DFC U.S. International Development Finance Corporation

BUILD Act Reauthorization: MFAN Recommendations for Strengthening the U.S. International Development Finance Corporation (DFC)

In recognition of the need to mobilize private capital and investment to help catalyze economic growth and counter China's bold activities in the developing world, Congress passed the "Better Utilization of Investments Leading to Development Act" (BUILD Act) in October 2018. The bipartisan legislation established the U.S. International Development Finance Corporation (DFC), successor to the Overseas Private Investment Corporation (OPIC).

In addition to merging OPIC with USAID's Development Credit Authority, the BUILD Act gave the DFC several powerful new tools for achieving its mandate as the U.S. government's premier international development finance agency and a critical partner in America's foreign policy. These include: the authority to make equity investments in projects or funds, authority that most development finance institutions (DFIs) already have; increased flexibility in financing (while preference is given to American investors, the requirement that 25% of every deal be owned by an American was eliminated); a doubling of DFC's liability limit to $60 billion; authority to do deals in local currencies; and technical assistance capacities. The BUILD Act also provided the agency with a stronger mandate to prioritize developmentally impactful projects in low-income and lower-middle income countries, as well as significant new accountability and risk management requirements.

The BUILD Act is scheduled for reauthorization in 2025. To realize the DFC's full potential, MFAN recommends a 7-year reauthorization that increases the liability limit to at least $100 billion and addresses the following issues:

- **Modify Equity Scoring:** The BUILD Act provided DFC with several critically important new investment tools, but none more important than permitting equity investments. For example, equity investments allow DFC to partner better with like-minded DFIs and multilateral development banks (MDBs) to enhance development impact and provide more flexibility to support early-stage investments in private companies. Indeed, it was anticipated that equity investments would be such an integral part of the DFC's overall portfolio that the Congress limited equity investments to no more than 35% ($21 billion) of the $60 billion portfolio.

- Unfortunately, despite the intention of the authors of the original legislation, the DFC's ability to carry out its mission and fully realize its investment potential is being restricted due to the way its equity financing is "scored" (accounted for, in budgetary terms). Currently, the agency's equity financing is scored on a dollar-for-dollar basis – as if every dollar invested is a grant that would never be paid back to the U.S. government. However, in most cases, these equity investments will eventually be paid back along with a financial return. By failing to take these realities into account, the current dollar-for-dollar scoring puts inordinate and unjustified pressure on the DFC's budget and on the International Affairs Budget (150 Account). It greatly hampers the agency's ability to make critical early-stage investments in low- and lower-middle income countries where private finance is limited or not available.

- An appropriate and permanent solution to this problem is to evaluate equity investments on a "net present value" basis and use appropriated subsidy[1] to cover the projected risk. This would more accurately score equity investments at a fraction of the cost of the actual investment.

- **Reinforce the Development Mandate:** To fully realize the potential of the DFC, the updated legislation should reinforce the development mandate at the heart of the BUILD Act. The legislation directs the DFC to concentrate its effort on low- and lower-middle-income countries, where capital markets aren't well established and access to finance is often a binding constraint. In those contexts, the DFC's marginal dollar can have an outsized impact – helping to truly crowd in private sector financing that will promote economic growth and deliver additional development benefits. While U.S. foreign policy priorities will factor into investment decision-making, the DFC was designed to advance private sector-led development where it is needed most. The DFC sets a higher bar for deals in upper-middle-income countries to help ensure its support is highly developmental.

- **Increase Risk Appetite:** In fulfilling the development mandate, the DFC should make better use of mechanisms to reduce the risk to private investors. But, like its predecessor OPIC and most DFIs, the DFC has a risk averse culture. The DFC should increase its support for investments in difficult environments, where its engagement is most needed, and make better use of de-risking mechanisms. Among the tools that can be more frequently deployed for the DFC to better share risk with private investors are:

[1] This is not a subsidy in the usual sense but is a budgetary allocation to cover the potential cost associated with the risk of an investment or loan. See GAO Glossary of Terms Used in the Federal Budget Process, p. 96.

- small grants and technical assistance
- concessional finance (below market rate and/or grace period)
- blended finance (a combination of market rate and grant finance)
- joint projects to bring in the resources and capabilities of USAID, USDTA, and MCC to share respective capabilities -- and other DFIs with whom sharing risk assessment would significantly reduce the cost and time for project approval
- collaborate more frequently with other DFIs and MDBs
- transparent investment data to allow the private sector to assess potential risk and return

- **Strengthen Transparency:** To improve measurement and accountability, and to increase participation from the private sector, the DFC should continue to improve the transparency of its data -- especially at the investment level. Increased transparency will provide the ability to measure important functions such as development impact, whether the private sector is being crowded in, not crowded out, and whether the DFC is following its own environment, social, and governance (ESG) policies. The focus should be on improving data around: (1) development impact, both predicted and actual (as currently assessed by the Impact Quotient): (2)mobilization of private sector resources, including by type of financial instrument; and (3) ensuring that US ESG policies are being practiced, especially for project affected communities.

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