



# Financing for Development

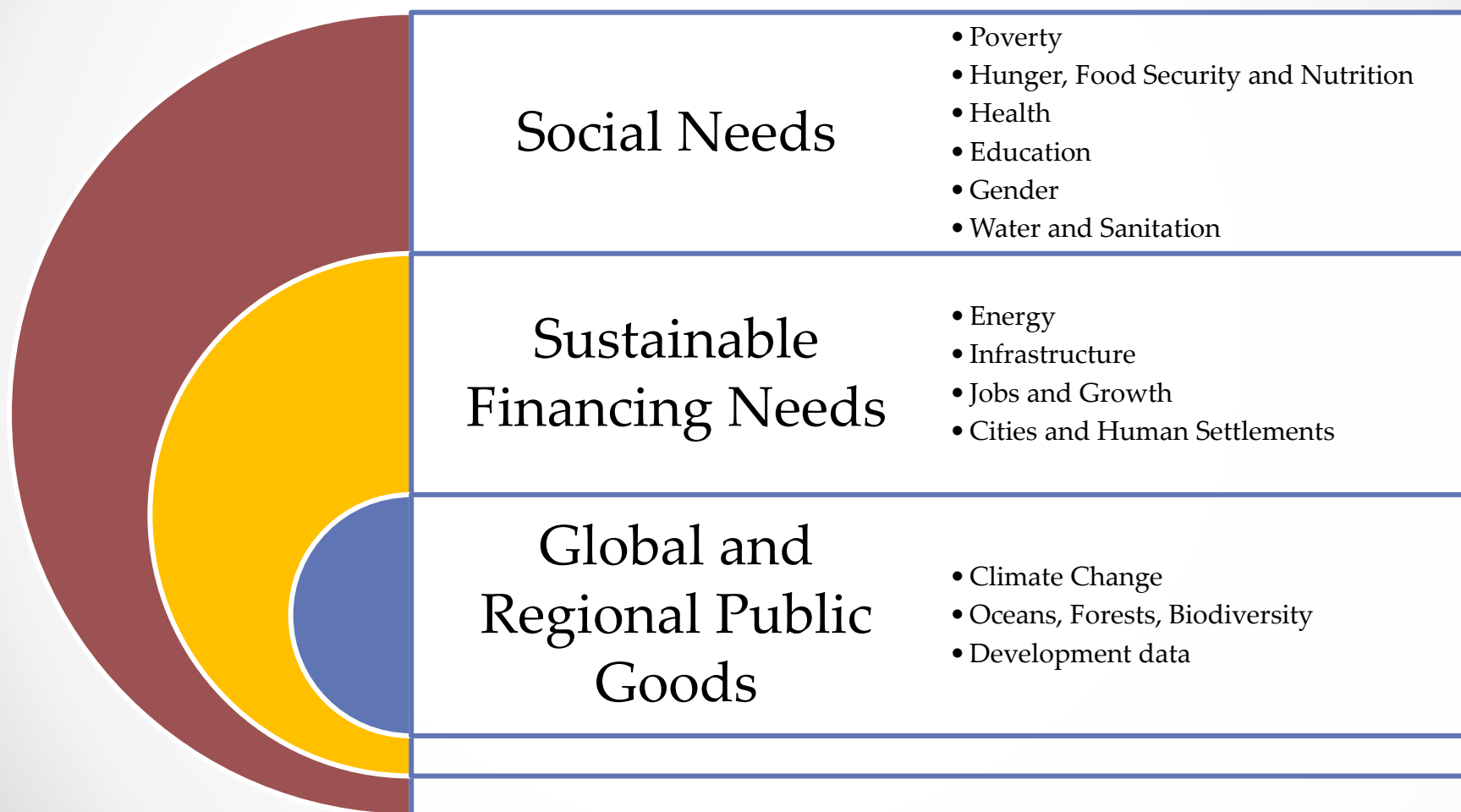
Supporting Countries to Achieve their Sustainable Development Goals

# Overall Structure

- I. MDBs and the SDG Financing Challenge
- II. Principles of Development Financing
- III. Trends in Financial Flows
- IV. Making What You Have Work Better: Raising Domestic Resources, Managing Natural Wealth, and Spending Efficiency
- V. Unblocking Flows for Sustainable Financing: Leveraging Private Investment, and Strengthening Long Term Finance.
- VI. Tailoring Solutions for Global and Regional Public Goods
- VII. The MDBs as Partners

# Part I: MDDBs and the SDG Financing Challenge

# The SDG Financing Challenge



# About the MDB Community... and the Support it Provides

- A community of country-owned institutions with a common goal to support development
- Each with a unique institutional mandate
- Wide ranging collaboration (working groups, collaboration on post-2015, statistics, analytics, etc)



# Part II:

# Principles of

# Development

# Financing

# Critical Components of FFD

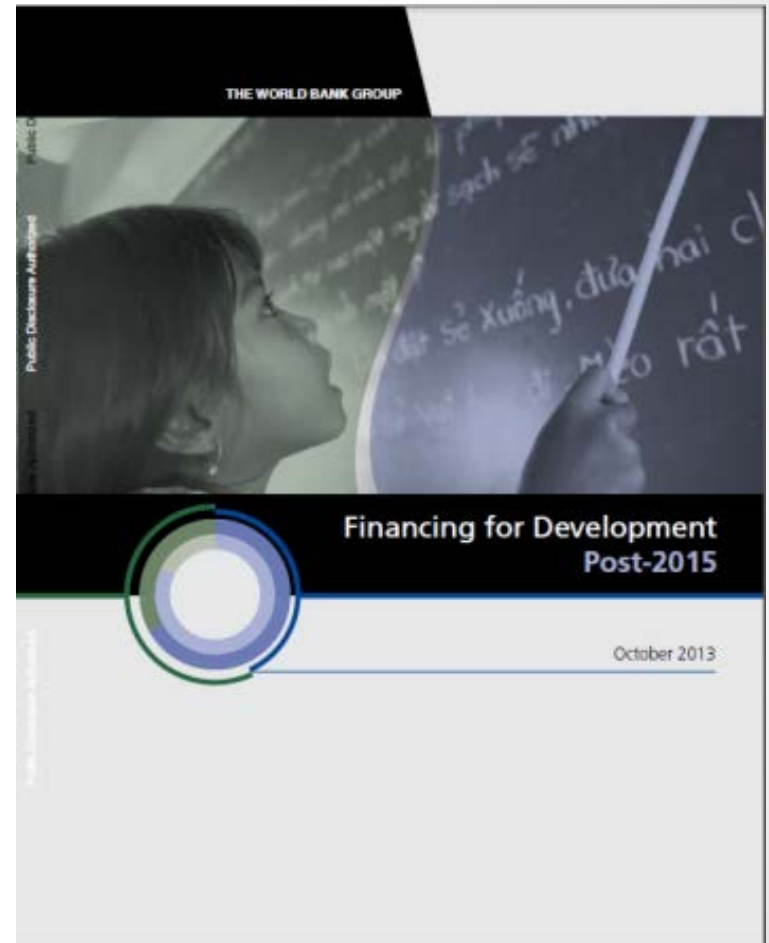
Effective  
domestic  
resource  
mobilization

