



DEVELOPMENT COMMITTEE  
(Joint Ministerial Committee  
of the  
Boards of Governors of the Bank and the Fund  
On the  
Transfer of Real Resources to Developing Countries)



**DC2005-0008**  
April 15, 2005

**FINANCING THE DEVELOPMENT AGENDA**

Attached for the April 17, 2005, Development Committee Meeting is a paper entitled "Financing the Development Agenda," prepared by the staff of the World Bank and the International Monetary Fund. This item will be considered under Item II of the Provisional Agenda. A background document entitled "Moving Forward: Financing Modalities Toward the MDGs," will be issued separately.

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# Financing the Development Agenda

## I. Financing for Development: Progress on the Monterrey Agenda

1. **The Monterrey Consensus represented an important milestone in framing the financing for development agenda.** It recognized that financing for development encompassed many elements and that progress was needed simultaneously on several fronts to achieve adequate and sustainable financing. Since then there has been considerable work on both assessing financing needs as well as on the different options for mobilizing development finance. As highlighted in the *Global Monitoring Report* there has been good progress, but further actions are needed in all of the areas identified in the Monterrey consensus.

2. **Developing countries must implement good policies and exert stronger efforts to mobilize more domestic resources to support accelerated progress toward their development.** Countries cannot rely on foreign flows alone to finance the needed investment and recurrent expenditures for poverty reduction. The policy agenda begins with more vigorous efforts to spur economic growth. In addition to macroeconomic stability, sustained growth requires a vibrant private sector, framed by good governance and a sound legal system. Mobilizing more domestic resources to support poverty reduction efforts will also require a strengthening of revenue administration including a broadening of the tax base. To ensure that resources are well spent, developing countries will need to improve the efficiency of their spending.

3. **Developing countries must also continue reforms that enhance their ability to attract private non-debt capital flows, especially foreign direct investment.** Foreign direct investment (FDI) is the largest source of external finance for developing countries—estimated at \$166 billion in 2004. There is clear evidence that FDI can yield large benefits in terms of growth when the conditions are right. A favorable investment climate and an appropriate and stable regulatory system are prerequisites to attracting and tapping the benefits of FDI. The recent work of the Bank on investment climate and the costs of doing business has highlighted the key areas for action and provided benchmarks to developing countries. Developing countries need to take a prudent approach to debt finance, as many of them already have relatively high debt levels. Moreover private debt is more expensive and subject to higher volatility for emerging markets.

4. **Remittances have emerged as an important source of external financing.** Developing countries' recorded remittance receipts have risen from \$31 billion in 1990 to \$126 billion in 2004, a likely underestimate of their actual magnitude. Low-income countries account for 35 percent of the total. Moreover, remittances are likely to increase further, given trends in migration and prospects for temporary movement of workers. With the right framework, many countries can reap large benefits from remittances for growth and poverty reduction, but for others the loss of human capital can offset these gains. There is an active international agenda underway with strong support from the Bank and the Fund to assess and enhance the development impact of remittances by: (a) improving data; (b) studying the development impact of remittances; (c) reducing

remittance costs, through a strengthening of the financial infrastructure; while (d) enhancing the integrity and efficiency of money transfer systems.

**5. A successful outcome on the Doha Development Agenda will be critical for boosting growth of developing countries and their capacity for sustainable domestic financing.** Multilateral, reciprocal, non-discriminatory trade liberalization offers the best means to realizing the development promise of trade. The international community must raise the level of ambition with respect to the Doha Round. Developed countries must lead, but significant trade liberalization by developing countries is also essential. The key benchmarks for progress are described in the *Global Monitoring Report* and in the separate note on *Aid for Trade: Competitiveness and Adjustment*. As a complement to an ambitious Doha outcome, “aid for trade” should be scaled up to enable the poorest countries to adjust to and benefit from the new Round.

## II. Increasing Aid and Its Effectiveness

**6. Significantly greater and more effective aid will be needed to accelerate progress toward achieving the MDGs,** even with stronger efforts to mobilize domestic resources and private financing. Official development assistance (ODA) remains critical for low-income countries. In sub-Saharan Africa, home to a majority of these countries, official flows account for two-thirds of capital flows. In middle-income countries aid plays a smaller but important catalytic role, and can be particularly valuable in accelerating progress on the social agenda, alongside the broader catalytic role of non-concessional multilateral bank lending in meeting large financing needs, including for infrastructure.

