

A Renewed EU Budget Support Framework to Maximise Leverage and Impact

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Abstract

Amid mounting pressure on European development budgets, the EU must maximise the effectiveness and impact of its development finance toolkit. Although the European Commission is among the world's largest providers of budget support, its allocations are not systematically aligned with partner countries' creditworthiness or debt vulnerabilities. This misalignment undermines efficiency, with grants often concentrated in countries that retain market access rather than those facing constrained fiscal space. The framework is further limited by uneven regional distribution, a bias toward lower-risk environments, and fragmented engagement beyond the EU Neighbourhood. Drawing on a comparative assessment of international best practices and financial modelling of alternative grant–loan configurations, this paper explores how EU budget support can be strengthened to expand financing capacity, enhance development impact, and increase leverage in the run-up to the 2028–2034 Multiannual Financial Framework. It outlines options for optimising the grant–loan mix and estimates the potential gains from a more strategically calibrated financial toolkit.

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Bernat Camps-Adroque, Tay Drummond, Mikaela Gavas, Laura Granito, and Jasper Siegfried. 2026. "A Renewed EU Budget Support Framework to Maximise Leverage and Impact." CGD Policy Paper 384. Washington, DC: Center for Global Development. <https://www.cgdev.org/publication/renewed-eu-budget-support-framework-maximise-leverage-and-impact>

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Center for Global Development. 2026.

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1. Introduction

The European Union (EU) faces growing pressure to adapt its development finance instruments to an increasingly complex global landscape. This pressure is compounded by sluggish economic growth in Europe, fiscal constraints and growing budget deficits, and a surge in military and economic support for Ukraine. Many EU member states have scaled back development budgets, and political pressures have led to a growing share of their official development assistance (ODA) being diverted to tackle urgent crises. As a result, fewer resources are available for predictable, multi-year development programming aimed at building partner countries' capacities. At the same time, financing needs in low-income countries (LICs) and lower-middle-income countries (LMICs) have skyrocketed. These countries face a combination of soaring debt, elevated interest rates, and inflationary pressures, which are limiting access to finance or increasing its cost.

In March 2024, the Center for Global Development published a paper setting out policy options to maximise the use of EU concessional finance. Among the recommendations was the introduction of concessional loans to be deployed alongside, or in place of, grants, particularly in partner countries with sustainable macroeconomic contexts and adequate debt carrying capacity. Currently, EU budget support is not correlated with partner countries' creditworthiness or debt vulnerability. This misalignment reduces overall efficiency, as grants tend to be most effective in countries with limited fiscal space, while countries with market access could rely more heavily on alternative forms of financing.

This paper explores options and models to optimise the use of EU budget support grants to increase financing capacity, impact, and leverage. It aims to inform policy choices ahead of the next Multiannual Financial Framework (MFF) for 2028–2034. The current juncture provides a timely opportunity to assess the merits of these options and to consider the design of a more integrated EU concessional finance toolkit that is responsive to country needs and maximises the impact of public capital.

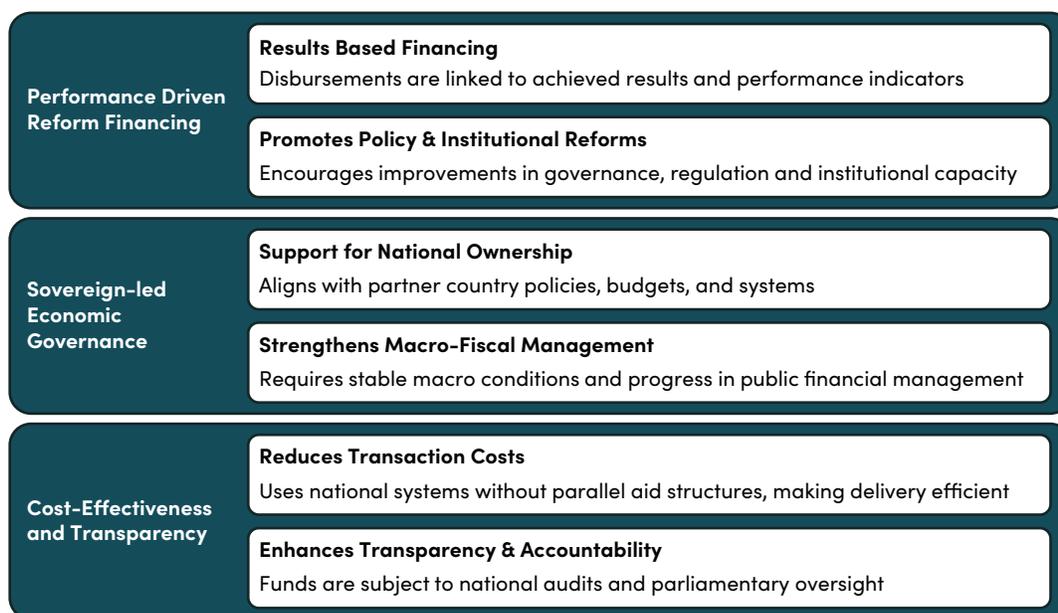
The paper first outlines the rationale, strengths, and limitations of budget support as an instrument. It then reviews the approaches of major international providers that deliver budget support in the form of grants and loans, including the EU. Finally, it proposes pathways to strengthen the EU's approach, including options to refine the grant-loan mix, and models the potential impact of an enhanced financial toolkit.

It is important to clarify the scope of this analysis. While the European Commission (EC) also provides balance-of-payments support through its Macro-financial Assistance (MFA) programme, this report focuses on the budget support instrument, which to date has been provided solely through grants. Similarly, although the EC plays a significant de-risking role through the European Fund for Sustainable Development Plus (EFSD+), whose guarantees underpin many activities of EU implementing partners, guarantees fall outside the definition of budget support and are therefore not examined in detail here, except insofar as they complement the options discussed.

2. Rationale for budget support and mapping of providers

Budget support is a form of development cooperation in which donors provide direct financial transfers to a partner country’s national treasury. These funds are managed through the country’s own budgetary and public financial management systems, generally in support of agreed policy and reform objectives. Within the EU, budget support is implemented in grant form through the Neighbourhood, Development and International Cooperation Instrument, Global Europe (NDICI—Global Europe) and in loan form through the Macro-Financial Assistance (MFA) instrument (which is technically provided to address balance-of-payments needs, but in practice, is often disbursed as budget support loans). The approach reflects international commitments under the Paris Declaration on Aid Effectiveness (2005) and the Accra Agenda for Action (2008), which emphasised country ownership, alignment with national systems, harmonisation of aid, and mutual accountability (Organisation for Economic Co-operation and Development (OECD)/Development Assistance Committee (DAC), 2008). The rationale for using budget support is highlighted in Figure 1 below.

FIGURE 1. Rationale for budget support¹



By relying on domestic systems, budget support reduces aid fragmentation, aligns external financing with national priorities, and fosters a more durable partnership.

In the EU context, budget support has been framed as a tool to advance the Sustainable Development Goals (SDGs), promote democratic governance, and foster resilience in partner countries. More recently, it has become closely tied to the EU’s broader strategic objectives of the Global Gateway.

¹ Lion’s Head Global Partners Illustration based on findings from: “2021 DPF Retrospective: Facing Crisis, Fostering Recovery, World Bank—2022”; “Corporate Evaluation on Policy-Based Lending at the IADB, OVE IADB—2024”.

Budget support has often generated debate among policymakers and practitioners. Its effectiveness depends on a careful balance between potential benefits and inherent risks. On the one hand, budget support provides predictable and flexible financing, strengthens national institutions, and deepens policy dialogue between providers and partner governments. On the other, it exposes providers to fiduciary and political risks, especially in contexts where governance and public financial management systems are weak.

Advocates highlight budget support's role in promoting country ownership and reducing aid fragmentation, while critics caution against overreliance on national systems that may lack transparency or accountability and warn of recipient government dependence. Over time, reforms have sought to maximise the benefits of budget support while mitigating its risks—for instance, by linking disbursements to performance, strengthening policy dialogue, or combining grants with complementary technical assistance.

Figure 2 highlights the main ODA budget support providers, dividing them into multilateral institutions and bilateral donors. To paint a fuller picture, we include the EC's balance-of-payments support loans provided through its MFA instrument. Among bilateral donors, three groups emerge:

- EU member states
- Other DAC members (including the United States, Japan, South Korea, Australia)
- Non-DAC members (including Saudi Arabia, the United Arab Emirates, Qatar, Türkiye)

FIGURE 2. ODA budget support and balance-of-payment support providers²

		Disbursement (US\$ bil.)					Funding Mechanism	Allocation Mechanism	
		2020	2021	2022	2023	Total 2020-23			
Multilateral Institutions		Grants	3.5	1.5	2.2	1.7	9.1	<ul style="list-style-type: none"> • EU Budget • Market Borrowing 	<ul style="list-style-type: none"> • Formula + Political priorities
		Loans	2.0	2.0	8.6	19.7	32.4		
		Grants	2.5	2.0	1.2	0.8	6.5	<ul style="list-style-type: none"> • Replenishment • Market borrowing 	<ul style="list-style-type: none"> • PBA Allocation • DSA Framework
		Loans	4.3	3.8	4.6	4.5	17.4		
		Grants	N/A	N/A	N/A	N/A	N/A	<ul style="list-style-type: none"> • Capital and Self-Sustaining 	<ul style="list-style-type: none"> • Demand-based
		Loans	10.3	4.3	2.6	2.5	19.7		
		Grants	0.4	0.1	0.2	0	0.6	<ul style="list-style-type: none"> • Replenishment • ADB transfers 	<ul style="list-style-type: none"> • PBA Allocation • DSA Framework
		Loans	2.1	0.5	1.1	0.1	3.8		
		Grants	0.9	0.2	0.1	0.1	1.2	<ul style="list-style-type: none"> • Replenishment • AfDB transfers 	<ul style="list-style-type: none"> • PBA Allocation • DSA Framework
		Loans	0.4	0.2	0	0.1	0.7		
	Grants	N/A	N/A	N/A	N/A	N/A	<ul style="list-style-type: none"> • Member contributions 	<ul style="list-style-type: none"> • PBA Allocation • DSA Framework 	
	Loans	0.4	0	0.9	0	1.4			
Bilateral Donors	EU Countries	Grants	0.7	0.2	0.7	0.2	1.8	<ul style="list-style-type: none"> • National budgets 	<ul style="list-style-type: none"> • Supply-based
		Loans	3.2	2.1	2.0	1.1	8.4		
	Other DAC	Grants	1.5	0.8	0.4	1.5	4.2		
	Loans	2.4	2.8	3.0	2.3	10.5	<ul style="list-style-type: none"> • National budgets 	<ul style="list-style-type: none"> • Supply-based 	
	Non-DAC	Grants	1.2	5.3	5.3	4.0	15.8	<ul style="list-style-type: none"> • National budgets 	<ul style="list-style-type: none"> • Supply-based
	Loans	N/A	N/A	0.6	0.1	0.7			

2 Data from OECD CRS Dataset, accessed 27/08/2025. Amounts are in constant prices not current. The "EC" logo refers to budget support provided by EU institutions and financed through the EU budget. The "EU countries" section in the bilateral row refers to bilateral budget support provided directly by individual EU countries through their respective national budgets. The European Stability Mechanism (ESM) also provides budget support but is not included in the CRS dataset as country recipients are not ODA eligible. IDA's logo refers to IDA and not World Bank as a whole (therefore does not include IBRD).

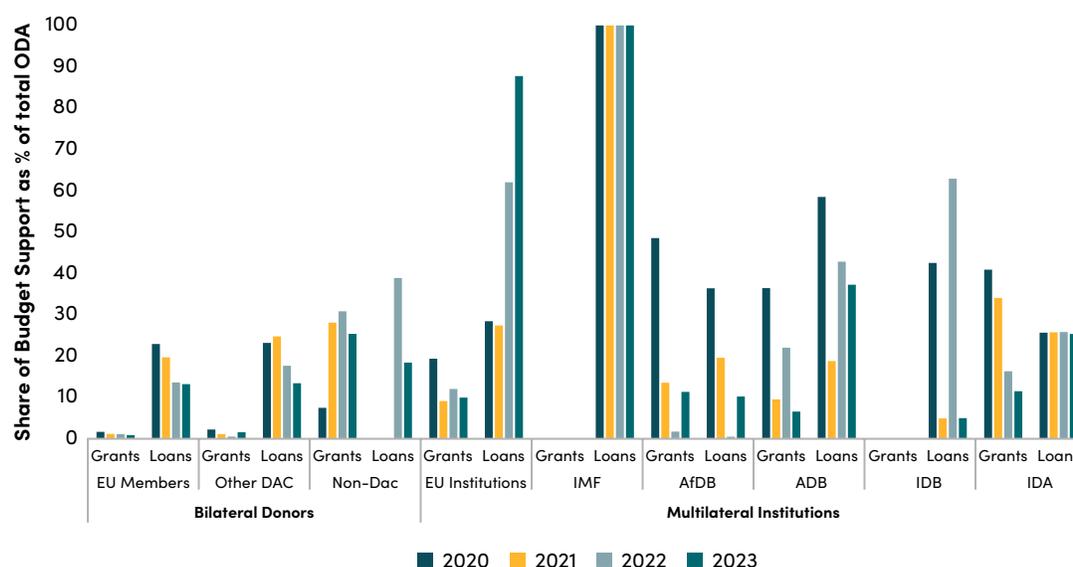
The EC dominates among multilaterals: The EC was the largest multilateral provider of budget support and balance-of-payments support between 2020 and 2023, both in grants and loans. However, the sharp rise in loan disbursements in 2022–2023 is primarily driven by support to Ukraine, which absorbed the vast majority of EU MFA loans during this period.

