investors.

While the modalities and nature of guarantees provided by MDBs and DFIs vary in context according to specific guarantors, evidence on the greater mobilisation of private finance for climate action remains limited. Moreover, as Figure 4 shows, guarantees are still a small proportion of the climate finance flows from MDBs, amounting to less than 3 per cent of the total in 2022.

Figure 4: Climate finance flow of the MDBs worldwide in 2022 by instruments (US$ millions)



Source: IDRB, ADB, EBRD, EIB, World Bank – Statista 2024.

Notably, the year 2024 marked the first year of MIGA implementing its commitment to align 85 per cent of its operations with the goals of the Paris Agreement. By 1 July 2025, MIGA aims to align 100 per cent of its guarantees to Paris Agreement goals.[45] According to MIGA's Annual Report for 2024, it issued US$8.2 billion in new guarantees across 40 projects – of these, 30 projects were focused on climate finance, representing 75 per cent of the total projects.[46] The climate finance component of the guarantees in FY24 totalled US$2.5 billion, representing 38 per cent of total guaranteed investment supported.[47] However, as civil society has documented, it is difficult to verify these figures due to a lack of data disclosure by MIGA.[48]

While guarantees for climate-focused renewable energy projects are set to become more central to the operations of financial institutions, there is variation between providers. A recent study by Climate Policy Initiative has also shown that there is a long way to go when it comes to using the full potential for guarantees as a means of mobilising climate finance.[49]

b) Debt-for-nature swaps

Guarantees are set to play an important role as a source for credit enhancement in debt swaps. A debt swap is a financial instrument that provides conditional debt reduction in exchange for the debtor agreeing to invest the freed-up resources (usually in local currency) in specific areas, such as education, health, climate or the environment.[50]

While debt swaps are not new, the latest iterations of debt for nature swaps have been gaining popularity in recent years, linked to climate change-related debt restructuring concerns. In addition to their original focus in Small Island Countries, debt swaps will likely rise across countries.[51] Their popularity is also visible in the emphasis on their role on the multilateral development finance landscape. For example, MIGA's new guarantee platform will also focus on guarantees for debt-for-nature swaps in conjunction with an emphasis on other innovative financing instruments such as carbon-credits and off-grid energy solutions.[52]

In the case of the latest debt-for-nature swaps, the debt conversion structure is as follows: a debtor sovereign buys back its debt from the secondary market at a discount. To finance that buyback, a new bond, guaranteed by an MDB or DFI, is issued by a Special Purpose Vehicle (SPV), which then issues a loan to the debtor country. The credit enhancement resulting from the guarantee from a highly rated entity, or the improved credit rating of the offer, not only helps to attract buyers to the new bond, but may improve the terms for the borrower issuing the bond. In return for the guarantee, and keeping in mind the benefits of the reduction in the volume of debt, the debtor agrees to use part or all of the savings in domestic currency for environmental or climate-related spending with clearly specified outcomes or goals.[53]

Two examples of recent debt swaps are illustrative of the main dynamics at play. In July 2024, the Inter-American Development Bank (IDB) and the European Investment Bank (EIB) approved guarantees totalling US$300 million for a debt-for-climate operation in Barbados. The operation, including the South Coast Water Reclamation Project, is focused on increasing the island's water security and also includes a sewage treatment plant. According to the EIB's website, the guarantee programme will support Barbados to develop policies for strengthening government capacity and implementing new climate investments.[54] The IDB had already guaranteed a debt-for-nature swap in Barbados in 2022.

In 2023, the IDB also issued a debt-for-nature swap in Ecuador, in partnership with the US Development Finance Corporation (DFC). The debt swap was designed to allocate resources for long-term marine conservation in the Galápagos Islands. The operation in Ecuador was estimated to generate savings to finance conservation activities worth US$323 million and these resources were used to create the Galápagos Life Fund.[55] The fund was designed to finance the Galápagos Marine Reserve and the *Reserva Marina Hermandad*, an area of conservation created in the Galápagos area in 2022 for around 18.5 years. However, in 2024, the Independent Consultation and Investigation Mechanism (MICI) of the IDB filed a complaint against the Galápagos Life Fund, in response to demands from local communities. The complaints focused on the lack of access to information or transparency and inadequate governance in the management of funds in the debt swap process.[56]

While in these examples of credit enhancement effectively reduced the cost of borrowing, the participation of public institutions guaranteeing the new bond issuance did not provide any oversight of the operation or assurance of compliance with transparency, accountability and other due diligence criteria.

c) Official Development Assistance (ODA)

As mentioned above, guarantees have been a prominent instrument in the way in which Sweden channels its development aid (see section 4.3 for more details). Under this model, a part of a guarantee fee can be subsidised by Sida grants, when necessary.[57] However, the role of guarantees is set to become even more significant for ODA linked to the new OECD-Development Assistance Committee (DAC) rules as well as adoption of guarantees by other donors (see Box 3).

Box 3: The new rules governing ODA – an incentive to expand the use of guarantees?

In 2023, the OECD-DAC Working Party on Development Finance Statistics (WP STAT), the main body responsible for the quality and integrity of ODA statistics, reached an agreement on rules for reporting Private Sector Instruments (PSI) as ODA. The agreement was reached through an iterative process whereby different batches of issues were agreed at various points over the 2023 calendar year, reaching a final agreement in October 2023.

The rules cut across a range of different types of instruments, including guarantees, and seek to quantify 'donor effort' and report this as ODA. In general, and for all different types of PSI, the rules were agreed with a view to:

a. establishing the ODA eligibility of PSI

b. establishing the grant equivalent basis of the different types of PSI

c. establishing the additionality of PSI.

In the past, official support for guarantees would not have passed the 'concessional in character' test – a pre-requisite of ODA eligibility. Now the new rules replace the 'concessional in character' requirement with a much less straightforward, and *open to interpretation*, concept of additionality.[58] The specific methodology related to reporting guarantees as ODA can be found in the agreements' Batch 1 Topics, which cover loans to the private sector and credit guarantees.[59]

In essence, there are three parts of a guarantee scheme that could eventually be considered to be eligible as ODA:

1. the service fee, which essentially covers the administrative costs of issuing the guarantee
2. an implied cost related to credit risk associated with the guarantee, calculated using a discount rate on the guaranteed amount
3. the actual guaranteed amount paid in case of a default.

The most controversial of these three components is the implied cost of the credit risk being quantified as ODA. This is calculated using a complicated formula that uses a variable discount rate on the guaranteed amount to generate a grant-equivalent figure reportable as ODA. This methodology, especially in the case of guarantees, will very likely result in rich countries increasing their ODA volumes without ever transferring any resources anywhere, let alone to countries in the global south.

Eurodad has warned in the past that the PSI rules risk inflating ODA volumes.[60] The new possibilities they open to report guarantees in this way appear, at least in principle, to cement this risk. What is more, rich countries will now enjoy greater incentives to deploy their aid resources in this manner. For them it is essentially a win-win situation, where they can get closer to meeting their ODA volume targets without having to dip into their national budgets.

Following Sida's model, in 2021 the Danish government also approved a four-year pilot phase to develop a guarantee facility in close cooperation with Sida and the Swedish National Debt Office. The pilot phase is led by the Danish development finance institution, the Investment Fund for Developing Countries (IFU) and the facility called the IFU Guarantee Facility, which was initially allocated DKK 2 billion (€268 million).[61] According to the Ministry of Foreign Affairs of Denmark, a total of DKK 50 million (€6.7 million) has been allocated for the IFU Guarantee facility for the year 2024.[62] While the pilot phase ends in 2025, the permanence of this model in Danish ODA may likely increase given Denmark's ambition to increase and strengthen its aid model.[63]

In 2023, Norway launched a new guarantee instrument to mobilise private capital for investments in renewable energy in low- and middle-income countries. The instrument will be managed by Norad, the Norwegian agency for development cooperation. The total framework for the guarantee instrument is NOK 5 billion (€430 million). Norfund, the Norwegian Investment Fund for Developing Countries (or the Norwegian DFI), will advise Norad in this work. Norwegian civil society has raised concerns that the provision for losses in the guarantee system will come from the Norwegian aid budget in 2024 and 2025.[64] This is aligned with the DAC's broader trend of counting PSIs as aid. As detailed by Eurodad, this contributes to an erosion of aid. A detailed evaluation of reporting of guarantees as ODA by rich countries under the PSI as well as Norway's changing ODA model is yet to be determined.