More private  
finance for  
development

More  
inclusive  
and  
innovative  
sources of  
finance

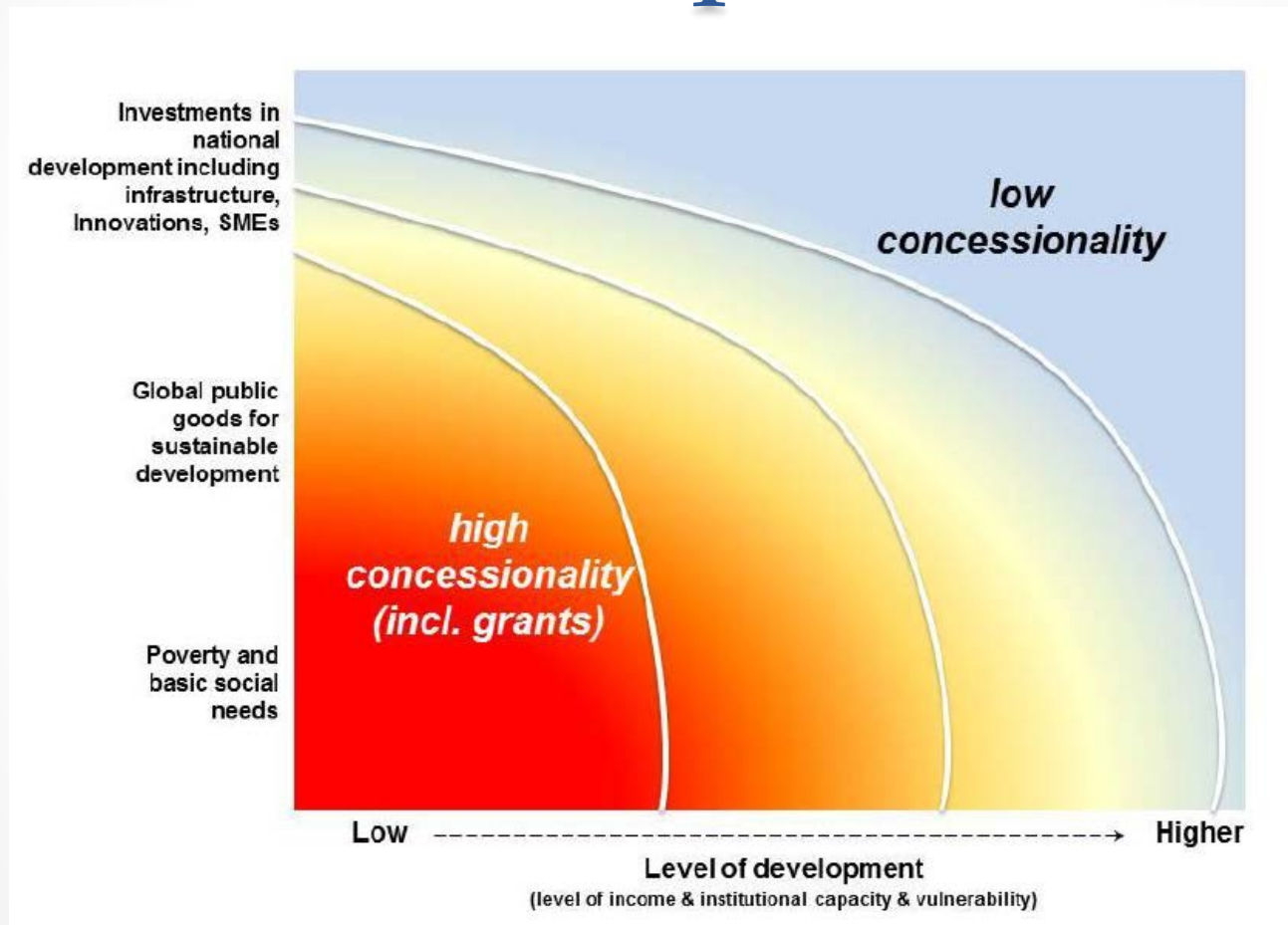
Better and  
smarter aid

Supportive framework for  
development cooperation





# Optimizing Financing for Development





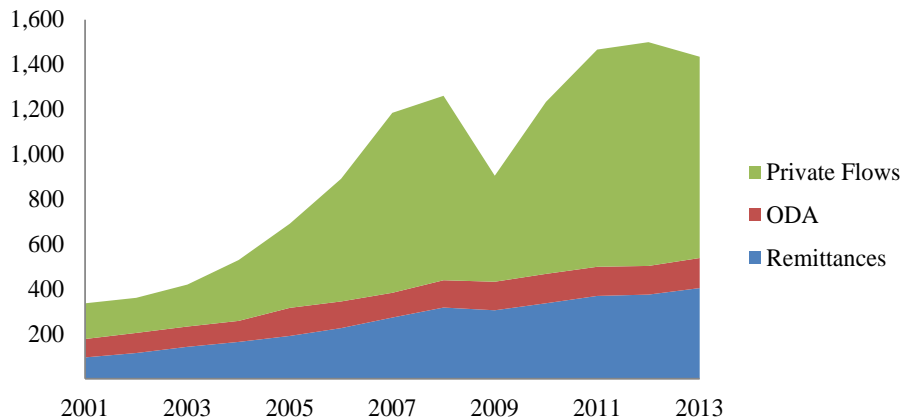
# Specific Country Needs Require Flexibility in Financing Options



# Part III: Trends in Financial Flows

# Financial Flows to Developing Countries

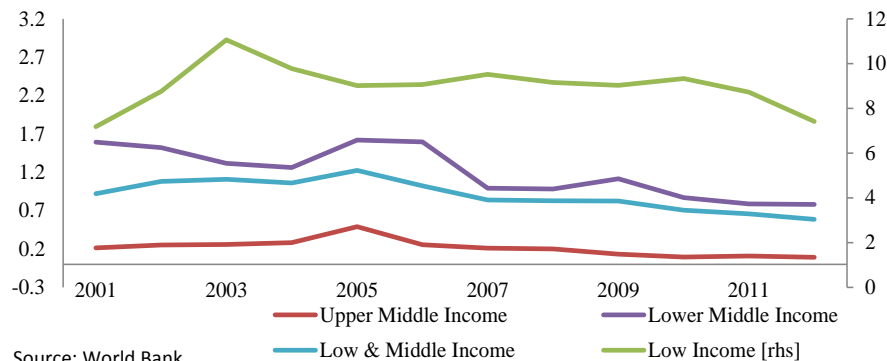
**Chart 1: Financial Flows to Developing Countries**  
(in billions of USD)



- Flows are trending higher, with strong growth in private flows and remittances
- However, private flows tend to be pro-cyclical and concentrated in a few developing economies.
- Most low income countries still lack access to international capital markets
- Financial flows to LDCs also depend on access to local currency, in some places restricted by regulation.

# ODA Flows

**Chart 2: The importance of ODA varies by income level**  
(Net ODA received, % of GNI)



- ODA remains an important source of financing for low income countries – equivalent to 7.4% of GDP, 60% of tax revenues.
- ODA plays a catalytic role in MICs, crowding in other sources of financing and facilitating knowledge transfers.
- ODA flows are expected to remain stable.
- South-south flows are increasing. While S-S flows tend to have lighter conditionality, they tend to more specificity in tying procurement, regional focus and sector focus.
- Private philanthropy is at \$59 billion and growing.
- Poor people vs poor country dilemma

# Recommendations

- Raise donor flows to the 0.7% of GNI target
- Make aid “better and smarter” by addressing the aid effectiveness agenda, linking aid to results, improving transparency, leveraging more private resources, and drawing on more innovative sources of finance.
- Target aid better in MICs to complement other sources of available finance. Focus on policy development, distribution of benefits, leveraging, and risk coverage.
- Improve effectiveness of aid cooperation, by decreasing fragmentation, increasing predictability, share of aid on budget, and strengthening and use of country budget and administrative systems.

