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Discussion Paper

Innovative Financing for Development: A New Model for Development Finance?

January 2012

United Nations Development Programme

POVERTY REDUCTION





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List of Acronyms and Abbreviations

ACTs	Artemisinin-based Combination Therapies	TB	Tuberculosis
AFD	Agence Française de Développement (French Development Agency)	UEMOA	West African Economic and Monetary Union
AMC	Advance Market Commitments	UN	United Nations
AMFm	Affordable Medicines Facility for Malaria	UNDP	United Nations Development Programme
BTC	Belgian Technical Cooperation	UNESCO	United Nations Educational, Scientific and Cultural Organization
CCRIF	Caribbean Catastrophe Risk Insurance Facility	UNEP	United Nations Environment Programme
CDM	Clean Development Mechanism	UNICEF	United Nations Children's Fund
CERs	Certified Emissions Reductions	UNODC	United Nations Office on Drugs and Crime
CTT	Currency Transactions Tax	UN-REDD	United Nations Collaborative Programme on Reducing Emissions from Deforestation and Forest Degradation
DAC	Development Assistance Committee	WB	World Bank
EC	European Commission	WHO	World Health Organization
EU	European Union	WWF	World Wide Fund for Nature WWF
EU ETS	European Union Emissions Trading Scheme		
FTT	Financial Transactions Tax		
GAVI	Global Alliance for Vaccines and Immunisation		
GNI	Gross National Income		
HIPCs	Heavily Indebted Poor Countries		
HSS	Health System Strengthening		
IBRD	International Bank for Reconstruction and Development		
ICT	Information and Communications Technology		
IDA	International Development Association		
IFFIm	International Finance Facility for Immunisation		
IMF	International Monetary Fund		
IRED	Initiative Régionale pour l'Énergie Durable (Regional Initiative for Sustainable Energy)		
LDCs	Least Developed Countries		
MDBs	Multilateral Development Banks		
MDGs	Millennium Development Goals		
NGOs	Non-Governmental Organizations		
OBA	Output-based Aid		
ODA	Official Development Assistance		
OECD	Organisation for Economic Cooperation and Development		
PES	Payments for Ecosystem Services		
PIUs	Parallel Project Implementation Units		
PPP	Public Private Partnerships		
SDRs	Special Drawing Rights		
StAR	Stolen Asset Recovery Initiative		

Abstract

This Discussion Paper explores recent experiences with innovative sources of development finance in order to capture lessons learned for the more effective implementation of both current and future initiatives. We first look at what is understood by the term 'innovative financing for development' since the term encompasses a heterogeneous mix of innovations both in fund-raising and in spending on the ground. We then summarise some of the major schemes implemented so far and outline how they work. The paper then reviews a number of proposals currently on the table for future innovative development finance schemes and examines the political dynamics associated with each. We then assess the record of innovative sources of development finance against nine key questions which serve as useful indicators of the added value and possible draw-backs of each instrument. These include questions such as: the extent to which initiatives have created additional financial flows for development, have supported country ownership of the development process, delivered predictable finance and supported concrete development results. Finally we explore the place of innovative financing for development in a changing development financing landscape. Specifically, we look at whether we are likely to see increased dependence on such mechanisms in the future and consider the possible benefits and risks associated with such a shift. The paper aims to provide some insights into the pros and cons of different approaches and, as such, make a useful contribution to international policy discussions over the design and implementation modalities of both current and future innovative sources of development finance.

1. Introduction

The multi-faceted nature of the challenges associated with development are reflected in the United Nations Millennium Declaration. The document recognises that good governance, improvements in institutional capacities, an equitable trade regime, improvements in health and education, empowerment of women, creation of productive employment, access to technologies, protection of the environment and strong partnerships with the private sector and with civil society organizations all play an essential role in the development process. The key role of adequate financial resources—domestic and external—is also recognised and since the year 2000, the international community has committed to “grant more generous development assistance” to the developing world.¹

The Millennium Development Goals (MDGs) quickly emerged as the blueprint agreed to by all the world’s countries to reduce poverty and accelerate development within a 15 year time-frame. Of the eight MDGs, seven focus on challenges such as poverty reduction and the eradication of hunger, as well as measures to improve access to health and education services, improve the position of women and preserve the environment. The eighth MDG recognises that developing countries will need a supportive international environment to have the best chances of success. This includes more generous development aid, especially for the poorest countries.²

Some attempts have been made to quantify the volume of external assistance required to meet different MDGs. Estimates as to the amount of resources needed annually to control malaria and tuberculosis stand at over US\$10 billion. US\$25 billion and US\$36 billion is required annually for HIV/AIDS and education respectively. To eradicate hunger requires an additional US\$30 billion per annum.³ While these estimates are subject to a high degree of uncertainty, it is clear that the amounts provided annually in Official Development Assistance (ODA) are far from sufficient to meet the MDGs and other international development goals; in 2010, ODA from the OECD DAC members reached US\$128 billion of which US\$46 billion was allocated to sub-Saharan Africa, the region furthest off-track towards the MDGs (MDG Gap Task Force, 2011).

This reality has stimulated multiple efforts by development partners—and by developing countries themselves—to find ‘innovative’ ways to raise additional and/or alternative sources of development finance to support the MDGs. And over the last decade, the concept ‘innovative financing for development’ has become increasingly the mainstream in the development discourse. The concept was first mentioned in the UN Monterrey Consensus of 2002, where signatories acknowledged, “the value of exploring innovative sources of finance provided that those sources do not unduly burden developing countries.⁴ Since then, both sovereign donors and private actors have championed an array of initiatives designed to help mobilize more resources for development and/or make them more effective.

Well known examples include the international solidarity levy on air tickets, the International Finance Facility for Immunisation (IFFIm), Advance Market Commitments (AMCs), debt conversions (e.g. Debt2Health, debt-for-environment and debt-for-education swaps), voluntary solidarity contributions (e.g. Product (RED), MASSIVEGOOD, the Digital Solidarity Levy), weather and commodity related insurance, diaspora bonds, counter-cyclical lending, emissions trading, curtailing illicit outflows of capital and the repatriation of stolen assets amongst many others. New ideas also continue to be developed. These include proposals for a global lottery, solidarity tobacco contributions, carbon taxes, use of the IMF’s Special Drawing Rights (SDRs) and a financial transactions tax (an old idea which has recently attracted renewed political interest).

The international community has signaled a clear interest in both the scaling up of existing innovative initiatives as well as the development of new ones. For instance, the United Nations Doha Declaration of 2008 calls on the international community “to consider strengthening current initiatives and explore new proposals, while recognising their voluntary and complementary nature.⁵ The UN General Assembly Resolution on innovative sources of development finance of February 2011 “stresses the importance of scaling up present initiatives and developing new mechanisms, as appropriate.⁶

Some view innovative sources of development finance as a natural and pragmatic response to the consistent failure of most donors to devote sufficient funds to international development. For others, innovative financing for development initiatives are simply representative of the important shift in the way development partners do business. This shift—which has been increasingly evident for some time—is founded on a reduced role for ODA and a much larger role for the private sector in development. This is combined with technological progress and innovations in financial engineering which have changed the landscape for mobilizing resources from the state, private sector and citizens.

Although small in absolute terms—the Organisation for Economic Cooperation and Development (OECD) estimates that for health innovative schemes have raised approximately US\$5.5 billion and US\$31 billion for climate/environment between 2002 and 2010—research shows that innovative financing for development initiatives have the potential to generate substantial resources for development and climate/environment. For instance, estimates as to the revenue which could be raised via the implementation of a coordinated currency transactions tax are in the region of US\$33 billion per year (United Nations 2009).⁷ Carbon taxes could raise revenues for development and climate change adaptation and mitigation of around US\$75 billion per year (United Nations 2009).⁸

The need to address colossal collective-action challenges such as climate change is also likely to lead to the development of new and innovative ideas to mobilize finance from the private and public sectors. As the scaling up of existing initiatives and the development of new schemes looks increasingly possible—if not inevitable—it will be critical to explore experiences so far in order to draw important lessons learned for both current and future initiatives.

In this context, this Discussion Paper assesses the record of some of the major schemes implemented so far against nine key questions listed below. These include questions such as: the extent to which initiatives have created additional financial flows for development, have supported country ownership of the development process, delivered predictable finance, been governed in an inclusive manner and supported concrete development results. Our findings are summarised in a table annexed to this paper. We then draw some lessons learned from these experiences as well as end with a discussion on the outlook for innovative sources of development finance in the future.

Questions to assess innovative financing

1.	Have innovative financing for development initiatives generated additional resources for development?
2.	Have innovative sources of development finance delivered concrete development results?
3.	Which countries have benefited from innovative financing for development and why?
4.	Have innovative financing for development initiatives delivered stable and predictable resources for international development and climate/environment?
5.	Have innovative financing initiatives strengthened country ownership of the development process?
6.	Have innovative financing for development initiatives supported capacity development in beneficiary countries?
7.	Have innovative financing for development initiatives accentuated issues related to fragmentation and coordination in international aid delivery?
8.	Is innovative financing for development sustainable over the longer-term?
9.	Can innovative financing for development be scaled up and/or initiatives replicated in other development areas or regions?

2. Innovative financing for development: what's it all about?

The term 'innovative financing for development' was coined in the early 2000s and since then its use has become commonplace in the development discourse. The term has come to mean many things to many people. As the UN Secretary-General's 2009 progress report on innovative sources of finance for development notes, "the concept of innovations now extends to such diverse forms as thematic global trust funds, public guarantees and insurance mechanisms, equity investments, growth-indexed bonds, counter-cyclical loans, distribution schemes for global environmental services, microfinance and mesofinance, and so on" (United Nations 2009). The landscape of innovations in financing for development is now truly vast. New innovations in development finance also continue to be developed.

There is no internationally agreed definition of 'innovative financing for development'. In reality, the term encompasses a heterogeneous mix of innovations in fundraising and innovations in spending, i.e. innovative financing for development comprises both innovations in the way funds are raised as well as innovations in the ways funds are spent on international development (World Bank 2009).

Several international bodies have offered various interpretations of the term 'innovative financing for development'. The Leading Group on Innovative Financing for Development suggests that innovative financing for development is "complementary to official development assistance. [Innovative mechanisms] are also predictable and stable. They are closely linked to the idea of global public goods and are aimed at correcting the negative effects of globalisation" (Leading Group 2009).⁹ The Leading Group also recommends that innovative financing initiatives comply with the principles of the 2005 Paris Declaration on Aid Effectiveness and the 2008 Accra Agenda for Action.

The World Bank defines innovative financing for development as "those that depart from traditional approaches to mobilizing development finance—that is, through budget outlays from established sovereign donors or bonds issued by multilateral and national development banks exclusively to achieve funding objectives. Innovative development finance therefore involves non-traditional applications of solidarity, PPP, and catalytic mechanisms that (i) support fundraising 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" (World Bank 2009).

The OECD considers 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; and
- new incentives (financial guarantees, corporate social responsibility or other rewards or recognition) to address market failures or scale up ongoing developmental activities" (OECD 2009).



Image: megainarmy/Shutterstock.com

Innovative financing for development: what's it all about?

Four broad categories or 'typologies' of innovative finance mechanisms can be identified:

1. **Taxes, dues or other obligatory charges on globalized activities:** this includes initiatives such as the airline ticket tax which is levied at the national level but within a framework of international coordination. The revenues raised are allocated to international development. Proposals for a financial transactions tax and carbon taxes are also examples which fit into this category. These initiatives generate new public revenue streams for development from the private sector.
2. **Voluntary solidarity contributions:** under such initiatives, consumers are given the option to donate a small sum to international development at the point of product purchase (e.g. an on-line hotel reservation). Although private in nature, public authorities facilitate such contributions through tax incentives and technical facilitation in the distribution of resources. Examples include Product (RED), the Global Digital Solidarity Fund and MASSIVEGOOD.¹⁰
3. **Frontloading and debt-based instruments:** an initiative which 'frontloads' resources makes public funds available earlier for development. It does this via the issuance of bonds on international capital markets. The International Finance Facility for Immunisation is one example. Mechanisms which 'frontload' public resources for development generate liabilities that are reportable as aid in several years' time, i.e. when the liabilities fall due. Other debt-based mechanisms include debt conversions (which reduce the amount of debt and debt service payable thereby freeing-up additional resources for development expenditures), diaspora bonds (a debt instrument — issued by a country, a sub-sovereign entity or a private corporation — to raise financing from its overseas diaspora) and socially responsible or 'green' bonds (bonds which target investors who wish to invest in development or environment initiatives and so may accept lower rates of return on their investments).
4. **State guarantees, public-private incentives, insurance and other market-based mechanisms:** this includes initiatives which leverage public funds to create investment incentives for the private sector, for instance through state subsidies or commitments to purchase a particular product at a set price (e.g. a vaccine). In so doing, these initiatives aim to correct market failures. Other mechanisms aim to reduce sovereign risk and/or macroeconomic vulnerabilities, for instance weather-based insurance or counter-cyclical loans (i.e. they aim to improve the effectiveness of finance rather than create new revenue streams for development).

The distinction between innovative sources of finance for development (which relates to how funds are raised, e.g. through a coordinated international tax) versus innovations in the ways resources are delivered (e.g. through countercyclical loans) is crucial. One can envisage an innovative source of development finance channeling its funds through multiple innovative spending channels (e.g. world lottery revenues channeled through vertical funds or other forms of public-private partnership).

3. Major innovative financing for development initiatives

Despite the high level of interest shown in current and potential innovative financing mechanisms, it has not been clear how dramatically they have impacted the development finance landscape thus far. Estimates as to the amount of resources raised through innovative financing instruments vary significantly according to the definition which is used. The World Bank estimates that Innovative fund-raising generated an estimated US\$57.1 billion in official flows between 2000 and 2008 (World Bank 2009). This amount however includes an extremely wide range of new developments in finance, such as development cooperation provided by emerging donors and initiatives which are designed to spread sovereign risk or manage macroeconomic vulnerability rather than tap new resources for development per se (e.g. weather or commodity-based insurance and so-called counter-cyclical loans).

The Leading Group on Innovative Financing for Development, which focuses on a much narrower set of innovations in financing for development, estimates that US\$5.5 billion has been raised in total so far for health through schemes such as the airline ticket tax and the International Finance Facility for Immunisation (Leading Group 2011).¹¹

Under the OECD definition of innovative finance, US\$31.3 billion has been raised between 2002 and 2011 for climate and the environment, the vast majority through carbon emissions trading under the Kyoto Protocol (US\$28 billion) (United Nations 2011).

Of the innovative financing for development initiatives implemented so far, many have focused on health and in particular the prevention of communicable diseases (such as HIV/AIDS and childhood immunization). Given the shared nature of such challenges, innovative approaches for the pooling of public and/or private revenue streams have been viewed as particularly suitable. The other major beneficiary sector has been the environment and climate change. This sector has benefited from initiatives such as carbon emissions trading, 'eco' or 'green' bonds and debt-for-nature swaps.

This section, while not exhaustive, provides an overview of some of the major innovative finance initiatives that have been implemented so far. It covers both those mechanisms which mobilize new revenue streams for international development as well as those which represent innovations in the way resources are spent. It is organized according to the broad set of typologies outlined in the previous section although some initiatives do not fit neatly into one category or cut across two or more of these broad classifications.



Major innovative financing for development initiatives

3.1 Taxes, dues or other obligatory charges on globalized activities

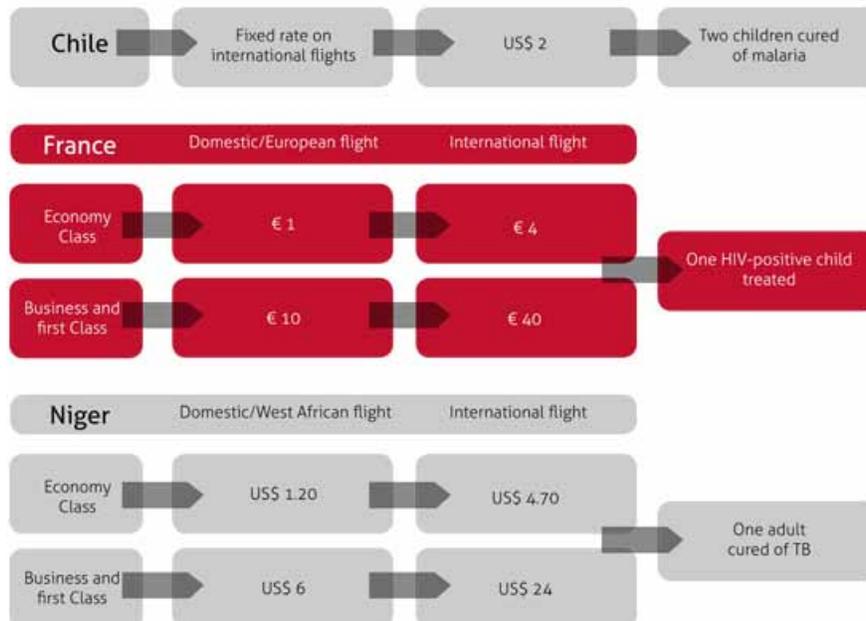
International solidarity levy on air tickets

One of the first innovative financing for development initiatives to be implemented was the 'international solidarity levy on air tickets' (or airline ticket tax). It was launched in 2006 by the Governments of Brazil, Chile, France, Norway and the United Kingdom, and was endorsed by the Secretary General of the United Nations. Philippe Douste-Blazy, the UN's Special Advisor on Innovative Financing for Development has described the initiative as "a great sign of global solidarity" (UNITAID 2011).

The tax on airline tickets is levied by the governments of participating countries and nine countries now participate in this initiative.¹² It is paid by individual air passengers when they purchase their ticket and airlines are responsible for collecting and declaring the levy. The cost of the tax varies from one country to the next but is low compared to the overall cost of the ticket. For instance, Chile imposes a fixed rate of US\$2 on all international flights. France distinguishes between economy and business/first class air travel. €1 is levied on domestic and European flights and €4 on international flights in economy class. Business and first class travellers are charged €10 for domestic and European flights and €40 for international flights (UNITAID 2011).

Most of the resources raised through the airline ticket tax are channeled into UNITAID. The agency was founded specifically to channel resources raised through this initiative into treatment and care for those affected by HIV/AIDS, tuberculosis and malaria, i.e. MDG 6.¹³ UNITAID derives around 70 percent of its income from the international solidarity levy on air tickets. The remainder comes from more traditional multi-year budgetary contributions from bilateral partners and other donors (UNITAID 2011). Since inception, UNITAID reports that it has raised close to US\$2 billion in resources to help provide treatment for approximately 47 million people worldwide (UNITAID 2011). The prospects for broadening the implementation of the airline ticket tax are high.

Figure 1: How the airline ticket tax works



Source: UNITAID.

Voluntary solidarity contributions

Voluntary contributions most closely resemble more traditional forms of fundraising and charitable giving; the innovation lies in the method of collection which is often technology driven. Several initiatives have recently emerged which collect 'solidarity' contributions from consumers, businesses or diaspora communities for international development on a strictly voluntary basis. These differ from initiatives such as the international solidarity levy on air travel which is a government imposed (i.e. mandatory) tax on all consumers of a specified product.