The EU’s allocation model is distinctive: Allocations of aid to different geographic regions are largely driven by political priorities and choices, while allocations within regions are informed by multi-criteria allocation models. These are, however, less transparent than the Performance-Based Allocation (PBA) models used by most multilateral development banks (MDBs) for their concessional windows. EC budget support is also more sensitive to assessments of fundamental values (human rights, democracy, and the rule of law) and political risk.

The grant-loan distinction follows a different logic: In contrast to the MDBs, the EC does not link decisions on whether a country receives grants or loans to Debt Sustainability Analysis (DSAs). For most MDB concessional windows (e.g., the World Bank’s International Development Association and African Development Bank’s African Development Fund), DSAs determine the financing mix in line with countries’ debt burden and ability to repay: countries at high risk of debt distress typically receive grants, while those at low or moderate risk receive loans.

Figure 3 presents the share of budget support as a percentage of total ODA, disaggregated by loans and grants.

FIGURE 3. Share of budget support as % of total ODA grants or loans³



³ Data from OECD CRS Dataset, accessed 18/09/2025. In sections 7.2 and 7.3 we explore some differences in the provisioning of budget support of EU member states.

The EU has maintained a relatively steady allocation of budget support, with grants representing between 10 and 20 percent of total ODA grants. Loan-based balance-of-payment support, i.e., MFA, averaged around 30 percent of total ODA loans until 2022, after which the Russian invasion of Ukraine triggered a sharp increase. This surge reflects the exceptional scale of EU loan disbursements to Ukraine.

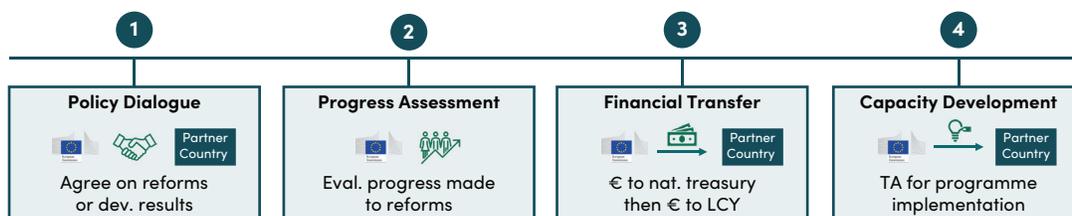
EU member states align closely with other DAC providers. For both groups, budget support—whether in the form of loans or grants—makes up a relatively modest share of total ODA, reflecting a tendency to rely more heavily on project/programme support since the mid-2010s. Non-DAC providers (such as Saudi Arabia, UAE, Türkiye, and many others) stand out for their use of budget support grants compared to their DAC peers.

3. EU budget support: Design and delivery

The analysis below examines the current EU budget support instrument and highlights opportunities to improve its design and delivery. In the following sections, we focus on grant-based budget support rather than the EU’s balance-of-payments support, the MFA programme.

Budget support is one of the most established and widely used instruments in the EU’s external action toolkit. The EU’s approach combines a financial transfer with a framework for policy dialogue, performance monitoring, and capacity building. Disbursements are conditional not only on macroeconomic stability and sound public financial management, but also on adherence to fundamental values such as human rights, democracy, and the rule of law. This makes EU budget support a policy tool as much as a financing modality. Figure 4 illustrates the main steps in the EU grant-based budget support process, from the initial assessment of eligibility criteria, through the programming and contract design stages, to disbursement, monitoring, and evaluation.

FIGURE 4. Steps in the EU budget support process⁴



4 European Commission, Directorate-General for International Cooperation and Development. (2017). Budget Support Guidelines. Publications Office of the European Union. These have gone through several iterations since the EC started becoming a significant provider and pioneer of budget support in the early 2000s.

To operationalise grant-based budget support, the EU has developed a set of comprehensive guidelines that govern its design and delivery. These guidelines establish the overall purpose and objectives of budget support, define the eligibility criteria that partner countries must meet, and set out the different instruments that can be applied depending on country context and policy priorities. Figure 5 provides an overview of these key elements.

FIGURE 5. EU budget support guidelines⁵



Building on these guidelines, the EU has developed a set of contract types that reflect different objectives and operating contexts. Each contract type is designed with specific preconditions, objectives, and design features, ensuring that grant-based budget support remains adaptable to country circumstances while maintaining a consistent overall framework. The EU distinguishes between three types of budget support contracts:

- **Sustainable Development Goal Contracts (SDG-Cs)** are the standard, long-term instrument designed to support broad reform agendas and progress towards the SDGs.
- **Sector Reform Performance Contracts (SRPCs)** are more narrowly focused on sector-level reforms and service delivery.
- **State and Resilience Building Contracts (SRBCs)** are short-term and politically sensitive, designed for fragile or crisis situations, where the priority is to restore macroeconomic stability, safeguard essential state functions, and build resilience.

As shown in Figure 6, each contract type differs in its preconditions, objectives, and design features, allowing the EU to tailor its support across diverse country contexts.

⁵ It is important to note that these guidelines do not apply to the EU's MFA programme. Unlike standard EU budget support, MFA is an instrument that provides medium- to long-term loans or grants primarily to EU candidate countries and neighbourhood partners. MFA operations are conditional on the existence of an active IMF programme. They are focussed on addressing balance-of-payments difficulties rather than supporting broader development or sectoral reforms.

FIGURE 6. EU budget support contracts⁶

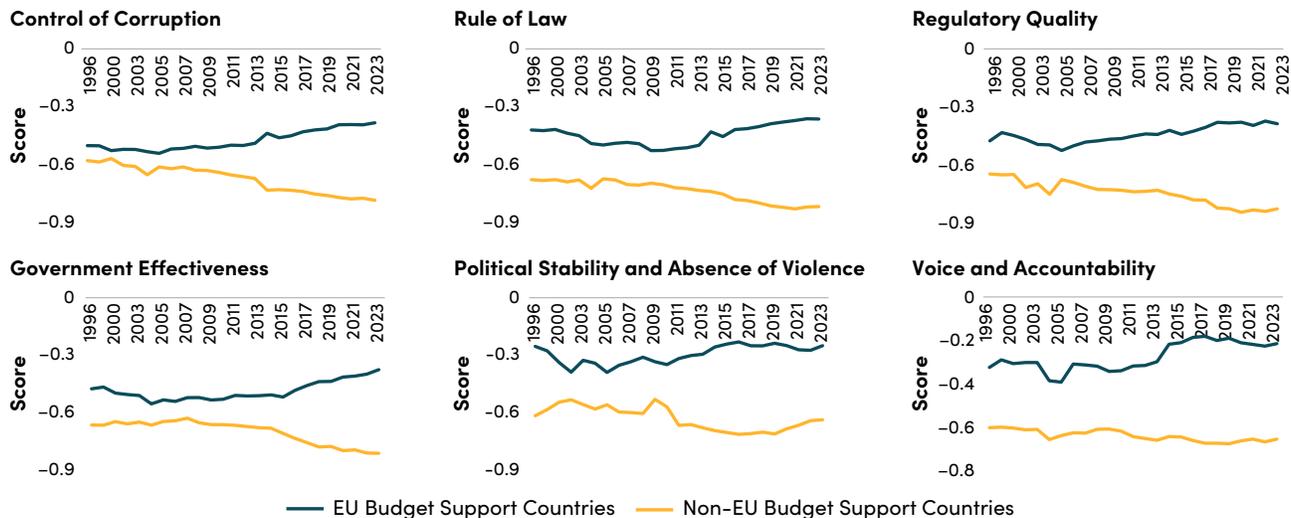
	SDG-C Sustainable Development Goals Contract	SRPC Sector Reform Performance Contract	SRBC State and Resilience Building Contract
Precondition	Satisfactory assessment and trend analysis of country's commitment to Fundamental Values	Fundamental values matter, but related risks are balanced against the need to protect basic service delivery	Fundamental values matter, but related risks are balanced against the risks of non-intervention
Objectives	Promote reforms and progress towards SDGs	Promote sector policy reforms	Restore macro-economic and fiscal stability and build on state and societal resilience
	Affress constraints on sustained, inclusive and equitable growth	Improve service delivery at sector level	Ensure vital state functions (peace and security, payment of civil service salaries...)
	Foster economic governance and domestic accountability	Address basic needs of the population with a particular focus on gender equality	Foster a transition process towards development and democratic governance
	Strengthening core governance systems and supporting broader reforms	Improve governance at sector level	Promotes reforms that address sources of vulnerability
Design Features	<ul style="list-style-type: none"> • 3–6-year commitments • FT+VT 	<ul style="list-style-type: none"> • 3–6-year commitments • FT+VT 	<ul style="list-style-type: none"> • 1–3-year commitments, can be renewed • FT only if 1 year • Closer monitoring and capacity building

Some of the preconditions set out in EU contracts and guidelines can be illustrated by comparing the Worldwide Governance Indicators (WGI)⁷ scores of developing countries that receive EU budget support with those that do not. The comparative analysis illustrated in Figure 7 shows that eligibility criteria effectively reflect stronger public financial management, control of corruption, and other political and governance considerations.

6 The Fixed Tranche (FT) has a fixed value specified in advance within the agreement. They are either disbursed in full (if all conditions are met), or not at all (if one or more conditions are not met). The Variable Tranche (VT) has a maximum value, specified in advance within the financing agreement. It is either disbursed in full or in part, with the amount based on performance achieved in relation to pre-specified performance indicators and targets.

7 The WGI draw on data from intelligence providers, think tanks, civil society organisations, academia and other sources to capture broad patterns in perception of governance quality across countries over time. They aggregate information across six key dimensions of governance.

FIGURE 7. EU budget support WGI scores⁸



According to the latest publicly available data,⁹ the EU’s active budget support portfolio amounted to EUR 11.1 billion in 2023, including the technical assistance that typically accompanies these programmes. New commitments reached EUR 1.2 billion in the same year—EUR 1.5 billion less than in 2022.

A notable surge took place in the Eastern Neighbourhood and the Western Balkans, reflecting the EU’s geopolitical priorities in response to Russia’s invasion of Ukraine. In terms of contract types, SRPCs dominate the portfolio, while SRBCs are primarily concentrated in the Neighbourhood and sub-Saharan Africa. Another notable feature is the higher geographical concentration of contracts per country in the Neighbourhood region, where stronger economic interlinkages and close trading relationships with the EU explain a more substantial engagement—averaging around five contracts per country, compared to one to two in most other regions.

As shown in Table 1, these patterns highlight the centrality of the Neighbourhood in the EU’s budget support architecture, both in terms of financial weight and contractual intensity. This concentration becomes even more evident when comparing the Neighbourhood with other regions in terms of ongoing commitments and actual disbursements in 2023 (see Figure 8). Whereas sub-Saharan Africa was the largest recipient on average over 2014–2021, the balance shifted dramatically in 2021: over 75 percent of all EU grant-based budget support disbursements went to the Southern and Eastern Neighbourhoods, with a sharp uptick in the East driven by Ukraine.¹⁰ Until 2020, Western and Central Africa and the Neighbourhood tracked closely, but as the Neighbourhood’s allocations surged, all other regions, including Asia and the rest of Africa, have seen a decline in commitments. Moreover, the average portfolio size per country in the Neighbourhood is three to seven times larger than in other regions, underscoring both its financial scale and political prioritisation for the EU.

⁸ EU Budget Support Trends and Results (2023) and World Bank Worldwide Governance Indicators Dataset Accessed July 2025.

⁹ 2024 Annual Report on the implementation of the EU’s external action instruments in 2023.

¹⁰ This grant-based budget support is further complemented by substantial MFA lending to support Ukraine.

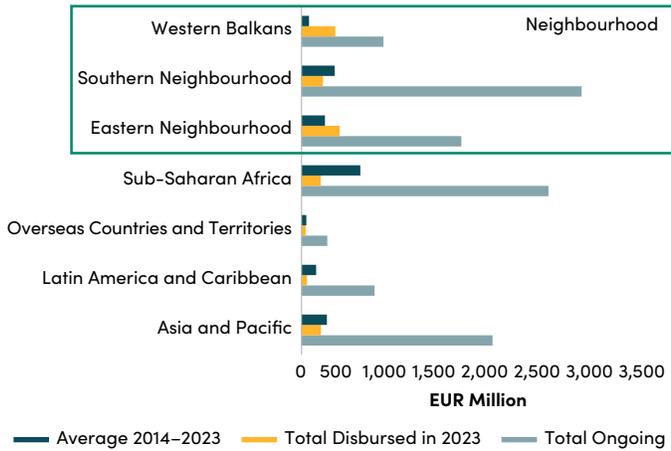
TABLE 1. EU budget support portfolio as of 2023¹¹

Region	Number of Countries	Number of Budget Support Contracts	Type of Budget Support Contract			Budget Support Commitments (in million EUR)		Total Disbursed in 2023
			SDG-Contracts	State and Resilience Building Contracts	Sector Reform Performance Contracts	Total Ongoing	Of Which New Commitments in 2023	
Asia and Pacific	20	40	0	3	37	2,009.3	84.8	204.2
Latin America and Caribbean	13	27	0	2	25	767.3	41	56.5
Overseas Territories	9	11	0	0	11	271.1	112.5	43.5
Sub-Saharan Africa	26	48	4	14	30	2,596.6	294	201.2
Eastern Neighbourhood	4	17	0	6	11	1,681.3	315	401
Southern Neighbourhood	4	41	0	3	38	2,946.2	432	224.7
Western Balkans	6	18	0	7	11	861.8	0	355
All	82	202	4	35	163	11,133.6	1,279.3	1,486.1

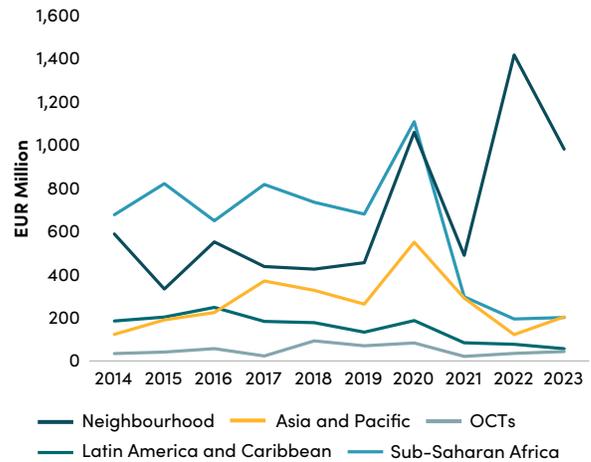
11 Directorate-General for International Partnerships. (2024). 2024 annual report on the implementation of the European Union's external action instruments in 2023. European Commission.