# Part IV: Making What You Have Work Better

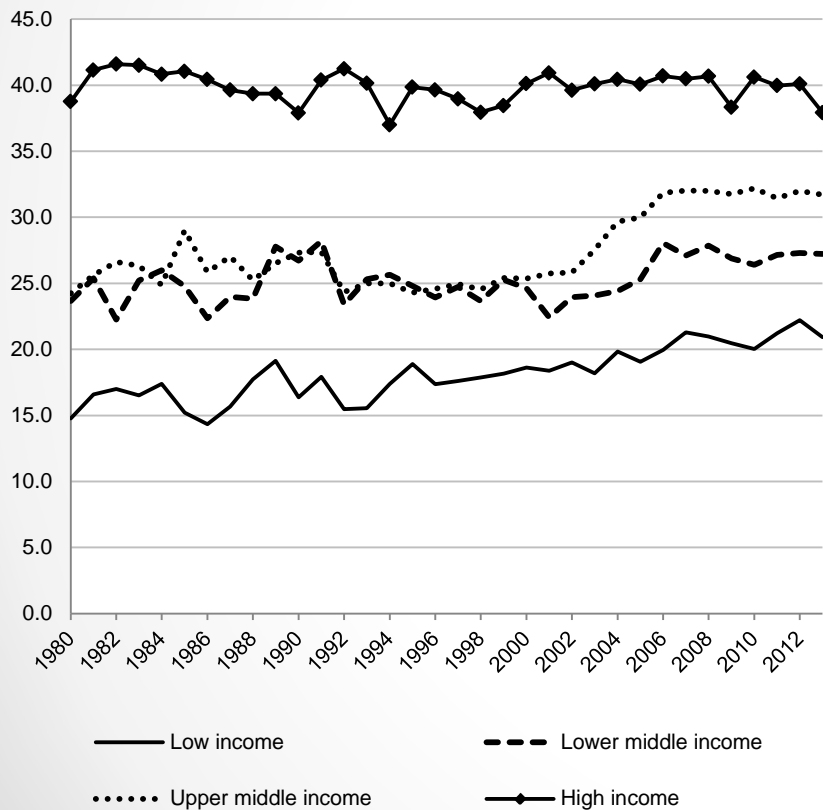
# Domestic Revenue Policies as the Foundation for...

- Supporting post-2015 achievement by aligning budgets and goals
- Macroeconomic stability
- Strengthening governance and building trusted institutions
- Bridging development gaps across income and population groups.
- Addressing persistent poverty
- For realizing the potential of urban and sub-national governance structures.
- Providing and facilitating domestic public goods



# Domestic Resource Mobilization Challenges

Government Revenue as a % of GDP

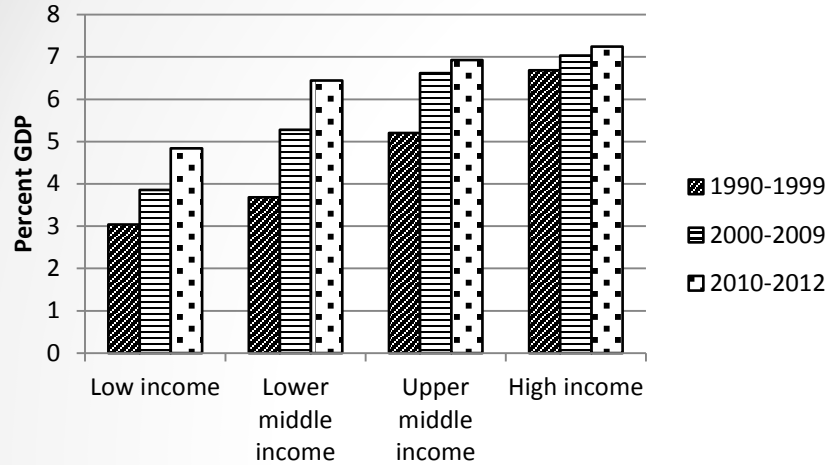


Revenues are improving in developing countries, but there are many common tax challenges:

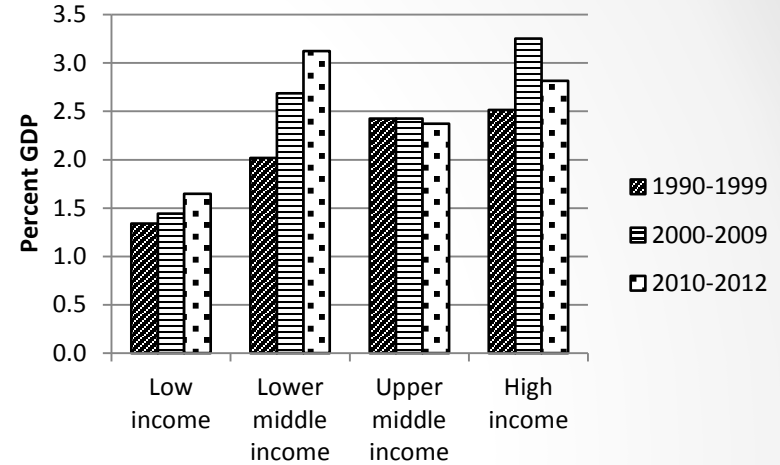
- Dealing with “hard to tax” sectors, especially where administrative capacity and compliance habits are weak
- Weak revenue administrations, low taxpayer morale, and poor governance
- Adroit tax planning of multinationals
- Non-compliance of state owned enterprises
- Shallow use of information from financial institutions
- Pressures from trade liberalization, regional integration, and international tax competition

# Trends, challenges, opportunities

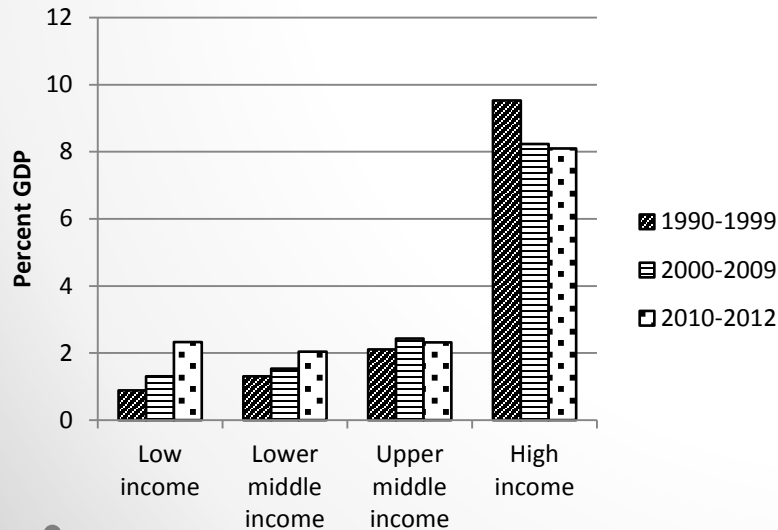
## VAT revenues have increased....