**7. There is a wide body of evidence indicating that aid remains well short of what poor countries need and can use productively. Moreover, existing levels of aid can be delivered more effectively.** At least a doubling of ODA is needed within the next five years to accelerate progress toward the MDGs. Further increases will be needed after that as countries strengthen their absorptive capacity. The need for an increase in ODA is especially great in Sub-Saharan Africa.

### *Delivery of Aid Commitments*

**8. There has been a welcome reversal in ODA trends following a decade of almost continuous decline; however, higher ODA has not been in the form of additional cash financing for the poorest countries.** According to the Development Assistance Committee (DAC) of the OECD, Official Development Assistance (ODA) levels rose in nominal terms from \$52 billion in 2001 to \$68 billion in 2003, and preliminary estimates indicate a further increase to \$78.4 billion in 2004. Taking into account inflation and the fall in the U.S. dollar, this represents a 4.6% rise in real terms from 2003 to 2004 and follows a 4.3% increase from 2002 to 2003. The total represented 0.25% of Development Assistance Committee (DAC) members’ combined gross national income (GNI), the same level as in 2003, but up from 0.23% in 2002 and 0.22% in 2001. While the reversal in ODA commitments is noteworthy, the increase of aid to finance MDG

needs in the poorest countries to date has been modest. The detailed breakdown for 2004 aid outcomes is not yet available, but as pointed out in the *Global Monitoring Report* the bulk of the \$8.5 billion increase in bilateral ODA during 2001-03 represents debt relief, technical cooperation, and other special purpose allocations including for strategic and security objectives. The increase in flexible forms of aid to finance project and program expenditure in recipient countries was a modest \$0.2 billion which was more than offset by exchange rate and price changes.

**9. The delivery of aid commitments already made is the most immediate and credible step to augment aid financing to meet the MDGs.** If DAC members meet the ODA volume commitments they made at and after the Monterrey conference, the ODA/GNI ratio should improve from 0.25% in 2004 to 0.30% in 2006, or \$19.4 billion in real terms from the 2003 level. There are two challenges if this potential increase is to provide the much needed impetus to scaling up on the MDG agenda. First, the aid commitments have to be delivered, which will be challenging in the current budgetary environment faced by many countries. Second, the incremental aid will need to be well targeted, notably to the poorest countries and for program and project expenditures needed to make progress towards the MDGs. Furthermore, the accounting of debt relief will need to be agreed upon. In particular, debt statistics need to sort out donors' strategic and security efforts and their assistance to meet the MDGs. For example, some debt relief will provide low-income countries with additional resources to finance MDG-related expenditures, while other forms of debt relief, such as for Iraq, will not produce additional resources for the MDG agenda in the poorest countries and should be excluded from MDG-related aid figures.

**10. The increase in resources agreed upon in the IDA14 replenishment can provide an anchor for accelerating efforts to meet the MDGs in the poorest countries.** IDA donors have agreed to a minimum resource envelope of US\$34 billion for FY06-08, of which \$18 billion would come from 40 donors, a 25 percent increase over IDA13. This increase in contributions can allow IDA to expand significantly its support to the poorest countries and increase the concessionality of assistance where warranted through the provision of grants. But the increase will be only a fraction of the resources needed by the poorest countries to step up programs significantly to meet the MDGs. Additional financing from bilateral sources that could be linked with IDA operations could help leverage the role of IDA and provide the financing needed to match country efforts to scale up investments and programs to meet the MDGs.

### ***Raise ODA Targets***

**11. Further progress towards the 0.7 percent ODA to GNI target will be critical to meet the growing financing needs anticipated in the medium and longer-term.** Since Monterrey, six countries have committed to meet the 0.7 percent ODA to GNI target, in addition to the five that have already reached this target. Other donor countries should consider the adoption of timetables for the attainment of the 0.7 percent goal. Setting intermediate targets for 2006 and monitoring progress towards these targets has been a useful means to make collective progress in raising ODA levels. Similarly, it may be useful for the donor community to adopt intermediate targets for 2010. The willingness

of citizens in donor countries to provide additional aid will depend on demonstrated results in the use of aid. Better assessments of the use of aid and better communications will be an important element of the strategy of mobilizing additional aid.

### *Improve Aid Quality*

**12. Improving the quality of aid will be just as important as increasing its quantity.** As the Development Committee requested in October 2004, the Paris Declaration, which was adopted by 90 countries and 27 development institutions, agreed on 50 commitments to improve the quality of aid, which will be monitored by 12 quantitative indicators. Participants agreed to set targets for 2010 for each of the indicators, which can help track and encourage progress on implementing these commitments by donors and partner countries. Five preliminary targets were agreed: these will be reviewed, and 11 targets will be agreed upon by the time of the United Nations' five year review of the Millennium Declaration in 2005. The challenge ahead is to translate these agreements into results on the ground which will require concerted and cooperative efforts on the part of all.