Sometimes referred to a 'micro-philanthropy', examples of recent initiatives include the '1% digital solidarity' initiative and MASSIVEGOOD. Under the former, public institutions and private companies are urged to donate one percent of the value of an information and communications technology (ICT)-related contract to the Global Digital Solidarity Fund which works to reduce the digital divide between developed and developing nations.¹⁴ The latter encourages travellers to make a micro-donation towards major global health causes such as malaria when they make a travel reservation on-line.¹⁵ Both initiatives are currently extremely small in size.

'Product (RED)' is a variation on this theme. When consumers purchase items branded Product (RED), producers donate 50 percent of profits on that item to the Global Fund to fight AIDS, TB and malaria.¹⁶ According to (RED), "since its launch in 2006, (RED) has generated over US\$170 million for the Global Fund and over 7.5 million people have been impacted by HIV and AIDS programs supported by (...) (RED) purchases" ((RED) 2011).

In principle significant potential exists to expand such initiatives in the future, facilitated in large part by new technologies. Internet and automatic payment systems have reduced collection costs to close to zero. On the other hand, such initiatives remain vulnerable to factors such as consumer/business preferences and perceptions, and broader economic conditions. The fact that MASSIVEGOOD (which was launched in Spain in June 2010) was discontinued from the end of 2011 is indicative of this vulnerability. Revenues raised will tend to be procyclical.¹⁷

International solidarity efforts have also been furthered by tapping national lotteries. To date, Belgium and the United Kingdom have financed international aid programmes through their national lotteries. Since 1987, Belgium has mobilized nearly €330 million from its national lottery for food security projects in sub-Saharan Africa carried out by the national development agency, Belgian Technical Cooperation (BTC), non-governmental organizations (NGOs) and international organizations. In the United Kingdom, since 1995, approximately US\$310 million of national lottery resources has funded projects in developing countries (World Bank 2009). Clearly much more potential exists in this area. Proposals for a 'global lottery' have also been tabled to fund international development and climate change.

3.2 Frontloading and debt-based instruments

Sustainable investing and tapping the diaspora

A number of initiatives have emerged which leverage private funds on international and domestic capital markets to help finance international development. For instance, the World Bank and other multilateral development banks have developed a range of 'sustainable investing' bonds which target those investors that are keen to integrate social and environmental concerns into their investment decisions. Investors are assured a safe return and proceeds are credited to special accounts that support loan disbursements for development or climate change adaptation and mitigation projects. Examples are World Bank Eco notes, World Bank Cool bonds and World Bank Green bonds.¹⁸ Until 2008, the World Bank had raised a total of US\$2.3 billion through bonds targeting so-called 'sustainable investing' (United Nations 2011). Some donors, such as France and Germany have used similar approaches and have raised funds for development via their domestic capital markets. These resources have, in turn, been counted as ODA by these donors.

Major innovative financing for development initiatives

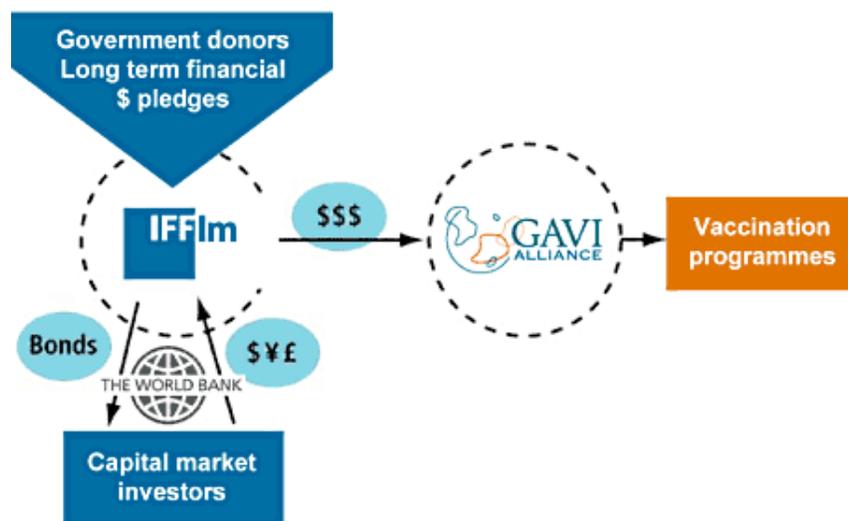
Diaspora bonds have also grown in size and importance over recent years. A diaspora bond refers to a debt instrument issued by a country or a sovereign entity aiming to raise funds through its overseas diaspora. India and Israel have been at the forefront of diaspora bond initiatives and have raised over US\$35-40 billion using these bonds (World Bank 2007). Mostly middle-income countries have used the instrument although some low-income countries have recently explored use of diaspora bonds, such as Ethiopia, Kenya, Nigeria, Rwanda and Zimbabwe. These initiatives create public debt liabilities which must be repaid in the future.

International Finance Facility for Immunisation (IFFIm)

The International Finance Facility for Immunisation offers a variation on the theme of innovative fund-raising on international capital markets. Launched in 2006 by six donor governments (United Kingdom, France, Italy, Spain, Sweden and Norway), the IFFIm raises money by issuing bonds on international capital markets and in so doing makes large volumes of resources immediately available for international development (specifically immunization programmes). The IFFIm repays private investors over periods of up to 20 years with the long-term (legally binding) ODA commitments of donor governments. This arrangement effectively allows governments to 'buy-now but pay later' or 'frontload' ODA (IFFIm 2011). This means that when donors repay bonds at a future date, these contributions will count as ODA. Since its launch several more donors have joined the initiative specifically South Africa, the Netherlands, Australia and Brazil (IFFIm 2011).¹⁹

To date, IFFIm has undertaken 18 separate bond issuances on 10 occasions in five markets, raising a total of US\$3.4 billion. At the end of 2010, US\$1.8 billion had been disbursed (IFFIm 2011). The majority of these resources have been channeled into the Global Alliance for Vaccines and Immunisation (GAVI), a public-private partnership launched in 2000 to increase children's access to vaccines in the world's poorest countries and to reduce the prices of those vaccines. The IFFIm has enabled GAVI to significantly scale up its health programmes. GAVI reports that by the end of 2010, it had supported the immunization of 288 million additional children, who might not otherwise have had access to vaccines, and prevented over five million future deaths (GAVI 2010). The 2011 Evaluation of the IFFIm estimates that between 1.3 billion and 2.08 million deaths will have been averted by the end of 2011 due to the IFFIm.²⁰

Figure 2: How the IFFIm works



Source: IFFIm.

Major innovative financing for development initiatives

Debt conversions (or debt swaps)

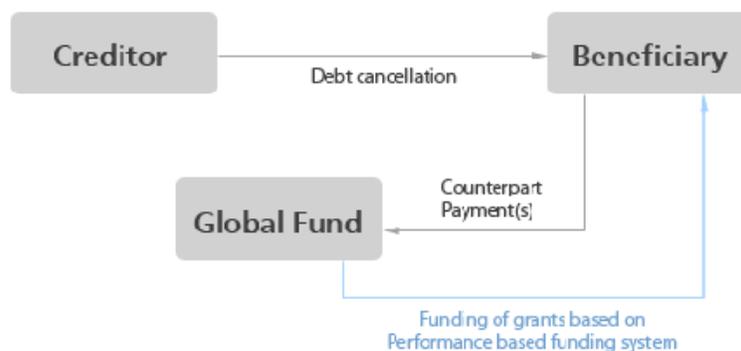
In contrast to the mechanisms described above which create new debt to make more resources available for development purposes today, debt swaps 'convert' the existing debts of developing countries into increased expenditures on important development programmes. Under debt 'swap' agreements, creditors agree to forego a portion of their claims on the condition that the debtor country spends an agreed amount on approved social or environmental programmes.

Debt conversions have been implemented on a largely ad-hoc basis over the years. In the 1980s, the World Wide Fund for Nature (WWF) initiated debt-for-nature swaps with commercial creditors as a mechanism to enhance financing for conservation efforts in developing countries. A debt-for-nature swap involved the purchase of a foreign debt on the secondary debt market (usually a commercial debt) by an NGO at an amount less than the face value of the debt. The debt was then converted into local currency and the proceeds used to fund conservation activities.²¹

Debt-for-education and debt-for-health swaps have also been implemented. UNESCO has been at the forefront of efforts to explore ways in which debt swaps can leverage more funds for education and other development purposes. Since 1998, 18 debt-for-education swaps have been initiated in 14 debtor nations, predominantly in Latin America (UNESCO 2011). In 2007, the Global Fund to Fight AIDS, tuberculosis and malaria launched the 'Debt2Health' initiative. Under Debt2Health agreements, the (official) creditor agrees to forego payment of a portion of interest and principal on the condition that the beneficiary invests an agreed amount in health via the Global Fund. To date, four Debt2Health agreements have been concluded. They involve Germany and Australia as creditor countries and Indonesia, Pakistan and Côte d'Ivoire on the beneficiary side (Global Fund 2010). The World Bank has also developed International Development Assistance (IDA) credit 'buy-downs' via which credits are retroactively converted into grants should certain development outcomes be met. Up until 2011, US\$316 million in IDA credits had been bought down (World Bank 2010).

Donors typically count debt conversions as ODA. As such they may not represent additional resources for development.

Figure 3: The Debt2Health initiative of the Global Fund



Source: The Global Fund.

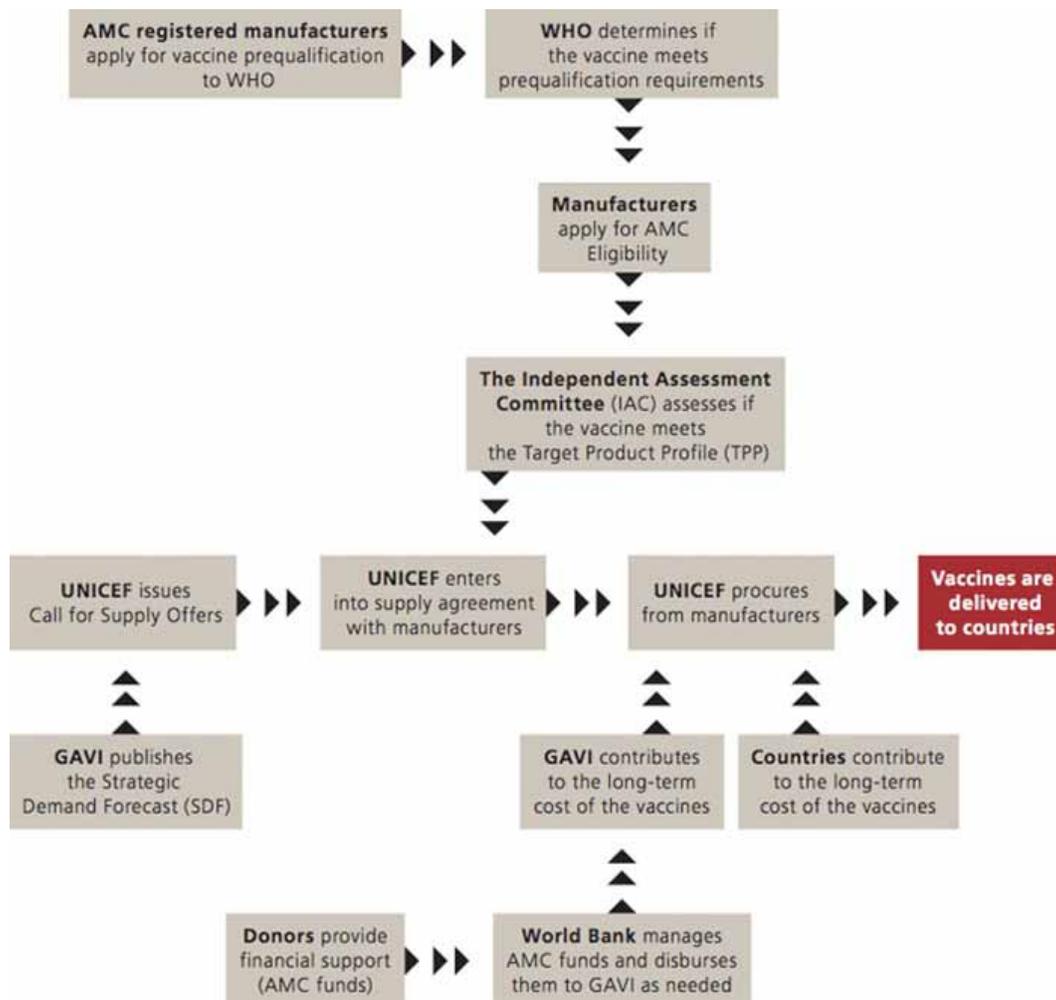
Major innovative financing for development initiatives

3.3 State guarantees, public-private incentives, insurance and other market-based mechanisms

Advance Market Commitments and copayment schemes

An emerging class of innovative finance initiatives involves the use of donor funds and/or private flows to catalyse market creation and development. The Advance Market Commitment (AMC) for pneumococcal vaccines is one example. Launched in 2007 by Canada, Italy, Norway, Russia, the United Kingdom and the Bill & Melinda Gates Foundation, this pilot initiative aims to accelerate the development and availability of a new pneumococcal vaccine. Thus far, donors have committed US\$1.5 billion to guarantee pharmaceutical companies the price of vaccines. These financial commitments provide, in turn, a new incentive to vaccine manufacturers to develop a product that might otherwise not be commercially viable and to produce it the scale necessary to meet demand in developing countries. In exchange, pharmaceutical companies sign a legally-binding commitment to provide the vaccines at an agreed price.²²

Figure 4: Advance Market Commitments (AMC) in practice



Source: GAVI Alliance Secretariat.

Major innovative financing for development initiatives

Each manufacturer receives a share of the committed AMC Funds of US\$1.5 billion in proportion to their supply commitment (GAVI 2011). In 2011, a total of 17 countries had been supported by pneumococcal vaccine introductions and a further two were under consideration from 2012 (AMC Annual Report 2011).²³ Two manufacturers had committed to supply 600 million doses over the next 10 years (GAVI 2011). The GAVI Alliance is the implementing partner agency in this initiative.

The Affordable Medicines Facility for Malaria (AMFm) is a variation on this theme. The AMFm involves negotiating a reduced price for artemisinin-based combination therapies with drug manufacturers, while donors make an additional copayment to further lower the sales price to end users in malaria-endemic countries (Global Fund 2011). The United Kingdom and UNITAID have committed resources to this initiative which in turn is managed by the Global Fund.²⁴ In both initiatives, donors' financial commitments count as ODA.

Carbon finance

Carbon finance—which refers to the purchase of greenhouse gas emission reductions in developing countries to offset emissions by governments and firms in developed countries—represents an emerging source of international finance. By establishing a framework for trading “reduction(s) in greenhouse gases by the equivalent of one metric ton of CO₂,” signatories to the Kyoto Protocol created a new globally traded commodity. The global market for greenhouse gas emission reductions through project-based transactions has been increasing sharply.

The Clean Development Mechanism (CDM) is one example.²⁵ The CDM allows a country with an emission-reduction or emission-limitation commitment under the Kyoto Protocol to implement emission-reduction projects in developing countries. Such projects earn saleable certified emission reduction (CER) credits, each equivalent to one tonne of CO₂, which count towards meeting Kyoto targets. A two percent levy on carbon credits generated through the CDM is channeled in turn to the Adaptation Fund which finances climate adaptation projects and programmes in developing countries that are parties to the Kyoto Protocol.²⁶ As of 2011, the Adaptation Fund had funded 11 projects in developing countries totaling approximately US\$70 million. Six are being implemented by UNDP (Adaptation Fund, 2011).

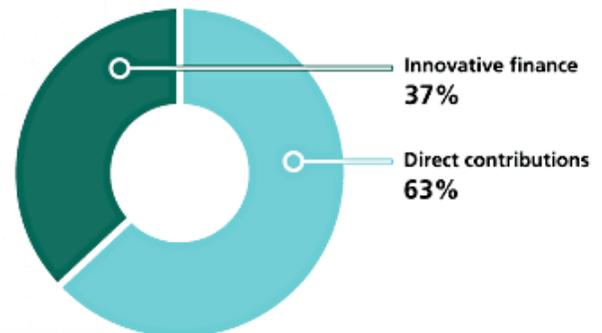
Under the European Union Emissions Trading Scheme (EU ETS), governments can auction or sell emissions permits to emitters or allocate them for free. Auction and sales revenues accrue to the government. In 2008 and 2009, Germany raised around €1.5 billion through this initiative. It allocated €327 million to support international climate-related projects in developing countries (BMZ 2010). The European Union (EU) recommends that 50 percent of government revenues via this scheme are invested in adaptation and mitigation measures both within and outside the EU. Moreover the EU ETS will be extended to the airline industry from 2012. As such, this may develop into an important source of climate and development finance in the future. Germany integrated the proceeds from the sales of emissions permits into its regular development cooperation budget and these funds were therefore reported as ODA.

Payments for Ecosystem Services

Payments for Ecosystem Services (PES), also known as Payments for Environmental Services have emerged as an instrument which offers financial incentives to farmers, landowners or governments in developing countries to protect or manage their land to provide

Figure 5: GAVI Funding Structure

GAVI's funding 2000-2010 by proceeds



Source: GAVI Alliance.

Major innovative financing for development initiatives

some form of ecological service (such as protection of the rainforest). These programmes thus promote the conservation of natural resources in the marketplace. One prominent example so far is United Nations Collaborative Programme on Reducing Emissions from Deforestation and Forest Degradation in Developing Countries (UN-REDD). The programme was launched in 2008 and aims to make forests more valuable standing than they would be cut down by creating a financial value for the carbon stored in trees. UN-REDD thus aims to tip the economic balance in favour of the sustainable management of forests (UN-REDD 2009). Funded through traditional ODA, 14 developing countries have so far received financial support through this initiative for a total of US\$59.3 million. Norway is the UN-REDD Programme's first and largest donor. Denmark, Spain, Japan and the European Commission (EC) have also contributed funds (UN-REDD 2009). There are also numerous other PES schemes which are not financed via traditional ODA. These include schemes implemented nationally by developing country governments themselves, especially in Latin America.

Improving the effectiveness of development finance

An emerging set of financial instruments aim to improve the effectiveness of development finance rather than create new revenue streams for development. This includes local currency lending, 'countercyclical loans', sovereign insurance pools and performance based aid.

Several development banks — and in particular regional ones — have begun to issue local currency bonds to fund country operations. Between 1995 and 2008, development banks raised US\$52 billion through local currency bond issues, the aim of which is to reduce currency risks in beneficiary countries and support local currency on-lending (World Bank 2009). Meanwhile, countercyclical loans piloted by the Agence Française de Développement (AFD) allow for adjustments in repayment terms and maturities in response to external shocks. External debt service is adapted to the ability of the borrower to meet those obligations and help governments to manage macroeconomic vulnerabilities.²⁷ As of 2010, France had extended countercyclical loan agreements to Burkina Faso, Mali, Mozambique, Senegal and Tanzania totalling €200 million (AFD 2010).