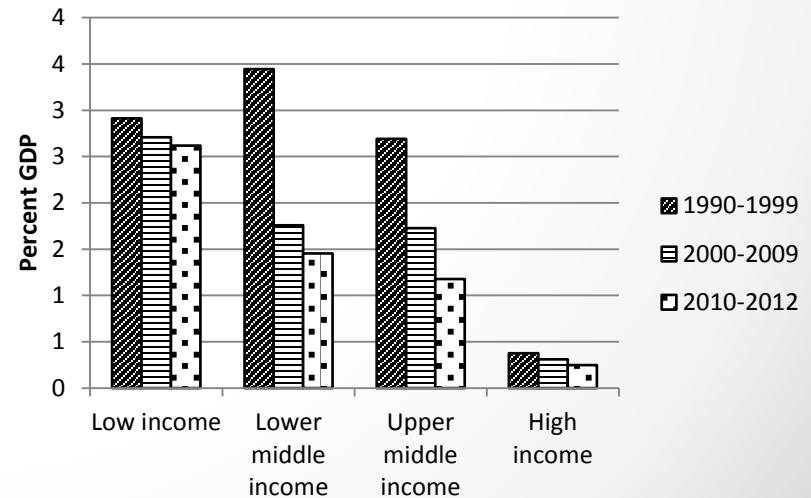
## ...and CIT revenues been robust



## PIT revenues are modest but rising...

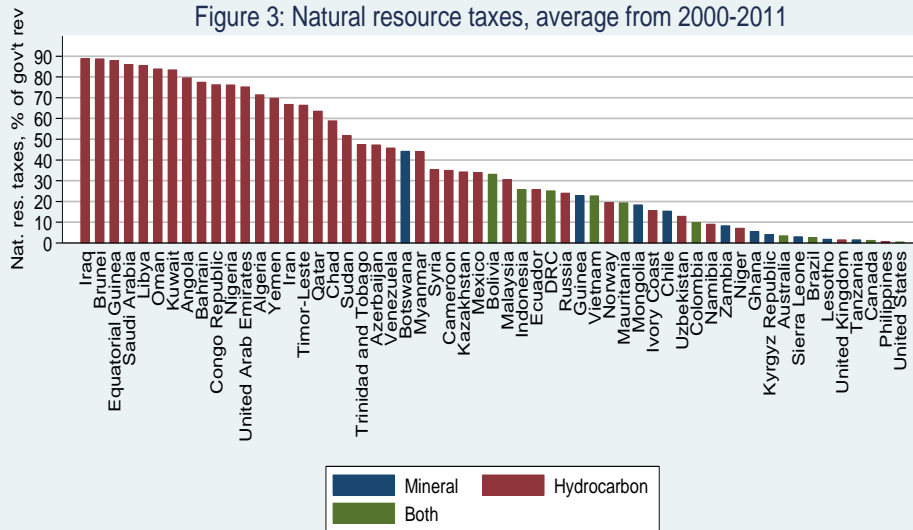


## ...and trade tax revenue is in decline



# Extractive Industries

Figure 3: Natural resource taxes, average from 2000-2011



- EI's are an important source of revenue, with significant discoveries in many low income countries
- Rents – the excess revenues over all costs of production, discovery and development – can be substantial
- Fiscal regimes vary and can be complex but...a regime that combines royalties (to secure early, stable revenues) with taxes explicitly focused on rents (to secure a good share of upside return) works well.
- Minimize fragmentation of responsibilities across agencies.

# Recommendations

## **Tried and tested methods to strengthen domestic revenue:**

- Build revenue administrations that effectively limit rent-seeking and inappropriate behavior, capable of implementation voluntary compliance through risk management and taxpayer segmentation.
- Adopt clear laws and regulations embodying strong taxpayer protection
- Eliminate tax incentives and exemptions that forgo revenue to little useful end.
- Implement a broad-based VAT with a fairly high threshold.
- Establish a broad-based corporate income tax, at internationally competitive rates
- Establish simple tax regimes for small businesses
- Review energy pricing in the light of not only climate issues but local pollution damage
- Extend the personal income tax base.
- Levy excises on a few key items that are adequate to revenue needs and broader social concerns
- Strengthen real estate taxes
- Ensure fiscal regimes for extractive industries are credible enough to provide investors the stability they need but flexible enough to ensure that revenue responds to changing circumstances.

## **Protecting the poorest:**

- Eliminate energy subsidies, with accompanying measures to protect the poorest
- Build progressivity into the tax rules to address issues of inequality
- Reduce the cost of money transfers to improve remittance flows.
- Garner political will to tax elites and high income/wealth individuals, to build the wider legitimacy of the tax system.

## **Emerging Challenges:**

- Develop rules and procedures to protect the tax base against international tax avoidance
- Strengthen regional cooperation and experience-sharing in tax matters

# Spending Efficiency: Mechanisms to Create Budget Space

Mechanism	Focus	Key Actors	Risks and Challenges
Rationalization of tax expenditures	Tax expenditures	CBO, tax administration, legislature	Cooperation from legislatures, resistance from pressure groups
PPP Portfolio reviews	Fiscal commitments and contingent liabilities from PPPs	MoF, CBO, PPP unit	Contract inflexibility, sunk costs
Overlapping zero-based budgeting exercises	Large programs, set of programs aimed at same objective	MoF, CBO, CoG, line ministries, evaluation office	Resistance from pressure groups, cooperation from line ministries
Cost containment programs	Cost-push in supply driven areas	CBO, line ministries, procurement authority, competition authority	Resistance from pressure groups, cooperation from line ministries
Fiscal sustainability of new legislation	Permanent legislation with fiscal implications	MoF, CBO, legislature, Independent Fiscal Institutions	Cooperation from legislature, autonomous expertise

