



# INNOVATIVE FINANCING TO FUND DEVELOPMENT: PROGRESS AND PROSPECTS

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The global economic and financial crisis has stimulated increased interest in innovative financing to help deliver more and better aid. But just what does “innovative financing” mean? This Issues Brief sketches the background to this interest, presents the current status of innovative financing for development, analyses its main characteristics, and makes recommendations to ensure full compliance of innovative financing with aid effectiveness principles.

## Introduction

The past decade has seen the emergence of many new actors and new sources of funding for development. In the health sector, new global partnerships have helped scale up aid to meet the relevant Millennium Development Goals (MDGs). Building on technical work commissioned by heads of state in 2004, new mechanisms have been created to help raise steady, predictable and concessional funding for achieving human development and other poverty reduction goals. For the past nine years, the idea of innovative financing has been regularly promoted at the global, G8 and European Union summits, stimulating new thinking around aid policies.

The lessons learned from the first initiatives, particularly in the health sector, are being widely shared. New potential mechanisms are being explored under the auspices of the Pilot Group on Innovative Financing for Development, which today brings together 61 countries (58 members and 3 observers) and various private and multilateral agencies. The most recent initiative in the health sector is a global voluntary contribution on airline tickets proposed in September 2009 by the Under-Secretary-General of the United Nations and Special Advisor on Innovative Financing for Development, Mr. Philippe Douste-Blazy.

## The landscape of innovative financing today

The first innovative financing mechanisms were created to combine public and private contributions to meet major health challenges. These were the GAVI Alliance (formerly known as the Global Alliance for Vaccines and Immunisation) and the Global Fund to fight AIDS, Tuberculosis and Malaria. Each took advantage of the upsurge in private philanthropy for development, particularly through the Gates Foundation, to create a new type of public-private partnership (PPP) that would fund major disease-fighting campaigns in developing countries.

These new health sector funds have themselves become drivers of further innovation. GAVI is now largely funded through the International Finance Facility for Immunisation (IFFIm), which is expected to raise a total of USD 4 billion by issuing bonds against long-term ODA commitments from eight donor countries. Through this mechanism, governments contribute to IFFIm to meet interest payments and the ultimate redemption of the bonds. Meanwhile, the Global Fund is now receiving contributions from (PRODUCT) RED, to which credit card and other companies contribute a share of their profits on goods marked with the (PRODUCT) RED trademark. The Global Fund has also made use of a more traditional form of development assistance – debt relief – through the Debt2Health initiative by which donors forgive the debt owned by developing countries on condition that these countries contribute half the forgiven amounts to Global Fund programmes there.

The financial crisis has also sharpened interest in schemes that involve a small levy on private (or sometimes public) purchases. The air ticket levy scheme launched in 2006 had, by 2009, been adopted by 13 countries, and an international purchase facility, UNITAID, has been created to distribute its proceeds with the objective of scaling up access to treatments for AIDS, tuberculosis and malaria.

Another new revenue-raising mechanism is emerging with the auctioning of permits to emit greenhouse gases. Germany announced that it would allocate EUR 225 million from the 2009 proceeds of these auctions to fund development activities.

The use of guarantees and insurance to stimulate financing for development is also expanding. In June 2009, the first Advance Market Commitment (AMC) was launched for the development of a vaccine against pneumococcal disease. Under this scheme, private and public donors commit to subsidise a vaccine which passes agreed tests. This provides a new incentive to pharmaceutical companies to develop a product that might otherwise not be commercially viable. Another type of financial promise that has recently been trialled is weather insurance. Here donors must put up the funds to buy an insurance policy. If stipulated rainfall or other thresholds are later met, the policy is triggered and farmers receive the indemnity specified in the policy.

## **Box 1. Recent history of innovative financing for development**

### **Strong and increasing political support at the global level...**

**International Conference on Financing for Development, Monterrey, March 2002:** The international community recognised "...the value of exploring innovative sources of finance provided that those sources do not unduly burden developing countries". Countries agreed "...to study, in the appropriate forums, the results of the analysis requested from the Secretary-General on possible innovative sources of finance".

**Geneva, January 2004:** The Presidents of Brazil, Chile and France, with the support of the United Nations Secretary-General, launched an initiative to fight hunger and poverty and called on the international community to create new sources of financing for development.

**Meeting of heads of state and government at the United Nations, September 2004:** A technical report on "Solidarity levies to fund development"<sup>1</sup> presented options for innovative financing mechanisms, with immediate possibilities for piloting in the area of health and AIDS.

