An overview of innovative financial instruments used to raise funds for international development

11th Plenary Session of the Leading Group on Innovative Financing

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Introduction

› MDG requirements still challenge DAC members in suitable policies, strategies AND financial resources

› Controversy not just over the level of funds needed to finance development, BUT also with regard to the sources („Will innovative financing replace ODA?“, The Development Newswire, 28.12.2012)

› Maintaining the 0.7 % goal AND/OR usage of local sources (taxation, reduction of capital flight) first, and use funds more efficiently

› Do countries have sufficient capacity to absorb the funds AND/OR does development finance „poison“ or weaken the local efforts for development?

› Possible solution: combination of policies strongly orientated toward development, increasing local revenues, strengthening the focus on results, increasing efficiency and mobilising additional international funding
What are innovative financial instruments?

- Given the sources of financing, we classify the instruments into:
  - Type 1: Additional *public* funds
  - Type 2: Additional *private* funds
  - Type 3: Efficiency improvements and debt conversion
Type 1: Mobilizing additional **public** funding

- **New taxes and levies** on specific activities, generally of a global nature  
  (Financial transaction, airline tickets, CO\textsubscript{2} emission)
- **Government sale/auction** of rights of use  
  (Certified emission rights, UMTS licences)
- Allocating **IMF special drawing rights**  
  (specifically to developing countries)
Type 2: Mobilizing additional private funding

- **Public Private Partnerships (PPP)**
- Government **guarantees/assumptions of risk** (IFFIm, AMC, GAVI)
- Concessionary loans **combining public and private funding** (Blending)
- Loans/bonds with **performance-dependent repayment** terms (Counter-cyclical loans, GDP-indexed bonds)
- Securities and **structured funds**
- **Ethical funds/bonds** and diaspora funds
- **Local currency** loans
- The **Clean Development Mechanism** and the **Adaptation Fund**
- Lotteries
Type 3: **Efficiency** improvements or debt conversion

- Result-based Financing, **Output-based** Aid, Health Impact Fund
- Weather **insurance**, catastrophe **insurance**
- Conditional **debt forgiveness**, debt buy-back and debt-for-development swaps
Identification of four cluster

Overview of IFD / February 2013

Identification of four cluster

- **Low volumes, only suitable for a few applications**
  - Government funds mobilised
  - Private funds mobilised
  - Funds freed up through efficiency improvements

- **High-volume, adequate range of applications (also suitable for poorer countries)**
  - Taxes (airline tickets, currency transactions)
  - Auctioning rights of use (CO2, UTMS etc)
  - CDM/AF
  - GDP-indexed bonds
  - Blending
  - Public-Private Partnerships

- **High-volume, broad range of application (but primarily suitable for developed countries)**
  - Weather/catastrophe/climate insurance
  - Loans in local currency
  - AMC, IFFIm
  - Securities & structured funds
  - Results-based financing/OBA
  - Counter-cyclical loans
  - Ethical funds

- **Acceptable level of productivity and range of application (suitable for many countries)**
  - Diaspora bonds
  - Lotteries
  - Weather/catastrophe/climate insurance
  - Weather/catastrophe/climate insurance
  - Weather/catastrophe/climate insurance
  - AMC, IFFIm
  - Securities & structured funds
  - Results-based financing/OBA
  - Counter-cyclical loans
  - Ethical funds
  - Diaspora bonds
  - Lotteries

**Key:**
- Breadth of regional/sectoral applications
- Fund volume which can be mobilised
Instruments that should be pursued with vigour

- **High-volume, broad range of application**, BUT primarily suitable for advanced/middle income countries
  - the driver is the private capital
  - not all ideas are practically verified yet (GDP-indexed bonds)

- **High-volume, adequate range of application**, ALSO suitable for poorer countries
  - the aim is to mobilize more public funds
  - problems arise from unfavourable prevailing market conditions (CDM) and from the uniqueness of some events (auction rights)
Instruments that could be considered more often

- **Fair level of volume and range of application,**
  THEREFORE suitable for many countries
  ➔ mixture of **efficiency improvements**
  ➔ **potential** for successful applications
  and increasing importance (local currency loans, structured funds)
Instruments that **complete** the former instruments in specific contexts

- Low volume and only suitable for a few, but for that context reasonable, applications
Conclusion: What do we learn for the future?

- **Focusing** on the fair and high volume instruments/ideas with a broad range of applications (Blending, GDP-indexed bonds, PPP, local currency loans)
- **BUT** all instruments/ideas with high or small volume are reasonable to *motivate financing*, which is needed for the development

- In the future
  - **Developing countries** have to be supported in their *own efforts* towards attracting financing for development beside the known problems (corruption, capital flight aso.)
    - How can perhaps **Remittances** be used for financing development?
  - **Misguiding incentives for traditional donors** should be mitigated
    - Not only invest in instruments that produce ODA, instead of developing new instruments that are not ODA.
  - **Think outside the box** to acquire new sources of financing.
  - **More private capital** should be motivated to speed up closing of the gap in financing for development.