Part V:  
“Unblocking”  
Flows for  
Sustainable  
Financing Needs

# The Pivotal Role of Private Finance

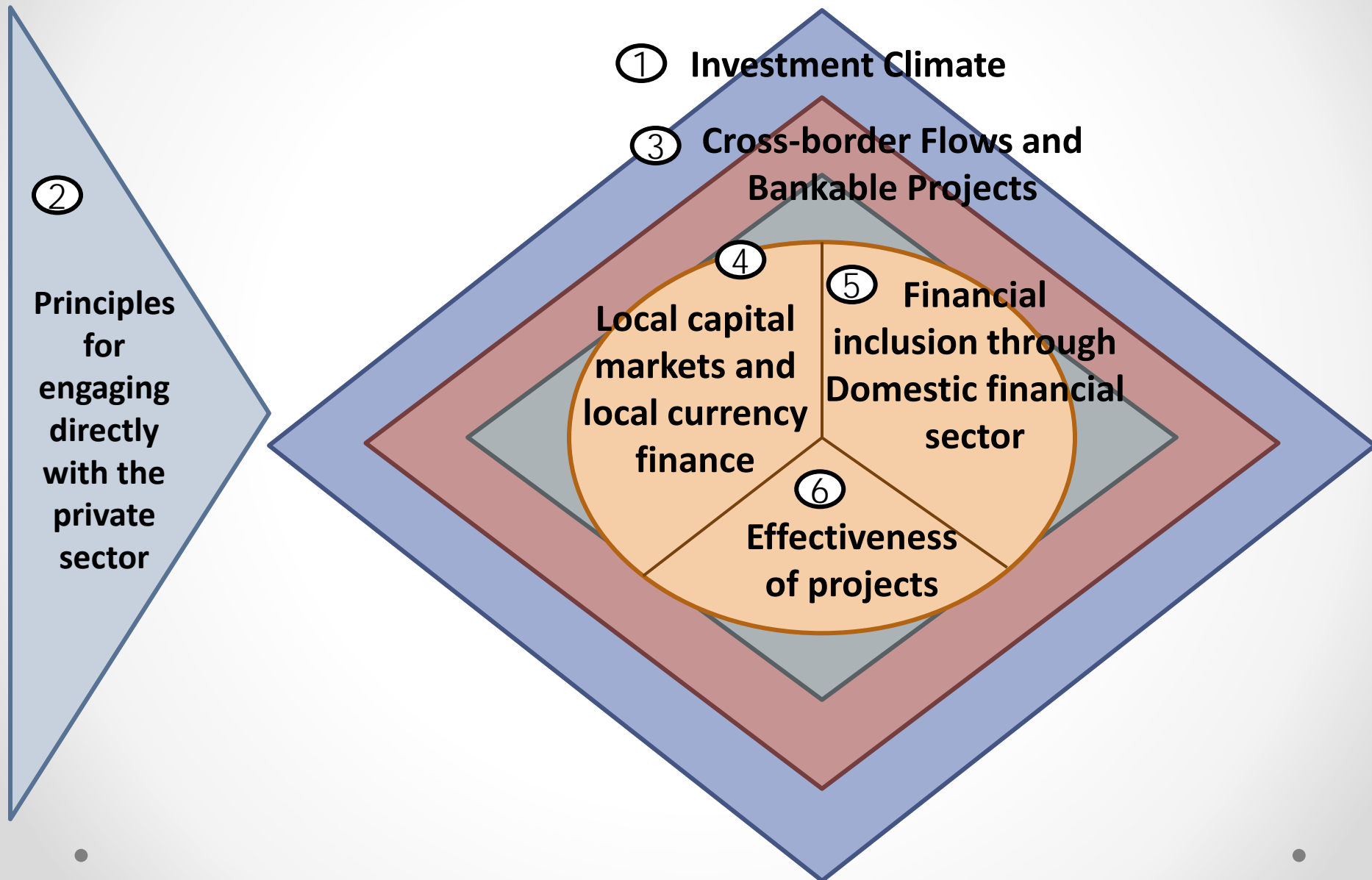
- An essential partner to the public sector in meeting the large financing demands of the post-2015 agenda.
  - Brings know-how, flexibility, and innovation to open up new approaches and instruments
  - “Shared value” with solutions to financial, societal and environmental issues.
- *“Central role of the private sector in advancing innovation, creating wealth, income and jobs, mobilizing domestic resources and in turn contributing to poverty reduction”*  
(Busan Partnership for Effective Development Cooperation)



# Private Investment and Solutions: Key Messages

1. Establish a predictable, transparent, and conducive investment climate
  2. Engage with private entities according to principles that support rather than undermine the viability of markets
  3. Use risk mitigation tools and project preparation know-how to catalyze cross-border capital flows and create bankable projects
  4. Develop local capital markets and facilitate greater access to local currency finance
  5. Strengthen local financial institutions and the financial infrastructure supporting them for inclusion of underserved individuals and SMEs
  6. Help companies expand their impact on development and the sustainability of their activities
  7. Create a supportive environment for social entrepreneurship
- An illustration: Mobilizing private finance to meet infrastructure requirements

# Private Investment: Key Issues



# Recommendations to Encourage Flow of Private Finance (1/4)

## ① Establishing supportive Investment climate

- Continue to improve investment climate with market-friendly regulations and institutions, including those governing specific sectors
- Strengthen PPP regulatory frameworks
- Greater use of public-private dialogues
- MDBs important for knowledge-sharing, advice and convening across public, private and CSOs
- Need increased focus on FCS, impact measurement, and political economy

## ② Establishing principles for engaging with the private sector

- MDBs, others to use key principles of public support for the private sector: additionality, crowding in, commercial sustainability, reinforcing markets, promoting high standards of conduct
- MDBs to publish principles and report on progress
- Utilize related IFI guidance for concessional finance in private sector, emphasizing transparency and phasing out over time

# Recommendations to Encourage Flow of Private Finance (2/4)

3

Risk mitigation and project preparation to catalyze capital flows and create bankable projects

- MDBs, governments to develop scalable pooled vehicles (or co-investment platforms) for risk mitigation through risk sharing, information economies of scale, and project structuring advice
- Build capacity to engage at the individual project level to mitigate risk, e.g. through PPPs, guarantees, risk insurance, blended finance, and innovative structures (structured finance, diaspora bonds)
- Prepare and structure complex projects with potential for commercial viability by 1) improving effectiveness of project preparation facilities (PPFs) and 2) expanding knowledge-sharing and technical assistance especially on PPPs
- Support expansion of traditional activities of MDBs to leverage more outside capital, e.g. equity and debt vehicles (AMC, MCPP, IADB CCFLAC, Africa Growing Together Fund)

# Recommendations to Encourage Flow of Private Finance (3/4)

④

Developing local capital markets and facilitating local currency finance

- MDBs provide 1) advice on institutions and regulations, 2) credit enhancement to increase attractiveness of bond offerings, 3) regional bond funds for scale, 4) their own local currency bond issues
- Address information asymmetry with benchmark and market data
- Expand domestic investor base, e.g. through growth of domestic insurance and pension funds
- Develop MDB access to local currency (e.g. Central Bank swaps, TCX)

⑤

Building the domestic financial sector for greater financial inclusion

- Expand financial inclusion of individuals: 1) policies and institutions to expand financial institution reach, foster innovative payment systems, and strengthen consumer protection; 2) project lending to support innovative financial and payment models; 3) knowledge sharing
- Expand financing for SMEs: 1) work with local banks, microfinance institutions, private equity funds, leasing to target SMEs, 2) build financial infrastructure -- credit reporting, collateral registries, payment systems; 3) regulatory and institutional reform to promote responsible financial sector growth, competition, capacity in judicial systems, new forms of collateral, 4) develop innovative debt funding structures (portfolio risk-sharing, etc.)

# Recommendations to Encourage Flow of Private Finance (4/4)

## ⑥ Improving the impact and sustainability of private sector activities

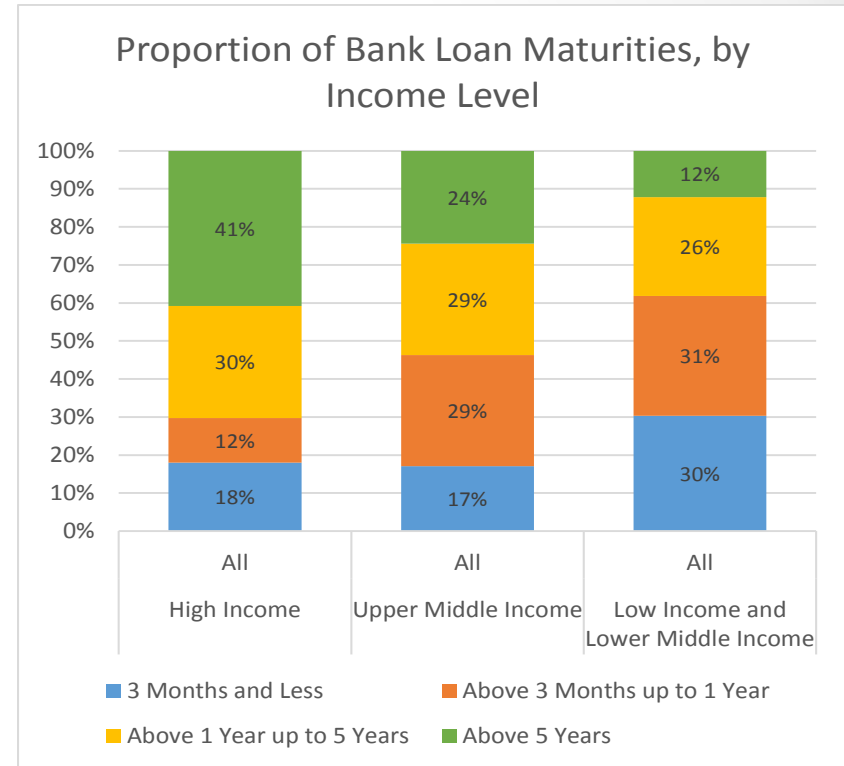
- Governments, development finance institutions, private philanthropy, academia help companies scale and replicate innovative inclusive business models via 1) adequate regulations and institutions, 2) market information on low income segments, 3) knowledge-sharing, capacity building, 4) financing innovative models
- Build partnerships to strengthen sustainability practices:
  - Credit enhancement to encourage private capital flows
  - MDB support for standard-setting, financing innovative approaches, knowledge-sharing on profitable practices