**World Summit, 2005:** Heads of state and government welcomed the international efforts to identify "innovative and additional sources of financing for development on a public, private, domestic or external basis to increase and supplement traditional sources of financing".<sup>2</sup>

**New York, September 2005:** 79 countries endorsed the Declaration on Innovative Sources of Financing for Development, co-sponsored by Algeria, Brazil, Chile, France, Germany and Spain. A Leading Group on Solidarity Levies (later renamed the Pilot Group on Innovative Financing for Development) was created to develop advocacy and technical work.

**International Conference on Financing for Development, 2008:** The Doha Declaration called for scaling up the use of innovative financing for development.

### **... led to concrete recommendations to implement innovative financing mechanisms**

The High Level Taskforce on Innovative International Financing for Health Systems (co-chaired by the President of the World Bank and the Prime Minister of the United Kingdom) was launched in September 2008. It was tasked to come up with practical proposals for new and innovative sources of finance in order to fill the financing gaps threatening the health MDGs. By spring 2009, this taskforce had formulated recommendations which include expanding existing mechanisms and exploring new forms of financing such as solidarity levies on tobacco or currency transactions.

At the Sixth Plenary meeting of the Pilot Group, held at the OECD on 28-29 May 2009, each member country was encouraged "...to adopt an innovative financing mechanism within a year's time and report to the Group's next plenary session on progress made". Furthermore, countries committed to implementing the air ticket solidarity levy were invited "...to undertake legislative and regulatory proceedings to do so, if possible, within a year".

The Leaders' Declaration at the June 2009 G8 meeting at l'Aquila called on the international community "...to consider, where appropriate, broadening innovative financing initiatives on a voluntary basis" and committed to "...explore the potential of new innovative financing mechanisms, including new forms of voluntary contributions by citizens and corporations".

1. <http://www.diplomatie.gouv.fr/en/IMG/pdf/LandauENG1.pdf>

2. Paragraph 23 (d) of UN General Assembly Resolution A/60/L.1.

Other schemes may be established soon, and the Pilot Group on Innovative Financing for Development has discussed a variety of possible initiatives. These include Mr Douste-Blazy's proposal for a global voluntary contribution on airline tickets, separate from the levy, and the implementation of the long-standing proposal for an impost on foreign exchange transactions (often referred to as a "Tobin tax" after its original proponent, Nobel economist James Tobin). This model of voluntary levy has already been applied by the Global Digital Solidarity Fund, to which private or government bodies contribute 1% of the value of new information technology contracts. The scheme was established in 2003 to help bridge the "digital divide" in developing countries.

Table 1 presents the purpose and working features of some of these existing and projected initiatives, and gives indications on the revenues accumulated by them by 2009. The last column gives an overview of the extent to which contributions to the initiatives qualify as ODA. The guiding principle here is that ODA arises at the time and in the amount of a government contribution to the scheme involved. Private contributions do not count as ODA, but would be included in data on developing countries' resource receipts. In practice, therefore, all new revenue-raising mechanisms (category A) would qualify as ODA when the revenues collected are spent on bilateral development assistance or disbursed to multilateral agencies. Bonds (category B) and guarantees (category D) would likewise qualify as ODA, but with a time lag. Voluntary schemes (category C) involve mainly private contributions which are not ODA. Finally, official contributions to new PPPs are reportable as ODA where the OECD Development Assistance Committee (DAC) has added the PPP to its list of ODA-eligible bodies.

## But what is innovative financing?

While there is no internationally agreed definition of innovative financing for development, a recent World Bank report<sup>3</sup> elaborates a definition based on sources of funding (mobilise public or leverage private resources) and the uses they support (public or private):

*Innovative financing involves non-traditional applications of solidarity, PPPs, and catalytic mechanisms that (i) support fund-raising by tapping new sources and engaging investors beyond the financial dimension of transactions, as partners and stakeholders in development; or (ii) deliver financial solutions to development problems on the ground.*

Using this definition, the World Bank estimates that "innovative fund raising generated USD 57.1 billion in official flows between 2000 and 2008" and that of this "alternative sources of concessional flows including solidarity levies and contributions represented USD 11.7 billion". The larger figure includes items that many may not regard as innovative financing, such as aid extended by emerging donors (USD 10.7 billion), and local currency bonds issued by the multilateral development banks (USD 40 billion in 2000-08). The numbers are much smaller if one limits consideration to the Bank's categories of solidarity levies (USD 1 billion over 2000-08), catalytic mechanisms such as carbon finance (USD 1.6 billion) and PPPs (USD 3.6 billion).