The PSI rules risk inflating ODA volumes ... What is more, rich countries will now enjoy greater incentives to deploy their aid resources [through PSI]

4. Overview of key guarantee issuing institutions

Three major institutions with common goals of poverty alleviation and socioeconomic development, namely, the World Bank's MIGA, EU's EFSD+ and the Sida make use of guarantees to mobilise finance for development and climate-related projects taking place in the global south. While the mandates of these institutions vary, their use of guarantees is based on the concept of financial and development additionality. The following discussion provides a brief introduction to how these institutions make use of guarantees accompanied by a summary of how development additionality in guarantees has been evaluated.

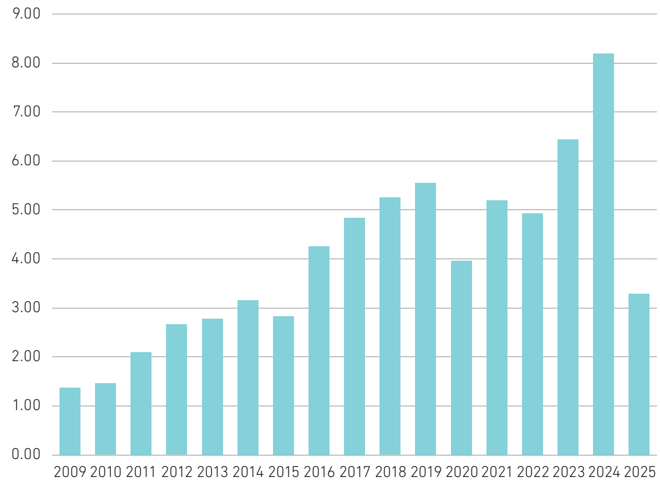
4.1 World Bank's Multilateral Investment Guarantee Agency (MIGA)

The World Bank's MIGA is one of the largest and most important issuers of guarantees in development and climate. Established in 1988, it was created to complement public and private sources of investment insurance against non-commercial risks in developing countries. MIGA's role is set to be even more central to the development finance landscape with the launch of a new 'one-stop guarantee platform', which, as discussed above, was announced in July 2024. The platform housed at MIGA will combine products and experts from the World Bank's International Finance Corporation (IFC). Bringing together the World Bank Group's existing guarantees in a coordinated ecosystem under MIGA, the platform is expected to prioritise 'blended' public-private finance for the energy transition.

MIGA offers three areas of coverage: credit guarantees for loans to the public or private sector; trade finance guarantees for trade finance projects involving public entities; and political risk insurance for private sector projects or public-private partnerships. The goal of the platform is to triple the volume of MIGA's guarantees from US$6.5 billion to at least $20 billion per year by 2030. In light of these changes, it is important to contextualise the existing issuance of MIGA's guarantees with a view to analysing the role of guarantees in mobilising finance.

MIGA's gross guarantee exposure rose over the 1990s from a negligible sum to US$4.4 billion in 2000, then lost momentum until 2008. However, following the financial crisis, issuance spiked to US$3.16 billion in 2014, and then even more sharply to US$6.45 billion in 2023 and escalated to US$8.20 billion in 2024 (see Figure 5). However, despite the recent rise, allocations for guarantees have been a small proportion of multilateral development financing. As the Institute for Energy Economics and Financial Analysis (IEEFA) notes, "guarantees account for only about 2 per cent of total business across the longest-established institutions."[65] Moreover, even with guarantees, private investment is often not attracted to low-income or even lower-middle income countries, leading to a disproportionate concentration of guarantees being used in less risky upper-middle income economies.[66] Another reason is that guarantee providers appear to prioritise supporting loans to borrowers with a low probability of default, and thus a lower likelihood of the guarantee being invoked. Not surprisingly, the loss rate on guarantees provided by the International Bank for Reconstruction and Development (IBRD) between 1993 and 2018 stood at a low 1.96 per cent and on the United States Agency for International Development (USAID)-DCA guarantees at an even lower 0.17 per cent.

Figure 5: MIGA's issued guarantees by fiscal year 2009-2024 (US$ billion)



Source: Authors' compilation from MIGA Annual Reports, various years.

Evaluation of MIGA performance

MIGA's issuance of guarantees should be considered in the context of the decline in private flows to low- and middle-income countries since the 2008 financial crisis. Private capital flows to low- and middle-income countries (excluding China) declined from a peak of 8.8 per cent of their GDP in 2007, falling to 3.2 per cent in 2022. In 2022, flows by category were as follows: bank lending (US$391 billion); foreign direct investment (FDI) (US$364 billion); portfolio equity flows (negative US$19 billion) and portfolio debt flows (negative US$72 billion). That adds up to a total net inflow of US$664 billion in that year. Compared with that, MIGA's annual report for the financial year 2022-23[67] claims to have leveraged US$8.6 billion in total financing from private and public sources through guarantees to cross-border private investors in developing countries.[68] Global ODA reached record levels in 2022: US$287 billion at constant 2021 prices.[69] However, despite recent increases in the volume of guarantees offered by MIGA, its role in driving private capital flows to developing countries has been minimal.

However, capital mobilisation on its own is not the goal of MIGA guarantees. MIGA's self-declared prime mandate "is to drive foreign direct investment to developing countries by providing guarantees to investors and lenders while supporting projects that reduce poverty and promote climate change mitigation". MIGA defines development impact as "the long-term, sustained effect of our interventions on people's lives. In the context of the new WBG vision and mission, this means ending extreme poverty and boosting shared prosperity on a liveable planet".[70]

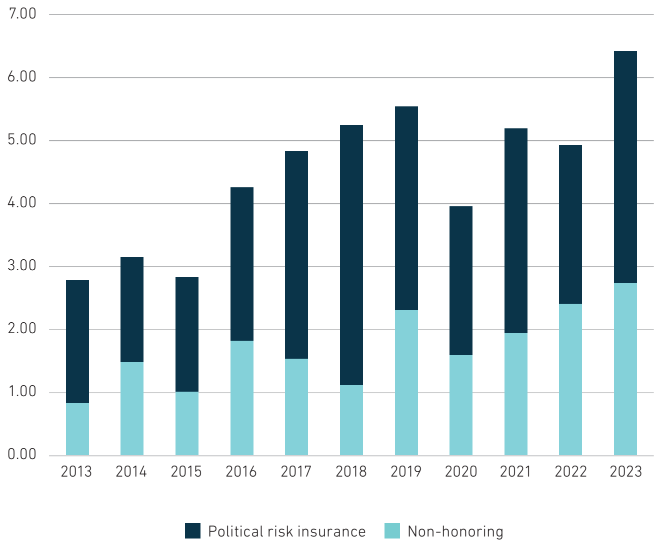
Academic studies of MIGA guarantees have highlighted the problem of conducting counterfactual analysis of guarantees.[71] In other words, financial additionality of guarantees cannot be adequately determined in cases where finance would have been mobilised anyway. To assess the developmental impact of its guarantee, MIGA developed the 'Measurement and Project Assessment Comparison Tool' (IMPACT) framework. This is an ex-ante development outcome assessment tool, which is based on a project's developmental impact. While the World Bank website states that IMPACT was implemented in 2018 and that it is fully integrated into MIGA's operations,[72] in the 13th Results and Performance of the World Bank Group (RAP) published in 2023, MIGA also states that IMPACT was piloted in FY19 and fully launched in FY20 (World Bank 2023).[73] The 13th RAP report is the latest report analysing the effectiveness and performance of the World Bank Group projects including MIGA. However, this report did not evaluate projects approved under IMPACT framework.[74] In the absence of a comprehensive evaluation of IMPACT, the following discussion focuses on MIGA's challenges of reaching least-developed countries (LDCs), targeting of countries and sectoral allocation.

a) MIGA's role as a unique guarantee provider

A substantial share of MIGA guarantees is in the form of political risk insurance, which is against expropriation risk, transfer risk (currency non-convertibility), war and civil disturbance, and breach of contract. The rest is in the form of non-honoring of financial obligations products, which protects against losses that occur when a government fails to make a payment on time (see Figure 6). Clearly, in the case of the former, guarantee decisions in these contexts cannot be influenced by market considerations alone and would be determined by the strategic interests of MIGA's shareholders. It would be expected that these stakeholders would provide an implicit guarantee that defaults would not occur, thereby avoiding the need to call on guarantees.