## Illustration: Mobilizing private finance for infrastructure

- Support special facilities for project preparation
- Focus on sound enabling environment and commercial sustainability of infrastructure investments
- IFIs can act as matchmakers, bringing together investors and projects, facilitating decisions with project preparation, knowledge transfer, access to decision makers, improvements in the investment climate, and leveraging other sources of finance (commercial banks, local bond market development, etc.)

# Closer Look at Long-Term Finance

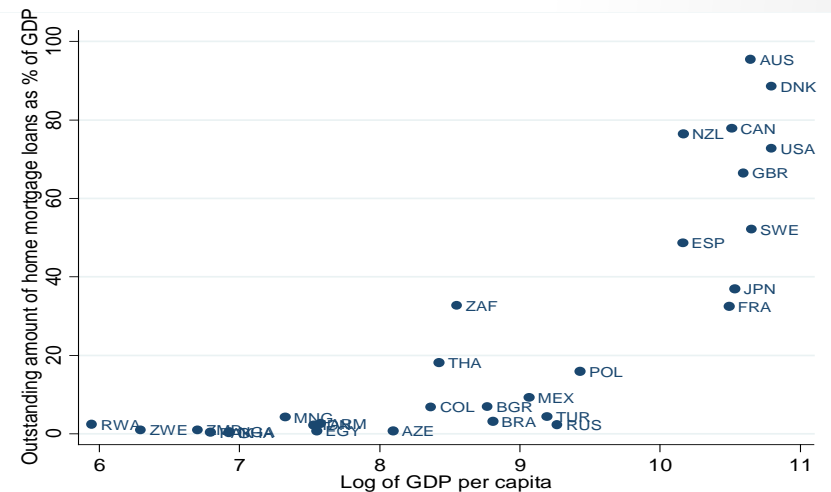
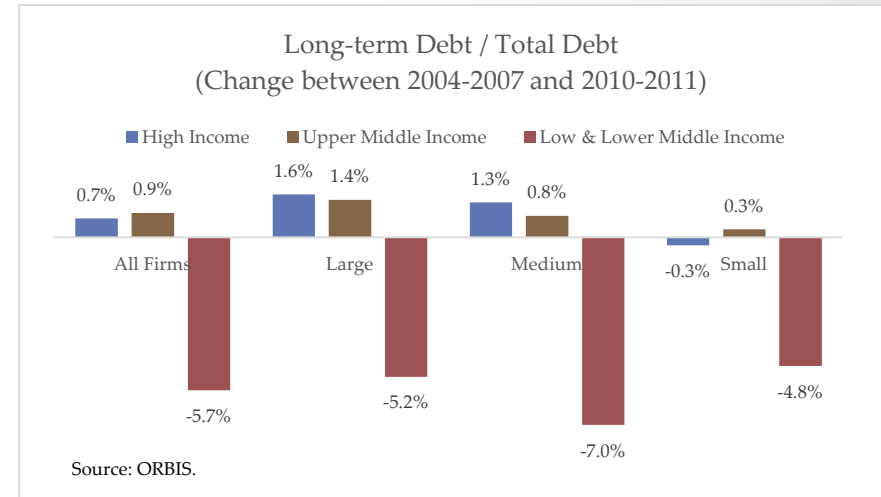
- Essential for investment in fixed assets for development, e.g. roads, railways, schools, power, communications.
- Allows firms to undertake fixed investment at a reasonable cost and minimal roll-over risk.
- Helps raise household welfare by smoothing and improving lifecycle income.
- But overextension of long-term finance could be costly and contribute to instability, especially in weak institutional and policy environments.
- Short-term lending can be valuable and bring scrutiny of firms, in particular when institutions are weak.
- Households may not comprehend complex financial instruments.