The Pilot Group offers a more normative description. It urges that such financing should:

- be additional, or complementary to ODA and not substitutive to it;
- be predictable and stable over time through multi-year commitments, new taxes or other permanent basis for funding;
- address, as much as possible, the negative effects of globalisation and address market failures in specific areas (such as the production of costly vaccines or drugs for developing countries or the application of the principle "polluter pays");
- comply with the principles of the 2005 Paris Declaration on Aid Effectiveness and the 2008 Accra Agenda for Action.

For the purposes of this Issues Brief, we consider innovative financing to comprise mechanisms of raising funds or stimulating actions in support of international development that go beyond traditional spending approaches by either the official or private sectors, such as:

- **new approaches for pooling private and public revenue streams** to scale up or develop activities for the benefit of partner countries;
- **new revenue streams** (e.g. a new tax, charge, fee, bond raising, sale proceed or voluntary contribution scheme) earmarked to developmental activities on a multi-year basis;
- **new incentives** (financial guarantees, corporate social responsibility or other rewards or recognition) to address market failures or scale up ongoing developmental activities.

3. World Bank (2009), *Innovating Development Finance: From Financing Sources to Financial Solutions*.

**Table 1. Some important innovative financing mechanisms (proposed schemes in italics)**

INITIATIVE	PURPOSE	HOW DOES IT WORK?	REVENUES	IS IT ODA?
<b>NEW AGENCIES</b>				
GAVI Alliance (2000)	Public-private partnership for immunisations	Pooled funds distributed, based on proposals from poorer developing countries.	About USD 300m. a year. USD 3.7b. approved for 2000–15, as of 2009.	Yes, but only for official contributions.
The Global Fund (2002)	Public-private partnership to fight AIDS, TB and Malaria	Pooled funds distributed, based on proposals from poorer developing countries.	About USD 3.2b. a year. Total of USD 14 b. raised by 2009.	Yes, but only for official contributions.
<b>NEW MECHANISMS</b>				
<b>(a) New revenue raising</b>				
Air-ticket levy (2006)	Fund a purchase facility (UNITAID) for AIDS, TB and malaria treatments.	13 countries apply a domestic tax (2009). UNITAID funds are channelled through existing institutions, esp. Clinton Foundation.	USD 251m. a year.	Yes, when funds collected are paid to UNITAID or other international agencies.
Auctioning/sales of emission permits (2009)	Provide funds for climate mitigation and adaptation	Under EU regulations, EU Allowances (EUA) for carbon dioxide emissions are sold to emitters.	Germany's 2009 budget allocates EUR 225m. in EUA sales to development.	Yes, when proceeds spent on development.
Currency Transaction Levy	<i>Increase the funds allocated to finance development</i>	<i>Governments apply a tax on foreign exchange transactions.</i>	<i>Levying 0.005% on major currencies would yield USD 33b. a year.</i>	<i>Yes, when funds collected are spent on development assistance.</i>
<b>(b) Bonds (front-loading)</b>				
International Finance Facility for Immunization (IFFIm, 2006)	Fund GAVI campaigns	Bonds are sold in the international capital markets against legally binding long-term ODA commitments from 8 donor countries.	USD 2.4b. raised by 2009; aim is to raise a total of USD 4b.	Yes, for government payments to meet bond interest and principal.
<b>(c) Voluntary contributions</b>				
Global Digital Solidarity Fund (2003)	Promote an inclusive information society	Public or private bodies voluntarily contribute 1% of digital procurement contracts.	Since 2003, more than EUR 30m. allocated to 300 grantees.	Yes, but only for official contributions.
(PRODUCT) RED (2006)	Provide additional funding to Global Fund's activities in sub-Saharan Africa	Product RED trademark licensed to global companies that pledge a share of profits from sales of RED Products to Global Fund programs.	USD 134.5m. transferred to Global Fund to date.	No, only private funds are involved.
<i>Airline ticket voluntary solidarity contribution</i>	<i>Provide additional resources to fund UNITAID activities</i>	<i>Individuals or corporations elect to contribute to development when booking flights.</i>	<i>USD 2 per ticket contribution might raise up USD 980m. a year.</i>	<i>No, only private funds are involved.</i>
<b>(d) Guarantees (incentives)</b>				
Advance Market Commitment (AMC, 2007)	Provide incentive to develop new vaccines	Donors commit to buy a successful vaccine from vaccine makers at a negotiated price, which covers development costs.	USD 1.5b. pledged by 5 donors and Bill & Melinda Gates Foundation for AMC for pneumococcal disease.	Yes, but only when donor governments pay for vaccines.
<i>Index-based weather insurance</i>	<i>Reduce the vulnerability of the rural poor to extreme weather events</i>	<i>IFAD-WFP partnership provides farmers with weather-indexed insurance.</i>	<i>Weather insurance schemes already piloted in Ethiopia, Malawi, Nicaragua, Honduras and India.</i>	<i>Yes, but only for official contributions to insurance premia.</i>



Thus we exclude innovative uses of traditional development finance, such as counter-cyclical lending, debt swaps and debt conversions or issuing guarantees to leverage private investment in partner countries. Such “financial engineering” is nevertheless an interesting subject for further research.