### *Additional Debt Relief*

**13. The HIPC Initiative continues to deliver significant debt reduction as more countries approach their completion point.** Eighteen countries have reached completion point as of mid-April 2005. In the 27 decision-point HIPCs, annual debt service payments relative to exports declined from an average of about 16 percent in 1998-99 to 7 percent in 2004 and debt service to fiscal revenues from 24 percent to 12 percent in the same period, levels lower than other low-income countries. The HIPC Initiative sunset clause has been extended for two years, giving remaining pre-decision point countries an additional opportunity to become eligible for HIPC Initiative debt relief.

**14. Proposals have been put forward for additional debt relief up to 100 percent to low-income countries; however the international discussion of these proposals is at an early stage.** There are three main objectives that motivate the proposals for additional debt relief: (i) to reduce the debt overhang in low-income countries consistent with long term debt sustainability considerations, and end the "lend and forgive cycle", which may keep some countries in a continuous "debt trap"; (ii) to help cushion the impact of exogenous shocks on low-income countries, as they can cause temporary payment difficulties as well as longer-term debt sustainability problems; and (iii) to provide financing for the MDGs.

**15. Further debt reduction could be warranted in some countries to achieve long-term debt sustainability.** Debt burdens of HIPCs have already been reduced through Paris Club arrangements, the HIPC Initiative, and voluntary debt relief by Paris Club creditors. But in some of these debtor countries, as in some non-HIPC low-income countries, debt burdens remain above levels considered prudent and could be constraining growth. The joint Bank-Fund debt sustainability framework, which underpins the IDA14 agreement, calls for allocating grants to countries facing a high risk of debt distress. It is

expected to gradually lower debt burdens in low-income countries to levels consistent with repayment capacity over the medium term. It is possible to adopt even lower thresholds in assessing debt sustainability for all or some low-income countries, but with concomitant higher costs of providing finance and potential adverse effects on overall aid allocations. While the IDA14 framework uses grants to reduce debt levels over time, this could also be achieved through stock reduction or service relief on existing debt.

**16. Additional debt relief could also be used to support long-term debt sustainability by providing insurance arrangements that protect countries' balance of payments and fiscal positions in the event of exogenous shocks.** Such an approach assumes that the debt overhang is not a chronic problem in low-income countries, and instead argues for providing additional debt service relief only when a country receives an exogenous shock that raises its debt servicing burden beyond some pre-determined level. The cost to donors of such an approach cannot be estimated with certainty but would be lower than other debt relief approaches.

**17. A third objective for providing additional debt relief could be to release resources to contribute to MDG financing.** In such an approach, debt sustainability would not be a consideration for the allocation of resources for additional relief. More important would be the MDG needs of the countries, their absorptive capacity, and their ability to put development resources to good use.

**18. Regardless of which approaches are chosen, some key principles should be adhered to if additional debt relief is to achieve its intended objectives:**

- First, as many have argued, further debt relief should be **additional** to resource transfers currently envisaged for low-income countries.
- Second, it should **not increase inequity** in the current aid system by rewarding some countries at the expense of others.
- Third, it should **not undermine the financial soundness of multilateral institutions**, and to that end, should be fully financed by additional resources. It should be noted that the current HIPC initiative is not yet fully financed.
- Fourth, it should **enhance aid efficiency** making it available where it is most needed, measured by aggregate financing needs and debt sustainability, and linked clearly to standards of strong policy performance and good governance.
- Fifth, any proposal should be transparent and relatively **simple to implement**.
- Sixth, debt relief in the context of IDA should be **supportive of progress made under IDA14** towards the provision of grants based on debt sustainability.
- Seventh, any further debt relief should be in the context of a comprehensive approach.

### III. Innovative Financing Mechanisms

19. **Existing commitments to increase aid, as well as efforts to increase aid levels further, will take time to materialize.** The Development Committee and the International Monetary Finance Committee asked that the Bank and the Fund continue their work on proposals to complement increased aid flows and commitments with innovative mechanisms, such as the International Finance Facility, global taxes, and others, and report on how to take such options forward. These efforts build on work by the Bank and the Fund on innovative financing, as well as the Landau Report, the Report of the Technical Group on Innovative Financing Mechanisms, and the UNU-WIDER study *New Sources of Development Finance*.