Given MIGA's membership of the World Bank Group, the Bank representative in a country can intervene at crucial moments and ensure that there is no default leading to a call on a guarantee.[75] Despite this advantage, MIGA is known to play safe. That is partly because it has adopted the strategy of reinsuring its guarantees, with the aim of releasing capital for provision of additional guarantees using its own resources. However, that implies that the guarantees on MIGA's books have to be such that they are considered safe enough by the reinsurer to back them, which restricts guarantees substantially to less risky projects in middle-income countries. As a result, the number of claims paid out on guarantees has been remarkably low. The total number of claims through MIGA's history is 11, all of which involved political risk insurance products; nine of the claims resulted from war and civil disturbance. There have been no claims for non-honoring of financial obligations products. As a whole, this is a remarkable record of near absent risk in projects guaranteed.

Figure 6: MIGA gross issuance – by product type (US$ billion)



Source: Mathiasen and Aboneaaj (2023)[76]

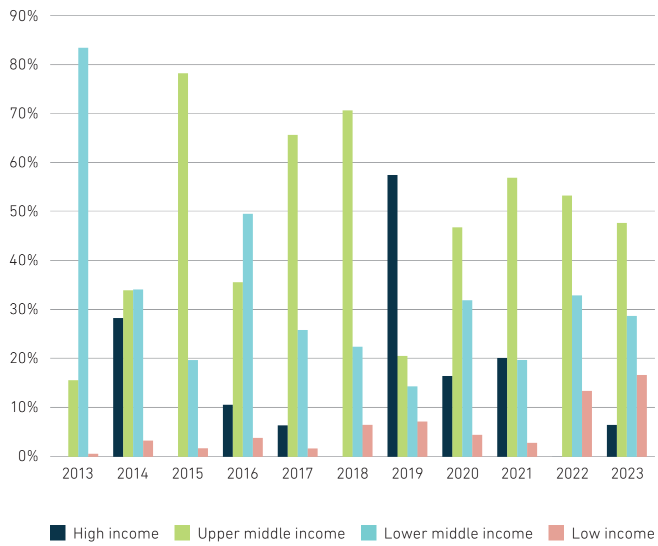
b) Challenges in reaching low-income countries

The question is – did the relatively small intervention from MIGA so far help drive flows to the low-income countries or least-developed countries? According to MIGA figures, 27 per cent of the US$8.6 billion supported flows to International Development Association (IDA) countries or low-income countries. That is, close to three quarters of MIGA support went to countries that would even otherwise have some degree of market access in the liquidity-abundant world financial system.

A 2023 study by Karen Mathiasen and Rakan Aboneeaj of the Centre for Global Development found that middle-income countries overwhelmingly dominated guarantee issuance by MIGA.[77] Although there has been some improvement since 2020, lower middle- and low-income countries, especially the latter, account for a small share of the total (see Figure 7). According to that study, "most of MIGA's exposure is in high- and upper-middle-income countries, often exceeding 50 percent of total guarantee volume. Guarantees in lower middle-income countries and low-income countries (LICs) represent a significant number of MIGA's operations but tend to be smaller in size, which is reflected in lower exposure figures. This helps explain why FY22 was the first time MIGA insurance in LICs exceeded 10 percent of new issuance volume."

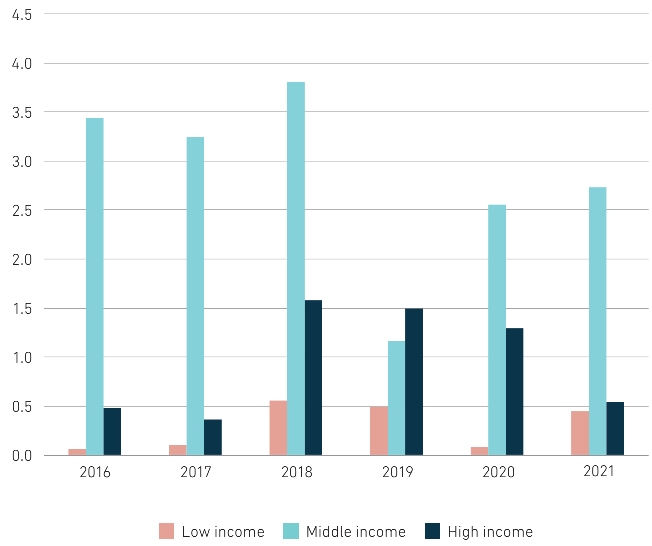
This affects the distribution of private capital leveraged by MIGA even more. For instance, in 2020, MIGA only mobilised US$78.5 million of the total, or 2 per cent, in LICs. This improved in 2021, with direct mobilisation reaching US$445 million in LICs, equivalent to 12 per cent. In MICs, however, MIGA directly leveraged US$2.6 and US$2.7 billion in 2020 and 2021 respectively (i.e., equivalent to 66 and 73 per cent)[78] (see Figure 8).

Figure 7: MIGA gross issuance by income group (%)



Note: The exceptional high-income coverage in FY 2019 is due to a transaction in Oman
Source: Mathiasen and Aboneaaj (2023)[79]

Figure 8: Direct mobilisation by income group (US$ billions)



Source: MDB Joint Reports on the Mobilization of Private Finance (quoted in Mathiasen and Aboneaaj, 2023)[80]

c) Sectoral allocation concentrated in financial services and energy projects

It is difficult to gather collated information on the kind of projects supported by MIGA guarantees, focusing on welfare and climate-related outcomes. Largely, MIGA seems to adopt a trickle-down approach to poverty reduction, claiming that by facilitating private investment "in countries where it is needed most", it ultimately fosters "economic growth and poverty reduction". Sectoral concentration in financial services and energy projects has been high, with 70 per cent of the US$26.6 billion mobilised during 2016-17 going to such projects.[81] A substantial chunk of the energy investments guaranteed by MIGA were fossil fuel projects, mainly gas projects.[82] Gross guarantees for investments in fossil energy is 48 per cent higher than for non-fossil energy projects, and total gross guarantee exposure to energy projects is higher for fossil projects compared to non-fossil projects (Figure). Gas projects not only emit greenhouse gases (GHGs) like methane, but have adverse social and environmental impacts. Financing of such projects continues despite the World Bank's commitment to align its financing and investments with the objectives of the Paris Agreement.

The overview of MIGA's guarantees show a tendency towards risk aversion, inclination towards middle-income countries and a focus on financial services and energy projects. MIGA guarantees are therefore not simply limited in their focus on mobilising adequate capital but are in need of reforming the issues of distributional allocations. In conjunction with the need for a robust analysis of how MIGA guarantees deliver on climate and developmental impact, it is important to understand whether an increase in guarantees will automatically reform the issues of distributional allocations.

4.2 The EU's approach to guarantees: EFSD+

The European Fund for Sustainable Development (EFSD) and its successor EFSD+ provide financing through a combination of financial instruments including blending operations, grants, technical assistance and budgetary guarantees (see Box 4). These instruments are adapted and mixed to suit each financing situation. The EFSD and EFSD+ combine extensive public blending and guarantee programmes as a derisking approach to support private sector investment for development.

Box 4: What is the European Fund for Sustainable Development Plus (EFSD+)?