This Brief also excludes innovative delivery mechanisms such as “results-based aid” and “cash-on-delivery”. These can be considered primarily as incentives designed to enhance aid effectiveness, although in some cases they may also provide an incentive to increase the total volume of resources.

Innovative is a relative term. The global funds created nearly a decade ago are already becoming part of the standard development financing landscape, and successful new mechanisms are also likely to become part of the range of “traditional” instruments to fund development. So “innovative” is not a permanent status and the list of innovative financing mechanisms will both grow and shrink over time.

## Ensuring that innovative finance adds value and has a positive impact

The DAC has recently decided to strengthen its monitoring and benchmarking of the activities financed by – and beyond – ODA, in order to promote greater public understanding of ODA and other forms of development finance and complementarities between them.<sup>4</sup> DAC work to ensure accurate statistical reporting and sharing of lessons on innovative financing fits well in this framework.

### Does innovative financing increase resources for developing countries?

Supporters of innovative financing hoped it would help scale up aid activities. Table 1 suggests this has indeed happened, though primarily in the health sector. The revenues column gives indications of the volume of each initiative, though precise figures on donors’ total contributions to these initiatives or total disbursements from them are not available at present. Current DAC statistics can provide only a partial picture of innovative financing, in particular because they:

- **Measure flows on a cash basis.** Data are collected on commitments and actual disbursements.<sup>5</sup> Pledges and guarantees are not recorded, since they do not (yet) constitute flows. DAC statistics do not therefore generally capture the “front-loading” or incentive features of innovative financing.
- **Distinguish between official and private flows,<sup>6</sup> but only record the specific uses of official flows.** While innovative financing to a sector or a theme in the form of public-private partnerships is fully recorded as outflows of resources from donor countries, only official sector contributions can be separately identified.

Measuring flows on a cash basis implies that contributions to IFFIm are recorded as ODA disbursements from donor countries when official donors actually make payments. This will be both during the life cycle of the bonds (to cover set-up costs, administration, interest payments to bondholders etc.), and more importantly at maturity when donor contributions will serve to reimburse bondholders. Donors’ ODA reporting of AMCs follows the same principle, i.e. funds are recorded when they are actually paid over to the World Bank, regardless of when the Bank disburses them for vaccines. If AMCs are not triggered, and contributions are eventually returned to donors, this would be reportable as negative ODA.

As regards the second point, work is already under way to develop the DAC’s statistical systems so as to establish a more complete picture of financing for development, consisting of both official and private flows. As of 2009, multilateral agencies are being asked to include **expenditures from private contributions in their reporting**. The DAC is also exploring possibilities for obtaining data on the geographical and sectoral breakdown of private flows with the Gates Foundation. Statistics on expenditure from the Global Fund, GAVI, IFFIm and AMC will in future represent their entire activity and thus, in the case of IFFIm, also reflect its front-loading (IFFIm expenditures will initially greatly exceed the ODA disbursements it receives). Table 2 summarises DAC data collection on innovative health financing.

4. See “DAC and Non-DAC OECD Donors Responding to Global Development Challenges at a Time of Crisis”, endorsed by the DAC High Level Meeting on 27-28 May 2009.

5. **Disbursement** is the placement of resources at the disposal of a recipient country or agency. A **commitment** is a written obligation by a government or official agency, backed by the necessary funds, to provide resources of a specified amount under specified financial terms and conditions and for specified purposes to the benefit of a recipient country or multilateral agency.

6. **Official flows** comprise transactions undertaken by central, state or local governments at their risk and responsibility, regardless of the source of funds (taxation or borrowing from the private sector). **Private flows** comprise transactions undertaken by firms, non-governmental organisations and individuals residing in the reporting country from their own private funds.