FIGURE 8. EU budget support portfolio evolution over time¹²

Current EU Budget Support Portfolio 2023 Update

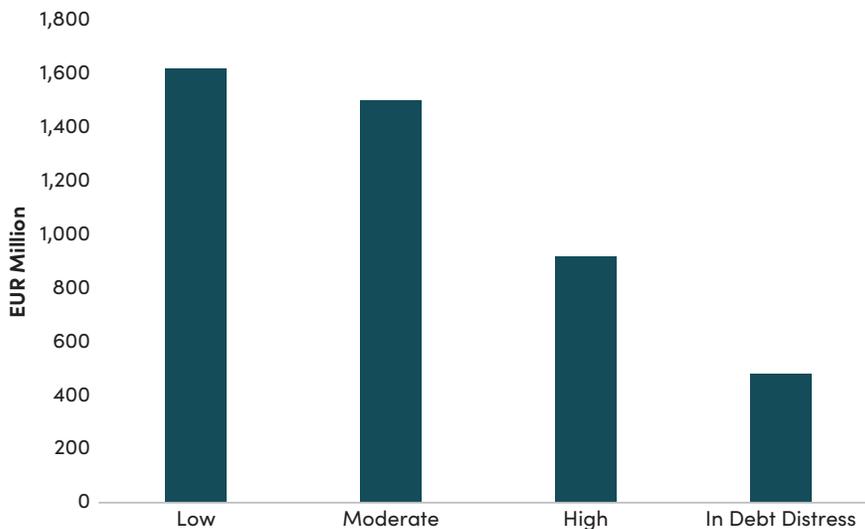


EU Budget Support Disbursements Over Time



Analysis of country-level allocation patterns confirms that, as the WGI assessment suggests, the EU framework tends to favour countries with stronger governance scores. These countries are also typically those with established or emerging market access. Figure 9 shows that the majority of EU grant budget support flows to countries classified as being at low or moderate risk of debt distress. This pattern indicates that EU grant-based budget support largely bypasses countries facing higher debt vulnerabilities, even though these countries often have the greatest need for concessional resources.

FIGURE 9. EU budget support 2023 allocation per risk of debt distress¹³

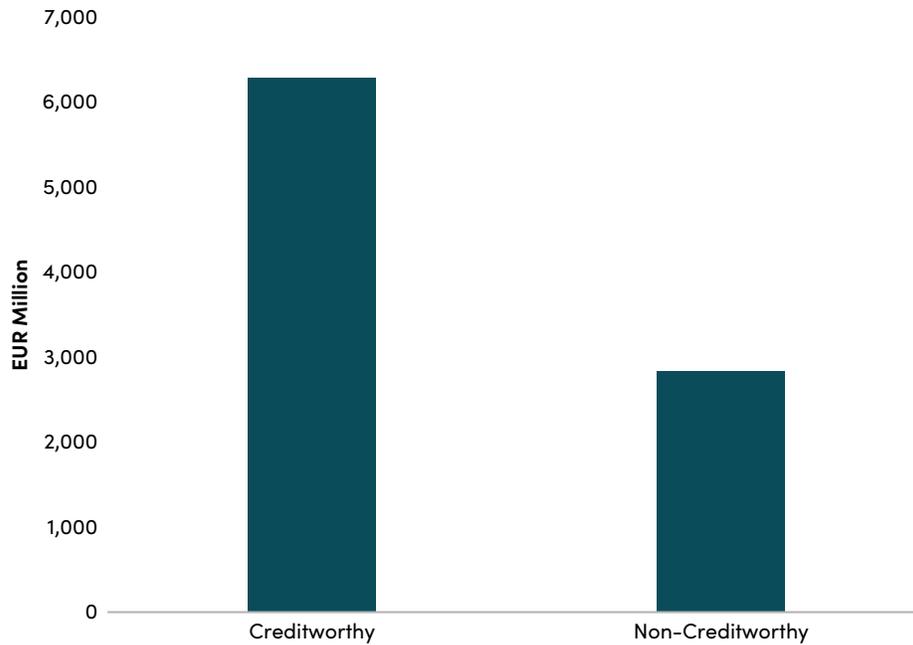


12 Directorate-General for International Partnerships. (2024). 2024 annual report on the implementation of the European Union's external action instruments in 2023. European Commission.

13 European Commission. (2023). EU budget support trends and results (2023). Publications Office of the European Union. In the EU budget support portfolio there are the following set of countries: 9 countries at low risk of debt distress, 19 countries at moderate risk of debt distress, 15 countries at high risk of debt distress and 3 countries in debt distress.

Similarly, as shown in Figure 10, creditworthy countries receive nearly double the allocation compared to non-creditworthy peers.

FIGURE 10. EU budget support per creditworthiness¹⁴



Three structural weaknesses limit the effectiveness and reach of the current EU budget support:

1. Unpredictable and uneven across regions

The distribution of EU budget support varies significantly across regions. Although multiannual indicative programmes set out preliminary geographic allocations, actual annual disbursements prove far more volatile (as illustrated in Figure 8).¹⁵ In recent years, support has become increasingly concentrated in the EU Neighbourhood, with sharp year-to-year fluctuations often linked to political or crisis-related developments.

2. Bias toward creditworthy, low-risk of debt distress countries

The EU framework appears to favour countries assessed as creditworthy and at lower risk of debt distress. Existing eligibility criteria and governance benchmarks—such as those based on WGI—tend to reinforce this pattern. As a result, the majority of grant-based budget support is directed either to creditworthy countries or to countries classified as being at low or moderate risk of debt distress.

¹⁴ Creditworthiness assessed by the World Bank if the country accessed international capital markets in the last 3 years.

¹⁵ This issue would potentially be addressed by the thresholds added under the proposed new Global Europe.

3. **Fragmented contracts portfolio**

While the EU Neighbourhood is supported through a dense and multi-layered portfolio of contracts, engagement in sub-Saharan Africa, Asia, and other regions is typically more fragmented and limited in scale, often comprising only one or two contracts per country. This disparity between concentrated and dispersed support constrains the EU's ability to achieve scale and sustain meaningful impact across its wider range of partner regions.

4. **Improving EU budget support**

The scale, composition, and geographical distribution of EU budget support reflect the EU's shifting strategic priorities. While the EU's approach has notable strengths, a review of best practices and design features from other budget support providers highlights three ways in which EU budget support could be strengthened to enhance predictability, balance, and scale—key conditions for leveraging public resources and freeing up additional capital for development:

1. **Strengthening transparency and predictability of allocation**

EU budget support allocations remain volatile, partly reflecting political choices governing the allocation of aid and selection of budget support instruments. In contrast, most MDBs apply PBA formulae to their concessional windows, balancing performance and need with transparent, objective criteria. Such approaches offer partner countries greater predictability, enabling them to plan on the basis of expected flows and reducing the perception that support is driven primarily by shifting EU priorities.

2. **Leveraging creditworthy partners for expanding financing capacity**

A significant share of EU budget support is channelled to countries that are at low or moderate risk of debt distress. This suggests that scarce EU grant resources are often allocated to places where concessional lending could be viable. Rebalancing grant instruments toward more debt-vulnerable contexts, while introducing concessional loan options for creditworthy countries and those at low risk of debt distress, would enable the EU to better match its financing tools to countries' needs and ability to repay. This would bring the EU more closely in line with the practices of other development finance partners and complement its existing portfolio of instruments.

3. **Aligning financing terms with debt sustainability**

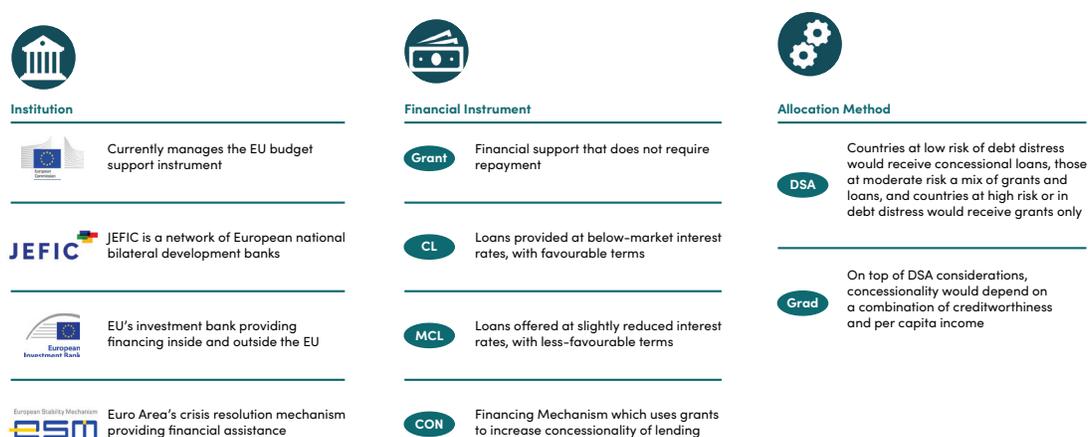
The EU is currently the only major provider of budget support that does not use the joint IMF-World Bank DSA to evaluate the risk of debt distress. Other providers use the DSA to calibrate the mix of grants and concessional loans, protecting highly indebted countries while offering more creditworthy ones financing terms that reflect their capacity to repay. In contrast, much of the EU's budget support goes to creditworthy countries or low-income countries at low or moderate risk of debt distress—contexts where concessional or blended

finance could substitute for full grants. This reduces the efficiency and overall financing potential of EU budget support resources and limits its ability to allocate grant resources to the countries most in need.

5. A proposed budget support framework

This section outlines options for a redesigned EU budget support framework that would move beyond grants. As shown in Figure 11, the redesign can be considered through a sequence of steps: first, defining the institutional set-up; second, selecting the financing instrument; and third, determining the allocation model between instruments.

FIGURE 11. Overview of the proposed budget support framework¹⁶



1. Institutional set-up

The first step is to decide on the institutional arrangements for hosting and delivering the instruments. The EC would continue to manage grants directly. For concessional loans and interest rate buy-downs, there are four options:

- **European Commission:** The EC retains full responsibility for managing both grants and concessional loans, with no transfer of functions to other institutions.
- **Joint European Financiers for International Cooperation (JEFIC) members:** Concessional loans would be administered by JEFIC members (Spain's AECID, France's AFD, Poland's BGK, Italy's CDP and Germany's KfW) through a transfer from the EU, making use of their operational expertise in partner countries. Grants would continue to be managed directly by the EC. Transfers to JEFIC members would apply only where a

16 It is important to note that the EC, primarily through EFSD+ guarantees, already provides a significant de-risking instrument that underpins many of the activities undertaken by the institutions referenced in this paper. As such, an operational relationship between the EC and these implementing partners is already well established. However, given that this paper focuses exclusively on budget support, guarantees are not included in the instrument analysis despite their central role in EU development finance. For a deeper examination of guarantees, see the report published earlier this year (Center for Global Development and Lion's Head Global Partners. (2025). The European Fund for Sustainable Development Plus: Maximising the EU guarantee for leverage and impact).

clear EU dimension exists and would not be used for transactions or programmes that are purely bilateral. Where JEFIC loans are more expensive than those of other lenders, additional grants to increase the concessionality of loans could also be considered (see below).

- **European Investment Bank (EIB):** Concessional loans would be administered by the EIB through a transfer of EU resources, while grants would remain under the control of the EC. To enhance the concessionality of lending, EU funds would be used to subsidise new policy-based loans delivered by the EIB. This would likely require an adjustment to the EIB's mandate, as it does not currently offer policy-based instruments or budget support. The EIB's capacity to raise finance on capital markets could further expand the scale of the instrument. Partnering with the EIB would also allow the EU to benefit from the bank's preferred creditor status.
- **European Stability Mechanism (ESM)¹⁷:** Concessional loans would be administered by the ESM through a transfer of EU resources, while grants would remain under the control of the EC. To date, the ESM has specialised in providing financial assistance to euro-area countries facing severe financing or sovereign debt crises. As an AAA-rated lending institution that regularly issues bonds, it has the capacity to leverage transferred resources on capital markets, expanding the lending volume beyond the initial EU contribution.¹⁸ As with the EIB, partnering with the ESM would allow the EU to benefit from preferred creditor status. However, extending the ESM's mandate to provide budget support beyond the Eurozone would require a revision of its mandate and the unanimous agreement of its shareholders.