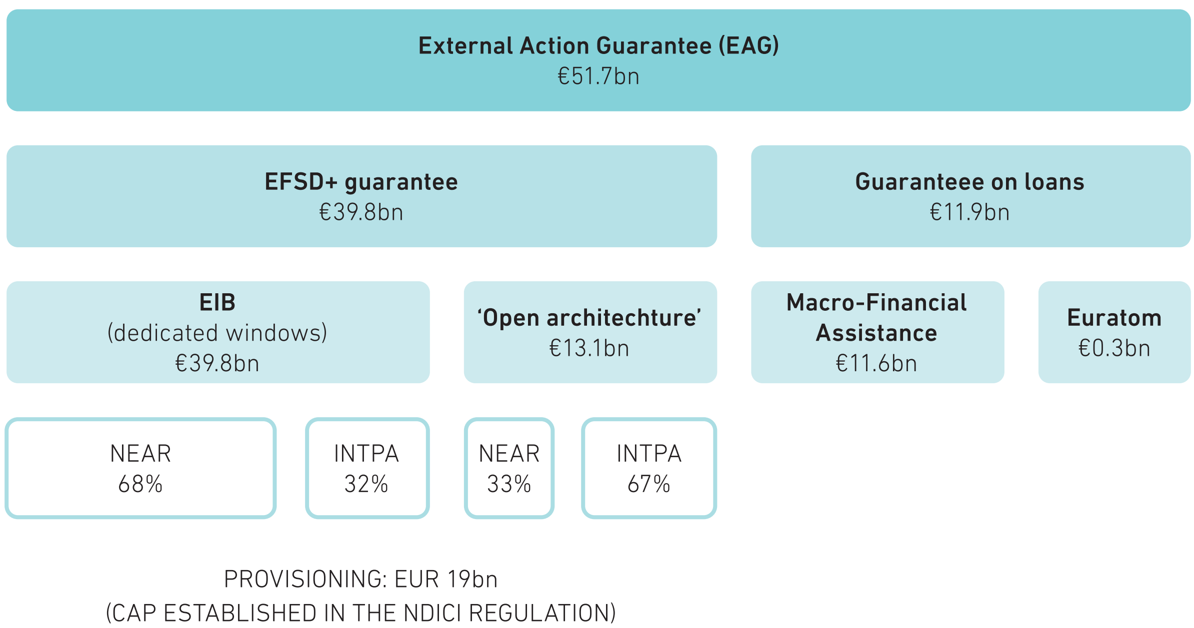
The European Fund for Sustainable Development Plus (EFSD+) is a financial instrument under the Neighbourhood, Development and International Cooperation Instrument-Global Europe (NDICI-GE). EFSD+ was established in 2021 within an extensive reform of the EU aid system, which significantly changed the Fund's programming in comparison to that of its predecessor, the European Fund for Sustainable Development (EFSD). The EFSD+ builds and expands on the EFSD with a more integrated approach to international development through an enhanced role of the private sector. When it comes to guarantees, the EFSD+ entails the External Action Guarantee (EAG), which merges and replaces the previous EFSD Guarantee, the EFSD Guarantee Fund, the External Lending Mandate (ELM) available to the EIB only, and the Guarantee Fund for External Actions (GFEA), providing budgetary guarantees for all countries covered by the EFSD+. Its governance consolidates the governance of blended finance and guarantee.

In December 2021, with the launch of the Global Gateway, the EFSD+ became one of its financing tools. The Global Gateway is the EU's new infrastructure investment strategy, which focuses on building sustainable and secure connections in digital, energy and transport sectors to boost Europe's competitiveness and supply chain security across the world. The Global Gateway strategy aims to mobilise up to €300 billion in investment in projects between 2021 and 2027 and relies on €135 billion of public and private financing to be mobilised by the EFSD+.[83] Under the Global Gateway, the EFSD+ offers risk-sharing instruments of €39.8 billion. In accordance with the 'policy first' principle, guarantees will be focused on flagship investments such as Team Europe Initiatives and thematic strategic priorities through calls issued by the EC.

The structure of the EFSD+ guarantees

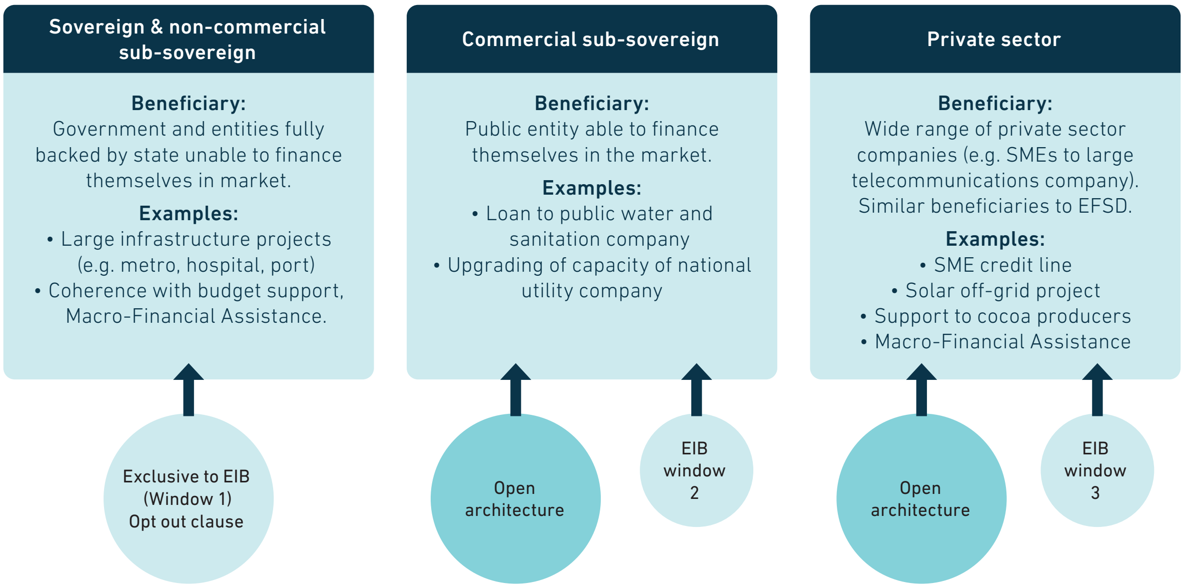
The EFSD+ Guarantee structure is deployed through a range of organisational arms. This includes External Action Guarantee (EAG), Open Architecture for guarantees in a series of priority investment windows, as well as blending projects decided within regional investment platforms (see Figures 9 and 10).

Figure 9: The EFSD+ guarantee: amounts 2021-2027



Source: EC (2023),[84] Euratom,[85] Macro-financial assistance (MFA)[86]

Figure 10: The EFSD+ guarantee: windows



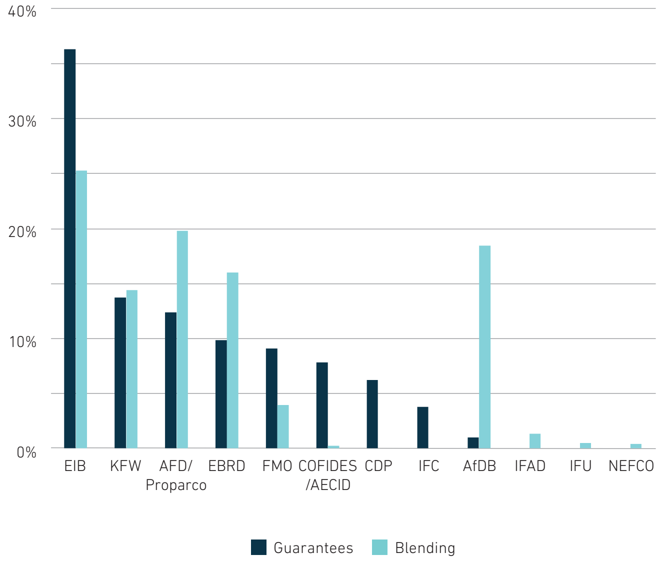
Source: EU Commission (2024).[87]

A range of eligible development finance institutions also act as the EU's implementation partners on the ground. The EIB and other Team Europe Partners such as European Development Finance Institutions (EDFI) are important implementation partners for the EFSD+ Guarantee (see Figures 11 and 12). EDFI's micro, small and medium-sized enterprises (MSMEs) is an important platform.[88] In 2022, the EFSD+ increased its guarantee coverage with a focus on key sectors (see Box 4).