**Table 2: Coverage of innovative financing to health in DAC statistics**

DAC statistics on <b>outflows</b> of resources from donor countries	DAC statistics on developing countries' resource <b>receipts</b>
<b>OFFICIAL FLOWS</b>	
<b>Bilateral ODA</b> Includes contributions to: UNITAID Debt2Health	<i>Not covered to avoid double-counting.  Will be separately identifiable as from 2010.</i>
<b>Multilateral ODA</b> Includes contributions to: Global Fund GAVI IFFIm AMC	<i>Separately identifiable but current statistics relate to official funding only.  <u>Objective:</u> expand data collection to cover expenditures of funds received from the private sector, to provide data series on financing for development (official and private).</i>
<b>Bilateral and multilateral other official flows</b>	
<b>PRIVATE FLOWS</b>	
<b>Private flows at market terms</b>	<i>No sectoral data are available at present, and are unlikely to be collected at national level.</i>
<b>Private grants</b> Includes grants by national NGOs, foundations and other private bodies ( <i>e.g.</i> Gates, (PRODUCT) RED, Airline ticket voluntary solidarity contribution) for development assistance and relief, extended directly to recipients or in the form of core contributions to multilateral agencies.	<i>No sectoral data are available at present.  <u>Objective:</u> Collect data on expenditures disaggregated by sector and by recipient from major NGOs and foundations.</i>

Accurate tracking of innovative financing will require additional efforts, in particular by those responsible for monitoring ODA and other official flows in donor agencies. The DAC can provide data on innovative financing only if donors classify their contributions in a sufficiently detailed manner in their reporting to the DAC. (In practice, this means completing implementation of the DAC's channel of delivery classification in donors' systems and reporting both bilateral and multilateral aid at activity level.) This is important, in particular, if analyses are to be carried out on the extent to which innovative financing adds to current donor ODA efforts or merely substitutes for them.

As explained above, some innovative financing mechanisms involve disbursing ODA funds several years from now. This could help some donors to fulfil their ODA pledges, especially for 2015. But there is also a risk that, as these public finance liabilities fall due, donors may have to reduce their traditional funding approaches (*i.e.* bilateral country programmable aid) *e.g.* to release the funds necessary for paying the IFFIm bondholders or redeeming AMCs. The DAC will closely monitor these operations to help donors ensure that front-loading will not endanger their future ODA budgets.

In addition to monitoring innovative financing within the current DAC statistical system, it may be necessary to rethink the DAC classification of other (non-ODA) development finance so as to increase the policy relevance of the data, and possibly their coverage. For example, DAC statistics do not currently capture financial guarantees for private sector investment in development. This is because a guarantee scheme involves no cross-border flows (except when the investment fails and the guarantee is called upon). Yet donors' support for such schemes provides additional incentives for development activities.

## Is innovative financing contributing to more effective aid?

DAC work on aid effectiveness suggests that innovative financing will secure maximum development impact, promote progress towards the MDGs and improve the global governance framework if it:

- Avoids discouraging countries from raising domestic revenues and developing equitable and fairly administered fiscal policies as a fundamental pillar of development.
- Complies with the Paris Declaration and the Accra Agenda for Action on aid effectiveness, as stated in the Conakry Declaration issued by the Pilot Group. These agreements call for strengthened country ownership, alignment within countries' priorities, budgets and institutions. Donors should avoid proliferation of delivery channels, institutions and reporting mechanisms.
- Takes account of the advantages and disadvantages of specific financial instruments. For example, while funds may be quickly raised on financial markets, front-loading ODA resources may reduce future ODA flows. Hence the importance of carefully balancing the costs and benefits of front-loading.
- Is simple and transparent, especially when calling on private solidarity participation.
- Follows good public financial management practice; in particular, that front-loading is not used or seen as a means of bypassing agreed government spending limits.

## So what next?

As innovative financing continues to expand it will be useful, building on recent initiatives,<sup>7</sup> to assess the added value of its various forms, to report on and regularly discuss its strengths and limitations in order to help ensure quality and maintain public support.

Future DAC work on innovative financing will include continuous improvements to DAC statistical monitoring and further monitoring by the Working Party on Aid Effectiveness in the context of the implementation of the Paris Declaration and Accra Agenda for Action.<sup>8</sup> The DAC and its members will also closely track progress on innovative financing to assess its impact on whole-of-government and policy coherence for development objectives.

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7. Such as the 2008 OECD Global Forum for Development workshop on innovative financing and health. See: [www.oecd.org/development/globalforum](http://www.oecd.org/development/globalforum).

8. Including through a Task Team on Health as a Tracer sector which reviews innovative financing mechanisms in the health sector from an aid effectiveness perspective.