2. Financial instrument

The second step is to determine which financial instrument is most appropriate for each recipient country:

- **Grants:** Grants would continue to play a role, ensuring support for countries most in need, particularly those that are fragile, conflict-affected, and/or experiencing debt-distress. This approach preserves continuity with the current framework while maintaining targeted assistance where it is most required.
- **Concessional loans:** Concessional loans would be introduced for countries with sufficient debt-carrying capacity, offering highly favourable terms.

¹⁷ The ESM was set up as an international financial institution by the euro area member states to help euro area countries avoid and overcome financial crises and maintain long-term financial stability and prosperity. The ESM carries out its mission by providing loans and other types of financial assistance to member states that are experiencing or are threatened by severe financial distress.

¹⁸ Originally established to help Eurozone members exit the 2008 financial crisis, with an effective lending capacity of around EUR 428 billion.

- **Moderately concessional loans:** These loans would feature shorter maturity and higher interest rates than concessional loans, suitable for countries at lower risk of debt distress.¹⁹
- **Concessional increase:** EU grant resources could be used to enhance the concessional nature of policy-based loans, for example, by reducing interest rates, extending maturities and grace periods, or adjusting repayment profiles. This would allow the EU to leverage its funds more effectively while incorporating policy-based lending into its toolkit.

3. Financing terms allocation model

The third step concerns the allocation of resources between instruments. As EU budget support evolves beyond a purely grant-based approach to potentially include lending instruments, a more differentiated allocation framework with greater scrutiny will be needed to assess countries' capacity to take on and repay concessional loans. Two allocation models²⁰ are proposed:

- **DSA-based model²¹:** Countries assessed as being at low risk of debt distress would receive concessional loans; those at moderate risk would receive a mix of grants and concessional loans; and countries at high risk or already in debt distress would receive grants only.
- **Graduation model:** Allocation decisions of different instruments would depend on a combination of creditworthiness and per capita income, allowing for a structured transition from grants to concessional and subsequently to moderately concessional loans as countries' income levels improve.

5.1 Analysis of future EU budget support models

Building on the proposed framework, this section presents a set of individual models that can be adapted to better reflect the needs of the EC and partner countries. These models illustrate different elements that could be combined into a comprehensive EU budget support toolkit, incorporating varying degrees of concessional nature suited to specific country contexts. Importantly, the models outlined below are not mutually exclusive. They can be combined or introduced sequentially depending on policy priorities, institutional capacity, and the evolving

19 The interest rate would be a small fee on top of the funding cost of a AAA-rated institution like the EIB or the ESM which could be attractive for countries with market access that issue at larger spreads. The interest rate of the moderately concessional loan could be subsidised by the interest rate buy-down.

20 A third option was explored which gave preference to the neighbourhood (NH). The DSA + NH model applied the DSA-based rules globally but made an exception for the EU Neighbourhood. Under this approach, Neighbourhood countries would continue to receive grants regardless of their debt sustainability classification, preserving the political priority attached to the region. However, this option was not considered in the end as most of the countries in the Neighbourhood are creditworthy and receive the highest share of the allocation rendering the models inefficient.

21 Initially, the EC could rely on the DSA developed by the IMF, while gradually developing its own in-house debt sustainability framework and incorporating additional relevant metrics.

circumstances of partner countries. The five archetypes presented are: (1) Budget Support Grants, (2a) Graduation, (2b) Graduation+, (3) Leverage, and (4) Concessionality Increase (see Figure 12).

FIGURE 12. Overview of the different models

Model	Instrument	Leverage	Institution	Allocation	Precedent
1	Budget Support Grants 	☆☆☆☆		Formula + Political priorities	European Union
2a	Graduation Grants + Concessional loans  	☆☆☆☆	 JEFIC	DSA model (Grants or loans depending on risk of debt distress)	ADF
2b	Graduation+ Grants + Concessional loans + Moderately concessional loans   	☆☆☆☆	 JEFIC 	DSA model + concessionality will decrease with increasing level of country development	JEFIC, IBRD, & IMF's RST
3	Leverage  Moderately concessional loans	☆☆☆☆	 ESM	Demand based/LMICs & UMICs	IDA Market Borrowing
4	Concessionality Increase % ↓ Interest rate buy-down	☆☆☆☆	 ESM JEFIC	Higher interest buy down decreasing with level of country development	GCCF

Model 1: Budget support grants

This model reflects the current system, in which the EC manages grants through its budget support mechanism.

Model 2: Graduation and Graduation+

In this model, loans are introduced alongside grants. Eligible countries “graduate” from grant to concessional loans and then to moderately concessional loans as their debt sustainability or development levels improve. This model allows capital that has been lent and repaid to be recycled, increasing overall financing capacity and improving the efficiency of EU grants allocated to budget support. Loans could continue to be managed by the EC or delegated to JEFIC members, who have experience with policy-based lending and budget support lending. The allocation of grants and/or loans would follow a DSA-based formula:

- High risk/in debt distress: 100 percent grants
- Moderate risk: 50 percent grants, 50 percent concessional loans
- Low risk: 100 percent concessional loans.

The EC already provides policy-based loans outside the EU through its MFA instrument. However, this instrument is constrained by EU budget rules, which limit its use to support during balance-of-payment crises and require an EU budget guarantee. Unlike MDBs, the EC does not leverage its capital

when deploying MFA as its borrowing corresponds one-to-one with its lending.²² Under this model, however, loan repayments from a concessional facility could be recycled into grants.

Model 2a (Graduation)

This variant enables the provision of grants and concessional loans, allocated in line with the DSA. Modelling shows that once grace periods expire, the EU could expect around EUR 200 million per year in recycled capital. This would be equivalent to financing an additional moderately-sized programme annually (see Annex 7.1.2).

Model 2b (Graduation+)

This variant adds moderately concessional loans (MCLs), which sit between market-rate and concessional loans. MCLs would accelerate repayment reflows, with higher-income countries facing less concessional terms. The model applies a sliding scale of concessionality that declines as income levels rise (for example, UMICs would face higher interest rates than LMICs). Comparable approaches can be found in KfW's differentiated lending model, the World Bank's International Development Association (IDA)—International Bank for Reconstruction and Development (IBRD) graduation pathway, and the IMF's Resilience and Sustainability Trust (RST).²³ Modelling suggests that, once grace periods end, around EUR 250 million per year could be recycled. This is equivalent to funding roughly one additional medium-sized programme annually (see Annex 7.1.2).²⁴

Legal considerations

While further legal analysis would be required, Models 2a and 2b appear legally feasible. The MFA instrument provides a precedent for combining grants and concessional loans without the need for a new legal basis; existing authorities and operational practices could be adapted.

22 The EC uses a unified funding programme for EU borrowing. This was introduced in 2023 as an extension of the approach used for NextGenerationEU, replacing the old practice of issuing separate bonds for each lending programme. For on-lending, the EC operates on a back-to-back basis: it borrows funds at AAA rates and passes the same terms (with a small margin or fees added) to the beneficiary country. There is no leverage when relending, i.e., the EC does not take deposits or equity to lend multiple times that amount; it essentially intermediates between capital markets and the beneficiary, with the EU budget as a guarantor. Because of this back-to-back model, the European Commission's lending volume is one-to-one with its borrowing authorisation and budgetary guarantees.

23 An analysis of other budget support providers is available in the annex.

24 For modelling purposes, the same level of grants as in the previous scenario is assumed. LMICs, or LICs/LMICs at low risk of debt distress, as well as countries at moderate risk, continue to receive concessional loans under the same terms as above (moderate risk would continue receiving 50 percent concessional loans and 50 percent grants). However, UMICs, which previously received concessional loans under Model 2, would receive 50 percent moderately concessional loans with a 15-year maturity, 3-year grace period, and an interest rate of 300 basis points (bps) if at moderate debt distress, and 100 percent if at low debt distress. This configuration reflects the transition toward less concessional but more financially sustainable lending terms as countries' income levels rise.

Model 3: Leverage

Model 3 introduces financial leverage²⁵ as a capital-efficient way to expand EU budget support. Because leveraged resources must ultimately be repaid, this model relies on a combination of grants and loans, particularly MCLs. These would be allocated primarily to LMICs and UMICs²⁶ with sufficient debt-servicing capacity. Future loan repayments would be treated as expected future revenue streams to raise additional capital on capital markets. This would increase the overall financing envelope available for EU budget support through both grants and loans. The degree of leverage achievable would depend on the quality of the loan portfolio; defaults, delayed payments or higher concessionality would reduce the potential multiplier.

Operationally, the EC would likely rely on the existing institutional setup, borrowing capacity, credit rating and preferred creditor status²⁷ of the EIB or the ESM to issue bonds. A comparable precedent is IDA's market-borrowing model. Because the portfolio would consist of countries outside the EU, it could also benefit from EFSD+ guarantees, which would reduce expected losses and capital requirements, thereby further increasing financial leverage potential.

Modelling suggests that EU budget support resources could be leveraged up to 2.5 times, assuming a portfolio quality comparable to historic budget support operations (see Annex 7.1.3).

Model 3 can be combined with Models 2a and 2b, complementing MCLs with grants and concessional loans. Although this would reduce overall leverage, it would enable cross-subsidisation across instruments, increasing financing capacity across country categories.

Legal considerations

Significant legal changes may be required as leveraging EU budget support and using the EIB or the ESM to borrow against the loan portfolio would likely necessitate legislative or treaty amendments.²⁸

Model 4: Concessionality increase

Under this model, the EU would use grants to increase the concessionality of loans provided by institutions such as the EIB, ESM, or JEFIC members. The level of subsidy would decrease with income level, similar to Model 2b ("Graduation+"). A relevant precedent is the Global Concessional

25 Introducing leverage means adding borrowed capital to increase financing capacity beyond current capital.

26 Countries would also only be eligible if they are not at high risk of debt distress or in debt distress as per country DSA.

27 Further analysis would need to determine the ability of the EC to obtain PCT for lending activity.

28 A way to implement Model 3 could for the EC to enter a guarantee/contribution agreement with the EIB or ESM (treated as an "international organisation" under FR Article 159), setting the portfolio cap, coverage %, loss waterfall, claims, recoveries and reporting. Persons or entities implementing Union funds under Article 62(1)(c) (which includes international organisations) may be entrusted to implement budgetary guarantees under Title X, subject to the Commission's ex-ante assessments and ongoing controls. Furthermore, ESM's mandate is currently restricted to Eurozone countries and would hence need amending should ESM be considered as implementation partner.

Financing Facility, which blends donor contributions with lending from development finance institutions to reduce borrowing costs for eligible countries.

For JEFIC members, this approach is most relevant in contexts where borrowing costs remain comparatively high, particularly for UMICs. Given that JEFIC institutions already tend to offer more concessional terms than the EIB or the ESM, the marginal benefit of additional concessionality would generally be lower. As a result, the instrument would be less attractive or less necessary in most cases. Nevertheless, it could still play a targeted role in specific situations, for example, where policy objectives require enhanced concessionality for particular operations.

Model 4 differs from Model 2a, 2b, and 3 in that it subsidises existing loans rather than creating a dedicated concessional lending instrument. Its impact depends on loan size and maturity; larger loans and longer maturities require more subsidy per basis point of buy-down. For simplicity, the model assumes that all resources are used for interest-rate buy-downs. Results suggest that the EU could achieve a multiplier of up to 10 times relative to the cost of buy-downs (see Annex 7.1.5. for budgetary and EFSD+ implications).

Increasing the level of concessionality of loans could offer a comparatively straightforward channel for directing EU resources to the EIB or JEFIC members, arguably easier than reallocating resources to the ESM or embedding them entirely within the EU budget. This could make the EIB and/or JEFIC members more practical institutional vehicles for scaling up concessional loans in support of external budget support operations. There is precedent for the EC blending JEFIC member lending with grants to increase loan concessionality, though this has so far occurred on an ad-hoc basis for specific projects rather than through an established and coordinated programme for budget support.

Legal considerations

This model is unlikely to require major legal changes, as EU financial regulations (Title V, Art. 135) already allow interest rate rebates.

A comparative summary of the advantages and considerations for each model is provided in Table 2.

TABLE 2. Comparative assessment of the different models

Scenario	Advantages	Considerations
1 Budget Support Grants	<ul style="list-style-type: none"> ✓ Simple and familiar framework for all stakeholders ✓ No repayment burden for beneficiary countries ✓ Low administrative and financial risk 	<ul style="list-style-type: none"> • No leverage or capital recycling—limited scalability • Limited differentiation between countries different macro fiscal frameworks and income
2a Graduation	<ul style="list-style-type: none"> ✓ 200m EUR per annum unlocked ✓ Improved capital efficiency and financing capacity using capital recycling through concessional loan repayment ✓ Better differentiation of support based on debt sustainability ✓ Maintains grant component for fragile high-risk countries 	<ul style="list-style-type: none"> • Less simple framework with higher administrative and financial risk • Potential pushback from countries for facing borrowing costs • Counterparty risk if lending is managed by JEFIC members
2b Graduation+	<ul style="list-style-type: none"> ✓ 250m EUR per annum unlocked ✓ Further improved capital efficiency and financing capacity using capital recycling through (moderately) concessional loans repayments ✓ Strengthens sustainability and fairness of resources allocation ✓ Aligns with best practices at of multilateral and bilateral peers 	<ul style="list-style-type: none"> • Structural complexity on pricing differentiation and eligibility thresholds • Potential pushback from some recipient countries for facing higher borrowing costs • Higher complexity on coordination and administration
3 Leverage	<ul style="list-style-type: none"> ✓ Substantially increases financing volumes (2.5× leveraged) ✓ Builds on existing EU financial architecture and market credibility of EIB/ESM ✓ Mobilises private and institutional capital ✓ Reduces direct pressure on EU budget 	<ul style="list-style-type: none"> • Higher financial and reputational risk exposure for EU institutions • Less concessional than other scenarios (as LICs are excluded) • Requires strong governance and risk management framework • Political feasibility from shareholders of the institutions
4 Concessional Increase	<ul style="list-style-type: none"> ✓ Multiplier of up to 10× relative to the cost of buy-down ✓ Cost-effective way to lower borrowing costs ✓ Highly flexible and compatible with existing lending operations ✓ Enables differentiated concessional across income groups 	<ul style="list-style-type: none"> • Administrative complexity in calculating and applying subsidies • May be less viable politically than direct grants • Requires high coordination with underlying lending institutions

6. Conclusion

EU budget support remains one of the EU's most distinctive and strategically valuable external financing instruments. Its emphasis on policy dialogue, country systems, and institutional strengthening gives it a unique role that cannot easily be replicated by project finance or guarantees. Yet, as this paper has shown, the current model is constrained by structural weaknesses that limit its predictability, geographic balance, and capacity to operate at scale.