Photo: UNDP Picture This/Chetan Soni

'Sovereign Catastrophe Risk Finance' support ex ante the management of sovereign risks and is a growth area in innovative finance. Sovereign insurance pools provide more affordable access to insurance against extreme weather events or other catastrophes (such as loss of livestock) by helping governments to transfer part of the fiscal risk associated with such events to the private sector. One of the most important examples of such initiatives is the Caribbean Catastrophe Risk Insurance Facility (CCRIF) which aims to reduce the economic impact of natural catastrophes by providing immediate liquidity to the region's governments through a range of sovereign insurance products.²⁸

Cash-on-performance attempts to link aid disbursements to development results, however defined. 'Output-based aid' (OBA)—a form of public-private partnership—involves contracting arrangements with the private sector which tie the disbursement of public funds or subsidies to the achievement of specified results. The World Bank has identified 159 OBA projects. These focus mainly on the water and energy sectors as well as health and social services (World Bank 2009). The World Bank states that increasingly, OBA schemes are being mainstreamed into the design of the International Bank for Reconstruction and Development (IBRD) and IDA lending operations (World Bank 2009).

4. Innovative financing for development: initiatives under discussion

A wide variety of innovative finance schemes have already been developed. Many more continue to be discussed, although they differ markedly in the amount of political support they generate. The widening interest and growing experience with past innovative initiatives combined with technological advances and international pressures to address development and climate challenges means the scope for more innovations in the future is both enormous and probably inevitable. As the UN Secretary-General's 2009 report on innovative financing for development noted, "innovative sources of financing can generate more funding for development, based on shared goals and a mode of international cooperation that has no historical precedent."

There are many innovative financing for development proposals currently under discussion for both feasibility and scale. Some represent old ideas newly 'resurrected' (such as the financial transactions tax, expansion of the role of SDRs etc.), some seek to expand existing initiatives to other development sectors, while others represent blue-sky thinking. This section summarises some of the major initiatives currently under discussion.

4.1 Financial transactions taxes

Since the outbreak of the recent economic crisis, interest in a financial transactions tax (FTT) has increased markedly. Over the last few years, new reports and campaigns have been launched to promote discussion over the feasibility and desirability of some form of globally coordinated financial transactions tax. These include the 'Robin Hood Tax' campaign, an initiative launched by a coalition of civil society organizations, the publication of a major study by the Leading Group on international financial transactions and development, and contributions from the UN Secretary-General's High-level Advisory Panel on Climate Change Financing, the International Monetary Fund (IMF), European Parliament and EC. UNDP's 2011 Human Development Report (HDR), "Sustainability and Equity: a Better Future for all" also looked at this issue and advocated for the global implementation of a Currency Transactions Tax (CTT) as a financing mechanism for human development.²⁹ In October 2011, the EC proposed the introduction of a European Union FTT within the 27 EU member states by 2014. The tax proposed charging financial institutions 0.1 percent against the exchange of shares and bonds and 0.01 percent across derivative contracts.³⁰ Articles and opinion pieces have also emerged against the idea.

The proposals currently under discussion are conceptual successors to the 'Tobin Tax' first floated in the 1970s by economist, James Tobin.³¹ He proposed a tax on all spot conversions of one currency into another proportional to the size of the transaction. Its aim would be to reduce volatility in capital flows and minimise the risks of exchange rate crises. Thus, the Tobin Tax rate would need to be high enough to influence foreign exchange market behaviour.

"As a result of the economic crisis, traditional forms of financing for development are under threat. ODA is under increased budgetary pressure in many donor countries, and private investment and remittances have also been affected. This adds further weight to the case for raising resources for development from new sources — and not least from the financial sector."

Helen Clark, UNDP Administrator, at the High-Level side event: "Innovative Financing for the MDGs", 21 September 2010

Current discussions differ somewhat in purpose. Some have centred on the potential of such an instrument to generate additional resources for development and/or climate change adaptation and mitigation in developing countries. Others have focused on financial transaction taxes as a possible tool to guard against financial instability. For instance, several developed country governments and the European Parliament have suggested that such a mechanism could be used as a contribution by the financial sector to the cost of the recent crisis or could act as an 'emergency fund' in the event of future economic crises. Under either scenario, the tax rate would need to be set lower so as not to cause major disruptions to financial market transactions.

Estimates as to the amount of revenue these taxes could generate vary widely due to differences in proposed tax rates and differences in the financial transactions covered/not covered by the tax. The UN estimates that a coordinated 0.005 percent tax on all the major currencies would raise approximately US\$33 billion each year (United Nations 2009). The European Parliament resolution on innovative financing (2011) estimates that a low-rate FTT could, with a large tax base, yield nearly €200 billion per year at EU level and US\$650 billion at global level.³²

The Leading Group's 2010 report, "Globalizing Solidarity: The Case for Financial Levies" analysed various forms of tax on financial transactions against several key criteria: sufficiency (where potential revenues are sufficient to make a meaningful contribution); market impact (where market distortions and avoidance are within acceptable limits); feasibility (where legal and technical challenges can be feasibly addressed); and sustainability and suitability (where the flow of revenues would be relatively stable over time, and the source suited to the role of financing global public goods) (Leading Group 2010). It concluded that a centrally collected multi-currency transaction tax would be "the most appropriate source of revenue to fund public goods and share the wealth generated by globalized economies."³³

The proposal enjoys support from a number of developed and developing countries, some of which have signed a political declaration in support of the FTT. These include Belgium, Benin, Brazil, Burkina Faso, Congo, Ethiopia, France, Guinea, Japan, Mali, Mauritania, Norway, Senegal, Spain and Togo.³⁴ In Europe, France and Germany in particular have indicated they would like to see a financial transactions tax and have urged the G20 to explore this issue, notably with the commissioning of a technical report on innovative finance from the global philanthropist, Bill Gates. The Gates report suggests that, "a small tax of 10 basis points on equities and 2 basis points on bonds would yield about US\$48 billion on a G20-wide basis, or US\$9 billion if confined to larger European economies. Some FTT proposals offer substantially larger estimates, in the US\$100-250 billion range, especially if derivatives are included".³⁵

Other governments—as well as some economists, financial institutions and other opinion leaders—have been more skeptical as regards the desirability and enforceability of a FTT. Arguments levied against such an initiative have focused on whether the FTT may reduce market liquidity and increase the costs for investors to trade assets and hedge their portfolios. This could lead to lower market efficiency and higher price volatility. The IMF has suggested that the instrument may not be able to address systemic risks in the financial sector, although current discussions have focused more on the role of the FTT as a revenue generation mechanism rather than as a means to reduce volatility in international capital flows. Finally, some governments have suggested that the FTT could only work if coordinated and implemented globally. For instance, the United Kingdom Government, which houses the world's leading centre for foreign exchange trading, as well as other financial assets, has argued that unless any FTT is imposed multilaterally such trade will migrate to other centres, such as Switzerland, New York or elsewhere with the consequent loss of jobs and taxes from the British economy. This means that the FTT could, in practice, generate very little new revenue.

In reality, various forms of FTT have been in effect for some time in several G20 countries, including South Africa, the Republic of Korea, Hong Kong SAR, India and the United Kingdom. Should such an initiative be implemented in the future, it is not clear from recent political discussions that the proceeds would necessarily be directed towards international development. The mechanism is also highly likely to be procyclical in nature, i.e. it would generate more revenues in economic booms and less in economic downturns.

4.2 Carbon taxes

The potential of carbon taxes and other forms of tax on activities which have negative impacts on the environment (such as maritime and aviation transportation) have also attracted increased attention over recent years. A carbon tax is a tax on the carbon content of fossil fuels (such as coal, oil and gas) and is designed to provide businesses and individuals with an incentive to curb activities that produce CO₂ emissions. In principle, the tax motivates entities to cut back on their carbon emissions if the cost of doing so is less than the cost of paying the tax. Under such initiatives, policymakers levy a fee for each tonne of CO₂ emitted or for each tonne of carbon contained in fossil fuels. Carbon taxes also sustain the 'Polluter Pays Principle' which is a key principle of the 1992 Rio Declaration on Environment and Development. Principle 16 encourages national authorities "to promote the internalisation of environmental costs and the use of economic instruments" to ensure that the polluter, in principle, bears the cost of pollution.³⁶

These taxes could help to reduce carbon emissions as well as generate a sizeable flow of revenues. The UN Secretary-General's High-level Advisory Group on Climate Change Financing reported that "if a carbon tax were imposed on all energy-related CO₂ emissions in the "OECD+" countries, it would raise in the order of US\$10 billion in 2020 for every U.S. dollar of tax per ton of emissions."³⁷ A Swiss Government proposal for a global carbon tax would involve every country imposing a base levy of US\$2 per tonne on all carbon dioxide emissions from fossil fuel use with an exemption on the first 1.5 tons of emissions per capita. This initiative would raise an estimated US\$48 billion per year (United Nations 2009). The World Bank and IMF have recently proposed global carbon taxes on aviation and ship fuels in developed economies to help reduce carbon dioxide emissions. This could raise around US\$250 billion in taxes in 2020. It suggests an international charge on aviation and maritime bunker fuels of US\$25 per tonne of CO₂ would "reduce CO₂ emissions from each sector by around five to 10 percent" (World Bank 2011).

A number of countries have implemented various forms of carbon tax on a national basis over the last two decades. Australia has recently introduced a carbon tax set at AU\$23 per tonne of carbon released into the atmosphere, to increase gradually until 2015.³⁸ In other countries however, such initiatives have proven politically difficult.

Coordinated international action on such measures has also been a challenge. The practicality and political feasibility of such proposals varies considerably across countries, in part because global approaches will need to ensure that poorer countries do not bear a disproportionate tax burden as a proportion of national income. At household level, by increasing the cost of using fossil fuels, a tax will have both direct impacts on household energy expenditures, and indirect impacts on broader household expenditures. This means that parliaments will be under considerable pressure to use revenues raised at the national level to soften the distributional effects of the tax on affected constituencies and/or to support investments in lower emissions energy technology at home. As a consequence, it is likely that those countries which do eventually implement such measures would probably commit only a small portion of overall revenue to international climate or development objectives.

4.3 Solidarity Tobacco Contribution

In December 2010, the Leading Group created a task force on health which, among other issues, will explore options to increase taxation on tobacco and pool additional revenues received. While many countries already tax tobacco heavily, proposals have recently emerged for some form of 'Solidarity Tobacco Contribution'.³⁹ At the discretion of the taxing governments, small increases in tobacco excise in both developed and developing countries could be pooled and allocated to a menu of internationally agreed global health objectives.

In 2011, the World Health Organization (WHO) released a discussion paper entitled: "The (Global) Solidarity Tobacco Contribution—A new international health-financing concept prepared by the World Health Organization."⁴⁰ The WHO estimates that a tax increase of US\$0.05 per pack sold in G20+ countries would raise US\$4.3 billion for international health

(WHO 2010). Bill Gates estimates that a Solidarity Tobacco Contribution may raise US\$9 billion per year for health (Gates 2011). Moreover it could combine substantial revenue mobilization with positive health outcomes. The WHO also reports that there is substantial room for many developing country governments to act at national level to increase tobacco taxes to raise more funds for health and development. In 2010, the WHO showed that a 50 percent increase in cigarette excise taxes in 22 low-income countries could generate US\$1.42 billion to strengthen national health systems (WHO 2010).

As with carbon taxes, governments typically face significant pressure to use the majority of revenues collected nationally on tobacco consumption to fund national health priorities. As such, it is likely that only a small proportion of revenues collected via tobacco taxes will ever be allocated to international development objectives such as health.

4.4 IMF's Special Drawing Rights

An enhanced role for the IMF's SDRs in supporting macroeconomic stability and international development has resurfaced in the context of the recent economic crisis. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of four key international currencies.⁴¹ SDRs are created by the Executive Board of the IMF. They are backed by the consensus of the world's governments and there is no material cost to their creation.

Under its Articles of Agreement, the IMF may allocate SDRs to member countries in proportion to their IMF quotas. Such allocations provide each member with a costless, unconditional international reserve asset on which interest is neither earned nor paid. SDRs may then be converted into the freely usable currencies of IMF members to be used as governments determine. The cost of converting SDRs is usually small. For many developing countries, SDRs are probably the most convenient, least expensive source of liquidity short of outright grants.

In 2009, to help mitigate the effects of the financial crisis, the G20 requested the IMF issue the equivalent of US\$250 billion in new SDRs to be allocated to member countries in proportion to existing IMF quotas. However, because wealthier countries hold larger quotas in the institution, developed countries were accorded the majority of SDRs. Of the 2009 SDR allocation, only around US\$16 billion of SDRs went to low-income countries (ActionAid and Third World Network 2010).

A number of proposals have recently emerged to either facilitate the transfer of SDRs to developing countries that may need them, or to mobilize idle SDRs into specialised trust funds to provide seed finance climate change adaptation and mitigation. In the wake of the recent economic crisis, several NGOs suggested that SDR allocations occur on a more regular basis and the proceeds allocated to those countries that most in need or that wealthy countries donate their idle SDR allocations to poorer countries.⁴² The IMF's Articles of Agreement allow for the donation of one member's SDRs to another, however as soon as SDRs are used, interest is payable on them. In 2009, France and the United Kingdom indicated that they would be prepared to lend their SDR allocations to the IMF, which could, in turn, on-lend these resources to developing countries. Currently, the IMF's rules do not provide for this. Moreover, under this approach, unconditional and cheap resources would be converted into conditional debt-creating loans.

In 2010, an IMF staff paper proposed the creation of a 'Green Fund'.⁴³ This fund would provide finance to help countries scale up their response to climate change. An initial capital injection would be provided by developed countries in the form of reserve assets, which would include SDRs.

Despite the potential offered by an enhanced role for SDRs—the UN's Commission of Experts on Reform of the International Monetary and Financial System has also articulated support for an expanded role for SDRs in support of the counter-cyclical financing needs of developing countries—political consensus has so far proved elusive. The fact that the majority of SDRs accrue to developed countries in any SDR allocation also compromises the ability of this mechanism to act as a tool for development finance.

5. Innovative financing for development and the experience so far: key issues and considerations for the future

Innovative forms of development finance show significant potential to expand and diversify in the future. However, the subject is not without its controversies. While some development actors cannot emphasise their positive contribution to development strongly enough, others have raised important questions. These questions have looked at both the way resources have been raised and the way they have been delivered.

In this section, we review the experiences so far with various innovative sources of development finance and draw preliminary lessons learned for the future. Our analysis is based on an extensive literature review, which includes formal evaluations of some initiatives, combined with country level evidence provided by UNDP country offices and other development partners on the ground. To help us determine the major pros and cons of different innovative finance initiatives, we assess some of the major initiatives implemented so far next to nine key questions. These include questions such as: the extent to which initiatives have created additional financial flows for development, have supported country ownership of the development process, delivered predictable finance and concrete development results as well as reached those countries most in need. Many of these issues have been raised in relation to traditional forms of development assistance and are key elements of the 2005 Paris Declaration on Aid Effectiveness and the 2008 Accra Agenda for Action. Our analysis helps us to determine whether certain initiatives may or may not represent a radical departure in their modus operandi from traditional ODA or are able to address some of the shortfalls associated with traditional aid. Our findings are summarised in an easy reference table annexed to this paper. This provides a useful snapshot of some of the main pros and cons associated with different approaches.

While we discuss some of the main issues that we consider important for aid and development effectiveness, this section is necessarily subjective and reflects the authors' judgment of certain initiatives as well as those of several experts consulted. This Discussion Paper has been rigorously peer reviewed by competent internal and external experts and stakeholders. Its aim is to inform international policy discussions over the form, direction and implementation modalities of both current and future innovative financing for development initiatives so that they are able to make the most effective contribution to development possible. UNDP thus invites feedback on this paper from qualified practitioners so that collectively we can further our understanding about this rapidly evolving area of global development finance.

"[V]oluntary mechanisms should be effective, should aim to mobilize resources that are stable and predictable, should supplement and not be a substitute for traditional sources of financing, should be disbursed in accordance with the priorities of developing countries and should not unduly burden such countries."

Resolution adopted by the UN General Assembly, Innovative mechanisms of financing for development, 4 February 2011

"As is the case with all resources for development, it will be important that what is raised from innovative financing mechanisms is used transparently and effectively, and complies with principles of aid effectiveness and coherence."

Helen Clark, UNDP Administrator, at the High-Level side event: "Innovative Financing for the MDGs", 21 September 2010

5.1 Have innovative financing for development initiatives generated additional resources for development?

Experience so far

Various UN documents and the Leading Group on Innovative Financing for Development emphasise that innovative sources of development finance should be additional and complementary to traditional forms of development assistance (emphasis added). The 2011 UN General Assembly Resolution on innovative financing for development reiterates that “such voluntary mechanisms [...] should supplement and not be a substitute for traditional sources of financing.”⁴⁴ So what has been the experience so far?

Several initiatives do, in principle, raise additional revenues for development. These include taxation instruments such as the airline ticket tax, carbon trading schemes and voluntary solidarity contributions such as Product (RED). For other innovative initiatives, the creation of new and additional revenues for development is not their aim. For instance, the IFFIm does not generate additional finance but rather intertemporally shifts funds available for child immunization (World Bank 2009). The AMC for a pneumococcal vaccine utilises ODA to alter incentives for manufacturers to engage in research, development, production and the distribution of a specified product. Some initiatives also deploy ODA to finance innovations in spending, e.g. in the case of counter-cyclical loans and subsidies for the payments of premiums related to catastrophe risk insurance programmes.

In practice, even where initiatives have generated additional financial flows for development, the resources raised have been counted by donor governments as ODA, i.e. they have been assimilated into donors’ normal development cooperation budgets. This is permitted under OECD DAC guidelines on what may be reported as ODA.⁴⁵ For instance, resources raised via the airline ticket tax are reported as ODA at the moment contributions are made to UNITAID and to the IFFIm. Germany integrated the proceeds raised under the EU ETS into its development cooperation budget (OECD DAC 2009).

Only a small set of initiatives do not currently qualify as ODA. This includes voluntary private contributions (such as Product (RED)), the World Bank’s Eco-Notes and Green Bonds and the two percent levy on Certified Emission Reductions (CERs) under the Clean Development Mechanism. So to what extent do some schemes simply represent ‘new wine in old bottles’?

The key issue is whether innovative finance initiatives which do qualify as ODA have boosted ODA levels in donor countries, or whether they have substituted for governments’ efforts to maintain and increase traditional development assistance, i.e. have they filled the ODA hole or increased the ODA pie? Substitution could occur for instance when the resources generated through a new source (e.g. an airline ticket tax) are used by a bilateral donor to offset declines in traditional forms of aid financed through domestic taxation. This may be attractive in donor countries where public opinion and/or the political commitment towards aid are more muted. For instance, in Benin, UNDP has reported that some donors have reduced traditional ODA to the health sector when the country received resources through programmes financed by innovative mechanisms.⁴⁶

While possible in theory, in practice this question is more difficult to answer because we do not have a workable counterfactual, i.e. we do not know what donors’ aid levels would have been in the absence of such innovative initiatives. Calculations of additionality are further complicated because donors report aid levels in the aggregate, which hides potential fungibility between ‘old’ and ‘innovative’ forms of finance. One apparently contradictory observation is that those donors most interested in innovative finance for development are also those whose aid levels are —by and large— on the increase, i.e. there seems to be a ‘rump’ of donors with both a low interest in aid and a low interest in innovative development finance instruments.