#### *International Finance Facility*

20. **Technical aspects of the International Finance Facility (IFF) proposed by the UK Treasury are being addressed through a pilot IFF for Immunization—the IFFIm.** Work is at a relatively advanced stage on this pilot facility that would raise frontloaded, reliable funding over a number of years to expand global immunization efforts to help achieve the child mortality MDG. Frontloaded IFFIm funds would be used for two primary purposes: accelerating production of new and existing vaccines, to stimulate private investment and competition and to reduce vaccine costs more rapidly than if there were no scaling up; and strengthening capacity to deliver vaccines to save children’s lives immediately, reduce the risk of disease, and support other health interventions by improving public health infrastructure. The IFFIm would rely largely on the governance structures and country programs of the Global Alliance for Vaccines and Immunization (GAVI) and the Vaccine Fund.

21. **The IFFIm is intended to be a small IFF, and if successful would serve as proof of concept for some aspects of the larger IFF,** including the capacity to garner donor support for such a mechanism and acceptance of IFF-generated AAA bonds by rating agencies and capital markets.

22. **A range of issues around implementation of the IFF remain, and many details need to be settled.** In particular, with the consideration of the IFFIm proposal by Eurostat, the IFFIm will be a test case for European donors for the feasibility of obtaining donor pledges of future support that are both legally binding and off-budget. It should be noted that some non-European countries have indicated that they would not be able to participate in an IFF mechanism under their domestic legal and accounting systems.

23. **Beyond the IFFm, several concerns about a full-fledged IFF remain.** They include:

- Although IFF flows are expected to disburse through existing delivery channels, establishing an efficient IFF governance structure remains a challenging issue, since it will have to accommodate competing considerations of participating donors and other interested entities.

- IFF planning and management must ensure that donor flows will not drop off, post-2015, from needed levels as donor pledges are drawn down to pay IFF bonds – the IFF must tap only incremental, truly additional aid increases while some required level of baseline aid continues.
- IFF flows can be used to respond to immediate needs and also provide assurance of funding predictability. Yet they would be relatively expensive resources, underlining the importance of good selection and implementation of IFF-funded programs.

### *Global Taxes*

24. A wide range of proposals has been made on ways to raise additional revenue through the introduction of global tax instruments. As directed by Ministers, **Staff provided a more systematic framework for the assessment of these proposals, based on the criteria of revenue adequacy and stability, efficiency, equity, ease of collection, and minimum required coalition size** (Table 1). The rough rankings presented do not represent any formal consensus – indeed, for some ratings opinions continue to differ and evidence is scant. The intention is not to select or rule out any alternatives, but to focus attention on areas in which further study is most likely to prove useful.

25. In addition to these criteria, **key issues of additionality, earmarking and implementation need to be considered**. Allocating the proceeds of a tax to development expenditure may partially or completely displace spending from traditional sources. With some exceptions, public finance specialists generally advise against the earmarking of revenue from particular sources to particular items of expenditure. And thus far, detailed aspects of implementing global taxes have received relatively little attention. While most of the candidates could be collected nationally, for example, questions arise as to how participating countries can reasonably assure themselves that their partners are implementing the tax with appropriate rigor.

26. **Increasing international attention on how to move forward on specific mechanisms may lead to more focused work on promising alternatives**. One possibility recently discussed in the European Union would be an international airline fuel tax. Such a tax could raise in the order of \$9 billion annually, if levied globally at a rate of \$0.20 per gallon. Another possibility is a tax on arms sales, which – with trade in the same order of magnitudes as expenditure on aviation fuel – could also raise significant sums. If technical and political difficulties can be resolved, global taxes could complement the IFF, generating additional aid funds in the medium to long term as IFF flows, designed to increase development funds in the short term, diminish while its bonds are being repaid.

### *Voluntary Contributions*

27. Private contributions for development from individuals, NGOs, and private foundations are increasing. These **voluntary contributions are made in a range of ways that could be encouraged, expanded, and made more effective**, although they



remain subject to many of the same considerations, such as need to assure additionality, that apply to global taxes. Some mechanisms, for example the use of opt-in charges on routine credit card or utilities payments, could be undertaken by banks or companies. Others, such as income tax deductions or the creation of a special purpose global lottery or premium bond, would require regulatory action by participating countries. Public-private partnerships, such as in work on vaccine pull mechanisms, are another way in which voluntary contributions can be used to foster development.