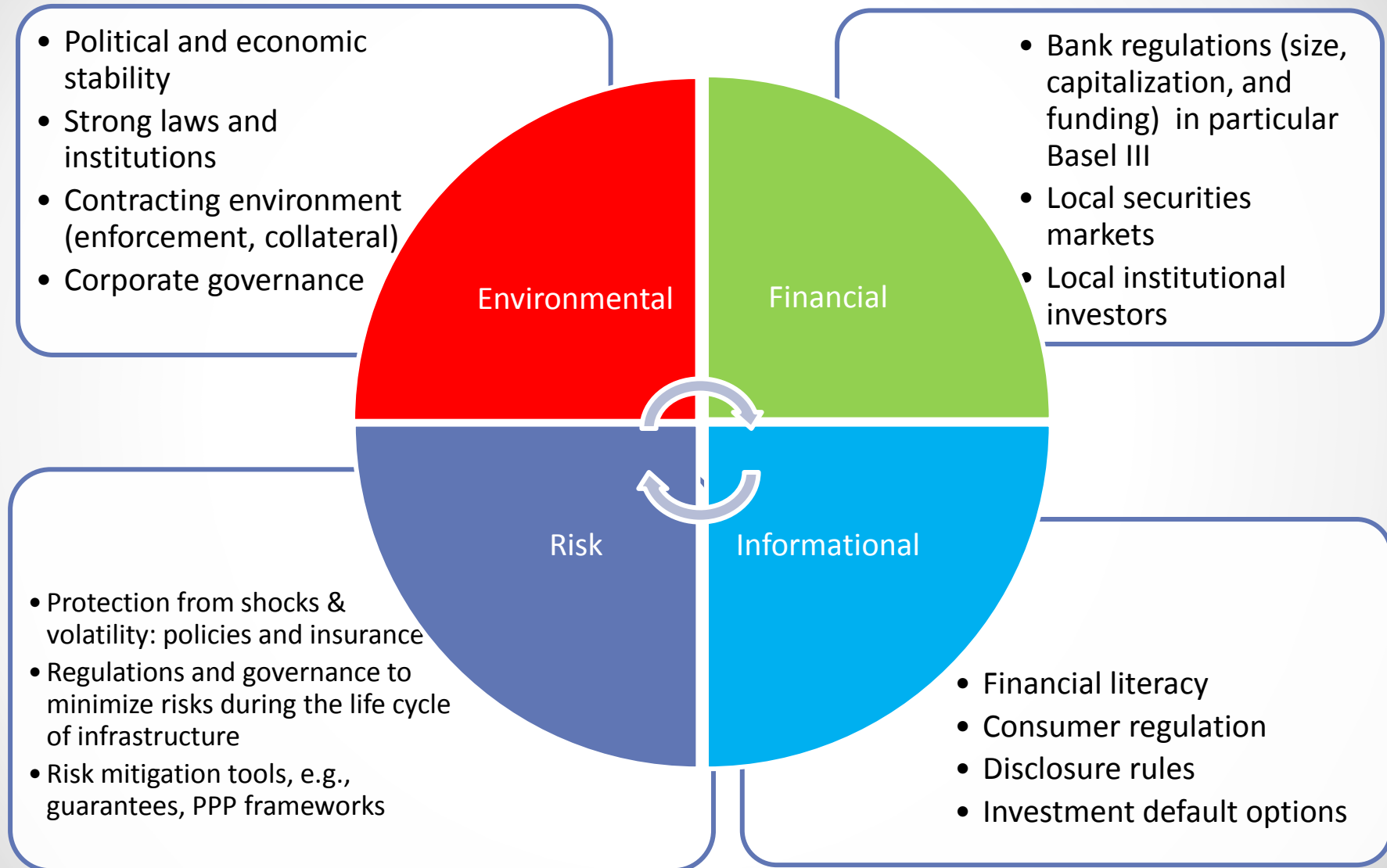


# Long-term Finance Trends

- Securities markets and financial institutions channeling long-term finance from savers to borrowers have developing significantly in advanced and emerging markets for the past decades.
- Since the global financial crisis, firm use of long term debt has declined in low income countries.
- Volumes of syndicated loans have declined since the financial crisis for countries of all income groups, but bond issuances have picked up in emerging markets.
- The use of long term finance by households is higher in more developed countries and in countries that have stable macroeconomic frameworks, low inflation and strong legal and institutional frameworks.



# Policies to Promote Long Term Finance



# Innovative Finance:

## Tailoring Financial Solutions to Development Challenges

### ENHANCING DEVELOPMENT IMPACT

The goals of innovative finance are to:

- 1) Find and multiply new resources,
- 2) Use financing efficiently, and
- 3) Incentivize results and crowd in partners.

- **Additionality – more money for development:**

A financial mechanism or solution is considered additional if it generates a distinctly new flow of funds for a development program or purpose.

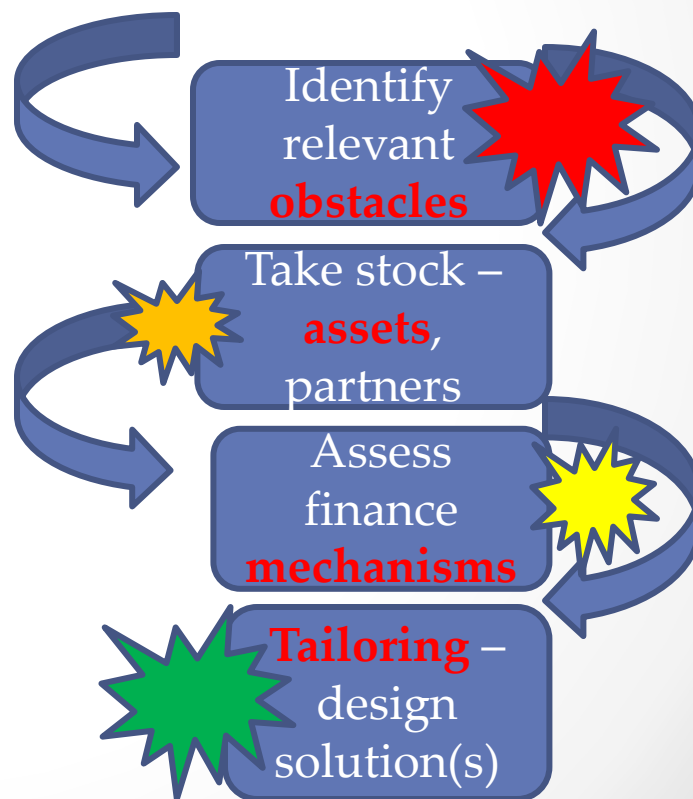
- **Efficiency – structure the money better**

Efficient financial mechanisms are a form of innovative finance that change the fundamental characteristics of cash flows to better align them with the needs of a program. Uncertainty and risk can be reduced by changing the currency of cash flows, the timing of receipts and payments, and/or their reliability or certainty of the cash flows.

- **Effectiveness – more development impact for the money**

Innovative financial mechanisms are effective when available funds are used to i) attract external resources to an initiative beyond those that could simply be purchased with the available funds, and/or ii) increase the purchasing power of the available funds.

### INNOVATIVE FINANCE ROAD MAP



# Innovative Finance Solutions

ADDITIONAL ----- EFFICIENT ----- EFFECTIVE

**LEVERAGING**

**POOLING**

**RIGHT-TIMING**

**RISK  
MANAGEMENT**

**RESULTS-BASED  
FINANCING**

## Instruments

Loan / Guarantee  
contributions

Grants/Payments to  
address externalities  
& incentivize private  
sector engagement

Multi-Donor TFs

Procurement  
Facilities/using scale to  
drive down price

Frontloading

Long-term grants

As-needed: lines of  
credit, bridge  
financing

Insurance (also a  
pooling instrument)

Hedging

Payment for  
Results/Pull  
Mechanisms

Buy-downs

Advance Market  
Commitments

## Examples

Climate Investment  
Funds

AMC for Vaccines

Umbrella Funds

GAVI, AccessRH,  
UNITAID\*

IFFIm

AFD Exogenous  
Shock LoC, Pledge  
Guarantee for  
Health\*

CAT DDO/CCRIF

Weather Derivatives

Currency Swaps

Health Results  
Innovation TF,  
AgResults,  
Prize Competitions

Polio Buy-downs

AMC for Vaccines

# Part VI: Tailoring Solutions for Global and Regional Public Goods

# Global, Regional and Country Strategies for GPG Challenges

- *Defining global public goods*: the global conversation often jumbles public and private goods; local, regional and global goods; public goods and public “bads”; public goods and externalities.
- Traditional guidance – *use public funds for public goods; private funds to support private goods* – is not easily applied. It is hard to measure and value externalities, global benefits/damages. Development challenges comprise both public and private goods, and require both public and private funding.