In the health sector, the OECD recently concluded that only US\$0.2 billion of the total estimated revenues of US\$5.5 billion raised by selected mechanisms between 2002 and 2010 was reported as “additional” to ODA (OECD 2011). In climate and the environment, of the US\$31 billion raised so far, most have been recorded as ODA (UN Report of the SG on innovative mechanisms of financing for development, 2011). The World Bank finds that budget outlays from emerging sovereign donors have been the only significant

source of additional concessional flows over recent years (World Bank 2009). Thus, the international community should be realistic about just how far—at least to-date—innovative schemes have generated significant additional resources for development.

It should also be noted that issues related to additionality also apply at beneficiary country level; in theory governments can offset increases in resources received via innovative finance mechanisms with a commensurate decrease in domestic resources allocated to the same sector/issue.

Looking forward: key issues and lessons learned

We should bear in mind the core aim(s) of innovative financing for development instruments. All initiatives are not alike. While some instruments aim to raise additional resources available for development, others seek to ‘frontload’ resources so that they can be spent today. Others aim to improve the effectiveness of external finance.

While some initiatives do aim to generate new revenue streams for development (e.g. the airline ticket tax and the two percent levy on CERs), overall, current evidence points to limited ‘additionality’ in innovative finance—although some initiatives have enabled donors to increase their ODA. To date, innovative finance mechanisms have played a more significant role in supporting financial solutions on the ground than in identifying and exploiting “alternative sources of ODA.” Most innovative finance schemes have instead leveraged or ‘manipulated’ ODA in one form or another.

Of the innovative finance proposals under discussion, some promise to deliver considerable additional resources for development and climate/environment. These include the FTT and carbon taxes on aviation and ship fuels. However, under current practice funds raised under national legislation via such instruments would be counted as ODA when spent on international development.

There is an undisputed need to raise sizeable and additional resources for development and climate related actions. Estimates as to the volume of external resources required annually to support achievement of the MDGs are extremely high and remain largely unmet to date.⁴⁷ Climate change requires further additional resources and also increases the costs of development. Several innovative finance mechanisms provide new and ‘additional’ revenue streams for development and can therefore help to meet these challenges. However, it is vital that these initiatives are not simply used to offset declines in traditional donor assistance. Two issues are important in this regard.

First, greater clarity is required on how innovative financing for development relates to the United Nations target of 0.7 percent of Gross National Income (GNI) allocated to ODA. The question is whether innovative initiatives should provide finance in addition to the United Nations target of 0.7 percent or whether donors are entitled to use all available means to reach 0.7 percent, including through the use of innovative financing for development mechanisms. The UN General Assembly Resolution is somewhat vague in this regard only emphasising that innovative financing mechanisms, “should supplement and not be a substitute for traditional sources of financing.”

Second, a broad international consensus is required as to how to categorise and count such flows. A clear distinction may need to be established between traditional and innovative forms of finance and the different forms of finance reported separately (i.e. disaggregate data by source). For instance, we should strive to report ‘regular government budget’ vs. extraordinary measures (airline ticket tax) separately. This will help to measure the extent to which the proceeds of new innovative sources of finance are used to lower efforts to increase traditional sources of development finance.

Such distinctions will also be critical as climate finance develops and expands further. Although many forms of external finance have dual development and climate objectives, they need to be counted and assessed separately next to different international commitments; the former against the UN target of 0.7 percent ODA as a percent of GNI and the latter next to the 2009 Copenhagen Accord commitments.

5.2 Have innovative sources of development finance delivered concrete development results?

Experience so far

A major rationale for innovative sources of development finance is that they help to increase the quantity and quality of development finance available. As such, initiatives should be able to demonstrate tangible development results and prove 'added value'. Several initiatives publish impressive headline development results, especially in the health sector. Others' results are more difficult to measure either because their remit is very broad and/or the funds have supported development activities whose results will take time to materialise.

In the health sector, the reach and development impact of initiatives such as the airline ticket tax, IFFIm and the AMC is well-publicised on each mechanism's respective website(s) and in annual reports. UNITAID, which is funded primarily through the international solidarity levy on airline travel, reports that it provides HIV/AIDS, TB and malaria treatment to approximately 47 million people in 94 countries worldwide. It has also reduced the cost of quality second-line anti-retro-viral treatments by more than 50 percent (UNITAID 2011). The 2011 Evaluation of the IFFIm estimates that between 1.3 million and 2.08 million deaths will have been averted by the end of 2011 due to the IFFIm (IFFIm 2011). The WHO reports that 8,000 future deaths will be averted with GAVI pneumococcal vaccine support from 2000-2010 (WHO 2010). However, it should also be noted that take-up of the pneumococcal vaccine in the developing world has been slow to-date (MSF and Oxfam 2010). Other development outcomes are also attributed to these initiatives, some of which are summarised in the annex.

Various factors are cited to explain these positive health outcomes. These are connected, in large part, to the delivery modalities selected for innovative finance streams. To-date, most innovative finance initiatives have channeled resources through so-called 'vertical funds' (also known as 'vertical programmes' and 'global programmes'). These programmes focus on specific themes (such as a communicable disease) and target resources exclusively at interventions to tackle that problem. Vertical programmes typically involve partnerships between multiple actors in both the public and private sectors.

'Vertical' programmes emerged in the early 1990s with multilateral initiatives such as the Global Environment Facility (GEF) and the Multilateral Fund for the Implementation of the Montreal Protocol—a fund established to protect the ozone layer. Both were established in 1991. In the health sector, vertical approaches emerged in the late 1990s as a way for bilateral donors to develop activities in some of the poorest countries and were initially considered interim strategies to improve health outcomes in 'fragile' contexts. Since then, vertical funds have experienced a boom in both number and size with the upswing in private philanthropy. Vertical programmes supported by global philanthropists such as Bill and Melinda Gates frequently adhere to businesslike values with problem-oriented strategies and a focus on immediate results (Sridhar and Tamashiro, 2009).

In the health sector, the results record has been attributed to the capacity of vertical programmes to develop economies of scale and to respond to countries' needs and demands for services typically in situations where governments do not have the capacity and/or resources to provide them. Most also operate clear monitoring and evaluation frameworks to help ensure accountability for monies spent and that development results are realised.

In the climate/environment sector, the same approach has been used and funds raised via innovative initiatives have also been channeled into thematic programmes. However, the initiatives supported have been more diversified and the results are sometimes qualitatively more difficult to measure. For instance, the impact of measures to enhance communities' resilience to the effects of climate change on agriculture and food security or activities which support adaptation to coastal erosion may only materialise over the longer-term.

In both thematic areas, it is important to note that assessments of development and environment impacts are subject to a high degree of uncertainty and results may be better—or worse—than those estimated. The availability of quality and comparable data across countries is one factor. It can also be difficult to attribute a development outcome to any one single intervention since progress (deterioration) in one area is often influenced by progress (deterioration) in other areas (UNDP 2010). It is also difficult to know whether a particular intervention financed through an innovative finance mechanism may have happened anyway, i.e. beneficiary governments may have diverted funds from another area to fund immunization anyway or found the resources through efficiency saving measures.

Additionally, while some initiatives publish impressive headline results in the aggregate, detailed information on individual project outcomes is frequently more difficult to obtain. It has also been alleged that despite the results-focused nature of certain initiatives, capacity building of recipient country institutions and systems is often neglected while parallel project implementation units are created in order to “get the job done” (see question five for further elaboration). Seen in this way, the definition of development results attributed to vertical programmes financed through innovative finance mechanisms may be too narrow since over the longer-term the sustainability of development results will ultimately rest on the presence of complementary sector-level and country-level policies and institutions (Global Monitoring Report, 2006).

Looking forward: key issues and lessons learned

The drive for immediate and reportable development results, while important, needs to be looked at in a balanced manner; solutions on the ground often take some time to materialise. This means that innovative financing initiatives should be reviewed in terms of their ability to efficiently and effectively deliver development results both in the immediate and longer-term.

There is a risk that the results-based approach which is currently popular in the development discourse could lead the international community to focus on ‘low-hanging fruit’ or ‘quick wins’ at the expense of longer-term development challenges (such as local capacity development) or perceived riskier interventions. For instance, interventions may focus on relatively simple, inexpensive initiatives (e.g. distribution of anti-malarial insecticide-treated nets), rather than more complex, expensive and longer-term interventions (e.g. empowerment of women). Such interventions frequently require long time frames for tangible impacts that mostly occur in the next generation (Richard et al 2011).

Broad public support for innovative sources of development finance will determine their relative success or failure. This popular support will hinge, to some extent, on the initiative’s abilities to secure results. However, this may present challenges for programmes which take a longer-term view. Thus, it may be useful to consider the ways in which innovative sources of development finance could complement and/or be blended with other forms of finance—domestic and external, official and private—to ensure both short and long-term objectives can be met. This will require close alignment behind nationally-devised development and climate change strategies (see question five on country ownership of innovative sources of development finance for further elaboration).

5.3 Which countries have benefited from innovative financing for development and why?

Experience so far

Much literature on aid effectiveness has explored whether ODA has been directed towards those countries considered ‘most in need’. It finds that ODA is heavily concentrated in a small number of developing countries and that this degree of concentration has increased over the last decade (MDG Gap Task Force 2011, UNDP 2011). In 2009, 10 countries received 25 percent of total OECD DAC aid receipts (MDG Gap Task Force 2011). These include Afghanistan and Iraq as the largest recipients. This is indicative of the

fact that donors provide aid for a variety of reasons, not necessarily linked to poverty reduction and economic development. The question is whether innovative financing for development initiatives have repeated or diverged from this pattern.

To some extent, the evaluation of which countries are most in need—and in which development areas—is subjective and open to continuous debate and revision. Nevertheless, it is useful to look at which countries have so far been able to access innovative finance initiatives and on what grounds. This requires, in turn, an exploration of the eligibility criteria and allocation practices of the vertical programmes which receive large resource allocations via innovative finance mechanisms.

In the health sector, many vertical programmes emphasise that they focus support on the world's poorest countries. For the GAVI Alliance (which receives resources through the IFFIm and the AMC), this is defined as countries with a GNI per capita below or equal to US\$1,520. This means a total of 57 countries are currently 'GAVI-eligible' (GAVI 2011). UNITAID, funded in large part by the airline ticket tax, implements projects in both low- and middle-income countries. It operates a more complex assessment for project selection based on criteria such as the importance of the public health problem in the country, feasibility of intervention, likely public impact and 'fit' with UNITAID's overall mission and objectives (UNITAID 2009). UNITAID reports that 94 countries currently receive UNITAID financial support (UNITAID 2011). Overall, in the health sector, the evidence indicates that resource allocations—which have focused extensively on health issues in low-income countries—have been more progressive in nature than traditional aid allocations.

In the area of climate and the environment, mostly larger middle-income countries have benefited to date. In Latin America and the Caribbean for instance, the region's larger economies have benefited from climate funds (funded through both traditional and innovative means). This includes Colombia, Mexico, Brazil, Argentina and Peru. These five countries have absorbed 55.5 percent of climate finance to Latin America and the Caribbean in the 2000s (Gottschalk 2011). The smaller and/or relatively poorer economies have received less.

Several factors explain this. First, there has been less clarity conceptually as regards the criteria which should be used to assess which countries are especially vulnerable to climate change and are least equipped to meet the challenges associated with it. The Adaptation Fund for instance has struggled to establish operational and objective criteria for the allocation of funds. The methodology for identifying 'the level of vulnerability' and 'the level of urgency and risk arising from delay' as well as criteria for 'adaptive capacity to the adverse effects of climate change' is still to be determined (Klein and Moehner, 2011). Second, smaller and poorer countries frequently lack the capacity (human, technical and institutional) to attract and apply for these funds even though they may need them the most, especially for climate adaptation. It is noticeable that the small Caribbean islands have been almost totally left out of climate funds to date.

With debt conversions (e.g. for health, education or the environment), the approach has been more ad-hoc and arbitrary based on factors such as the willingness of creditors and debtors to engage in the process, availability of debt which may be 'freely' converted without contractual restrictions, availability of hard currency and credibility of project proposal(s) amongst others. Thus, debt conversions have not necessarily taken place in those countries with the highest public debt burdens combined with the most critical health, education or environment needs relative to other developing countries.

With the World Bank's 'Green Bonds', middle-income countries have also been the beneficiaries, primarily because resources generated through this mechanism are on-loaned and must be repaid by recipient countries. This approach therefore may be more suited to relatively wealthier countries.

Looking forward: key issues and lessons learned

On the surface, there is greater transparency as regards the criteria for access to resources generated via innovative finance mechanisms than has been the case with traditional ODA. This is positive. However, important issues remain. These include the capacities of smaller and/or poorer countries to access this finance. For GAVI, in addition to income per capita criteria, eligible

countries must fulfill further conditions and countries' applications for funds frequently undergo multiple rounds of revisions before they are approved. This can be both time and resource intensive for smaller and/or poorer countries (Sridhar and Tamashiro 2009). It points to the need to simplify procedures, as well as consider other delivery modalities for innovative sources of development finance such as direct budget or sectoral support (see question five on ownership for a more detailed discussion).

Similar issues also apply with regard to climate initiatives. Six countries in the Caribbean (Dominica, Guyana, Haiti, Jamaica, Saint Lucia and Saint Vincent and the Grenadines) have received a total of US\$35 million in climate resources funded through innovative mechanisms so far whereas five large Latin American economies have received US\$289.6 million (Gottschalk 2011). More work is needed to establish objective and easy to understand criteria for access to this finance, as well as to simplify procedures to ensure that smaller and poorer countries have the capacities to access these resources. This will be especially critical as climate finance expands further over the coming years.

Information on country coverage also tells us little about whether interventions actually reach the poorest communities in those countries—although in the health sector the evidence points to enhanced access to healthcare and medicines for the neediest provinces and communities. In addition, in absolute terms, more poor people live in middle-income than in low-income countries. This raises questions as regards which indicators are most appropriate to assess level of need relative to others. The people/institutions empowered to make important decisions over eligible vs. non-eligible countries is crucial in this regard (see question five for further discussion).

There are also important lessons learned as regards debt conversions. This instrument could, in principle, be expanded considerably especially for official debt. In addition, creditors could develop 'multi-creditor' conversions, i.e. several creditors simultaneously 'convert' their debt claims to help beneficiary countries increase expenditures on important social and/or environment objectives.⁴⁸ It may be useful to establish objective criteria as regards need and eligibility for such initiatives to ensure that those countries most in need of debt write-downs to support social and economic development programmes are able to access them.

5.4 Have innovative financing for development initiatives delivered stable and predictable resources for international development and climate/environment?

Experience so far

The literature on aid effectiveness underscores the importance of stable and predictable finance for recipient countries. Where ODA is unpredictable it can raise the cost of financial management, worsen the composition of investment and amplify the fiscal effects of business cycles. For instance, unexpected shortfalls in ODA typically lead governments to shift expenditures away from long-term investments towards short-term consumption (Desai and Kharas, 2010). Thus, the extent to which innovative sources of development finance are able to both raise and deliver resources in a stable and predictable manner is a key question for consideration.

In one sense, innovative finance initiatives are only able to disburse resources on a stable, predictable basis in so far as they are able to raise finance in a stable and predictable manner—whether these resources are delivered, in turn, in a predictable manner is a separate question.

So do innovative sources of development finance raise resources on a more stable and predictable basis than conventional ODA? Predictability is frequently touted as a major advantage of innovative finance initiatives over conventional approaches to external assistance (Leading Group 2011).

Some initiatives score more favourably than others. But most remain vulnerable to different forms of uncertainty or shock. For instance, initiatives which rely on continuous donor pledges or frequent replenishment rounds (such as IFFIm, AMC etc.) may only be able to assure predictable resources for certain periods of time (until donors make fresh commitments to the initiative).

Initiatives based on taxation—such as the airline ticket tax—may appear inherently more stable and predictable but they are also vulnerable to fluctuations in global economic or other conditions. For instance, air travel dropped sharply following the September 11 attacks on the twin towers in the United States as well as in late-2008 and 2009 as the global financial crisis began to unfold. Airline travel has recovered from both shocks and, overall, the industry has grown steadily over the last decade. Nevertheless, such shocks, where they occur, can reduce predictability for such initiatives. Voluntary solidarity contributions (such as Product (RED) and others) are also vulnerable to changes in consumer preferences as well as broader economic conditions (recessions often affect consumers' and businesses' abilities and willingness to donate to so-called 'good' causes). This means that, similar to conventional ODA, many innovative sources of development finance are also procyclical in nature.

The delivery channels selected for innovative sources of development finance are equally, if not more, important where predictability is concerned; even where resources are raised in a sustainable and largely predictable manner, some initiatives may not deliver this finance in a stable and predictable manner.

Current evidence points to limited predictability in the delivery of resources raised through innovative financing for development initiatives. Many vertical programmes—through which innovative typically channel their resources—operate performance-based allocation processes. These aim to incentivise and reward governments for positive development outcomes and the effective use of resources. Results-based finance means that the performance of recipient countries influences subsequent releases of funds. For instance, the Global Fund, which receives resources through Product (RED) and the Debt2Health initiative (among many other conventional funding sources) links the “provision of funding to the achievement of clear, measurable and sustainable results” (Global Fund, 2011).

It is argued that such approaches create incentives for countries to improve performance (Global Fund 2011). It facilitates public scrutiny (by both donor and recipient) and helps to bring the public on board through the clear and effective communication of the role of different initiatives in positive development outcomes. But it can also reduce predictability in development finance which, in turn, undermines aid effectiveness. In particular, the results based approach may penalise weaker and/or poorer countries as well as increase incentives to misreport development outcomes. It may, therefore, tell us little in practice (Sridhar and Tamashiro 2010). A lack of predictability in aid flows can also lead to macroeconomic instability. The OECD (2010) finds that for a large number of developing countries, regardless of sector, results-based finance does not enhance predictability in access to development finance.

Looking forward: key issues and lessons learned

In the long-run, on average, volatility in ODA is negatively correlated with economic growth (UNDP 2011). Thus, innovative financing for development initiatives should strive to provide stable and predictable revenue streams for recipient countries.

While no initiative may be entirely immune from external shocks which temporarily interrupt their normal revenue generation patterns, initiatives such as the airline ticket tax and emissions trading schemes have on the whole provided more constant and predictable revenue streams for international development. This predictability cannot, at present, be matched through traditional budget outlays from donors which are constantly vulnerable to political preferences, economic conditions and other pressures. Financial transactions taxes and carbon taxes could offer similar advantages. Nevertheless, like conventional aid, many instruments tend to be procyclical. This needs to be taken into consideration so that appropriate aid delivery modalities may be designed; for instance it may be desirable for some initiatives to disburse more finance in bad times and less in good, i.e. on a countercyclical basis.

The use of performance based allocation systems can reduce predictability in the delivery of resources on the ground. This can impact the effectiveness of this finance. The use of such approaches also raises questions as regards which performance indicators

and development outcomes are the most appropriate to measure (and which may be waived in cases of non-performance), and more importantly who decides. As a result, they may skew accountability upwards towards donors rather than downwards towards citizens (the ultimate beneficiaries). With some vertical programmes, beneficiary countries define their own performance criteria but this may still reduce predictability in the delivery of resources.

Currently, many innovative financing for development initiatives are small. However, as initiatives become larger in the future and/or countries begin to receive relatively large sums via such mechanisms, efforts will need to be undertaken to ensure that such financial flows are delivered on a stable, predictable and transparent basis. Performance-based allocation systems may not be appropriate in some cases and the case for direct budget or sectoral support may need to be examined more closely (see question five).