The absence of a transparent allocation logic, the implicit bias toward creditworthy and lower-risk countries, and the fragmentation of contracts outside the EU Neighbourhood together reduce both the efficiency and the development impact of scarce EU grant resources. At the same time, the exclusive reliance on grants prevents the EU from recycling capital, leveraging its balance sheet, and tailoring its financial instruments to countries' varying capacities to carry and repay debt.

By introducing a more differentiated approach, aligning the use of grants and concessional loans with countries' fiscal space and financing conditions could substantially increase the scale, predictability, and impact of support without increasing budgetary resources. The framework and models set out in this paper show that reform is both conceptually feasible and operationally realistic. The models are not mutually exclusive and could be introduced incrementally, allowing the EU to adapt its approach in line with institutional capacity, legal feasibility, and policy priorities.

As negotiations on the 2028–2035 Multiannual Financial Framework advance, this is a timely moment to reconsider how budget support is structured. A more integrated concessional finance toolkit—aligned with debt sustainability, responsive to country context, and capable of leveraging public capital—is essential for the EU to maximise impact in an increasingly resource-constrained and geopolitically complex world.

7. Annexes

7.1 Modelling of the models

The five highlighted models employ four separate financial instruments: 1) grants, 2) loans, varying in their concessionality, 3) leveraged lending, and 4) interest buy-downs. Accurate modelling requires first an understanding of what the current market rates for these products might look like at comparator institutions, followed by an assessment of how implementation would work from an EU perspective.

7.1.1 Derivation of modelling assumptions

The OECD Creditor Reporting System (CRS) database reveals patterns in concessional loan pricing and structure across development finance institutions (Figures A1-A2). Most institutions offer loans with fixed interest rates ranging from 0 to 600 basis points. Budget support lending from JEFIC members, KfW, and AFD shows similar rate distributions to the overall institutional averages. From the EU point of view, Figure A1 highlights all CRS-recorded lending for budget support activities, encompassing MFA. The modal rates from the last MFF here are approximately 0, 125, and 300 basis points. These are comparable to modal rates at the other institutions and therefore define the assumption for the pricing of the concessional (125 bps) and moderately concessional (300 bps) products. This modelling (see Table A1) uses fixed rates so as not to introduce error from interpreting the forward path of the risk-free benchmarks; however, in reality, at least the MCL is likely to be a floating rate. These are used as order-of-magnitude correct figures and should not be interpreted as a guide to pricing. Figure A2 extends this analysis to loan lengths and structures, highlighting organisations' use of common structures around 10, 15, 20, and 30 years. Finally, a grace period of 6 years is used, given that this is the typical duration of the existing EU budget support programmes.

TABLE A1. Instrument modelling assumptions

Instrument	Interest Rate	Grace	Tenor	Structure
Grant	n/a	n/a	n/a	n/a
Concessional Loan	1.25%	6	15	Amortising
Moderately Concessional Loan	3%	6	30	Amortising

FIGURE A1. CRS Dataset EU & EDFI pricing

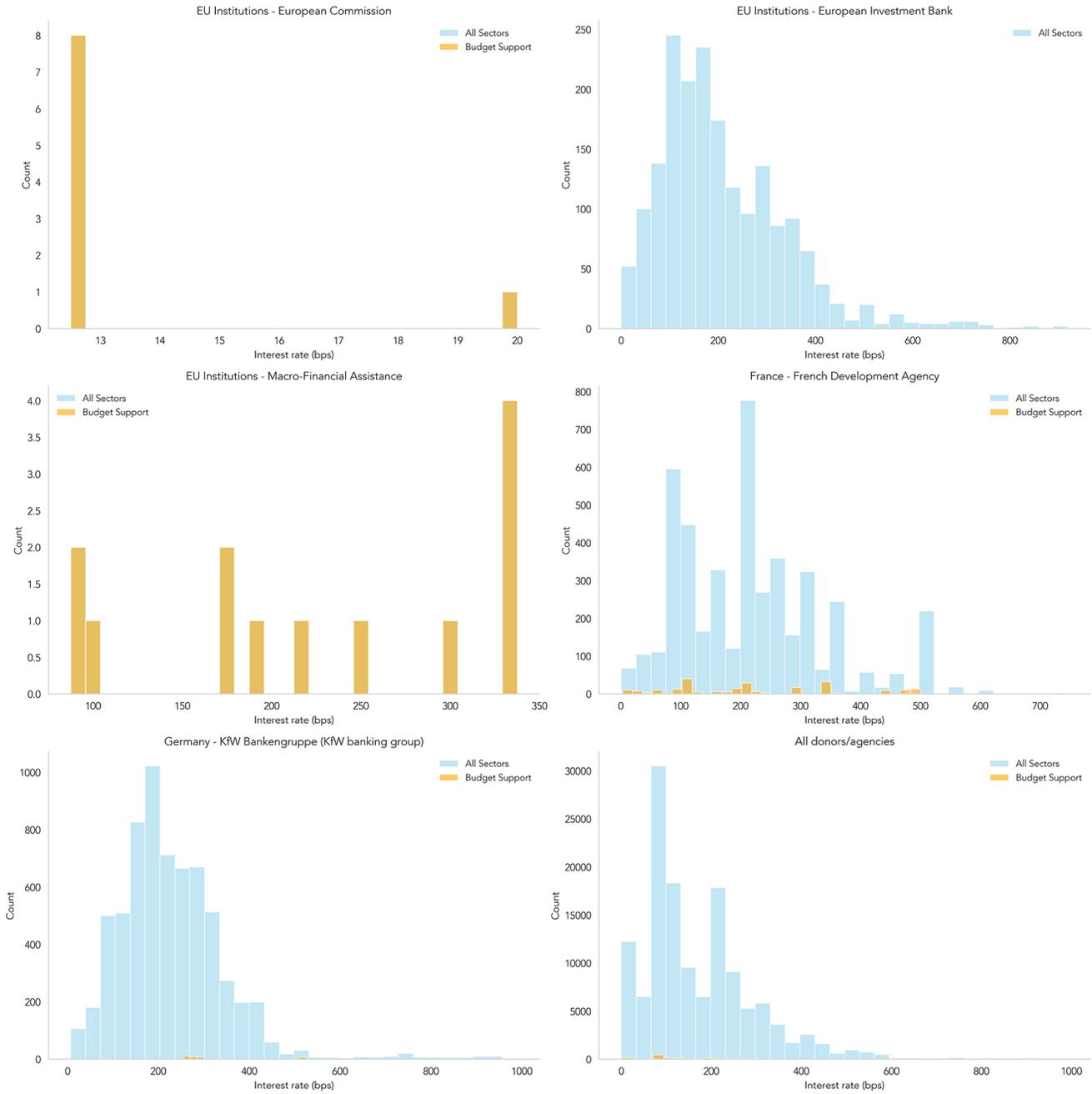
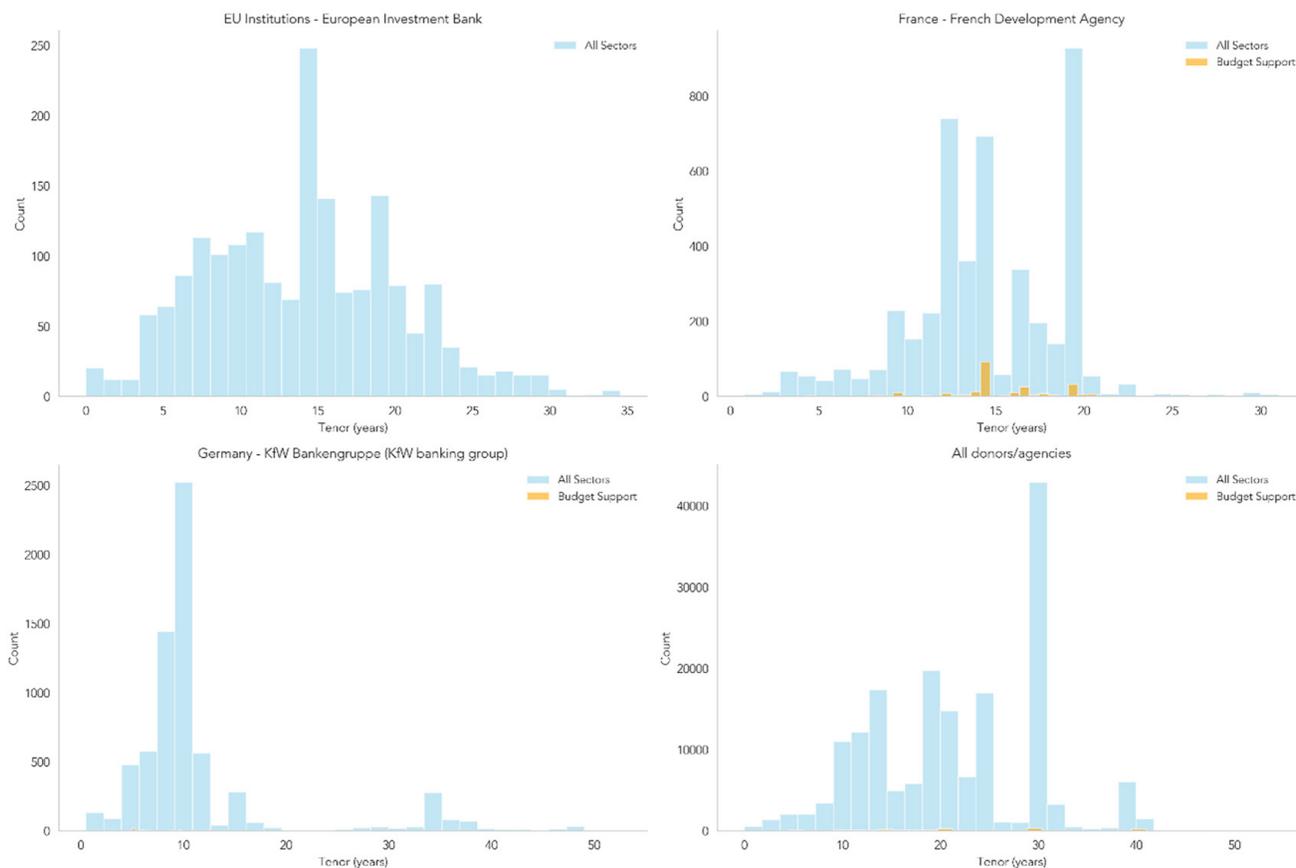


FIGURE A2. CRS Dataset EDFI tenors



The final key assumption is the portfolio allocation by country. The allocation weighting and overall size are taken from the EU budget support—trends and results 2023.²⁹ For models with debt repayment, the sovereign rating and implied probability of default inform the expected return. For each sovereign, the blended average long-term sovereign rating on a 21-point scale is used alongside a smoothed average of the Moody’s, Fitch, and S&P 2023 sovereign time to defaults. Table A2 summarises the modelling assumptions.

29 European Commission. (2023). EU budget support trends and results (2023). Publications Office of the European Union.

TABLE A2. Model summary

Metric	Model 1 (Budget Support Grants)	Model 2a (Graduation)	Model 2b (Graduation+)	Model 3 (Leverage)	Model 4 (Concessional Increase)
Modelling Method	Simple Aggregation	Default adjusted cash flow (Reflows)	Default adjusted cash flow (Reflows)	Credit Default Modelling	NPV of Interest Differential
Allocation Model	Grant: 100%	DSA: DD ³⁰ /High: Grants Moderate: 50% Grant, 50% CL Low: 100% CL ³¹	If UMICs and Low DSA: 100% MCL	n.a.	n.a.
Budget Multiplier	1.0x	1.0x + Reflows	1.0x + Fast Reflows	~2.5x – 2.7x	Varies by rates and size
Key Risk	Inefficiency	Repayment Risk	Affordability for Partner	Systematic Market Risk	Interest Rate Volatility
Main Constraint	Budget Ceiling	Slow Capital Recycling	Political Acceptance	Treaty/Mandate Change	EU Grant Budget for Buy-down

7.1.2 Models 2a & 2b: Graduation and Graduation+

Cashflows are calculated in four steps: instrument allocation, loan profiles, state evolution, and aggregation.

First, the models allocate each country’s total commitment across concessional loans, MCL loans, and grants under two policy scenarios. The allocation uses the consolidated debt distress risk and Gross National Income (GNI) per capita. Model 2a applies a rule based only on distress risk. Model 2b applies the same rule but replaces part or all of concessional lending with MCL lending once GNI per capita exceeds the threshold. Grants do not generate cashflows.