Figure 11: How guarantees to derisk investment are provided

Source: Adapted from EC (2023).[89]

Figure 12: Share of EU contributions to guarantees and blending operations by EFSD implementing partners (2017-2020)



Source: CGD (2021).[90]

Evaluations of EFSD+ guarantees

The evaluation of the EFSD+ is part of the European Commission's obligation to report regularly on its implementation. This includes an annual report to the EFSD+ Strategic Board detailing progress in implementing the EFSD+ under the NDICI framework (Article 33.6). Additionally, specific information about the EAG and EFSD+ must be included in an annual report to the European Parliament and the Council on the implementation of the NDICI-Global Europe instrument (Article 41.7).[91] The regulation also mandates that an evaluation of the use and effectiveness of the EAG should be completed by 31 December 2024, with further evaluations to follow every three years (Article 42.5).

The EFSD+ was implemented while its precursor EFSD was also in the early stages of implementation. This limits the scope of evaluating a comprehensive as well as focused analysis of the EU's use of guarantees, especially since the EFSD+ was only operationalised in June 2021. While the concept of development conditionality in EU regulation is quite comprehensive (see Box 5), there is no comprehensive study focusing solely on EU guarantees.

Instead, studies on evaluations of guarantees have primarily focused on EFSD operational reports[92] whilst also making use of EFSD+ Operational Board documents with information about Proposed Investment Programmes for the EFSD+ Open Access Guarantee.[93]

Box 5: Development additionality in EU guarantees

The concept of additionality, originally under the EU regulation 2017/1601, was to ensure that "EFSD guarantee operations do not replace the support of a Member State, private funding or another Union or international financial intervention, and avoid crowding out other public or private investments".[94]

This has been extended by the EU Regulation 2021/947 for the EAG under the EFSD+:[95]

- "'Additionality' means the principle based on Article 209(2) of the Financial Regulation, according to which, in the context of this Regulation and the IPA III Regulation, the External Action Guarantee support under the EFSD+ contributes to sustainable development by operations which could not have been carried out without that Guarantee, or which achieve positive results above and beyond what could have been achieved without it."
- "The principle of additionality also means that the operations supported by the External Action Guarantee crowd in private sector funding and address market failures or sub-optimal investment situations as well as improve the quality, sustainability, impact or scale of an investment."
- "The principle also ensures that External Action Guarantee operations do not replace the support of a Member State, private funding or another Union or international financial intervention, and avoid crowding out other public or private investments unless duly justified in accordance with the objectives and principles of the Instrument. Projects supported by the External Action Guarantee typically have a higher risk profile than the portfolio of investments supported by the eligible counterparts under their normal investment policies without the External Action Guarantee."

Some highlights from the evaluation reports of EFSD+ are as follows:

a) Challenges in reaching LDCs: Guarantees under EFSD and EFSD+ show challenges in reaching out to LDCs.[96] Countries like the Democratic Republic of the Congo, Chad and Somalia will receive less than 2 per cent of the country allocation resources from the EFSD+ guarantees.[97]

b) Challenges of resource allocation to SMEs: An evaluation study of EFSD based on annual reports and information on EFSD+ Proposed Investment Programmes found that it is difficult to determine how EFSD grants and guarantees target small and local companies.[98] The category of MSME covers a broad range of actors from individual entrepreneurs to companies with up to 250 employees and €50 million of annual turnover, which can be fully owned by shareholders or include participation by international investors and groups. It is not clear how EFSD's private sector development windows are targeting small local businesses. The fact that developing countries are highly composed of informal sectors makes this even more difficult.

c) Role of financial intermediaries: This evaluation study finds that EFSD+ is focused on enhancing its inclusive approach towards investment in MSMEs. Financial intermediaries used by MSME programmes include impact funds, which focus on economic development. These include the EDFI Liquidity Platform for Impact; the AfDB Social Impact Investment Program for Africa; and the PROPARCO Africa Ventures Programme. However, the study notes that most MSME programmes also rely on entities or intermediaries that do not necessarily engage in inclusive economic development. These intermediaries are venture funds or equity funds as well as local financial intermediaries.

d) Targeting and poverty reduction: This study shows that it is difficult to assess the role of programme partnerships in job creation and the creation of income opportunities. Programmes also have a tendency to target groups too broadly in most cases. Moreover, while EFSD+ priority areas are explicitly focused on finance for private and cooperative sector development, the programmes are not explicitly aimed at cooperatives.

EU guarantees are guided by the EU developmental agenda and focused on increasing the linkage of blended finance and guarantee operations to country-specific priorities. The hasty evolution and implementation of the EU's developmental agenda from EFSD to EFSD+, and now the Global Gateway, has led to guarantees taking a more central role in derisking flagship investments. However, as the above summary from the evaluation reports of the EFSD+ show, the developmental impact of EU guarantees is limited in its scope in targeting SMEs as well as delivering on poverty reduction targets. Once again, this also means that a rise in guarantees for flagship projects under the Global Gateway, and the goals of mobilising capital on its own, do not equate to evidence of developmental impact for EU guarantees. Although the European Commission has set an ambitious goal for the EAG to serve as a tool for addressing market failures and improving the sustainability of projects, whether this will be achieved is still uncertain.

4.3 The Swedish International Development Cooperation Agency (Sida)

Over the last two decades, Sida has been using guarantees to channel Swedish aid to developing countries. It describes the role of guarantees as a catalyst for projects and sectors that are perceived as too high risk for financial institutions.

A guarantee by Sida is backed by the Swedish state. It is provided for commercial as well as political risk, serving as a credit enhancement tool for private sector investors and lenders. Guarantees provided by Sida are generally conceived as a risk-sharing tool, where Sida insures a pre-defined part of the loan amount, making financing of the development projects less risky for the financiers. In this scheme, Sida charges a risk-based fee for the guarantee to cover expected losses. In cases where the guaranteed investments perform and/or loans are repaid, Sida does not accrue any expenses. Box 6 shows the types of guarantees offered by Sida.

By issuing a guarantee, Sida takes on a share of the risk to help reduce the uncertainty of investments. The National Debt Office conducts an independent risk assessment to evaluate the potential challenges involved. This analysis determines an amount known as the expected loss. To cover this expected loss, Sida charges a guarantee fee to the bank or organisation receiving the guarantee (see below).

Box 6: Types of guarantees offered by Sida

The Sida guarantee portfolio includes five different types of guarantees:

Loan Portfolio Guarantees cover several loans or investments in a financial institution's portfolio on an individual and ongoing basis.

Project Finance Guarantees cover a single loan between an identified lender and an identified borrower.

Balance Sheet Guarantees use Sweden's AAA sovereign rating to release headroom in the lender's balance sheet, which enables the financier to increase its lending using capital that was previously locked by capital requirements. The underlying asset can be, for instance, a loan or project portfolio.

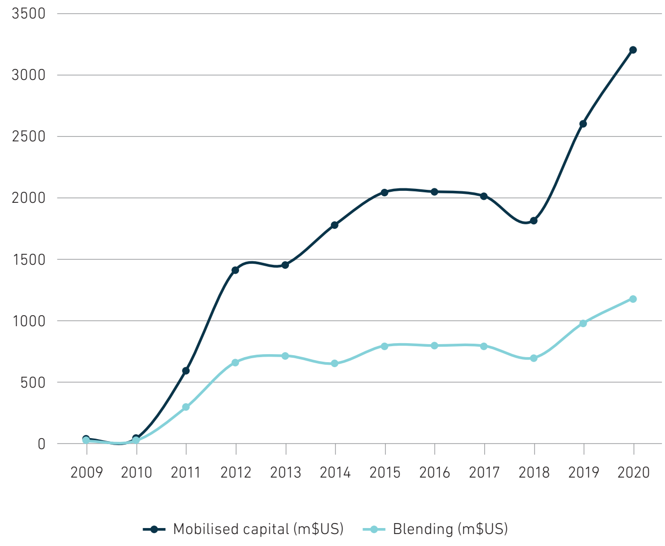
Fund Structure Guarantees cover a fund that is set up to attract capital for a certain purpose in line with the Sida objectives. Normally, the guarantee is not called upon for single loan defaults, but rather on a cumulative level at the fund's closure, covering potential net losses of the investment in its entirety.