5.5 Have innovative financing initiatives strengthened country ownership of the development process?

Experience so far

It is well-documented that ODA is most effective when it is nationally-owned and increases beneficiary countries' policy space (Paris Declaration 2005). In practice however, how ODA is spent has often reflected donor priorities. It has also been plagued by policy conditionalities which have proven largely ineffective and often counterproductive (DfID 2005, OECD 2008). To be as effective as possible, innovative financing for development initiatives should therefore aim to strengthen beneficiary country ownership over the development process. They should be fully aligned with nationally-devised development strategies rather than define their own priority areas for intervention. In this context, it is useful to explore the record so far as regards innovative sources of development finance.

To date, most innovative finance initiatives have channeled resources through thematic single-issue 'vertical programmes' which focus on specific areas of intervention, such as HIV/AIDS, malaria or climate change. This means that in most cases, funds are 'earmarked' at the outset for specific purposes. By definition, this may reduce alignment behind national development strategies and priorities and may reduce beneficiary government control over domestic development programmes and priorities.⁴⁹ It may also have other consequences. These include allocative inefficiency since earmarking creates rigidities in government expenditures. Earmarking may also lead to increased transaction or administrative costs—such as additional staff time—as earmarked funds often require special application, monitoring and reporting arrangements (Adujna 2009).

In the health sector, some literature has questioned whether earmarking can lead to a supply-driven health agenda.



This can result in substantial attention and resources devoted to high-profile diseases such as HIV/AIDS at the expense of primary health care and the social determinants of health (Garrett 2007, EURODAD 2008, Aduagna 2009). It also appears that the MDG agenda has influenced allocations of resources raised through innovative finance mechanisms—rather than channel funds to, say, the health sector in general and allow beneficiary countries to allocate resources as they see fit across the sector, health problems such as HIV/AIDS, TB, malaria and childhood immunization have been prioritised by the mechanisms implemented so far.

In principle, the application process is intended to increase country ownership and align projects with countries' long-term national development goals and priorities. Country-driven proposals aim to give recipients an increased sense of ownership and make them more accountable for the implementation and outcome of their programmes (United Nations 2011). However, application processes for earmarked resources can be complex and burdensome for government administrations, especially in countries with weaker capacities and institutions. As a consequence, some countries have relied heavily on external expertise to complete such processes.

The governance structures of innovative financing for development initiatives are also an important measure of the level of ownership exercised by recipient countries since Executive Board structures influence decisions over the development priorities selected and how resources are allocated. Again, the governance structure of the revenue generation mechanism may be different from that of the delivery vehicle(s).

On the revenue generation side, many innovative finance initiatives are implemented nationally—albeit within a framework of international cooperation. In principle, this means that governments may allocate the revenues raised to the programmes they choose (and may modify their allocations from year to year). In relation to the expenditure side, the governance structures of vertical programmes must be analysed. On paper at least, the governance structures of most vertical programmes signify an advance in developing country representation, as well as in the representation of other important stakeholders such as UN agencies, civil society organizations and the private sector.

For instance, UNITAID's Executive Board consists of 12 members which represent the five founding countries (Brazil, Chile, France, Norway and the United Kingdom), and Spain, one representative each from Africa and Asia, two representatives from civil society organizations, one representative from private foundations and one representative from the WHO (UNITAID 2011). The Board of the GAVI Alliance is composed of a broad range of stakeholders which include developed and developing country governments, research and technical health institutes, the vaccine industry in the developed and developing world, independent experts, civil society representatives, the Gates Foundation, UNICEF, WHO and the World Bank (GAVI 2011). The Board of the Adaptation Fund also represents a geographical mix as well as contains representatives from the country groups recognised as particularly vulnerable to climate change, i.e. the Least Developed Countries and Small Island Developing States (Adaptation Fund 2011).

Nevertheless, it is always difficult to gauge whether one stakeholder (or group of stakeholders) exercises more power or influence over decisions relative to others. Moreover, it is important to think about whether some stakeholders have been able to participate in decision-making in an equal and genuinely meaningful way from the outset or whether some stakeholders were essentially dealt a 'fait accompli', i.e. major decisions as regards development priorities selected and other important issues had already been taken when they were invited to participate in the initiative and in its governance structures.

Looking forward: key issues and lessons learned

In principle, there is no reason why monies raised through innovative finance initiatives could not be channeled via direct budget or sectoral support. This would allow recipient governments to spend the resources as they see fit. Indeed there is a strong demand from many developing countries for donors to channel more funds through national budgets and public financial management systems. This is also a key commitment contained within the Paris Declaration, the Accra Agenda for Action and more recently the Busan outcome document on effective development cooperation (OECD 2005, 2008 and 2011). However, progress has been slow. In practice, innovative finance initiatives have followed broader trends towards the earmarking of ODA.

A key question is whether it is realistic to suggest that resources raised through innovative means should be channeled directly to beneficiary governments to spend as they choose. It is argued — often persuasively — that earmarking resources helps to mobilize public interest for clearly identified needs, i.e. earmarking helps to ‘sell’ development to the public and ensures that citizens and businesses remain motivated to make contributions. The real politik is such that participating governments are always likely to want to retain some degree of control over how resources raised domestically for international purposes are spent. This means that, irrespective of development results in recipient countries, innovative sources of finance will constantly remain vulnerable to donor preferences. Current discussions over the possible aim(s) of any future financial transactions tax show that governments will always face pressures from domestic constituents to allocate resources in a particular direction — this may include purposes other than international development.

In reality, earmarking may be, at best, only partially effective. For earmarking to have some effect on the composition of government expenditure in the beneficiary country, the earmarked aid should not be fully fungible. If it is fully fungible — i.e. a government can offset donor spending by reducing its own expenditure on the same purpose — earmarking may not succeed in increasing the amount of money that goes into the specific purpose for which the money is earmarked (Adugna 2009).

In essence, earmarked funds represent a form of ex-ante conditionality. ‘Cash-on-performance’ approaches meanwhile represent a form of ex-post conditionality. This means some innovative finance initiatives may in fact carry a ‘double conditionality burden’, i.e. the resources must first be spent on specified purposes plus recipients must attain certain development objectives before more funds are released. While the idea of national and local ownership over the development process is now extremely popular in the development discourse, without a reduction in the ex-ante and ex-post conditionality requirements associated with some innovative initiatives, true ownership will be difficult to achieve.

As new — and potentially much larger — innovative finance instruments are developed, the ex-ante and ex-post conditionality requirements associated with this finance will be central — not only because donors and recipients want the most effective use of resources but because they will be central to the legitimacy and credibility of the initiative. We should bear in mind that initiatives which carry more conditions could find themselves increasingly sidelined as developing countries find alternative official and private sources of finance which offer greater flexibility and have fewer ‘strings’ attached.

Innovative financing for development initiatives should enhance domestic ownership and policy space in recipient countries as well as support improved aid management capacities. To achieve this end, inclusive governance structures will be vital — not only to ensure the legitimacy of initiatives but also to overcome possible political or other biases in aid allocation decisions. International and/or regional agreements which outline the shared aims and principles behind internationally coordinated schemes may help to overcome these challenges.

Innovative finance initiatives which are developed and implemented by developing countries themselves may provide more scope for local and/or regional ownership than those developed and implemented exclusively by developed countries (see question nine). However, given that we are also likely to witness the development and expansion of ‘joint’ North-South initiatives, inclusive governance structures will be key measures of the credibility and legitimacy of all initiatives.

5.6 Have innovative financing for development initiatives supported capacity development in beneficiary countries?

Experience so far

A country’s successful development hinges on having sufficient capacity. Financial resources are vital, but they are not sufficient to promote and sustain human development. Without supportive national development strategies and policies, well-functioning institutions and administrations, effective laws and procedures and educated and skilled people, countries lack the foundation to

plan, implement and review their national and local development strategies. Put simply, it is about the 'capable institution' that is able to better achieve its mandate (UNDP 2009). To ensure that development results are sustained and can be built-on over time, innovative financing for development initiatives should therefore support, not undermine, the development of local capacities. It is important then to look at the record of different initiatives in this area.

Many vertical programmes—through which most innovative initiatives channel their resources—have tended to use parallel project implementation units (PIUs) to deliver resources at the country level. Although such structures have been recognised as problematic and there are international commitments to reduce their use (the 2005 Paris Declaration on Aid Effectiveness commits OECD DAC donors to reduce by two-thirds the use of parallel implementation structures), they are widely utilised by many vertical programmes, especially in the health sector.

The rationale behind this approach is that it enables the programme to move in and 'get the job done' as quickly and efficiently as possible. Although there is undoubtedly an immediate and important health dividend to 'getting the job done', over the longer-term this approach may undermine the sustainability of development results where local institutions are by-passed. In Benin, the government has cited the poor involvement of the Ministry of Health in Global Fund programmes as well as the use of parallel project implementation units in the provision of anti-retrovirals and mosquito nets (UNDP Benin 2011). Richard et al (2011) suggest that while quick wins (and simple packages) have successfully attracted a significant proportion of international and philanthropic funding for global health, many of these initiatives have been developed in parallel to, not integrated into, the health care system in countries.

The results-based nature of certain initiatives may also create tensions between local systems strengthening and shorter-term outputs. In 2004, Josh Ruxin, assistant professor of public health at Columbia University, compared the first wave of people receiving HIV antiretroviral treatment to "low-hanging fruits", but noted: "You quickly reach a point where you can't treat more people unless you develop the national health systems". Although success in scaling up HIV treatment has shown this skepticism not to be entirely warranted, programmes that run in parallel to health systems, of which HIV treatment is a prime example, continues to be the subject of lively debate (Richard et al 2011).

Some vertical programmes now integrate capacity development into their broader activities. For instance, since December 2005, the GAVI Alliance has channeled resources into health system strengthening recognising that "immunisation coverage is often constrained by health systems issues that are not immunisation-specific." It reports that by the end of 2010, GAVI had committed US\$568 million to health system strengthening support (HSS) for 53 countries (GAVI 2011). The GAVI Alliance, Global Fund and the World Bank also collaborate on health systems funding. However, overall, the evidence so far suggests that many innovative financing for development initiatives have—indirectly—run counter to international commitments to strengthen and use country systems.

Looking forward: key issues and lessons learned

The development of local capacities is the key to ensuring that development results are sustained over the longer-term. Innovative financing for development initiatives should therefore use recipient country systems to the maximum extent possible and stand-alone project implementation units should be discouraged; if national systems are not strong enough, they should be reformed and strengthened, rather than bypassed (UNDP 2009). This is also a key commitment contained within the Busan outcome document for effective development cooperation. The agreement commits donors to "use country systems as the default approach for development cooperation" and "will state the reasons for non-use" where full use of country systems is not possible (OECD 2011). This pledge should be honoured by the international donor community. Innovative finance initiatives should make the most of local resources—people, skills, knowledge, technologies and institutions—and build on these rather than import or displace them.

Looking forward, considerable emphasis will need to be placed on capacity development if countries are to take advantage of dramatically scaled up initiatives—as seems possible. Only where country systems are strengthened can some of the challenges associated with scaled up and fast disbursing finance be overcome.

5.7 Have innovative financing for development initiatives accentuated issues related to fragmentation and coordination in international aid delivery?

Experience so far

The extent to which innovative financing for development initiatives further complicate an already fragmented international aid architecture has been the subject of much discussion since the emergence of the first innovative finance schemes. The term ‘fragmentation of aid’ is increasingly used to describe the unwanted situation of having many small aid activities initiated by many different donors (Bürcky 2011). Fragmentation is an important issue because its costs have been shown to be very large for recipients, to the point that it significantly reduces the value of ODA. It can lead to poor coordination between development activities and actors, duplication and creates transaction costs and administrative burdens for recipient countries (OECD 2011). The Accra Agenda for Action commits OECD DAC donors to reducing fragmentation and improving the division of labour.

The development finance architecture has changed rapidly over the last decade. The proliferation of both actors and initiatives has increased the complexity—and potentially the inefficiencies—of an already intricate web of donors, procedures and regulations. The OECD estimates that the number of multilateral agencies engaged in providing development assistance totaled 263 in 2008, up from 47 in 1960 (OECD 2008). Since 2008, the international community has established a new climate finance initiative at an average rate of one every two months (Heinrich Böll Stiftung and ODI, 2010). Thus, even without innovative financing for development initiatives, developing countries face increasing complexity—but also choice—in their range of development partners. The question is whether innovative financing for development initiatives have accentuated issues related to aid fragmentation or whether the net benefit of such initiatives has outweighed any additional costs associated with aid fragmentation.

Empirical research has shown that transaction costs do not grow proportionally to the volume of the aid activity; in other words, smaller aid allocations have relatively higher transaction costs than larger ones. Within a given aid envelope, this means that (i) a smaller number of aid activities by a donor is preferable to a higher number of aid activities and (ii) a larger financial commitment per aid activity is preferable to a smaller amount (Bürcky 2011).

The data shows that the amounts raised so far via innovative financing for development initiatives have been relatively small in absolute terms, at about US\$5.5 billion for the health sector and US\$31 billion for climate and environment between 2002 and 2011 (United Nations Report of the Secretary-General on innovative mechanisms of financing for development, 2011). These amounts are also spread over a range of different initiatives which would seem to suggest a high degree of fragmentation in the delivery of resources. In the case of the airline ticket tax, a new agency, UNITAID, was established specifically



to channel resources raised through the initiative and existing multilateral channels were not used. The Adaptation Fund also emerged as a new agency funded through the issuance of CERs. On the other hand, innovative sources of development finance have often been used by many vertical programmes used to complement other sources of finance. This has helped to increase their overall resource envelope and to scale up activities (e.g. GAVI Alliance).

Looking forward: key issues and lessons learned

New sources of development finance—whether from ‘innovative’ sources, emerging donors, private philanthropists or other stakeholders—bring with them more resources to help developing countries reach the MDGs. They also expand developing countries’ choice and help them to exercise at least some degree of influence over the behaviour of suppliers (aid donors). However, many small and uncoordinated priorities and programmes are also associated with more fragmented aid delivery and can create heavy transaction costs which reduce aid effectiveness.

Looking forward, there is a danger that, should innovative finance initiatives expand, issues related to fragmentation and poor coordination will be exacerbated. These risks are especially pronounced in the area of climate finance. Both traditional and non-traditional forms of climate finance can be expected to expand significantly over the next decade as the international community strives to meet its 2009 Copenhagen Accord commitments to provide US\$100 billion per annum in climate finance by 2020 (United Nations 2009). If new initiatives each establish their own resource delivery modalities, this will worsen the ‘spaghetti bowl’ of channels through which these forms of finance are already delivered.

The UN Secretary-General notes that there is considerable scope for streamlining delivery procedures, including through greater use of direct budget support (United Nations 2011). However, it should be noted that while many innovative sources of development finance have been rather small to date (and thus the transaction costs associated with them relatively higher), this is mostly due to political will. Much more potential exists to considerably scale up some initiatives as well as develop new and large initiatives (see question nine). This may help to reduce the transaction costs associated with many small initiatives. However, as old initiatives expand and new initiatives are developed, the division of labour between them will become increasingly important if direct budget or sectoral support is not considered possible.

5.8 Is innovative financing for development sustainable over the longer-term?

Experience so far

A major rationale for developing innovative sources of development finance is that they provide avenues to mobilize resources in ways which are not dependent on donors and which are sustainable over the longer-term. This could transform the ways in which international development is financed in the future, as well as raise unprecedented sums for development and climate-related actions. But just how true is this assertion?

Some initiatives do indeed demonstrate significant potential to raise sizeable resources sustainably over time. This includes taxation based instruments such as the airline ticket tax, the FTT and various forms of carbon tax. However, they are only sustainable in so far as governments remained prepared to implement the tax and citizens/businesses/investors remain prepared to pay it.

Voluntary solidarity contributions—a form of traditional charitable donation—have a long and rich history. However, their ability to generate sustainable revenue streams for development is contingent on several factors which include public perceptions of the cause(s) to be supported and the wider economic climate. The closure of MASSIVEGOOD is indicative of the vulnerability which faces such approaches. The initiative was closed at the end of 2011 due to insufficient returns in the current economic climate.

Initiatives which depend on ODA and/or continuous donor replenishments to operate may also be less sustainable over time. This includes the AMC for a pneumococcal vaccine and the IFFIm. Both depend on donors' commitments to resourcing them; replenishment rounds may be more or less successful each time. Indeed the UN Secretary-General's 2011 progress report on innovative finance notes that, "[f]or IFFIm, which so far demonstrates the greatest potential, future funding for this mechanism is in decline" (United Nations 2011). Debt conversions are also largely 'one-off' operations; they may provide much-needed fiscal space and/or support useful development projects in the short-term but they are not designed to resolve broader issues related to debt sustainability or social and economic development.

There are also other considerations with regard to the sustainability of innovative finance mechanisms. It is important to note that some innovative financing for development initiatives may not necessarily provide resources on concessional terms or have a clear development focus. This means that medium and long-term debt sustainability in beneficiary countries must be factored-in to analyses of the sustainability of some innovative finance instruments. For instance, diaspora bonds, local-currency loans and funds raised through the World Bank's Eco-Notes and Green Bonds all create public debt liabilities which must be repaid by sovereign borrowers. The terms and conditions will depend, in part, on market conditions.

In this context, some innovations aim precisely to reduce sovereigns' risks of unsustainable debt. Countercyclical loans reduce/eliminate debt service payments when major economic shocks occur while local currency loans aim to hedge currency risk associated with borrowing in foreign currencies. Local currency financing has been widely used by regional development banks in particular. The use of countercyclical loan instruments has so far been limited to the Heavily Indebted Poor Countries (HIPC) which have experienced debt repayment problems in the past. However, given the increased intensity and frequency of various forms of economic shock, a strong case can be made to extend such innovative financial instruments to other developing countries.

Looking forward: key issues and lessons learned

Some initiatives demonstrate more potential to generate a sustainable stream of resources for development and climate change/environment over time. Others represent shorter-term cash injections or help to free-up additional fiscal space in the short-term. However, most initiatives remain vulnerable to various forms of uncertainty, such as the prevailing economic climate, donor politics or citizen preferences.

With this in mind, it is useful to consider whether some initiatives may be more suited to supporting some development areas over others. For instance, short-term initiatives may generate instabilities and inefficiencies in beneficiary countries and thus may only be appropriate under certain circumstances (e.g. a rapid vaccination campaign or an immediate humanitarian intervention). Initiatives which provide a more predictable and sustainable stream of resources over time may be used by beneficiary governments to support longer-term investments and development programmes. Meanwhile, voluntary solidarity contributions may only ever play a complementary financing role due to the vulnerabilities cited above. SDRs may be most appropriate as a countercyclical financing tool.

Some instruments generate non-concessional public debt liabilities in beneficiary nations and thus may be more suited to middle-income countries. These instruments may also be more appropriate for the financing of projects which are expected to generate a positive return on investment. This implies that low-income countries may need continued support from innovative financing initiatives exclusively—or almost exclusively—in the form of grants.

Finally, measures of the sustainability of different mechanisms may also need to include an assessment of the feasibility of implementation both in the immediate and long-term, i.e. what are the associated technical, financial and human skills which may be required to set-up and run specialised initiatives? Some initiatives may demand more intensive (and costly) inputs in terms of specialised sectoral or financial expertise. How will these be secured over the longer-term? Capacity development in beneficiary countries will thus be a critical component of the longer-term sustainability of such initiatives.