**Public goods are:**

**“non-rival”** (if I consume a public good this does not prevent you from doing so)

**and**

**“non-excludable”** (I can’t restrict you from consuming a public good)

**FINANCING GOAL should be  
most effective use and leverage of public/grant funding**

# GPG Challenges: Examples

## **Health**

Underinvestment in local, regional and global public goods (preparation, knowledge, surveillance, immunization)

## **Agriculture**

Need to distinguish between farming as a private activity versus AGR R&D as a GPG, externalities (ecosystems services, nutrition)

## **Climate Change –**

Development finance and climate finance are two sides of the same coin: climate change is one of the most significant threats to development



# Framework for Climate-Development Finance

Incidence of benefits of climate action	Local (private and public) good for a developing country	Blended local and global benefits.	Global public good
	<ul style="list-style-type: none"> <li>• Benefits of climate resilient development are local</li> <li>• Climate resilience is equivalent to sound and sustainable development.</li> </ul>	<ul style="list-style-type: none"> <li>• Local benefits also accrue from climate mitigation actions by removing preexisting distortions and improving policies with income</li> </ul>	<ul style="list-style-type: none"> <li>• National returns to climate mitigation actions only if incremental cost of global public goods is covered (and remaining distortions removed)</li> </ul>
Implications for climate and development finance	<ul style="list-style-type: none"> <li>• Climate finance is development finance, goals are aligned</li> </ul>	<ul style="list-style-type: none"> <li>• Climate finance complements development finance</li> </ul>	<ul style="list-style-type: none"> <li>• Development finance becomes climate finance</li> </ul>
Design considerations to enhance impact	<ul style="list-style-type: none"> <li>• Concessional terms for low-income countries</li> <li>• Additional finance for preventive action, institutional development and risk management</li> </ul>	<ul style="list-style-type: none"> <li>• Opportunity to leverage private finance</li> <li>• Local public good justifies co-financing from local public funds</li> <li>• Support for regulatory reforms and institutional strengthening</li> </ul>	<ul style="list-style-type: none"> <li>• Climate finance may be structured as result-based payments to purchase global public goods</li> <li>• Policy conditionality for sustainable outcomes</li> <li>• Strong leverage of local private and public finance</li> </ul>

Alignment of climate and development  
Adaptation and Resilience  
Lower-income countries  
Public finance dominates  
Low conditionality

Need for realignment  
Mitigation  
Higher-income countries  
Private finance dominates  
Strong policy conditionality

# Recommendations: GPG Challenges

- True global public goods – e.g. knowledge, security, global commons, etc – should be handled internationally, cooperatively
- True GPGs need global financial resources: assess existing institutions and global funds and their potential for coordination, collaboration, scale up.
- Exercise caution in establishing new “vertical” funds to address GPGs, since addressing these challenges often requires fundamentally domestic, systemic and multi-sectoral responses.
- Big development challenges mix public-private good and regional/global issues. Continue to get better at coordinated public-private support; keep States first in the driver’s seat domestically while providing support and incentives for coordination.

# Part VII: The MDBs as Partners

# The MDBs as Partners

- Core services
  - Long-term finance for development needs
  - Technical advisory services, including helping to develop measures of development effectiveness, and to adapt global goals into country specific targets, plans, policies and programs.
- Working together to serve clients better
  - Joint analysis, joint analytical work, harmonizing processes? Collaborate on country partnership frameworks, analysis of SDG funding needs?
  - Joint product offers (Trust Funds, co-financing platforms, technical assistance)
  - Capacity building (e.g. statistics)
  - Co-financing operations
  - Joint support to pre-reform initiatives (e.g. public expenditure and financial accountability)
  - Working with the new Banks (e.g. AIIB and NDB)
  - Collaborate on the strengthening and use of country systems
- Expanding services
  - Unique offers based on individual mandates?
  - Leveraging private investment
  - Innovative, customized financial solutions

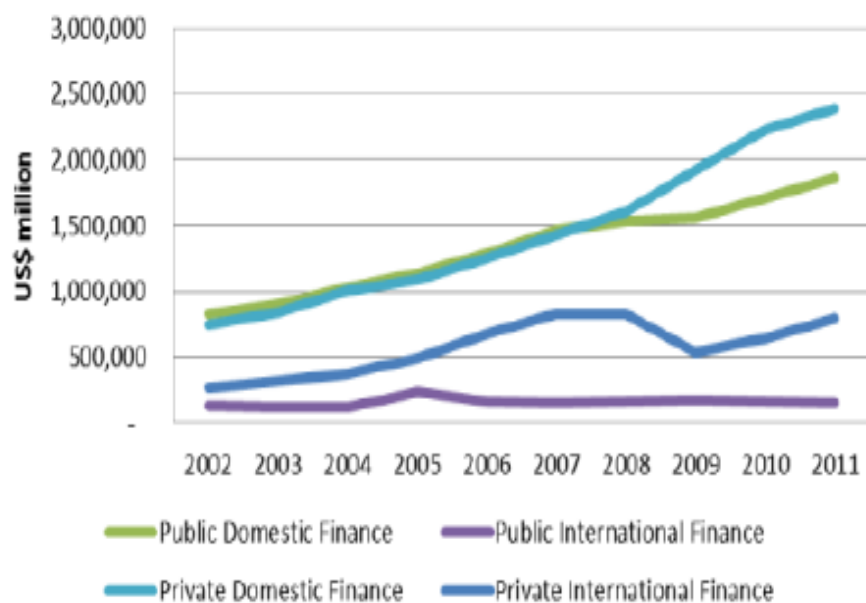
# Timeline



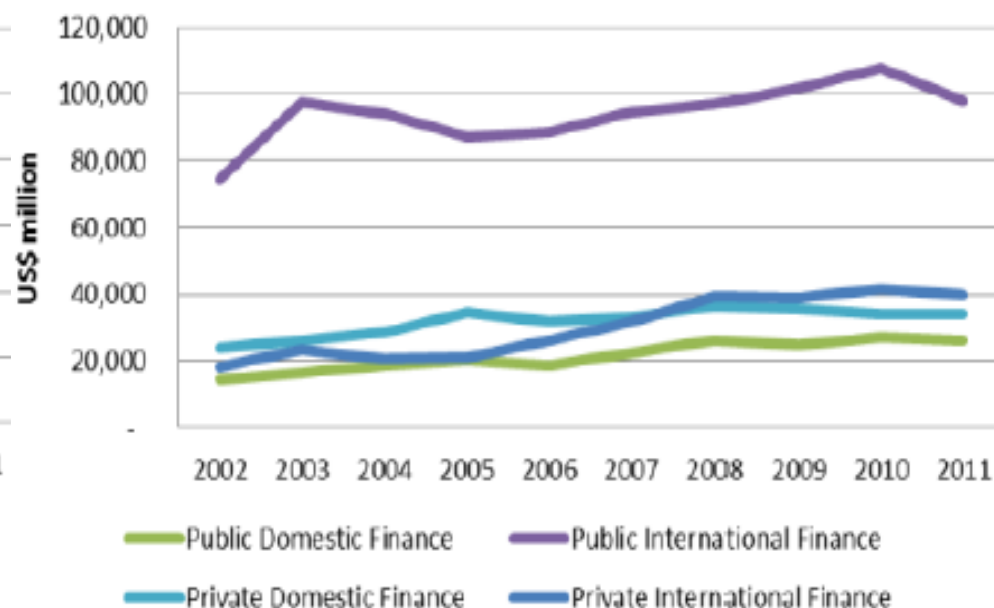
# Additional Slides

# Financing Flows by Type of Finance

**Development finance, all developing countries**



**Development finance, Least Developed Countries**





# Policies to Promote Long Term Financing

- Stable political and macroeconomic environment
- Strong legal and institutional environment
- Attention to the contracting environment, especially framework for collateral, contract enforcement, credit quality information.
- Corporate governance
- Regulations that affect bank size, capitalization, and funding.
- Local securities markets and institutional investors as a complement to the role of the Banking system.
- Foster a domestic base of institutional investors
- Limit the transmission of shocks and volatility in financial markets
- Enhance the availability and use of long term finance by households, e.g. with financial literacy, consumer regulation, disclosure rules and provision of investment default options.
- Regulatory environment to minimize risks at various stages of the production and life cycle of infrastructure assets
- Public sector policies and programs to stimulate the environment for long term private contracts, e.g. guarantees and risk enhancements, PPP frameworks.