Volume Guarantees aim to insure manufacturers against low demand by guaranteeing sales of a certain volume. This has the potential effect of enabling economies of scale in the manufacturing process, lowering the price for the consumer. This has proven effective in the health sector, such as for the distribution of vaccines.

Aggregate trends in guarantees and mobilised finance by Sida

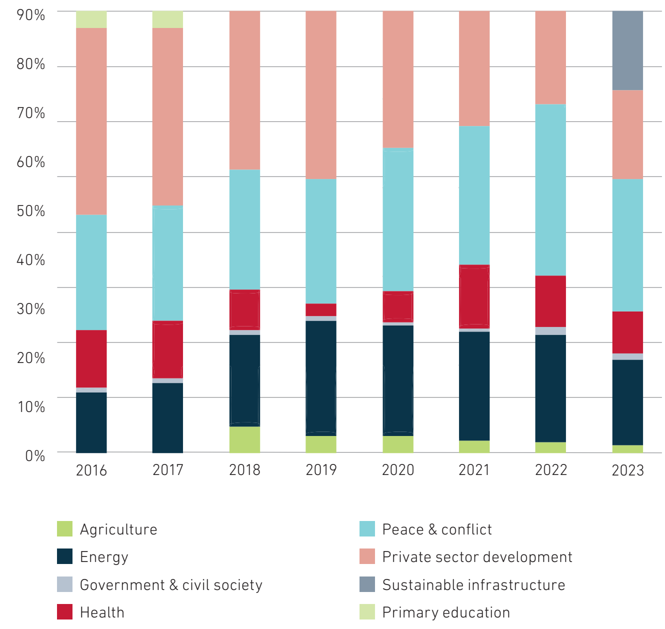
The amount of guarantees provided by Sida have been rising, which has enabled more private finance to be mobilised over the years (see Figures 13 and 14). At the end of 2022, Sida had 48 active guarantees with a total commitment of US$1.4 billion, which led to US$3.8 billion in mobilised capital. A total of US$60.2 million was provided as grants subsidising fees related to the guarantees. By the end of 2023, Sida's guarantees increased to 52, amounting to a total guarantee value of 15.7 billion SEK (US$1.5 billion).[99]

Figure 13: SIDA financing pattern including mobilised capital and guaranteed amount (2010-2021)



Source: Sida (2022).[100]

Figure 14: Agreed guaranteed amount share per sector 2016-2023

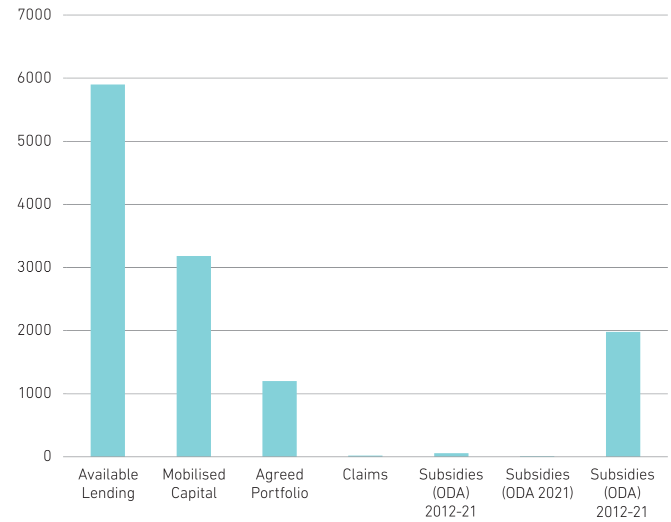


Source: SIDA Guarantee portfolio 2023 (not online, shared by SIDA staff).

Guarantees provided by Sida and ODA

As mentioned above, a part of a guarantee fee can be subsidised by Sida grants, when necessary.[101] In this case, the expected loss amount, including subsidy, is deposited into the state guarantee service account. The funds from the service account are used to make payments in case of defaults. No other Sida resources for grants are used for the repayment of defaults. See Figure 15 on the guaranteed amount for 2021.

Figure 15: Sida's guaranteed amount 2021 (US$ millions)



Source: Sida (2022) Sida Guarantee Portfolio.[102]

However, as mentioned earlier, from 2024, as part of an ongoing process known as ODA modernisation, guarantees can be reported as ODA, considering a discount rate percentage. A PSI agreement established a set of rules to determine the 'grant equivalent' part of a guarantee based on the concept of additionality not concessionality.[103] This represents a significant change in traditional aid giving, which could impact how Sida reports its guarantees – as of now, only the discount on the premiums is reported as ODA. A detailed evaluation of Sida's reporting is not available; however, the risks are discussed in Section 5.

Evaluation of Sida

Sida publishes reports and brief analyses of ad hoc guarantee projects.[104] Some external agencies have also conducted studies on Sida's guarantees, with a focus on projects as well as brief orientations looking at their impact.[105] However, in the absence of comprehensive reviews on the long-term impact of Sida's guarantees, some insights can be highlighted through a health project in Uganda.

In 2012, Sida partnered with the USAID Health to provide guarantees for Uganda's Centenary Bank for Rural Development (CRDB). The main goal of the intervention was to promote access to private healthcare in in Uganda, particularly in rural areas. Individuals and companies in Uganda often lack collateral to apply for loans. The loan portfolio guaranteed covered loans to privately owned and operated MSMEs as well as healthcare workers in the health value chain. The total cover is 60 per cent of the principal amount of the loans, of which Sida and USAID each guarantee 30 per cent. The expectation was that the guarantee would increase the value of the collateral for those clients by 60 per cent, enabling them to receive larger loans from the bank, which is often an obstacle in Uganda's financial sector.

The impact of the guarantees was reported as being mixed. While existing borrowers benefitted from the guarantee by enabling them to obtain larger and longer-term loans, the presumed advantage of the guarantee (60 per cent extra collateral) did not fully materialise. The study also mentions that it could not be established whether the provision of guarantee "changed the longer-term risk perception and lending policy of CRDB towards health sector borrowers however. Neither is there an indication that other banks followed CRDB's example and ventured into the health sector."[106] In addition, the evaluation also mentions concerns about support to private healthcare and potential crowding out of public healthcare services.

5. Growing guarantees: Assessing the risks and opportunities

The role of guarantees in development and climate finance is set to increase, and this will be led by major MDBs and DFIs as well as development assistance providers. However, the efficacy of guarantees as a tool for mobilising finance into risky projects needs comprehensive research, based on studies covering long-term analysis. The evidence available suggests that the success of guarantees has been mixed, both in terms of the ability to kickstart private investment and in terms of realising the social outcomes that justify their use. While guarantees widen opportunities for investment, they are also associated with risks of different kinds. There is a compelling case for monitoring and regulation to ensure that outcomes align with objectives.

Unlocking opportunities to mobilise finance

If designed and deployed appropriately, guarantees can be a major opportunity for mobilising both public and private finance.

They can be deployed as credit enhancement devices to reduce the risk of providing finance to projects seen as risky. In turn, the guarantor can promise to cover losses resulting from shortfalls in payment covering a pre-specified ceiling. Governments in the global south, often hesitant to increase spending in sectors that deliver economy-wide benefits, might be persuaded to provide the unfunded guarantees that help mobilise private finance to do the job. Incentivising private investment in this manner can also be crucial where fiscal conservatism restricts government spending and limits investments in socially desirable projects.