Second, the models build cashflow vectors for each loan type. For a given horizon, each loan has unit notional. For each year up to the contractual maturity of the loan, the outstanding balance is 1. Interest in each year up to maturity equals the loan rate. Principal is repaid in a single bullet in the final year. Beyond maturity, outstanding balance, interest, and principal are all zero. This yields vectors for interest, principal, and outstanding for concessional loans and for MCL loans.

Third, the models simulate rating migrations and defaults across countries and years. Countries start from an initial rating index inferred from market ratings or, if absent, from the debt distress category. Ratings evolve through a Markov transition matrix with 21 states, shown in Table A3, where the final state represents default. At each year and for each simulation, the model draws region factors with a correlation structure given by the region correlation matrix and a Cholesky

30 Debt Distressed.

31 Concessional Loan.

decomposition. It also draws country-specific shocks. The model combines both with a single correlation parameter into a normal variable for each country, converts it to a uniform variable through the normal Cumulative Distribution Function (CDF), and maps it through the cumulative transition probabilities of the current rating state to obtain the next rating state. A country enters default when its rating reaches the default state and then remains there.

Fourth, the models derive cashflows for each year and simulation. For any country that newly enters default in a given year, the models record a recovery equal to the recovery rate times the outstanding notional of concessional and MCL loans in that year, scenario by scenario. For non-defaulted countries, the models apply the interest and principal vectors at that year to the allocated volumes of concessional and MCL loans, again by scenario. It then sums interest, principal, and recovery across all countries for each simulation and year. The result is a time series of simulated flows for interest, principal, and recoveries under models 2a and 2b, which can then be combined, summarised, or analysed further.

TABLE A3. Rating transition matrix on a 21-point rating scale

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	
1	0.97	0.03	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
2	0.07	0.86	0.07	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
3	0	0.07	0.86	0.07	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
4	0	0	0.08	0.84	0.07	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
5	0	0	0	0.13	0.76	0.1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
6	0	0	0	0.01	0.13	0.79	0.07	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
7	0	0	0	0	0.01	0.12	0.79	0.07	0	0	0	0	0	0	0	0	0	0	0	0	0	
8	0	0	0	0	0	0.01	0.13	0.72	0.13	0.01	0	0	0	0	0	0	0	0	0	0	0	
9	0	0	0	0	0	0	0.01	0.1674	0.7	0.11	0	0	0	0	0	0	0	0	0	0	0	
10	0	0	0	0	0	0	0	0.01	0.15	0.76	0.07	0	0	0	0	0	0	0	0	0	0	
11	0	0	0	0	0	0	0	0	0.02	0.2	0.68	0.1	0.01	0	0	0	0	0	0	0	0.01	
12	0	0	0	0	0	0	0	0	0	0.02	0.15	0.71	0.11	0.01	0	0	0	0	0	0	0.01	
13	0	0	0	0	0	0	0	0	0	0	0.01	0.11	0.75	0.12	0.01	0	0	0	0	0	0.01	
14	0	0	0	0	0	0	0	0	0	0	0	0.01	0.1067	0.7	0.16	0.01	0	0	0	0	0.02	
15	0	0	0	0	0	0	0	0	0	0	0	0	0.01	0.14	0.72	0.1	0	0	0	0	0.03	
16	0	0	0	0	0	0	0	0	0	0	0	0	0	0.01	0.1517	0.7	0.07	0	0	0	0.07	
17	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.02	0.26	0.46	0.07	0.01	0	0.17	
18	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.01	0.07	0.3	0.1	0.07	0.45	
19	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.05	0.1	0.85	
20	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0
21	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1

Modelling suggests that once the loan grace periods are over, the EU would expect between EUR 220 and 250 million per annum (see Figure A3 and Table A4). This is equivalent to an additional large-sized programme each year.

FIGURE A3. Models 2a and 2b loan annual repayment

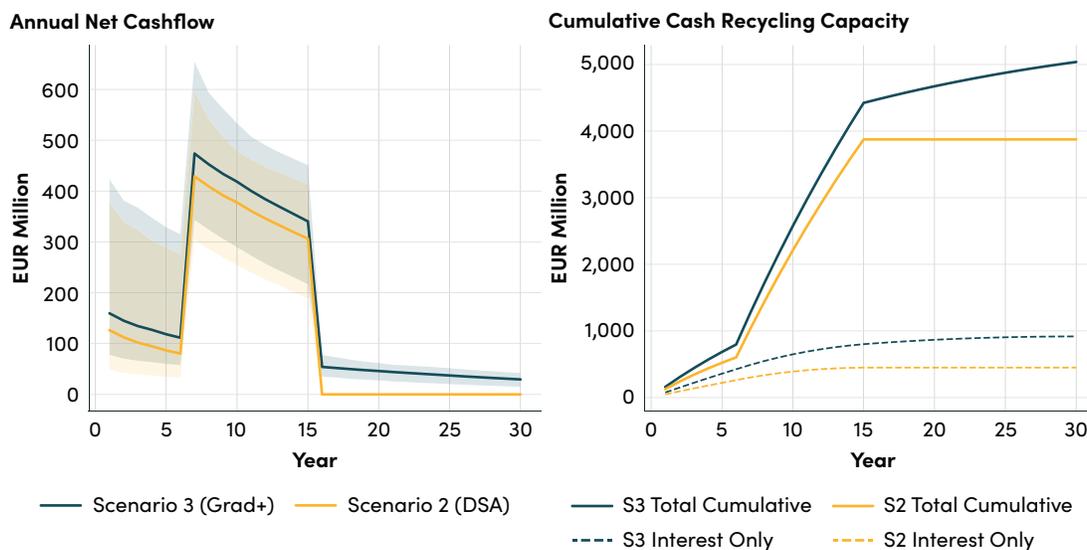
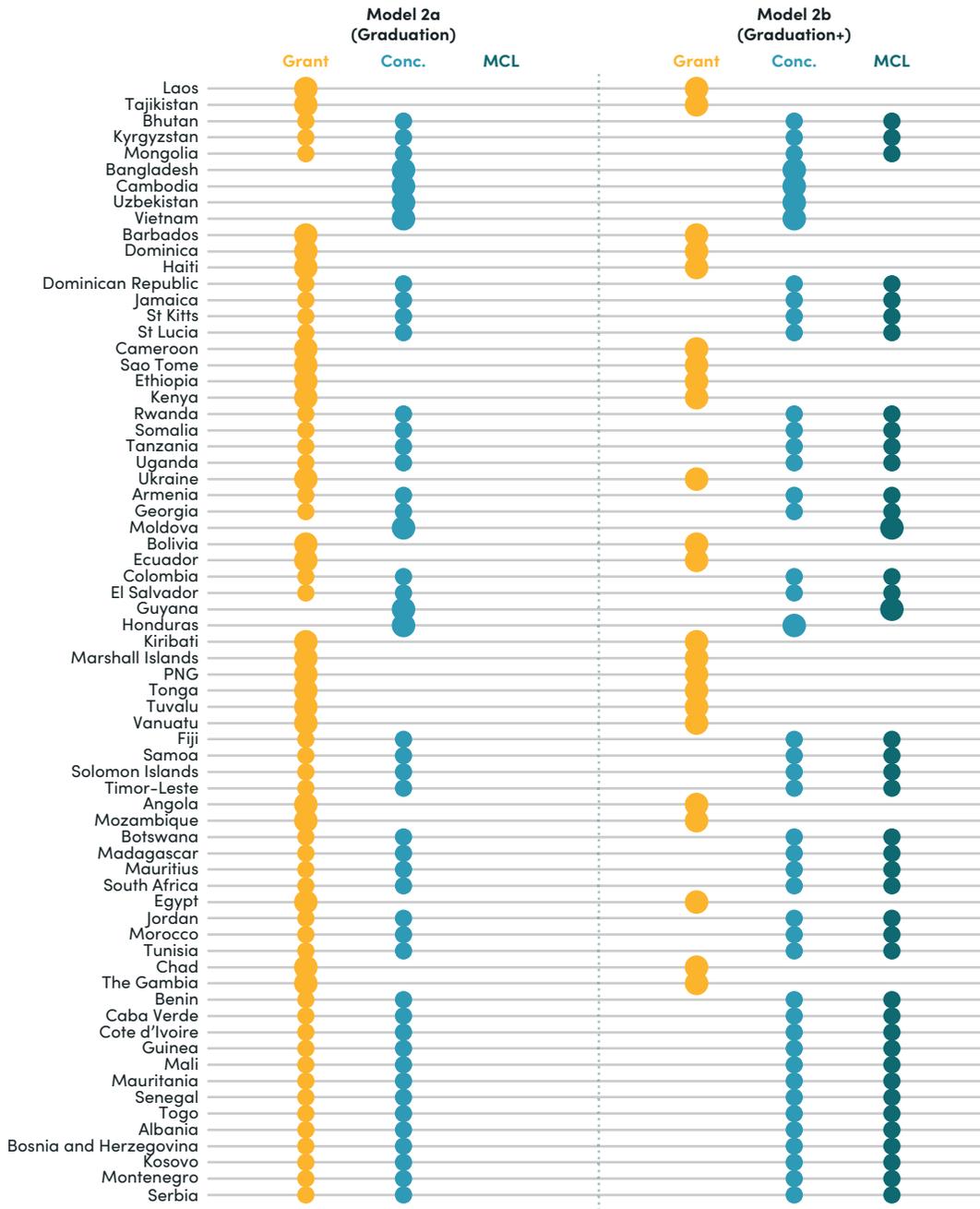


TABLE A4. Models 2a and 2b comparison

Metric	Model 2a	Model 2b
Expected Total Return	3875	5038
VaR	3320	5354
Avg Annual Interest (Y1-14)	31.8	55.8
Avg Annual Principal	187.5	195.4
Total Annualised	219.3	251.2

FIGURE A4. Model 2a and 2b loan annual repayment



7.1.3 Model 3: Leverage

Cashflows follow the same four-step structure as in the previous section but link directly to the leveraged lending set out in the main text.

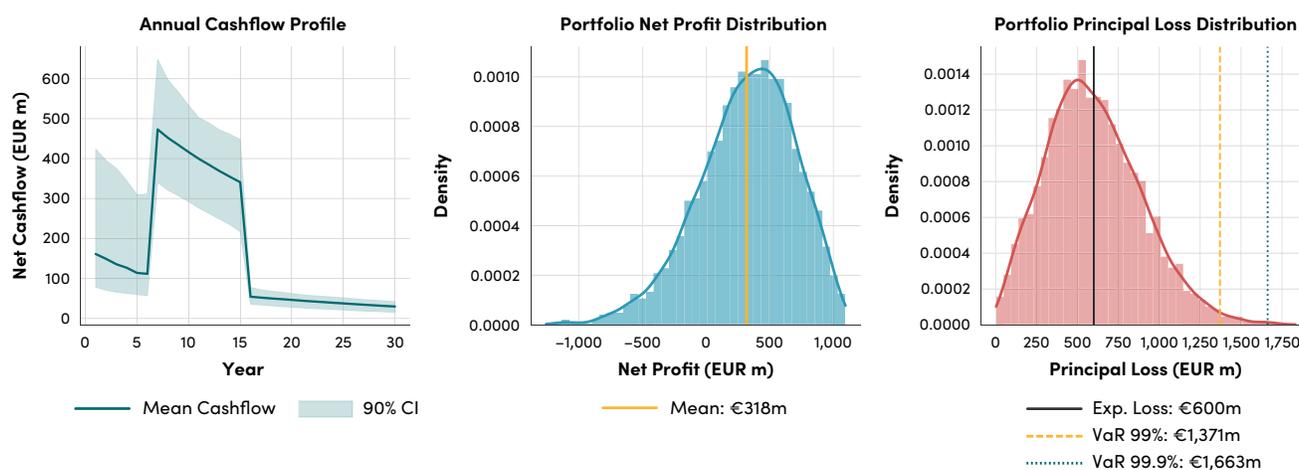
Budget support lending forms a portfolio of concessional sovereign loans rated predominantly BBB to CCC. To leverage these upfront, an AAA-rated institution would need to issue upfront; credit modelling

must therefore be used to estimate the return on the portfolio which is secure at the AAA loss level. Statistical modelling demonstrates that credit losses, even in extreme stress scenarios (99.9 percent confidence interval), are unlikely to exceed 40 percent of the total portfolio volume. Therefore, at a high level, the issuers will likely not experience principal loss and can achieve a 40 percent credit enhancement, or 2.8x leverage ratio (see Figure A5). In an actual programme, the portfolio will also exhibit duration mismatch and term structure risk as well as interest rate risk on the cost of funding, which, even at the AAA level, is likely to be higher than that received on the concessional loans. This can most simply be solved by overcollateralising the lending programme and so the actual leverage achieved is likely to be lower than what is represented here. Table A5 summarises modelling assumptions.

TABLE A5. Summary table leverage

Metric	Value
Total Asset Pool	€ 4,721 m
Expected Loss	€ 600 m
Unexpected Loss (99.9)	€ 1,063 m
Required Equity (First Loss)	€ 1,663 m
Senior Debt Capacity	€ 3,058 m
Achievable Leverage	2.8x

FIGURE A5. Portfolio distributions and leverage for CLs and MCLs



7.1.4 Model 4: Concessionality increase

This model calculates use of a fixed capital budget B (e.g., from a grantor such as the EC) to:

1. Buy down the interest margin on loans from a “market” schedule $D(m)$ to a concessional “policy” schedule $A(m)$; and
2. Extend loan maturities beyond what the market would normally provide (maturity transformation);
3. Optionally provide a first-loss guarantee (EAG) that also consumes the same budget.