5.9 Can innovative financing for development be scaled up and/or initiatives replicated in other development areas or regions?

Experience so far

The sheer scale of resources required to fund development and meet the challenges of climate change are such that innovative finance mechanisms which demonstrate significant potential for scale and/or that may be easily replicated are especially attractive and warrant further exploration. Large-scale initiatives may also help to reduce the significant transaction costs associated with many small initiatives. Some initiatives demonstrate more potential in this regard than others.

For instance, the airline ticket tax could easily be implemented by many other countries — developed and developing alike. Diaspora bonds could also be explored by a wide range of countries. Of the initiatives currently under discussion, financial transaction taxes, carbon and tobacco taxes all demonstrate significant potential for scale. As noted earlier, most initiatives will tend to be procyclical in nature and will generate more revenues in good economic times than in bad.

On the other hand, the IFFIm is unlikely to expand significantly in the future. The IFFIm model is not easily understood by the wider development community and is also vulnerable to a number of financial risks and constraints. The IFFIm's AAA credit rating has enabled it to access funds on international capital markets at exceptionally low interest rates. This has helped to hold down costs. However, it remains vulnerable to a credit downgrade which would increase borrowing costs and undermine the ability of the initiative to fund new health programmes. The 2011 evaluation of the IFFIm suggested that although proof of concept had been successfully demonstrated over the last five years, its full potential for scale had not been realised, in large part due to lack of donor interest (IFFIm 2011).

Debt conversions could be implemented on a more systematic basis with a particular focus on the most severely indebted developing countries. Multi-creditor debt conversions also demonstrate potential and could be explored in more detail. Voluntary solidarity contributions could also be expanded further. However, overall such initiatives are likely to remain small and highly 'complementary' in nature.

The debate over innovative sources of development finance is certainly not limited to the ways in which developed countries can channel more and better resources to the developing world. Already, the developing world has played an important role as a driver behind, and participant in, several innovative initiatives. For instance diaspora bonds have now been implemented in several countries and many more have plans to develop such instruments. A number of developing countries have helped to found and now implement the airline ticket tax, including Cameroon, Congo, Madagascar, Mali, Mauritius and the Niger on a 'differentiated' basis.⁵⁰ Recently South Africa has pledged US\$20 million over 20 years to the IFFIm.⁵¹ The West African Economic and Monetary Union (UEMOA) has developed a sub-regional initiative in the energy sector entitled 'Regional Initiative for Sustainable Energy' (Initiative Régionale pour l'Energie Durable — IRED) which pools the community's resources into a concessional fund dedicated to boosting the region's supply of electricity.⁵² The Caribbean Catastrophe Risk Insurance Facility (CCRIF) also pools financial contributions from the region (combined in some cases with external funds) to provide insurance cover against extreme weather events and other major shocks.⁵³

While the health and environment/climate sectors have benefited from most innovative finance initiatives so far, attention has also begun to turn towards the ways in which innovative financing for development could be applied more actively to areas such as education and agriculture. In 2010, the Leading Group published a report on options to raise resources innovatively for education. Proposals included a tax on international financial transactions, increased use of debt for education swaps, a tax on sports revenue and micro-donations from individual bank transactions (whereby credit card users voluntarily allow their banks to round-up transactions donating the difference to education in developing countries) (Leading Group, 2010). The Leading Group has also established an international task force on innovative financing for food security which will prepare a report on innovative financing

for food security and agriculture to be presented to the Leading Group by mid-2012.⁵⁴ The Leading Group on Innovative Financing for Development is playing an important role in spearheading international debates on possible new initiatives. However, so far, these new ideas have been slow to develop further.

Looking forward: key issues and lessons learned

As is clear from the innovative finance schemes implemented so far, even small programmes have taken time to negotiate and come to fruition—and most have failed to attract broader political and/or financial support. Thus, despite the potential shown by many initiatives, the difficulties associated with reaching an international agreement to implement them in a coordinated manner should not be underestimated; coordinated action typically requires years of international negotiation followed by domestic action. This reality means that the implementation of smaller schemes by individual countries, 'like-minded' countries or regions is the more likely scenario in the future.

Regardless of the initiative, national governments are also likely to face significant pressure to divert a portion of revenue from a particular source to domestic uses, rather than the entire revenue flow. It is always difficult to convince legislatures to divert revenue raised domestically to foreign beneficiaries. This difficulty will only be exacerbated in many countries over the next decade due to austere fiscal environments. Thus, there will be important political challenges associated with the scaling up and/or the implementation of new schemes.

As we review the outlook for innovative finance in the future, innovative initiatives are also likely to emerge from developing countries themselves and/or they may choose to participate more actively in existing arrangements. Renewed interest and investment in regional political and economic integration in most developing regions provides fertile ground to explore the development of regional innovative finance initiatives. Already, there are examples of this, such as the Caribbean Catastrophe Risk Insurance Facility (CCRIF).

For instance, there is significant scope for developing regions to explore regional innovations, such as currency transaction taxes, airline ticket taxes, regional lotteries, various forms of carbon finance and risk sharing strategies. Given increased economic uncertainty and more frequent economic shocks in many parts of the world, instruments which are designed to reduce sovereign risk (e.g. countercyclical loans and sovereign insurance pools) may become especially attractive. Regional initiatives may have the added advantage that, in principle, the countries which develop the initiative retain control over the design, governance and implementation of the initiative. Accountability also stays within the region. The impact of innovative sources of finance will very much depend on the extent to which the legal, regulatory and institutional structures of the host government accommodate an environment for mobilizing and pooling domestic resources.



Photo: Lisa S./Shutterstock.com

6. Looking forward: the place of innovative finance in a changing development financing landscape

As the analysis presented so far suggests—and as the most recent financial crisis has demonstrated so visibly—the scope for innovations in finance is limited only by the human imagination. The key will be to ensure that innovations in financing for development make a constructive contribution to development and that undesirable side-effects (such as substitution for traditional forms of development assistance) are erased or mitigated to the largest extent possible.

It is not impossible to imagine a future in which innovative finance plays an increasingly important, if not major, role in financing for development. New technologies will be an important driver of this process but the large-scale development and expansion of innovative finance initiatives will ultimately hinge on political will. The experience so far shows that despite the possibilities for scale demonstrated by some innovative fund-raising initiatives, they have so far been fairly small in size and scope.

When the MDGs were developed in the early 2000s, ODA, combined with domestic resource mobilization, were viewed as central to attainment of the goals for many countries.⁵⁵ Other forms of finance, such as private international capital flows and innovative finance mechanisms were viewed largely as complementary to more traditional development efforts. Since then, the range of actors involved in international development has become more diversified and attitudes have shifted in relation to who should be involved in the ‘development business’ and how.

To some extent, this represents a pragmatic response to the limitations of traditional ODA. Many donors have also encouraged a more active role for the private sector in development and new powers have emerged. But this shift also means that, post-2015, regardless of the development framework finally agreed, our collective view about how development should be financed is likely to be very different from that expressed 15 years earlier. Innovative finance could become a central component of a ‘new vision’ on financing for development since many initiatives provide a means to mobilize new resources that are not dependent on continuous donor contributions and that are sustainable over time.

On the surface, this idea may sound attractive. It has the potential to transform the ways in which international development is financed, as well as raise unprecedented sums for development and climate-related actions. But the real appeal and value of this approach will only be leveraged in so far as innovative finance initiatives are implemented well. The challenge will be to ensure that innovative finance mechanisms are governed in an inclusive manner, allocate resources equitably and transparently between countries and ‘issues’ on the basis of clear and objective criteria, build capacity and respond flexibly to beneficiary countries’ needs and priorities as expressed by them. These are all issues which will require considerable further research and clarity. It will also be vital to ensure that initiatives are not captured by vested political and business interests since this will severely compromise both their effectiveness and legitimacy. There are also risks that donors will reduce their future investments in traditional ODA as a consequence.

While many countries will understandably be keen to leverage new and additional sources of development finance, it will be important to consider the ways in which this financial support may or may not be superior to traditional aid. There have been significant transaction costs associated with some innovative finance initiatives, in part due to the delivery channels selected for this finance. There are also significant start-up costs to certain schemes as well as costs associated with financial engineering. The flows generated by most mechanisms qualify and are counted as ODA. They are also largely ‘earmarked’ thus the extent to which they have truly given beneficiary countries’ more choice and influence over external finance is questionable.

These considerations lead us to question whether countries may, in fact, have been better off with ‘normal’ ODA and whether efforts should instead be redoubled on urging donors to reach international aid commitments. On the other hand, some mechanisms can help to mobilize considerable new finance for development that would otherwise not have been delivered at all. Hardheadedly,

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it may also help to relieve 'donor fatigue'. In this sense it may be argued that innovative initiatives can contribute significantly to development.

The development of regional mechanisms or mechanisms by smaller sets of 'like-minded' countries is a probable growth area for innovative financing in the future. As noted earlier, international agreements remain politically very difficult. As such, the architecture for innovative finance is likely to evolve in a somewhat uncoordinated and messy manner with possibilities for an even more rapid proliferation of instruments and a 'spaghetti bowl' of channels through which finance is both raised and delivered. This may undermine the effectiveness of some of this finance even where individually initiatives may work very well. Although concerns have been raised that innovative finance mechanisms could weaken countries' incentives to mobilize more resources domestically for development, the opposite is also true; they can help countries and regions to think creatively about how they may implement their own innovative mechanisms which may be best suited to their country or region's development needs.

The pressure to meet the 2009 Copenhagen Accord commitments on climate change is also likely to drive new innovations in financing for development. The Accord commits the developed world to mobilizing US\$100 billion per year by 2020 to support climate change adaptation and mitigation measures in developing countries. The agreement states that, "this funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance."⁵⁶ As such, the sources of financing for climate related actions are likely to expand and diversify in the future; this may accentuate the 'spaghetti bowl' effect even further.

Clearly, some countries will require sustained support to be able to make effective use of scaled up innovative sources of development finance, especially the poorest and smaller countries. This will require complementarity across both traditional and innovative finance initiatives and across international, regional and national programmes, as well as a focus on capacity development in beneficiary countries.

While efforts to increase the quality and quantity of resources into developing countries—via both traditional and innovative means—are vital, it is also important to address the other side of the equation, namely how to curtail the haemorrhage of financial resources out of developing countries. The losses to developing countries associated with practices such as tax evasion, tax avoidance, criminal activities and corruption are estimated in the hundreds of billions. From 2000 to 2009, it is estimated that developing countries lost US\$8.44 trillion to illicit outflows of capital through government corruption, criminal activity and commercial tax evasion and avoidance (GFIP 2011). UNDP finds that the 49 LDCs lost some US\$26.3 billion in 2008 through trade mispricing alone, roughly equivalent to the amount received in ODA in the same year (UNDP 2011).

Recently, more attention has focused on the repatriation of so-called 'stolen assets', i.e. wealth that is lost to bribery, embezzlement, and other corrupt practices and which often finds safe haven in the world's international financial centres. The World Bank and the United Nations Office on Drugs and Crime (UNODC) operate the StAR Initiative (Stolen Asset Recovery Initiative) which works directly with developing countries to prevent the laundering of the proceeds of corruption and to facilitate the systematic and timely return of stolen assets.⁵⁷ It currently works with 10 countries on a regular basis although no country has so far been able to recover lost assets through its collaboration with StAR given the complexities and costs associated with the process (StAR 2011).

The Leading Group considers the fight against 'illicit financial flows' as an innovative source of development finance, underscoring that there is a "direct link between illicit flows and the financing of development" (Leading Group 2009). Regardless of how one categorises phenomena such as tax evasion, tax avoidance, embezzlement and bribery etc., it is clear that a truly coherent approach to financing for development requires national and international policies which support both the mobilization of new and additional resources for development, as well as policies to curb the illicit outflow of capital. Sustainable development for all will require improved governance and transparency in the global financial system so that it works in the collective interests of all countries and citizens, not just the privileged few. Innovative sources of development finance will only complement these much broader efforts. It is also clear from current discussions in the context of the Rio+20 United Nations Conference on Sustainable

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Development that approaches to development must integrate economic, social and environmental concerns simultaneously. It is not certain whether current approaches to innovative financing for development are able to accommodate this.

This Paper has scratched the surface of a relatively new area in development finance. But given that innovative sources of development finance are likely to expand much further in the future, it will be important to continuously review countries' experiences and share lessons learned. More work is needed, especially at the country level, to explore country level perspectives of the innovative mechanisms implemented so far — both positive and negative. This is the best way to inform modifications and improvements to such instruments and it can also tell us a great deal about how any future schemes should best be implemented. UNDP, together with developing country governments and other development partners, will endeavour to fill this knowledge gap moving forward and thus provide important opportunities to share knowledge and best practices.

In conclusion, there are several key messages which can be taken away from this preliminary analysis. These are summarized in the table below. However, as this area expands and diversifies in the future, these will undoubtedly be subject to review.

Key Recommendations on Innovative Financing

Country ownership	Country level ownership over innovative sources of development finance is vital to ensure development results over the longer-term. Country ownership involves much more than country devised project proposals. It involves meaningful participation and inclusion in the governance structures of innovative finance initiatives. It involves alignment behind countries' nationally devised development strategies, including much greater use of direct budget and/or sector wide support by innovative initiatives.
Capacity development	Development results can only be sustained and built-on over time where local capacities are strengthened. Innovative sources of development finance must balance 'quick wins' with longer-term capacity development. Short-term initiatives may be more suitable to certain types of intervention (e.g. humanitarian actions).
Complementarity	As innovative sources of development finance expand and diversify in the future, it will be vital to ensure complementarity and effective coordination between different initiatives. There is a risk that too many new structures will be created in order to deliver innovative sources of development finance. This will only reduce overall effectiveness.
Additionality	More clarity is needed on how innovative sources of development finance should be 'counted' to reduce substitution risks and 'double-counting'. Although many forms of external finance have dual development and climate objectives, they need to be counted and assessed separately next to different international commitments; the former against the UN target of 0.7 percent ODA as a percent of GNI and the latter next to the 2009 Copenhagen Accord commitments.
Predictability	Innovative sources of development finance should deliver predictable finance so as to ensure maximum aid effectiveness. Many mechanisms will tend to generate more revenues in good economic times than in bad, i.e. they will be procyclical. It may be useful to consider ways in which some instruments could deliver resources in a countercyclical manner.

Notes

1. United Nations, Millennium Declaration, 2000, Section III, para. 15: www.un.org/millennium/declaration/ares552e.htm
2. See: UN Millennium Development Goals: www.un.org/millenniumgoals/bkgd.shtml
3. Sources: 2008 Global Malaria Action Plan, 2006 Global Plan to Stop TB 2006–2015, What Countries Need: Investments Needed for 2010 Targets, UNAIDs, EFA Global Monitoring Report 2010, Food and Agriculture Organization (FAO).
4. United Nations Monterrey Consensus on Financing for Development, Monterrey, Mexico 18-22 March 2002: www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf Paragraph 44: We recognize the value of exploring innovative sources of finance provided that those sources do not unduly burden developing countries. In that regard, we agree to study, in the appropriate forums, the results of the analysis requested from the Secretary-General on possible innovative sources of finance, noting the proposal to use special drawing rights allocations for development purposes. We consider that any assessment of special drawing rights allocations must respect the International Monetary Fund's Articles of Agreement and the established rules of procedure of the Fund, which requires taking into account the global need for liquidity at the international level.
5. United Nations Doha Declaration on Financing for Development, Doha, Qatar, 29 November - 2 December 2008: www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf Paragraph: 51: We recognize the considerable progress made since the Monterrey Conference in voluntary innovative sources of finance and innovative programmes linked to them. We acknowledge that a number of the initiatives of the Technical Group created by the Global Action Initiative against Hunger and Poverty and the Leading Group on Solidarity Levies to Fund Development have become a reality or are in an advanced stage towards implementation. These include, inter alia, the International Finance Facility for Immunization; the pilot advance market commitments and the airline ticket solidarity levies, which finance health programmes in several developing countries, including the international drug purchase facility UNITAID to help combat HIV/AIDS, tuberculosis and malaria; and instruments based on the carbon market. We encourage the scaling up and the implementation, where appropriate, of innovative sources of finance initiatives. We acknowledge that these funds should supplement and not be a substitute for traditional sources of finance, and should be disbursed in accordance with the priorities of developing countries and not unduly burden them. We call on the international community to consider strengthening current initiatives and explore new proposals, while recognizing their voluntary and complementary nature. We request the Secretary-General of the United Nations to continue to address the issue of innovative sources of development finance, public and private, and to produce a progress report by the sixty-fourth session of the General Assembly, taking into account all existing initiatives.
6. Resolution adopted by the UN General Assembly, 65/146. Innovative mechanisms of financing for development, 4 February 2011: www.un.org/ga/search/view_doc.asp?symbol=A/RES/65/146&Lang=E
7. Based on the implementation of a coordinated 0.005 percent tax on all the major currencies. United Nations, Report of the Secretary General, Progress Report on innovative sources of development finance, 29 July 2009
8. United Nations, Report of the Secretary General, Progress Report on innovative sources of development finance, 29 July 2009
9. The Leading Group brings together 63 countries, international organizations, foundations and NGOs to discuss, share information and promote innovative financing mechanisms. UNDP is a member. For further information, see: www.leadinggroup.org
10. There has been much discussion around ways to mobilize migrant remittances for development (see for instance, World Bank, Migration and Remittances: www.tinyurl.com/32fwnpn). The Leading Group cites migrant remittances as an innovative source of development finance, and if considered as such, they would fall into the loose category of 'voluntary solidarity contributions'. However, whether migrant remittances constitute an innovative source of finance has been questioned. In principle, such flows represent private transactions between individuals and the recipient may use the proceeds as s/he sees fit. As such, they should not be viewed as a substitute for domestic government investments or external support such as ODA. Nevertheless, migrant remittances have been leveraged on the ground in innovative ways to support development interventions and help recipients gain access to credit or other financial services. For instance, financial institutions in some developing countries now offer remittance-backed mortgages or remittance-backed small business credits to low-income families in receipt of regular remittance flows.
11. Leading Group, Bamako Declaration following the Ninth Plenary Session, 25 June 2011: www.leadinggroup.org/article890.html
12. The countries which implement the airline ticket tax as at end-2011 are: Cameroon, Chile, Congo, France, Madagascar, Mali, Mauritius, Niger, Republic of Korea.
13. See: UNITAID: www.unitaid.eu