Furthermore, guarantees can direct finance to preferred activities with lower pecuniary returns and high risks by derisking private investors. In addition to attracting investors, guarantees can also improve the credit-rating of sovereign bonds issued in financial markets.

In theory, this can help lower the interest rate on debt and reduce the cost of capital for socially desirable projects that are expected to yield less profits than other competing opportunities. However, as the next section highlights, guarantees are not a silver bullet for addressing the structural challenges that leave less-developed countries vulnerable to debt stress or prone to debt crises.

Understanding the risks of guarantees

a) The real risk of inflating and diverting scarce ODA budgets

The use of aid budgets to issue guarantees, and subsequently report them in ODA statistics, raises two interrelated concerns that could undermine the integrity and purpose of aid.

First, the notion of donor effort – a crucial principle of ODA – becomes problematic as the new reporting rules essentially provide a reward to the rich country, in the form of increased ODA volumes, for taking on a potential liability that more often than not will fail to materialise. In short, ODA volumes will increase without ever leaving a rich country's balance sheet.

Second, in the real world of fixed (or worryingly decreased) aid budgets where resources are capped, locking in money for guarantee schemes means that that money cannot be spent elsewhere. This forces rich countries into making trade-offs about where to allocate their money. For a donor preoccupied with showcasing wins and getting 'value for money', guarantees are attractive but they risk undermining the integrity of ODA. Furthermore, it may be counterintuitive, but the reporting of guarantees as ODA essentially offers rich countries a no-risk situation where they get credit in terms of ODA volumes whether or not they ever actually transfer any resources. This is a situation that could seriously distort their aid allocation priorities – for example, by favouring private sector projects with contested development additionality.

Beyond these concerns around aid accounting and prioritisation there is a more fundamental concern about how ODA is best used and for what purpose. The shift towards private sector instruments marks a departure from the core value of ODA, which is centred on development rather than profit. The existing safeguards are insufficient to maintain a clear distinction between development and profit-driven activities, making the concept of 'additionality' increasingly difficult to define.[107] While Sida's diversion of aid resources to cover guarantee losses remains to be seen, in the case of Norway's new guarantee, the diversion of aid has already been confirmed.[108]

The extent to which these concerns will ring true should soon become clearer as the new reporting directives are widely implemented in rich countries, which are issuing guarantees and claiming them as part of their ODA budgets. What will be especially telling down the road is the extent to which ODA is trending towards these instruments, the extent to which ODA volumes are increasing thanks to these instruments, and in particular whether volumes reflect an actual transfer of resources, or are simply the result of a dubious quantification of donor effort.

b) Encouraging increased private finance in climate, while evading the responsibility of the global north

Using guarantees to mobilise private finance for climate action contradicts demands for grant-based climate finance from countries in the global north, on the basis of the polluter pays principle, and common but differentiated responsibilities of richer countries that are primarily responsible driving global warming and climate change.

Political uncertainty surrounding the US government's role in multilateral processes as well as attempts to enhance the climate finance contributor base are likely to increase interest in guarantees. The resulting tensions were clearly seen during New Collective Quantified Goal (NCQG) negotiations at COP29. On the second day of the COP, the G77 + China group rejected the substantive draft text on the NCQG that did not meet their proposed annual target of US$1.3 trillion to cover adaptation, mitigation and loss and damage.[109] At another session of the COP29, the Independent Latin American and Caribbean Association (AILAC) reportedly highlighted the need to ensure that finance is not a source of indebtedness but that instruments such as guarantees could be a source to enable more space for climate action.[110] As this intervention points out, proposals that are not based on actual mobilisation of debt-free climate finance promised by developed countries to global south countries risks being mere distractions. As noted by Mariana Paoli, Global Advocacy Lead at Christian Aid:

> "Developing countries cannot accept a deal that does not address their needs. The multilayer proposal by developed countries has been a distraction because it shifts the burden from them – and their obligation to provide public finance at scale to fulfil the Paris Agreement and the Convention – to the private sector. This reverse in the narrative is pervasive and morally wrong because what will guide finance is where profit can be found and not the needs of developing countries, especially those most marginalised. Moreover, the private sector is not accountable to the Agreement or the Convention, only governments are."[111]

Additionally, the sectors and countries that tend to dominate guarantee allocation form another area of risk. The use of guarantees may be naturally inclined towards supporting large profit-oriented infrastructure investments in renewable energy owing to the need for high private investment. Moreover, as highlighted in section 4.1, risk aversion could lead MIGA guarantees to be allocated mainly towards investments in energy projects involving fossil fuel or gas rather than renewables. However, such an emphasis can risk overemphasising mitigation at the expense of adaptation and loss and damage, which are essential for vulnerable countries in the global south to deal with the impact of climate change. To mitigate against a skewed and problematic model of climate financing, there is a need to ensure that profitability does not take over just transition needs.

c) Exacerbating global south indebtedness

Countries in the global south are facing an escalating debt crisis. According to the recent figures from the World Bank Group, "nearly half of [the poorest economies] – twice the number in 2015 – are either in debt distress or at high risk of it".[112] Between 2010 and 2020, average annual spending on debt repayments tripled for low-income countries, from US$20 billion to US$60 billion. In addition, low-income countries and most climate-vulnerable countries collectively spend twice as much in debt repayments as they receive in climate finance.[113]

The fiscal risk that a global south country exposes itself to when issuing a sovereign guarantee to attract private investment in a project is a cause for concern, as its financial position is adversely impacted through the accumulation of contingent liabilities. The unpredictably of anticipating when guarantees will be called upon means an additional constraint in already reduced budgets of countries in the global south, forcing the governments to cut already dwindling levels of public spending. While this sounds like an extreme scenario, the risk of sovereign guarantees on private investment is a reality linked to the underdeveloped status of countries in the global south and their perpetual need for attracting private investors.

Meanwhile, guarantees for credit enhancement for sovereign debt issuance can also lead to debt-related considerations. In cases of sustainable debts that need refinancing, the issuance of guarantees for credit enhancement that effectively reduces the costs of sovereign borrowing is not necessarily problematic, in a scenario where countries need to reduce borrowing costs. However, if the country is dealing with unsustainable debt levels, regardless of what debt sustainability analysis from the World Bank and IMF indicate, credit enhancement over a sovereign debt issuance to refinance existing and unsustainable debt is a problematic approach. In practice, it retracts countries from the much-needed debt restructuring and cancellation.

Moreover, inadequately regulated guarantees increase the risk of moral hazard by incentivising excessive risk-taking by investors, the costs of which are transferred to the insurer or guarantor in case of a default.

d) Promoting questionable debt swaps

Guarantees are used in debt swaps through debt buy-back from the market by issuing credit enhancement of the new bonds. As such, the implications of using guarantees in debt swaps needs to be analysed, recognising the challenges in the way that debt swaps are being implemented.

Typically, guarantees have been deployed in debt-for-nature swaps to lower the cost of the new debt in the debt buyback operation. In return for reducing the foreign exchange denominated debt servicing burden of a stressed debtor country, the latter accepts to devote domestic currency equal to those 'savings' to pursue a specified environmental goal, such as marine protection. This appears to be a win-win strategy: it helps reduce the debt costs, and it contributes to the realisation of environmental goals. Indeed, as previous research by Eurodad shows, under specific circumstances, debt swaps could provide conservation, climate or development finance. For instance, if there is a substantial discount in the debt buyback, if a reduction in the cost of the new bond is secured, if the transaction costs are minimised, and if transparency, local communities' participation and accountability conditions are met.

In practice, however, barring a few cases, the experience with debt-for-nature swaps has not been as positive as expected. In most such swaps, the actual reduction in the volume of debt outstanding and in the debt service payments due has been disappointingly small. Moreover, the actual environmental gains have not been significant or even clearly measurable. Most cases do not have monitoring or enforcement mechanisms to assess whether projected gains have been registered and, when they can be measured, there is no real corrective to prevent shortfalls from targets. Additionally, the cost of the transaction has become so steep that it has lost substance either as a debt reduction exercise or as an exercise in positive environmental or climate action. It is against this background that we have to assess the use of guarantees to facilitate such transactions.