**28. The extraordinary response to the tsunami disaster by individuals worldwide demonstrated the potential for voluntary contributions – but also the relative lack of a supporting architecture.** Voluntary contributions provide a significant and valuable source of flows, but they can compound aid harmonization and simplification problems. In some cases, good governance and effective delivery channels are absent. In addition, clear and consistent worldwide data about these flows are not available, a gap which should be addressed. The international community should find ways to protect the private and voluntary nature of these flows, but still align them with recipient country programs and priorities.

### *Blending Arrangements*

**29. Blending arrangements – that is, combining flows from different sources and with different financial terms and characteristics to increase concessionality or gain leverage – are a possible way to enhance the leverage of current aid flows.** A blend of concessional loans and grants can help the poorest, IDA-only countries to scale up investment and spending to meet the MDGs without undermining debt sustainability. Blending can also be used to give impetus to the MDG agenda in middle-income countries and to finance global and regional public goods. In addition, it can help address the needs of the “gap countries” that have limited creditworthiness for or capacity to carry MDB debt, as well as per capita GNI above the IDA eligibility cutoff.

**30. Different blending instruments could be structured in a variety of ways to provide different types of funding appropriate to country and program circumstances.** “Buy-downs” combine different types of funds to lower the overall cost to the borrower, and thus can be used to tailor financing terms to a target level of concessionality. Blending guarantee support with multilateral lending could prompt additional development flows to countries facing exposure or lending limits. In appropriate circumstances such as for gap countries, buy-downs and guarantees could be combined to reduce both lender credit risk and borrower cost. Innovative blending arrangements have been piloted, for example the polio eradication “buy-downs” in Nigerian and Pakistan which combined IDA credits with grant support from foundations.

31. Following last fall’s discussion of blending arrangements by Ministers, the Bank has consulted donors and recipients about possible participation in a variety of blending and other cooperative arrangements designed to enhance the overall effectiveness of development aid. There is a considerable interest in exploring the potential of blending arrangements to help accelerate progress on poverty and other MDG goals in middle-income countries, and to expand provision of global and regional public goods. Further work and consultations are planned to develop more specific proposals.

**Table 1: Scoring Tax Candidates /1**

	Revenue (\$Billion p.a.)	Efficiency	Equity	Collectability	Moderate Coalition Size
<i>Tax Instruments:</i>					
Global carbon tax	60-130 /2	H	M /3	H	M
'Tobin' tax	30 /4	L	M /5	M	M
General financial transactions tax	H	L	M /5	H	L
International aviation Fuel	9 /6	H	M	H	M
Maritime pollution tax	1 /7	H	M	H	M
Tax on arms sales	2.5-5 /8	H	M	M	M
Taxes on global commons	L	H	H	H	H
Surtax on multinational Profits	M	M	H	L	L
Surcharges on VAT or income tax	M	L	M	M	H
<i>Voluntary Contributions:</i>					
Add-ons to routine bills	L	H	H	H	H
Tax-based measures	L	H	H	M	H
Lotteries/premium bonds	M	H	H	H	H

**Notes:**

- /1 H = high, M = medium, L = low. Where revenue estimates are unavailable, revenue score is H (M, L) if estimated yield at a reasonable rate seems likely to exceed \$20 billion per annum (is between \$10 and \$20 billion, less than \$10 billion).
- /2 Higher figure assumes uniform application of \$21 per metric tonne; lower assumes implementation only by developed countries (Sandmo (2004)).
- /3 Assuming levied only in developing countries.
- /4 Nissanke (2003).
- /5 Relatively little is known about the distributional impact of these taxes.
- /6 Staff calculations.
- /7 Landau report (2004).
- /8 Reisen (2004).

#### **IV. Issues for Discussion**

- Meeting the large financing needs for development, including for more rapid progress towards the MDGs, will require progress on many fronts. What are the priorities on this agenda?
- Do Ministers agree that delivery of commitments already made, further progress towards the goal of 0.7 percent of GNI, and improving the effectiveness of aid should be the main pillars of the aid agenda? What concrete targets should be adopted in this regard?
- Do Ministers agree that work on additional debt relief should be taken forward based on the principles identified?
- Do Ministers agree that implementation of the pilot IFF for Immunization should move forward, including as a proof of concept for the larger International Finance Facility?
- Do Ministers consider global taxes to be a possible way to increase funding for the MDGs that should be pursued by coalitions of interested countries?
- Do Ministers support systematic work by the Bank to develop further operational proposals to blend aid with other sources of financing including for targeted development needs in middle income countries?