14. For further information on the Global Digital Solidarity Fund, see: www.dsf-fsn.org/cms/component/option,com_magazine/func,show_magazine/id,11/Itemid,194/
15. MASSIVEGOOD: www.massivegood.org/
16. For further information, see: Product (RED): www.joinred.com/red/
17. In November 2011, the Board of the Millennium Foundation decided to discontinue MASSIVEGOOD at the end of 2011. Although it was reported that MASSIVEGOOD had been successfully piloted in Spain, the Board did not see sufficient enough returns for such a micro-philanthropy initiative in the current economic climate. See: www.massivegood.org/en_US/news-feed/432-new-direction-for-massivegood
18. For further information, see: Navin Girishankar, World Bank (2009), *Innovating Development Finance: From Financing Sources to Financial Solutions*, pp. 16-19
19. The World Bank acts as Treasury Manager for the initiative and IFFIm bonds currently enjoy a AAA credit rating.
20. Two different models were used to derive the figures of 1.3 billion and 20.8 billion deaths averted. The WHO model suggests that IFFIm will have averted 2.08 million deaths by the end of 2011 (of the 5 million deaths averted by GAVI as a whole). The LRC&I model suggests IFFIm may have averted over 1.3 million future deaths by the end of 2010 and is likely to avert between 2.5 million and 3.5 million future deaths over the lifetime of the facility. See *Evaluation of the International Finance Facility for Immunisation*, June 2011, p. 26
21. See World Wide Fund for Nature, *Debt for Nature Swaps*: www.worldwildlife.org/what/howwedoit/conservationfinance/debtfornature swaps.html
22. Under the AMC, pneumococcal vaccines are made available in the poorest countries at no more than US\$ 3.50 per dose, subject to inflation adjustments for a minimum of 10 years. This is less than 5% of the public market price in the United States. The vaccines are paid for by the Global Alliance for Vaccines and Immunisation with a co-financing contribution from recipient country governments. Pharmaceutical companies receive an additional payment of US\$ 3.50 per dose for approximately 20 percent of the doses they provide paid for by AMC donors' commitments (AMC Annual Report 2010).
23. Pneumococcal vaccines introductions as of 31 March 2011: Benin, Burundi, Cameroon, Central African Republic, Congo Republic, Democratic Republic of Congo, Ethiopia, Gambia, Guyana, Honduras, Kenya, Malawi, Mali, Nicaragua, Rwanda, Sierra Leone, Yemen. Countries under consideration: Madagascar, Pakistan. AMC Annual Report 1 April 2010-31 March 2011, p. 32.
24. For more information, see: Global Fund, *Affordable Medicines Facility - Malaria*: www.theglobalfund.org/en/amfm/
25. See: United Nations Framework Convention on Climate Change (UNFCCC), *Clean Development Mechanism (CDM)*: <http://cdm.unfccc.int/>
26. See: *Adaptation Fund*: www.adaptation-fund.org
27. Cohen Daniel, *Lending to the Poorest Countries: A New Counter-cyclical Lending Instrument*, 2008
28. See: *Caribbean Catastrophe Risk Insurance Facility*: www.ccrif.org
29. UNDP, *Human Development Report (HDR), 2011, "Sustainability and Equity: a Better Future for all"*: <http://hdr.undp.org/en/reports/global/hdr2011/>, p. 95.
30. European Commission, *Financial Transaction Tax: Making the financial sector pay its fair share*, 28 September 2011: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1085&format=HTML&aged=0&language=EN&guiLanguage=en>
31. See: Tobin, James, *A Proposal for International Monetary Reform*, Yale University, *Eastern Economic Journal* pp. 153-159, 1978
32. European Parliament resolution of 8 March 2011 on innovative financing at global and European level: www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0080+0+DOC+XML+V0//EN
33. The taxation options examined by the Leading Group report included: a financial sector activities tax; a Value Added Tax (VAT) on financial services; a broad financial transaction tax; a nationally collected single-currency transaction tax; a centrally collected multi-currency transaction tax. See: *Leading Group, Globalizing Solidarity: The Case for Financial Levies*, 2010: www.leadinggroup.org/IMG/pdf_Financement_innovants_web_def.pdf
34. To read the full text of the political declaration, see: *Leading Group, Innovative Financing for Development – Declaration*: www.leadinggroup.org/IMG/pdf/pdf_DeclarationTTF_ENG.pdf
35. See: *Leading Group, Bill Gates' pre-report: the FTT does not need to be universal to be put in place and could yield substantial resources*: www.leadinggroup.org/article921.html
36. *UN Rio Declaration on Environment and Development*, 3 to 14 June 1992: www.unep.org/Documents.Multilingual/Default.asp?documentid=78&articleid=1163

37. See: UN, Report of the Secretary-General's High-level Advisory Group on Climate Change Financing, Work Stream 3: Revenue Options from Carbon-Related Sources: www.un.org/wcm/webdav/site/climatechange/shared/Documents/AGF_reports/Work_Stream_3_Revenues%20from%20Carbon%20Related%20Sources.pdf
38. For more information, see: www.carbontax.net.au/
39. See: Technical Note on the Report of Bill Gates to the G20 on Financing for Development, Geoffrey Lamb, Draft, September 28, 2011
40. World Health Organization: The (Global) Solidarity Tobacco Contribution - A new international health-financing concept prepared by the World Health Organization, 2011: www.who.int/nmh/events/un_ncd_summit2011/ncds_stc.pdf
41. See: IMF, Special Drawing Rights (SDRs), Factsheet, September 2011: www.imf.org/external/np/exr/facts/sdr.htm
42. See: Ambrose, Soren and Mucchala, Bhumiika, Fruits of the Crisis, Leveraging the Financial & Economic Crisis of 2008-2009 to Secure New Resources for Development and Reform the Global Reserve System, January 2010: www.twinside.org.sg/title2/finance/docs/sdr_reserve_final.pdf
43. See: IMF: Financing the Response to Climate Change, Hugh Bredenkamp and Catherine Pattillo, March 25, 2010, IMF Staff Position Note: www.imf.org/external/pubs/ft/spn/2010/spn1006.pdf
44. See: paragraph 5, Resolution adopted by the UN General Assembly, 65/146. Innovative mechanisms of financing for development, 4 February 2011: www.un.org/ga/search/view_doc.asp?symbol=A/RES/65/146&Lang=E
45. See: OECD DAC Working Party on Statistics, Mapping of Some Important Innovative Finance for Development Mechanisms, February 2011.
46. UNDP Benin, November 2011
47. In 2010, ODA from OECD DAC reached US\$128.7 billion, its highest real level ever. However, had all developed countries met their commitment to allocate 0.7 percent of GNI to ODA, aid would have reached US\$282.2 billion in 2010 implying a delivery gap of US\$153.4 billion (MDG Gap Task Force 2011).
48. See UNDP's proposals for multi-creditor debt conversions for climate adaptation in: UNDP, Discussion Paper, Achieving Debt Sustainability and the MDGs in Small Island Developing States, October 2010: www.beta.undp.org/content/undp/en/home/librarypage/mdg/achieving-debt-sustainability.html
49. Earmarking can be understood as the practice of dedicating aid to spending on specific public services or activities in recipient countries with a view to influencing a government's spending choices in favour of those programmes and services deemed important by the donor (Adugna 2009).
50. Some African countries have chosen to impose the levy only on international flights or on business- and first-class tickets.
51. See: IFFIm donors: www.iffim.org/donors/
52. UNDP Benin country office and 2010 Franc Zone Annual Report: www.banque-france.fr/gb/eurosys/telechar/franczone/RAZF-2010-the-regional-initiative-for-sustainable-energy-IRED.pdf
53. See: Caribbean Catastrophe Risk Insurance Facility (CCRIF): www.ccrif.org/
54. See: Leading Group: www.leadinggroup.org/article955.html
55. See: para. 41, United Nations Monterrey Consensus on Financing for Development, Monterrey, Mexico 18-22 March 2002
56. Copenhagen Accord of 18 December 2009, paragraph 8: http://unfccc.int/meetings/cop_15/copenhagen_accord/items/5262.php
57. Stolen Asset Recovery Initiative (StAR), World Bank and UNODC: www1.worldbank.org/finance/star_site/about_us.html

Annex: A Snapshot of the Pros and Cons of Different Approaches

Innovative Financing Mechanism	Description	Revenues raised	Reported results	Beneficiaries	Additionality
EXISTING MECHANISMS					
Taxes, dues or other obligatory charges on globalized activities					
Solidarity Levy on Airline Tickets	Launched in 2006 by the Governments of Brazil, Chile, France, Norway & the UK it collects funds for UNITAID and IFFIm through nationally employed, yet internationally coordinated tax on airline ticket sales. Each passenger is charged a low tax rate on each air ticket purchased. 14 countries currently participate in this initiative and the tax level varies from one country to the next.	US\$1 billion between 2006 & 2011.	UNITAID, which is funded primarily through the international solidarity levy on airline travel, reports that it provides HIV/AIDS, TB and malaria treatment to approx. 47 million people in 94 countries worldwide. It has also reduced the cost of quality second-line anti-retro-viral treatments by more than 50%.	94 countries receive UNITAID support: 11 in the Americas, 26 in Asia, 7 in Eastern Europe, 8 in N. Africa & Middle East, 41 in sub-Saharan Africa.	The mechanism generates new revenue streams for development from the private sector. However, the amounts are integrated into donors' regular development cooperation budgets & are counted as ODA.
Voluntary Solidarity Contributions					
Product (RED)	Consumers are encouraged to purchase (RED) branded products. In turn, collaborating producers donate 50% of profit to the Global Fund to fight AIDS, TB and malaria.	Since its launch in 2006, (RED) has generated over US\$180 million for the Global Fund.	Over 7.5 million people have been impacted by (RED) supported Global Fund grants.	(RED) money funds grants that currently go to HIV/AIDS programmes in Ghana, Lesotho, Rwanda, South Africa, Swaziland & Zambia.	The mechanism generates new revenue streams from the private sector for development. They are not counted as ODA so are always fully additional.
Frontloading and debt-based instruments					
International Finance Facility for Immunisation (IFFIm)	"The IFFIm raises funds by issuing bonds in international capital markets. In so doing, it makes more resources available for development today. The IFFIm repays bondholders over periods of up to 20 years with the long-term (legally binding) ODA commitments of donor governments. This arrangement effectively allows governments to 'buy-now but pay later' or 'frontload' ODA. Launched in 2006 by 6 donor governments (UK, France, Italy, Spain, Sweden and Norway). South Africa, the Netherlands, Australia and Brazil have also joined."	US\$3.4 billion between 2006 & 2011.	The 2011 Evaluation of the IFFIm estimates that between 1.3 million and 2.08 million deaths will have been averted by the end of 2011 due to the IFFIm.	Most IFFIm resources are channeled into GAVI. From 2000 to 2011, GAVI has disbursed almost US\$2.9 billion to over 70, mostly low-income countries (although GAVI also receives funds from other sources in addition to the IFFIm).	The mechanism does not generate new revenue streams for development but rather intertemporally shifts funds available for child immunization (i.e. 'frontloads' future ODA). By issuing bonds on international capital markets to fund development, donors also incur additional costs (e.g. interest payments to bondholders etc.) which are reported as ODA.

Predictability	Ownership	Capacity development	Fragmentation	Sustainability	Possibilities for scaling up
Funds can be raised in a fairly stable and predictable manner based on projections of air travel. However, revenues raised may also be affected by economic downturns or other major shocks (e.g. Sept. 11th). Whether resources are spent in a predictable manner will depend on delivery modalities selected for the finance.	Funds are 'earmarked' for specific health purposes, notably HIV/AIDS, TB & malaria only. Countries submit project proposals to UNITAID to receive financial support.	Contingent on UNITAID's approach to capacity development. UNITAID has provided capacity development support to vaccine manufacturers in China.	A new structure — UNITAID — was founded to manage resources generated through this initiative. The initiative is also relatively small to-date, although considerable potential exists for scaling up which could help to reduce fragmentation and transaction costs.	Generates sustainable resources for development in so far as it is based on a constantly expanding commercial product (air travel), & governments remain prepared to levy the tax and air travelers remain prepared to pay it given its small amount.	Possibilities for scaling up are high. The initiative could easily be implemented by many more countries - both developed & developing. The infrastructure is already in place to manage revenues in a coordinated manner at an international level.
Revenues raised via Product (RED) may be fairly predictable and straightforward to forecast. However, they may also be vulnerable to economic downturns or other shocks. The Global Fund (which channels (RED) resources) operates a performance based allocation mechanism which may reduce predictability in the delivery of resources.	How funds are allocated across issues and countries is likely to be influenced by consumer preferences. This may require some earmarking of resources raised.	Contingent on the Global Fund's approach to capacity development. The Global Fund is a partner in the Health Systems Strengthening (HSS) Platform.	Product (RED) channels its resources through the Global Fund, an established thematic programme. A new structure to deliver resources was not created.	The mechanisms is sustainable in so far it is based on a commercial product which consumers wish to purchase combined with producers that wish to collaborate. The 'extra' amount consumers pay for branded products should be set at a low level.	The potential for scaling up this - and similar initiatives - is significant. Success will depend, in large part, on consumer confidence in the brand(s). Any 'extra' charge levied on branded products should also be negligible.
The mechanism depends on continuous donor commitments which may reduce predictability. The ability to secure buyers for vaccine bonds at a reasonable rate also depends on market conditions.	Most funds are earmarked for GAVI Alliance immunization programmes. Country ownership is supposed to be secured via the project application process.	GAVI Alliance has since 2005 provided Health Systems Strengthening (HSS) grants and capacity development to vaccine manufacturers in developing countries.	IFFIm did not create a new structure to deliver resources; most IFFIm resources are channeled into GAVI, an agency established in 2000. IFFIm funds enabled GAVI to scale up its operations.	The mechanism depends on continuous donor funding commitments. The IFFIm has also been heavily reliant on a AAA credit score to hold down costs; should its credit rating decline, this would increase the mechanism's borrowing costs and may mean it no longer becomes cost-effective.	In principle, such a mechanism could be scaled up but it has attracted limited donor interest. Its complex structure is not easily understood by the wider development community. Its reliance on a AAA credit score also means it may not easily be replicated (e.g. by developing country governments themselves). On the other hand, it has enabled GAVI to significantly scale up its activities.

Innovative Financing Mechanism	Description	Revenues raised	Reported results	Beneficiaries	Additionality
Frontloading and debt-based instruments					
Debt conversions (swaps)	Debt swaps are financial transactions in which a portion of a developing nation's foreign debt is forgiven in exchange for local investments in social or environmental conservation measures.	Unknown amounts for debt-for-nature and debt-for-education swaps. Debt2Health has written-down €163.6 million. US\$316 million in IDA credits have been bought down for Nigeria & Pakistan.	Over the years, debt conversions have supported a range of environment, education and health projects with mixed outcomes.	Since 1998, 18 debt-for-education swaps have been initiated in 14 debtor nations, predominantly in Latin America Indonesia. Pakistan & Cote d'Ivoire have benentired from Debt2Health. Pakistan & Nigeria have benefited from IDA buy-downs.	Official creditors count foregone debt service repayments as ODA.
Sustainable investing bonds (e.g. Green bonds etc.)	'Sustainable investing' bonds target investors that wish to integrate social and environmental concerns into their investment decisions. Proceeds are credited to special accounts at the World Bank that support loans for development or climate change adaptation and mitigation projects. Examples are World Bank Eco notes, World Bank Cool bonds and World Bank Green bonds.	Since the inaugural issue in 2008, the World Bank has issued approximately US\$3 billion in Green Bonds through 44 transactions and 16 currencies.	World Bank Green bonds have funded loans to Colombia for sustainable urban transport; Egypt for wind power development and Turkey for renewable energy and energy efficiency.	Middle-income countries have benefited.	Resources raised are additional.
Diaspora bonds	A diaspora bond refers to a debt instrument issued by a country or a sovereign entity aiming to raise funds through its overseas diaspora.	The Governments of India and Israel have raised over US\$35 billion.	Funds are assimilated into governments' budgets. India has used the instrument for balance of payments support. Israel has funded major public works initiatives such as housing and communications infrastructure.	Mostly middle-income countries have used the instrument although some low-income countries have recently explored use of diaspora bonds such as Ethiopia, Kenya, Nigeria, Rwanda & Zimbabwe.	The mechanism generates new revenue streams for development from private actors.

Predictability	Ownership	Capacity development	Fragmentation	Sustainability	Possibilities for scaling up
In principle, the amounts of debt forgiven should be negotiated beforehand by the different partners. However, given the complexities involved with such negotiations, figures may be subject to change and negotiations can break down at various stages.	Debt conversions require that resources be allocated to specified purposes. Early debt swaps were sometimes perceived as a challenge to national sovereignty because they often resulted in the transfer of local assets to foreign ownership or control, or were tied to the purchase of goods &/or services from the creditor nation. Conversion of bilateral debt also raised issues as regards policy conditionality since bilateral debt conversions often required beneficiary countries to meet certain macroeconomic & political criteria. More recent debt conversion agreements represent improvements, however funds must still be spent on specified purposes via specified channels.	Debt conversions can be complex processes. In many cases, debtor governments have commissioned foreign financial advisors to assist them in implementing debt swap transactions.	Debt swap transactions are often complex & time-consuming. They often involve multiple parties to the transaction. Transaction costs are high for relatively small amounts of debt.	Debt conversions are essentially 'one-off' operations; they may help support useful development projects in the short-term but they are not designed to resolve broader issues related to debt sustainability or social & economic development.	To a limited extent, there are new opportunities for debt swaps. In particular, countries with severely high public debt ratios but which are not eligible for HIPC/MDRI (multilateral debt relief initiative) could be considered for debt swaps. Objective eligibility criteria for such initiatives requires more work. Debt swaps should be carefully considered, as if managed in an inappropriate way, can affect the country's credit rating and increase costs of sovereign borrowing. Hence, such a swap could be particularly considered if there is already an ongoing, wider debt-restructuring.
The World Bank leverages its reputation, financial strength and expertise to raise predictable finance from international capital markets at affordable rates. However, bond issuances are always subject to broader market conditions. Once loans are approved, disbursements are often made over several years when each project milestone is reached. This may reduce predictability in the delivery of loan finance.	Funds are 'earmarked' for specific climate/environment purposes. Project selection criteria are defined by the World Bank and are aligned with the governance structure of the World Bank and its safeguards for its projects. Beneficiaries submit project proposals to the World Bank.		The World Bank is one of the world's largest financiers of social and environmental projects world-wide.	Debt sustainability considerations need to be kept in view. The proceeds from bond issuances are on-lent on commercial terms to beneficiary countries thus the mechanism may be more suited to middle-income countries.	The market for so-called 'green' or 'sustainable' bonds can be expected to increase over the next decade as more investors become interested in integrating social or environmental concerns into their investment decision.
The success of bond issuances will depend on several factors which include: kinship ties, the diaspora's confidence in the home-country government, the economic position of the broader diaspora & economic conditions in countries of residence.	Countries spend the resources they raise as they see fit and are country-owned. However, to attract investors, governments may 'ring-fence' some funds for specific development purposes.	Incentives to build on and maximise national capacities exist as revenues are utilised directly by the recipient government/ subnational entity.	Diaspora bonds do not accentuate issues related to fragmentation in the delivery of resources since resources are used directly by government entities.	Debt sustainability considerations need to be kept in view. Diaspora bonds create public debt liabilities in developing countries which must be repaid. Market conditions are important.	Significant potential exists for some developing countries to make use of diaspora bond instruments, especially those with access to international capital markets and large diaspora communities. For some very poor and/or very small countries, there may be limited scope. Oppressive or otherwise unstable political regimes may also find it more difficult to use such instruments. Preliminary estimates suggest that sub-Saharan African countries could potentially raise US\$5 billion – 10 billion per year by issuing diaspora bonds.