Given the crucial role of guarantees in attracting private investors into debt swaps, there is a risk of further promoting the use of debt swaps without the necessary conditions for them to work in the public interest.

e) Promoting politically and economically costly policy reforms through conditionalities

Guarantees can increase the promotion of MDBs' blueprint of policy reforms in global south countries, through the use of policy conditionality that constrains their policy space. While most providers embed policy conditionalities in their guarantees, the most documented example is that of MIGA Policy Based Guarantees (PBG).

Policy-based guarantees (PBGs): A fiasco?

MIGA's PBGs are an explicit instrument that use conditionalities to link a country's macroeconomic policy to sovereign lending. By defining the conditions of a sound macro framework in the recipient country and implementing additional corrective measures determined by the World Bank, the implementation of PBG becomes a tool for directly influencing policy.[114] Beyond explicit conditionalities, the rise of guarantees can also lead to implicit conditionalities in cases where defaults on guarantees become imminent. In such cases, countries in the global south are faced with limited options and can easily comply with politically and economically costly policies to avoid a guarantee default.

The first PBGs provided by the WBG were to Argentina (1999) and Colombia (2001) and they included innovative 'rolling reinstatable' clauses. The guarantee applied to only a part of the loan, but was rolled over to cover a second similar sum, when the first was repaid. In case of default leading to the guarantee being called, the IBRD could reactivate the guarantee if the borrower fully reimbursed it. Supported by the World Bank's PBG, Argentina was able to borrow US$1.5 billion in the international markets, with a series of six US$250 million zero-coupon bonds maturing sequentially over the period 2000-2004. Since the World Bank enjoyed 'preferred creditor status', the expectation was that the institution would be able to compensate creditors, in the case of default, and in time obtain a reimbursement from the debtor. Not surprisingly, the loan was rated investment-grade by Standard & Poor, even though Argentina's other foreign debt did not meet investment grade requirements.

Colombia resorted to a notes issuance of US$1 billion using a similar facility. From the point of view of these countries, the guarantee allowed them to borrow at low cost against unsecured bonds in a market that was increasingly wary about emerging-market debt. From the point of view of the World Bank, guarantees were a substitute for lending under existing development policy operations, with no change in its exposure.[115]

In practice, expectations were not met. Argentina defaulted on its bonds in October 2002. The World Bank had to pay US$200 million to bondholders as required under the PBG. Argentina, however, failed to reimburse the World Bank within 60 days, preventing the guarantee from being reinstated. But the World Bank had to give Argentina five years to repay the money, starting in 2005.

Despite that experience, the global financial crisis of 2007-09 and the Eurozone crisis revived an interest in PBGs. Financially stressed banks subject to more stringent capital and liquidity requirements prescribed in response to the global financial crisis, had little appetite even for relatively safe debt instruments. Emerging markets that were also hit by the crisis turned to the World Bank and IMF for support, and PBGs found a new role. In fact, the operational guidance on PBGs was changed in 2013, subjecting them to rules governing the World Bank's development policy financing, and making the instrument available to low-income countries (so-called International Development Association countries) that did not meet the earlier eligibility criteria.

However, even under the new rules, PBGs could be extended to only those IDA-only countries that have low or modest risk of debt distress. For example, the World Bank board gave Ghana a waiver and issued it a guarantee in 2015. Ghana used that to borrow US$1 billion against bonds due in 2030, backed by a guarantee against 40 per cent of the principal, or US$400 million. A few years later Ghana was in severe debt distress.[116]

In practice, the World Bank Group sees guarantees as a financing instrument that can extend its role as a financier with the ability to influence policy, without stretching its own resources.

6. Conclusion

This report presents the first civil society mapping of guarantees for development and climate action. It does so with a focus on the implications that an increased use of guarantees can have for socioeconomic development and a climate justice agenda for the global south.

The growing interest in policy circles in guarantees as a tool for mobilising finance is part of a broader trend that emphasises the role of private finance to close a so-called financing gap. It is also aligned with the ongoing emphasis on creating yet more liquidity in global south countries to solve the multiple crises of indebtedness, lack of funds and climate change.

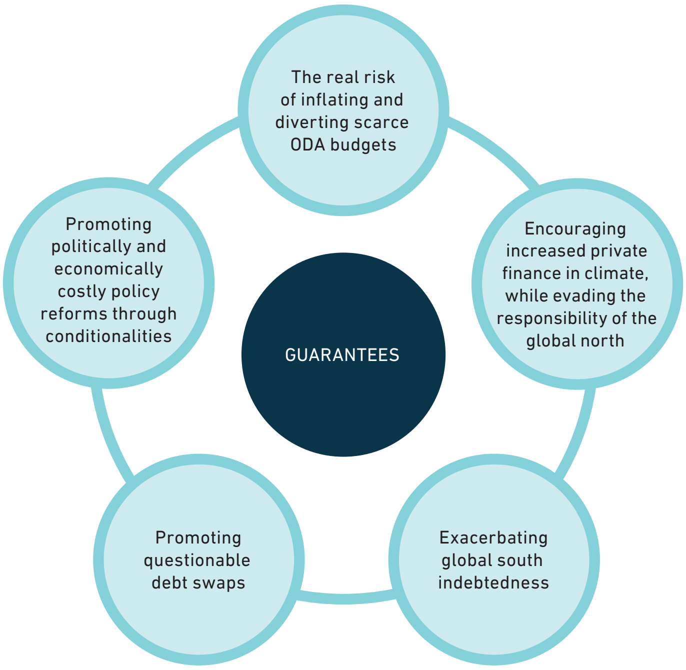
The current promotion of guarantees is reflected in continuous efforts to promote initiatives aimed at attracting private finance into development and climate action. Illustrative of this trend are recent policy developments led by MDBs, the European Union and rich countries such as Sweden, Denmark and Norway, and discussions at COP29 on climate finance. In these cases, there are still development additionality and climate justice considerations that can be raised. Also, there is a high risk of diverting scarce aid budgets with little evidence of financial additionality.

Guarantees can boost the traditional lending operations for development and climate finance by lowering specific types of risks to attracting public and/or private finance. However, as with other instruments that come under the umbrella of 'innovative finance', an analysis of guarantees in development and climate action must be linked to the broader socioeconomic and political context in which guarantees are implemented. As such, guarantees in development and climate finance are not a force for good or bad in isolation. Instead, the extent to which they are a relevant tool is determined by the conditions and context in which they are issued.

As this report argues, to understand the evolving role of guarantees, it is essential to go beyond a technocratic rationale and an analysis focused on the amount of money mobilised and instead to contextualise the necessity of its issuance and assess its long-term impact on development and climate policy. While guarantees could play a key role in catalysing or accelerating private investment globally, questions remain about their exact role, nature and relevance for sovereign states in the global south, for the quality of aid budgets of rich countries, and for the socioeconomic structural transformation of these countries.

As our report highlights, an expanded use of guarantees can bring five main risks, and they should be carefully considered (see Figure 16).

Figure 16: Risks associated with the rise of guarantees in development and climate



In conclusion, from a development and climate justice perspective, there is still a case to be made before expanding the use of guarantees. We find that more transparency is needed on the exact nature and role of individual guarantees and the long-term financial and development additionality of guarantees. Furthermore, more evidence from the providers, but also independent evaluations, is needed regarding the actual value of guarantees from a development and climate justice perspective. This is key to ensuring that their expanded use for development and climate action does not divert attention from unmet development commitments in the form of concessional finance and the need for grants-based climate finance from countries in the global north.

Endnotes

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About Eurodad

The European Network on Debt and Development (Eurodad) is a network of 60 civil society organisations from 28 European countries. We work for transformative yet specific changes to global and European policies, institutions, rules and structures to ensure a democratically controlled, environmentally sustainable financial and economic system that works to eradicate poverty and ensure human rights for all.

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