Here m denotes a maturity bucket (e.g., $\leq 8y$, 8–10y, etc). The key outputs are:

- The volume of loans (and number of loans) you can support per maturity bucket
- How the fixed budget splits between (a) interest buy-down and (b) guarantee provisioning
- The incremental cost of longer maturities (maturity transformation) relative to a short-tenor base case

MDB sovereign loans are typically priced as:

$$\text{Rate} = \text{Reference Rate} + \text{Contractual Spread} + \text{Maturity Premium} + \text{Funding/risk charges}$$

For example, IBRD Flexible Loans (IFLs) in USD use Secured Overnight Financing Rate (SOFR) (or other overnight benchmarks) plus a contractual spread (currently 50 bps), plus a maturity premium that increases with the average maturity, plus a charge for IBRD’s funding spread. For this model we:

1. Select a reference risk-free curve, here Euro Short-Term Rate (ESTER).
 - For each maturity bucket m estimate the market spread $D(m)$ and policy spread $A(m)$ over the reference rate using IBRD variable spread data by average maturity for countries of similar credit quality³²
2. Use the shortest bucket (e.g., ≤ 8 years) as the base maturity, where the maturity premium is typically zero or lowest (as in IBRD, where the maturity premium applies only above a certain average maturity)

$$\Delta(m) = \overbrace{[D(m) - A(m)]}^{\text{Policy Buy-down}} + \overbrace{[D(m) - D(8y)]}^{\text{Tenor Extension}}$$

Where:

- m is the maturity of the loan (e.g., 20 years).
- $D(m)$ is the Market Spread (Default) for maturity m .
- $A(m)$ is the Policy Target Spread for maturity m .
- $D(8y)$ is the “Base” Market Spread (anchored at 8 years).

The market vs policy rate for each tenor has been estimated using the delta between IBRD’s high-income lending and its blend lending. The model calculates the Present Value (PV) of the subsidy to determine the upfront capital required per dollar of lending. The discount rate, r is set to ESTER.

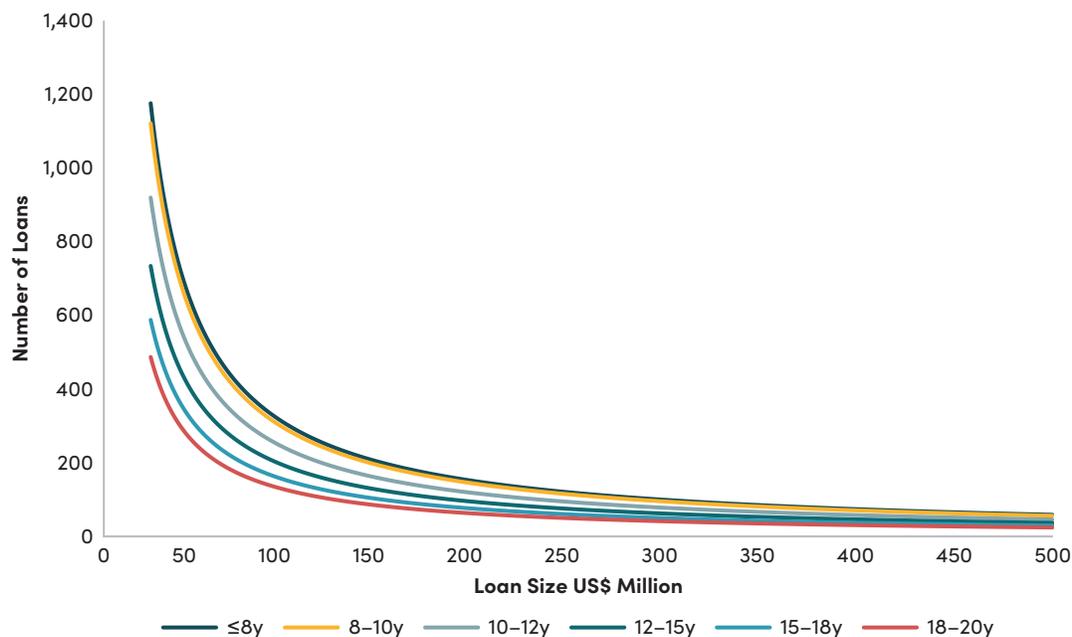
$$S_{PV}(m) = \sum_{t=1}^m \frac{\Delta(m) \times \text{Outstanding}(t)}{(1+r)^t}$$

Figure A6 shows how many loans could be funded if the entire budget support budget was used for interest rate buy-downs of a particular tenor and face value. The relevant variables are the size of

³² International Bank for Reconstruction and Development. (2018). Changes in IBRD loan pricing effective July 1, 2018. World Bank Group.

the loan, the amount of rate buy-down, and the loan's tenor. Figure A6 fixes the policy rate buy-down amounts within each tenor ($D(m) - A(m)$) by estimating what these might be from IBRD's market and policy lending. This analysis highlights that the EU makes a trade-off in subsidising more, cheaper and shorter loans, vs fewer longer more expensive loans. Additionally, the interest rate buy-down can also be used for maturity transformation, shown in Figure A6 by moving between lines.

FIGURE A6. Additional lending achieved by loan size and tenor



7.1.5 Model 4: Analysis 2, provisioning

The analysis above indicates that the EU may be able to go further and be more flexible with lots of small, short loans. However, each of these loans will likely need to be covered by the External Action Guarantee, and modelling suggests that this works in the opposite direction. This is maturity-independent, but interacts with maturity via the volume of loans you can support at each maturity:

$$\text{Provisioning Cost} = \text{Principal} \times \text{Provisioning Rate (9\%)}$$

For each maturity bucket, m :

$$S_{total}(m) = S_{pv}(m) + S_{prov}$$

This is the total budget cost per 1 unit of loan principal at maturity m , combining:

- Interest buy-down + maturity transformation (PV subsidy $S_{pv}(m)$)
- Guarantee provisioning S_{prov}

Given a fixed Budget Support capital budget B , the total principal supported at each maturity if the entire budget is in that bucket is:

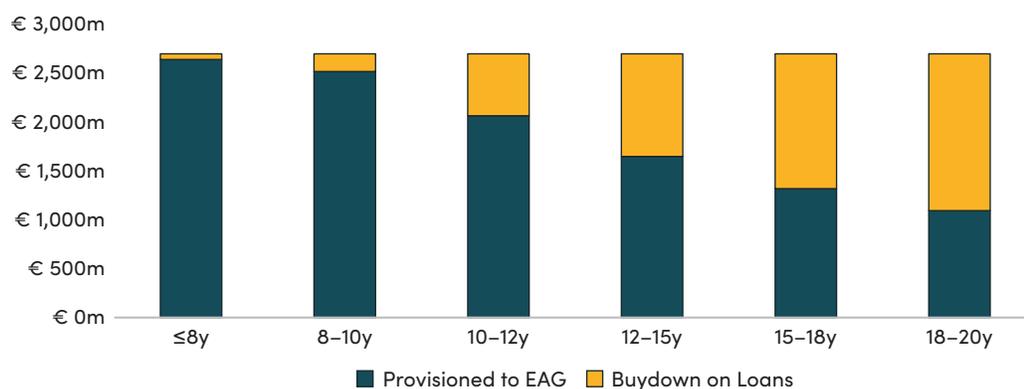
$$\text{Total Principal}(m) = \frac{B}{S_{\text{tot}}(m)}$$

For a given loan size L , the number of loans supported is:

$$N(m,L) = \frac{B}{S_{\text{tot}}(m) \cdot L}$$

Figure A7 shows that as for shorter, smaller loans, the EU is spending only a small fraction of the loan on the buy-down, the relative cost of covering the provisioning becomes very significant. Comparing loans buy-down programmes with the same present value, Figure A7 highlights that were the EU to exclusively programme smaller, shorter loans (<8y), it would spend 98 percent+ of its budget support allocation on EAG provisioning and <2 percent on the actual programme. In this scenario, clearly the effective capital multiplied is very low. This is an extreme example, but it highlights a real consideration in implementing interest rate buy-downs, that the EU must balance provisioning with loans size and maturity.

FIGURE A7. EC buy-down total financed by maturity



8. Selected budget support providers

8.1 World Bank—IDA & IBRD

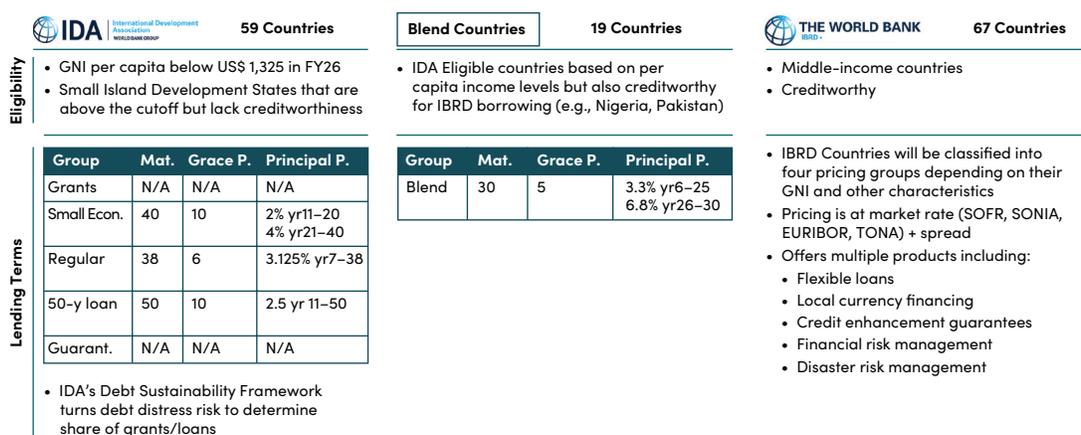
Among the various multilateral and bilateral actors, the World Bank stands out as the second-largest provider of budget support. Not only is it one of the largest providers of budget support globally, but it has also developed a well-established framework that combines concessional and non-concessional financing with clear rules on aid allocation and strong links to country policy frameworks. Additionally, the World Bank has progressively internalised and addressed many of the challenges associated with budget support. Concerns around fiduciary risk, weak country systems, and limited accountability have shaped successive reforms of its budget support instrument. As a result,

the World Bank has incorporated safeguards, conditionality mechanisms, and results frameworks that are explicitly designed to mitigate these risks.³³

The World Bank Group delivers budget support mainly through two arms: IDA, which provides grant and concessional loans to low-income countries, and BRD, which lends on non-concessional terms to creditworthy middle-income countries. Together, IDA and IBRD constitute the “World Bank” in the strict sense and account for the bulk of its budget support operations, while other parts of the World Bank Group (such as IFC or MIGA) focus on private sector operations and guarantee provision, respectively.

For allocation of resources through its concessional financing window (IDA), the World Bank relies on the PBA system. This means that the volume of support a country can access is determined by a formula taking into account a country’s income level, population, and performance on governance and policy indicators. Similar formulae are also used in other MDB concessional financing windows, such as the African Development Fund (ADF), and the International Fund for Agricultural Development (IFAD). For the IBRD, which lends to MICs, allocations are influenced by demand but remain subject to creditworthiness assessments and prudential limits. The IDA and IBRD lending terms for eligible countries are summarised in Figure A8.

FIGURE A8. IDA/IBRD lending terms and transition framework³⁴



The World Bank offers three core financing instruments: Development Policy Financing (DPF), Program-for-Results (PforR), and Investment Project Financing (IPF). Borrowing countries can select among these options depending on the nature of the development challenge they face and the type of financing or support most appropriate to address it.

33 The European Commission also has comprehensive guidelines on budget support that have gone through several iterations since its own pioneering work—particularly on variable, results-based tranches and long-term commitments—from the early 2000s. These are discussed further in Section 3.

34 World Bank. Lending rates and fees (IDA, IBRD). World Bank Treasury. World Bank. (2025). IDA21 terms effective 10-01-2025. World Bank Group.

For the purposes of this paper, the most relevant instrument is the DPF, which constitutes the World Bank’s primary modality for budget support. DPF operations provide quick-disbursing resources linked to the adoption of policy and institutional reforms. The World Bank’s PforR instrument can, depending on its structure, also be regarded as budget support, as it shares some features of policy-based lending by disbursing directly into the recipient government’s central treasury account, with disbursements linked to the achievement of agreed results. Together, these instruments reflect the World Bank’s broader approach to combining financial transfers with institutional strengthening and policy dialogue. Figure A9 provides a snapshot of the three instruments and their main features, while Figure A10 presents disbursements under these instruments, disaggregated by IDA and IBRD.