Innovative Financing Mechanism	Description	Revenues raised	Reported results	Beneficiaries	Additionality
State guarantees, public-private incentives, insurance and other market-based mechanisms					
Advance Market Commitments (AMC) for a pneumococcal vaccine	Under the AMC, donors commit funds to guarantee the price of pneumococcal vaccines. These financial commitments provide, in turn, a new incentive to vaccine manufacturers to develop a product that might otherwise not be commercially viable and to manufacture it at scale. In exchange, pharmaceutical companies sign a legally-binding commitment to provide the vaccines at an agreed price. The AMC was launched in 2007 by Canada, Italy, Norway, Russia, the UK and the Bill & Melinda Gates Foundation.	US\$1.5 billion donor commitment in total.	AMC could save approximately 900,000 lives by 2015 and up to 7 million lives by 2030.	Benin, Cameroon, Central African Republic, Democratic Republic of Congo, Guyana, Honduras, Kenya, Mali, Nicaragua & Yemen.	The initiative uses ODA to catalyse market development and is thus not additional.
Carbon-emissions trading	Carbon Emissions trading, as set out in Article 17 of the Kyoto Protocol, allows countries that have emission units to spare, i.e. emissions permitted to them but not "used" - to sell this excess capacity to countries that are over their targets.	US\$28 billion under the Kyoto Protocol & US\$810 million from Germany's auctioning/sales of emissions permits under the EU ETS.	A wide range of initiatives have been supported via carbon emissions trading, especially renewable energies.	Mostly larger middle-income countries so far. China has been the major beneficiary of the Clean Development Mechanism (CDM).	In principle, such mechanisms generates new revenue streams for development/ climate actions. However, donors are permitted to report their official concessional support for CDM projects as ODA. Germany also reported as ODA the proceeds from the auction/sale of emissions permits under the EU ETS.
2% share from the sale of Certified Emissions Reductions (CERs)	The CDM allows a country with an emission-reduction or emission-limitation commitment under the Kyoto Protocol to implement emission-reduction projects in developing countries. Such projects earn saleable certified emission reduction (CER) credits, each equivalent to one tonne of CO ₂ , which count towards meeting Kyoto targets. A 2% levy on carbon credits generated through the CDM is channeled in turn into the Adaptation Fund which finances climate adaptation projects and programmes in developing countries.	12 projects so far totaling approx. US\$70 million.	To early to ascertain: most projects were approved only from late-2010.	Mauritius, Mongolia, Maldives, Ecuador, Eritrea, Solomon Islands, Nicaragua, Pakistan, Senegal, Honduras.	Resources raised are additional.

Predictability	Ownership	Capacity development	Fragmentation	Sustainability	Possibilities for scaling up
The AMC is dependent on donors' financial contributions and vaccine manufacturers' willingness to participate. This may reduce predictability.	The funds are 'earmarked' for pneumococcal vaccines only.	Recently, the GAVI Alliance which implements the AMC has focused more attention on developing the capacities of vaccine manufacturers in emerging economies.	The GAVI Alliance manages implementation of the AMC; no new structure was created for this initiative.	The initiative is dependent on donors' resources to lower the price of pneumococcal vaccines. Developing countries are expected to progressively assume the cost of vaccines but some observers still consider vaccine prices too high for many countries to bear. Key to the sustainability of such initiatives will be the development of vaccine production capacities in developing countries themselves.	Take-up of the pneumococcal vaccine has so far been slower than expected by developing countries, although GAVI has announced plans to step-up country coverage.
The primary objective of cap and trade initiatives is to achieve certain emissions reductions targets, rather than raise predictable finance for development.	Countries which have ratified the Kyoto Protocol are eligible to submit CDM project proposals for consideration by the CDM Executive Board. Government and non-government entities may develop project proposals.	Questions have been raised as regards the capacities (human, technical and institutional) of smaller and poorer countries to attract and apply for these funds to date.	Under the EU ETS, Germany integrated the resources raised via the sale/ auctioning of emissions permits into its overall development cooperation budget.	The initiative is based on an expanding, new globally traded commodity.	Carbon is now tracked and traded like any other commodity which means high possibilities for scaling up. However, it is also highly dependent on political buy-in.
The primary objective of cap and trade initiatives is to achieve certain emissions reductions targets, rather than raise predictable finance for development. As regards delivery of resources, project proposals must be submitted to and approved by the Adaptation Fund which can reduce predictability.	Resources generated through the 2% levy are channeld into the Adaptation Fund which earmarks monies for climate adaptation and mitigation projects only.	Questions have been raised as regards the capacities (human, technical and institutional) of smaller and poorer countries to attract and apply for these funds to date.	The Adaptation Fund was created in 2008 as a new fund to finance climate change adaptation & mitigation. It thus adds to the complexity of the emerging climate finance architecture.	The initiative is based on an expanding, new globally traded commodity.	High possibilities for scaling up yet highly dependent on political buy-in.

Innovative Financing Mechanism	Description	Revenues raised	Reported results	Beneficiaries	Additionality
PROPOSALS UNDER CONSIDERATION					
Financial Transactions Tax (FTT)	An FTT is a tax placed on a specific type of financial transaction such as the exchange of currency, shares, bonds & derivative contracts.	A coordinated 0.005 percent tax on all the major currencies would raise approximately US\$33 billion each year. A low-rate FTT could, with a large tax base, yield nearly €200 billion per year at EU level and US\$650 billion at global level.	N/A	N/A	The initiative would raise new resources for development and climate actions. However, how the flows are 'counted' by implementing governments remains open to question (i.e. will the flows be integrated into regular ODA budgets and used to off-set declines in traditional ODA?).
Carbon taxes	A carbon tax is a tax on the carbon content of fossil fuels (such as coal, oil & gas) & is designed to provide businesses & individuals with an incentive to curb activities that produce CO ₂ emissions. In principle, the tax motivates entities to cut back on their carbon emissions if the cost of doing so is less than the cost of paying the tax. Under such initiatives, policymakers levy a fee for each tonne of CO ₂ emitted or for each tonne of carbon contained in fossil fuels.	A base levy of US\$2 per tonne on all CO ₂ emissions from fossil fuel use with an exemption on the first 1.5 tons of emissions per capita would raise an estimated US\$48 billion per year. Carbon taxes on aviation and ship fuels in developed economies could raise around US\$250 billion in taxes in 2020.	N/A	N/A	Carbon taxes will raise new resources for development &/ or climate actions. However, how the flows are 'counted' by implementing governments remains open to question (i.e. will the flows be integrated into regular ODA budgets and used to off-set declines in traditional ODA?).
Global Solidarity Tobacco Levy	Participating countries commit to pool small increases in national tobacco tax to support global health priorities in developing countries.	A Solidarity Tobacco Contribution may raise US\$9 billion per year for health. A tax increase of US\$0.05 per pack sold in G20 countries would raise US\$4.3 billion for international health.	N/A	N/A	In principle the initiative would generate new resources for development. However, it is likely that participating governments would integrate such resources into their usual development cooperation budgets (i.e. the resources raised would be counted as ODA).

Predictability	Ownership	Capacity development	Fragmentation	Sustainability	Possibilities for scaling up
<p>Good estimates could be made as regards the annual amounts which could be raised via a FTT. However, it would remain vulnerable to market conditions & amounts raised could decline in economic downturns. Whether the FTT delivers predictable resources for development will depend on the delivery modalities selected for this finance.</p>	<p>Whether the FTT supports country ownership will depend on the delivery modalities selected for the finance. In reality, implementing governments are likely to want to retain some say in resource allocation decisions & are likely to want to retain some revenues raised for domestic purposes rather than international development.</p>	<p>Whether the FTT supports capacity development will depend on how resources are delivered to beneficiary countries.</p>	<p>Whether a FTT accentuates issues related to fragmentation in ODA will depend to a large extent on the size of the initiative (smaller initiatives may carry higher transaction costs) & the aid delivery modalities selected for the finance (i.e. will a new structure be created to deliver funds or will they be channeled through existing institutional arrangements?).</p>	<p>Raises sustainable resources for development/ climate as it uses well established financial products and services (e.g. currency conversion).</p>	<p>The initiative is ideally implemented by many countries simultaneously. Revenues are expected to be higher in countries that are major financial centres. The potential for scaling up is high yet remains dependent on political will; some governments have indicated they do not support such taxes. This makes the development of smaller initiatives by 'like-minded' governments more realistic.</p>
<p>Good estimates could be made as regards the annual amounts which could be raised via various forms of carbon tax. Whether such taxes deliver predictable resources for development will depend on the delivery modalities selected for this finance.</p>	<p>As above. Whether carbon taxes support country ownership will depend on the delivery modalities selected for the finance. Governments are likely to want to retain some say in resource allocation decisions & may face pressure from domestic constituents to retain some portion of revenues raised for domestic purposes.</p>	<p>Will depend on the finance delivery modalities selected.</p>	<p>As above. Whether carbon taxes accentuate issues related to fragmentation in ODA will depend to a large extent on the size of the initiative (smaller initiatives may carry higher transaction costs) & the aid delivery modalities selected for the finance (i.e. will a new structure be created to deliver funds or will they be channeled through existing institutional arrangements?).</p>	<p>Raises sustainable revenues for climate/ environment in so far as carbon consumption around the world continues and is taxed.</p>	<p>Carbon is now tracked and traded like any other commodity which means high possibilities for scaling up. However, it is also highly dependent on political buy-in.</p>
<p>Good estimates could be made as regards the amounts which could be raised via tobacco taxation. As with most initiatives, revenues could decline in economic downturns (when tobacco consumption could be expected to decline). Whether the solidarity levy on tobacco would deliver predictable resources for development will depend on the delivery modalities selected for this finance.</p>	<p>Discussions so far have centred on earmarking such revenues for health.</p>	<p>Will depend on the finance delivery modalities selected.</p>	<p>As above. Whether tobacco taxes accentuate issues related to fragmentation in ODA will depend to a large extent on the size of the initiative (smaller initiatives may carry higher transaction costs) & the aid delivery modalities selected for the finance (i.e. will a new structure be created to deliver funds or will they be channeled through existing institutional arrangements?).</p>	<p>Taxes on tobacco consumption represent a sustainable source of revenue in so far as tobacco consumption continues (although we may wish it to become a steadily declining source of revenue based on consumers progressively reducing their consumption of tobacco products).</p>	<p>Governments typically face significant pressure to use the majority of revenues collected nationally on tobacco consumption to fund national health priorities. It is likely that only a small proportion of revenues collected via tobacco taxes will ever be allocated to international development thus possibilities for scaling up may not be very high.</p>

Innovative Financing Mechanism	Description	Revenues raised	Reported results	Beneficiaries	Additionality
PROPOSALS UNDER CONSIDERATION					
Special Drawing Rights (SDRs)	The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. SDRs are created by the Executive Board of the IMF. Under its Articles of Agreement, the IMF may allocate SDRs to member countries in proportion to their IMF quotas.	US\$250 billion in SDRs was created in August 2009 and allocated to member countries in proportion to the IMF quotas.	SDRs are assimilated into member countries overall national budgets and may be used as governments see fit (e.g. to balance budgets in time of liquidity crisis).	All IMF member countries may benefit from SDR allocations (in proportion to their IMF quotas).	SDRs are additional. SDRs may be created by the IMF Executive Board. SDRs are backed by the consensus of the world's governments and there is no material cost to their creation (although interest must be paid when they are used).

Predictability	Ownership	Capacity development	Fragmentation	Sustainability	Possibilities for scaling up
<p>SDRs are condition-free resources which could, in principle, be allocated on a regular, predictable basis.</p>	<p>SDRs may be converted into the freely usable currencies of IMF members to be used as governments determine.</p>	<p>SDRs support governments' general budgets. Thus, they support the decision-making capacities of indigenous institutions over time.</p>	<p>SDRs do not accentuate issues related to fragmentation in the delivery of resources since they represent direct budget support.</p>	<p>Regular SDR allocations would represent a sustainable form of finance.</p>	<p>SDR allocations could, in principle, be made on a regular basis. Therefore, possibilities exist to make greater use of this form of finance, especially as countercyclical finance. SDR allocations could also be pooled and used as a form of seed capital in special purpose thematic trust funds. In principle, the IMF's Articles of Agreement permit the donation of SDRs from one country to another.</p>

Glossary: Major innovative financing for development initiatives

2% share from the sale of Certified Emissions Reductions (CERs)

The Clean Development Mechanism (CDM) allows a country with an emission-reduction or emission-limitation commitment under the Kyoto Protocol to implement emission-reduction projects in developing countries. Such projects earn saleable certified emission reduction (CER) credits, each equivalent to one tonne of CO₂, which count towards meeting Kyoto targets. A 2 percent levy on carbon credits generated through the Clean Development Mechanism is channeled into the Adaptation Fund which finances climate adaptation projects and programmes in developing countries.

Advance Market Commitments (AMC) for a pneumococcal vaccine

Under the AMC, donors commit funds to guarantee the price of pneumococcal vaccines. These financial commitments provide, in turn, a new incentive to vaccine manufacturers to develop a product that might otherwise not be commercially viable and to manufacture it at scale. In exchange, pharmaceutical companies sign a legally-binding commitment to provide the vaccines at an agreed price. The AMC was launched in 2007 by Canada, Italy, Norway, Russia, the United Kingdom and the Bill & Melinda Gates Foundation and the total amount raised so far is US\$1.5 billion.

Affordable Medicines Facility for Malaria

The Affordable Medicines Facility for malaria aims to increase the provision of affordable artemisinin-based combination therapies (ACTs). It is managed by the Global Fund which negotiates the price with manufacturers and in turn subsidises the cost to first-line buyers from the public and private sectors alike.

Carbon-emissions trading

Carbon Emissions trading is a new trading commodity as set out in Article 17 of the Kyoto Protocol, allowing signatory countries that have emission units to spare as per the assigned targets (emissions permitted to them but not “used”) to sell this excess capacity to countries that are over their targets. Total amount raised so far is US\$28 billion.

Carbon taxes

A carbon tax is a tax on the carbon content of fossil fuels (such as coal, oil and gas) and is designed to provide businesses and individuals with an incentive to curb activities that produce CO₂ emissions. In principle, the tax motivates entities to cut back on their carbon emissions if the cost of doing so is less than the cost of paying the tax. Under such initiatives, policymakers levy a fee for each tonne of CO₂ emitted or for each tonne of carbon contained in fossil fuels. Australia has most recently introduced a carbon tax set at AU\$23 per tonne of carbon released into the atmosphere, to increase gradually until 2015.

Caribbean Catastrophe Risk Insurance Facility (CCRIF)

CCRIF is a risk pooling facility, owned, operated and registered by participating governments in the Caribbean. Through the purchase of insurance, it is designed to limit the financial impact of catastrophic hurricanes and earthquakes to Caribbean governments by quickly providing short term liquidity to finance post-disaster recovery needs. It pools countries' risks by keeping reserves and by transferring the remaining risks to the market where it purchases reinsurance and catastrophe swaps.

Countercyclical loans

Countercyclical loans allow for adjustments in the repayment terms and maturities of loans in response to external shocks. External debt service is thus adapted to the ability of the borrower to meet its financial obligations. Such loans are designed to help governments to manage macroeconomic vulnerabilities. As of 2010, France had extended countercyclical loan agreements to Burkina Faso, Mali, Mozambique, Senegal and Tanzania totalling €200 million.

Debt conversions (swaps)

Debt swaps are financial transactions in which a portion of a developing nation's foreign debt is forgiven in exchange for investments in social or environmental conservation measures. Debt-for-nature swaps have been widely implemented. Debt-for-education swaps involve external debt cancellation in exchange for investments in the education sector of the debtor country. Debt2Health is an initiative of the Global Fund. Under Debt2Health agreements, the (official) creditor agrees to forgo a certain amount of debt on the condition that the beneficiary invests an agreed amount in health via the Global Fund.

Diaspora bonds

A diaspora bond refers to a debt instrument issued by a country or a sovereign entity aiming to raise funds through its overseas diaspora. They thus tap emigrants' savings. Israel and India have successfully issued diaspora bonds in the past; other countries have been less successful. They may be a useful way to raise funds for infrastructure and development projects. Investors must be repaid with interest.

Digital Solidarity Levy

Senegal and Guinea have promoted a proposal to encourage organizations (private or public) to incorporate a 1 percent levy into the IT tenders they issue. The proceeds would be dedicated to overcoming the digital divide between rich and poor.

Financial Transactions Tax (FTT)

A financial transactions tax is a tax placed on a specific type of financial transaction such as the exchange of currency, shares, bonds and/or derivative contracts. The idea for a tax on foreign exchange transactions—first floated in the 1970s—was devised to cushion exchange rate fluctuations. More recent discussions have centred on the potential of such taxes to raise resources for development or other purposes.

Global development or humanitarian lottery

Ideas under discussion range from the creation of a specific world lottery to amalgamating existing national lotteries. Often the discussion focuses on helping finance food needs in developing countries. Some donors, e.g., the United Kingdom and Belgium, have tapped into national lottery funds to finance development projects.

Global Solidarity Tobacco Levy

The proposal for a Global Solidarity Tobacco Levy encourages countries to pool small increases in national tobacco tax to support global health priorities in developing countries.

International Finance Facility for Immunisation (IFFIm)

The IFFIm raises funds by issuing bonds in international capital markets. The IFFIm repays bondholders over periods of up to 20 years with the long-term (legally binding) ODA commitments of donor governments. This arrangement effectively allows governments to 'buy-now but pay later' or 'frontload' ODA. Launched in 2006 by 6 donor governments (United Kingdom, France, Italy, Spain, Sweden and Norway). South Africa, the Netherlands, Australia and Brazil have also joined. The total amount raised thus far is US\$3.4 billion.

Local currency lending

Traditionally, loans by multilateral development banks (MDBs) and other development partners have been offered almost exclusively in foreign currency. Recently, some MDBs have started to engage in local currency lending. This helps to reduce exchange rate risk and currency mismatches associated with borrowing in foreign currencies.

MASSIVEGOOD

MASSIVEGOOD was launched in Spain in 2010. It enables travelers to make a micro donation to international development with the purchase of a travel product on-line. The initiative terminated at the end of 2011 due to insufficient returns in the current economic climate.

Product (RED)

Consumers are encouraged to purchase (RED) branded products. In turn, collaborating producers donate 50 percent of profits to the Global Fund to fight AIDS, TB and malaria. The total amount raised so far is US\$173 million.

Solidarity Levy on Airline Tickets

Launched in 2006 by the Governments of Brazil, Chile, France, Norway & the United Kingdom, it collects funds for UNITAID through a nationally employed, yet internationally coordinated tax on airline ticket sales. Each passenger is charged a low tax rate on each air ticket purchased. Nine countries currently participate in this initiative and the tax level varies from one country to the next.

Special Drawing Rights (SDRs)

The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of four key international currencies. SDRs are created by the Executive Board of the IMF and they represent a potential claim on the freely usable currencies of IMF members. SDRs are allocated to member countries in proportion to IMF quotas.

Sustainable investing bonds

'Sustainable investing' bonds target investors that wish to integrate social and environmental concerns into their investment decisions. Examples are the World Bank's Eco notes, World Bank Cool bonds and World Bank Green bonds which are used to support loans for climate change adaptation and mitigation projects in middle-income countries.

VAT 'De-Tax'

Italy has proposed a voluntary rebate by businesses on their Value Added Tax payments to benefit development (specifically health). Under the proposal, donor governments would donate 1 percent of VAT revenues received from businesses that subscribe to the initiative to international development.

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