FIGURE A9. World Bank lending instruments

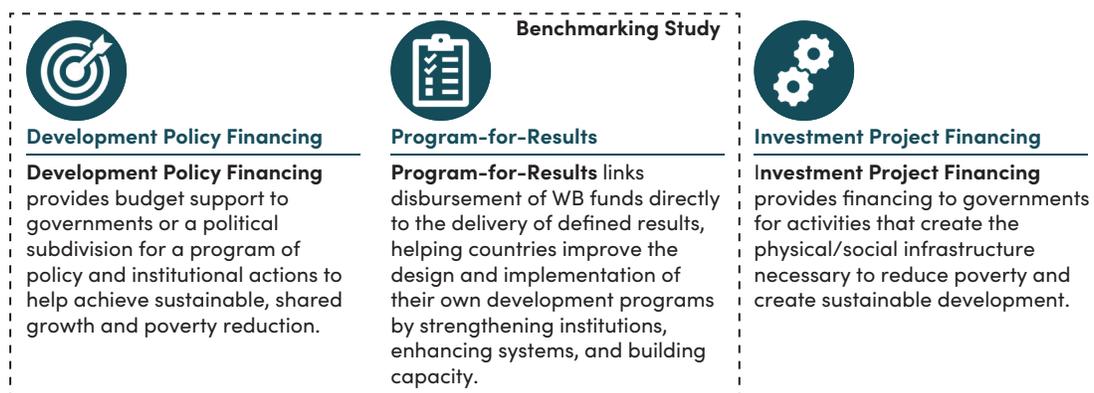


FIGURE A10. IDA and IBRD lending per instrument³⁵



Another defining feature of the IDA’s approach is the rules-based distinction between grants and loans, which is guided by joint DSAs conducted with the International Monetary Fund. Under this framework, countries assessed to be at high risk of debt distress—or already in debt distress—receive their full allocation as grants. Countries at moderate risk receive a 50-50 mix of grants and concessional loans, while those at low risk receive their allocation entirely as concessional loans.

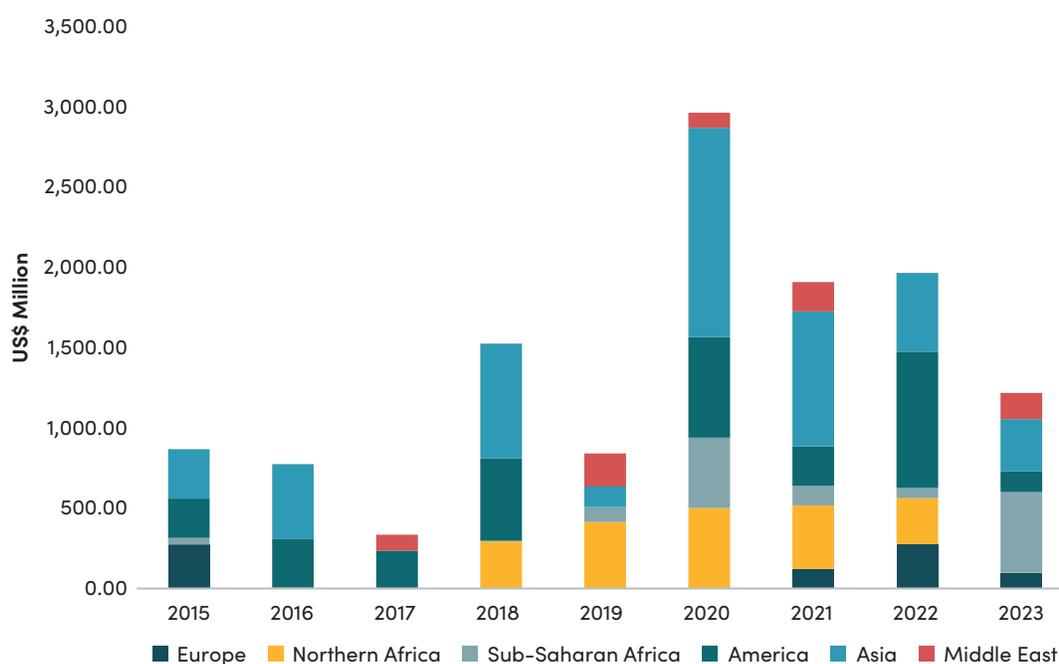
³⁵ International Development Association. Financing. World Bank Group.

This framework is not unique to IDA; it is also applied by other multilateral development banks, such as the ADF, ensuring consistency across the concessional finance architecture.

8.2 Kreditanstalt für Wiederaufbau (KfW)

KfW’s budget support operations represent the largest portfolio among EU bilateral donors, with AFD providing a similarly significant volume. KfW’s geographical distribution of budget support is relatively balanced. However, over the past eight years, the majority of its operations have been directed towards Asia, the Americas, and Africa—the latter being almost evenly split between sub-Saharan and Northern Africa (see Figure A11).

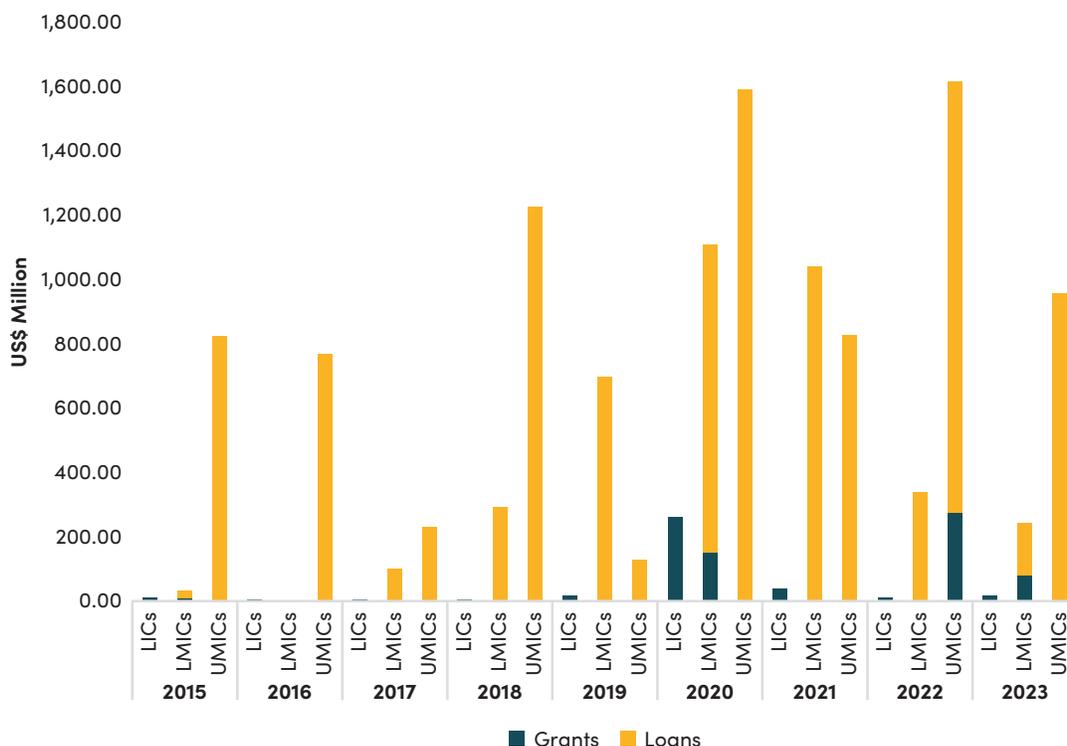
FIGURE A11. KfW’s budget support per region³⁶



KfW provides budget support in both grants and loans. Grants are directed exclusively to LICs and LMICs, whereas loans are exclusively allocated to LMICs and upper-middle-income countries (UMICs), with the exception of Ukraine in 2022, which received grant-based budget support. While the specific financial terms of KfW’s budget support loans are not publicly disclosed, they are generally characterised by long maturities, extended grace periods, and low interest rates, indicating a high degree of concessionality. Notably, the level of concessionality and the grant element of KfW loans decrease with the level of country development, reflecting the institution’s differentiated approach to financing. As illustrated in Figure A12, this pattern is evident in the structure of loans and grants by income category.

³⁶ Data from OECD CRS Dataset, accessed 18/09/2025.

FIGURE A12. KfW's budget support per income category³⁷



8.3 Agence Française de Développement (AFD)

Together with KfW, AFD is one of the leading bilateral providers of budget support within the EU. It has accumulated substantial experience in delivering this form of assistance over a long period. Budget support operations account for roughly 30 percent of AFD's total activity, reflecting the institution's strategic commitment to supporting partner countries' public policies and reforms. AFD provides budget support through two main instruments:³⁸

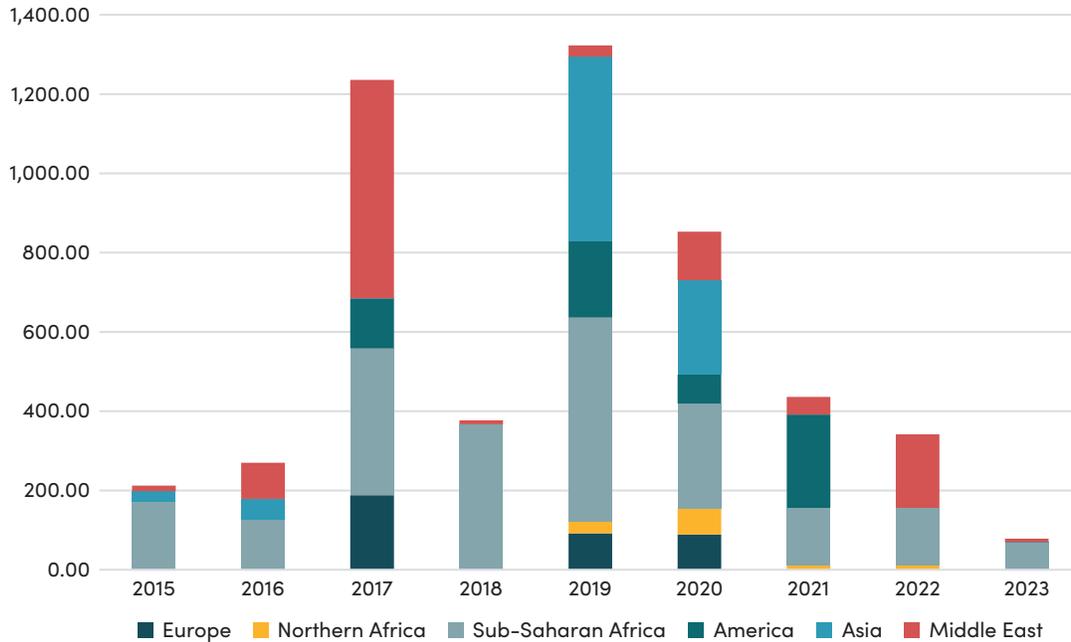
1. **Policy-Based Support**, which aims to accompany the implementation of sectoral or cross-cutting reforms, and
2. **Programme Budget Support**, which is designed to fully or partially finance a sectoral expenditure programme.

As illustrated in Figure A13, sub-Saharan Africa, Asia, and the Middle East represent the largest regional shares of AFD's budget support portfolio.

³⁷ Data from OECD CRS Dataset, accessed 18/09/2025.

³⁸ As will be discussed in the next section, this approach closely mirrors the EU's budget support contracts.

FIGURE A13. AFD's budget support portfolio per region³⁹

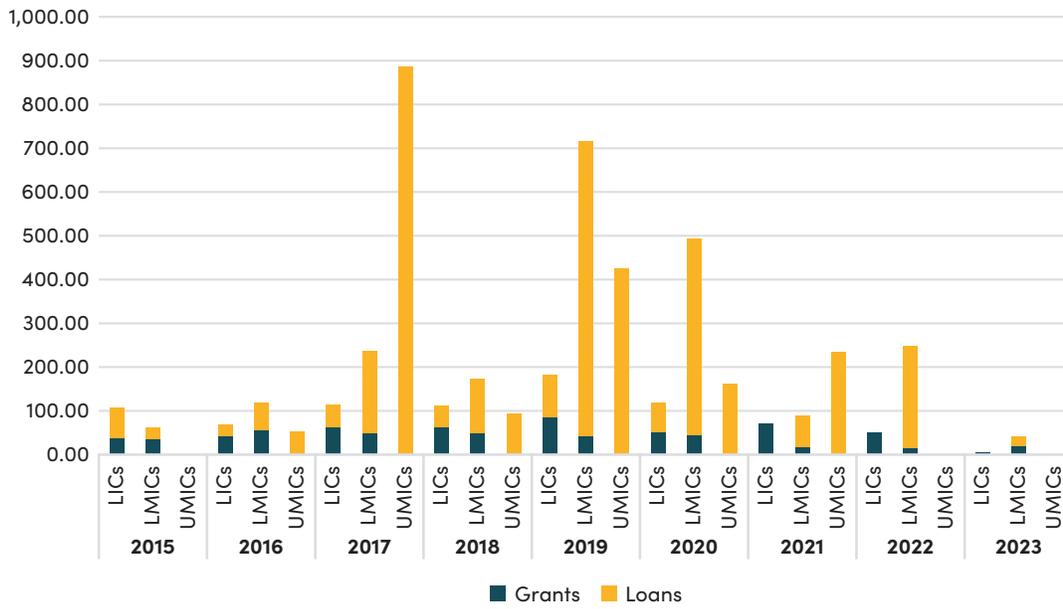


AFD offers budget support both in the form of loans and grants, depending on the income level and financing needs of partner countries. Its loan instruments typically have maturities ranging from 5 to 20 years, with an optional grace period of up to 7 years. The interest rate is generally set at six-month EURIBOR plus a margin and is accompanied by a commitment fee of 0.5 percent and an appraisal fee of 0.5 percent. In terms of allocation, UMICs receive only loans, while LICs and LMICs benefit from a mix of grants and loans. As shown in Figure A14, LICs receive a higher share of grants, reflecting AFD's differentiated approach to concessionality, which aligns with the practices of MDBs and KfW.⁴⁰

³⁹ Data from OECD CRS Dataset, accessed 18/09/2025.

⁴⁰ Despite KfW's overall budget support portfolio being larger in US\$ terms, the grant envelope is the same than AFD's.

FIGURE A14. AFD's budget support portfolio per income category⁴¹



⁴¹ Data from OECD CRS Dataset, accessed 18/09/2025.