Ministerie van Buitenlandse Zaken

Dutch approach to Innovative Financing for Development

policy paper and toolbox

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Foreword

Foreword

It is my pleasure to present this Innovative Financing for Development (IFD) manual. It brings together knowledge available at the Dutch Ministry of Foreign Affairs on how to apply forms of development financing that are different to those that have commonly been used to date.

The idea at the centre of IFD is to deploy public funds to create maximum leverage for private financing to address development challenges. This can often help make funding structures for development sustainable.

The Netherlands has been regularly involved in innovative forms of financing in the past decade, in projects like the Health Insurance Fund and the Currency Exchange (TCX) Fund. This year, based on these and other positive experiences, we have set up a new Dutch Good Growth Fund to help small and medium-sized enterprises with trade and investment in low- and middle-income countries. These innovative forms of financing generate a greater development impact by, for instance, involving more partners or making projects more business-oriented and commercial without sacrificing their development value.

Development impact and innovative forms of cooperation are an essential focus of the Global Partnership for Effective Development Co-operation. GPEDC brings together a wide variety of partners for sustainable development, while IFD facilitates innovative partnerships. By sharing our knowledge and experience, we seek to make GPEDC successful and contribute to the debate on financing the post-2015 sustainable development agenda.

Innovative financing has become integral to of the debate on development cooperation and to our development financing practice. However, I am aware that IFD instruments need to be thoroughly assessed. This manual offers guidelines for assessing new project proposals in terms of IFD and developing ideas further.

I hope you will find this manual useful. All your suggestions for improvement and critical observations are more than welcome.

Lilianne Ploumen
Minister for Foreign Trade and Development Cooperation
The Hague, 10 December 2014

Summary IFD

What is innovative financing for development (IFD)?

1. IFD comprises financial and economic instruments that are common in the business community, but not yet widely applied in or still under development in the context of development cooperation.
2. IFD refers to non-traditional mechanisms for mobilising and spending development funds.
3. IFD is a container concept, in that many different financing mechanisms are seen as innovative.
4. Well-known examples include financial guarantees, equity investments, advanced market commitments and public-private partnerships.
5. IFD has so far made a modest additional contribution to financing for development but this could be increased.

What are the advantages of IFD?

- IFD can enhance development benefits/efficiency by reducing costs and increasing revenue.
- Some forms of IFD can potentially generate substantial additional funds (crowding in): this is important in financing global public goods, including climate and the post-2015 agenda.
- IFD offers an innovative financial and economic toolbox that ties in well with a modern approach to international cooperation. Many development partners are experiencing rapid economic growth and demanding more ownership. IFD offers them the tools to achieve this, while giving them greater responsibility for financing their own development agenda.
- The share of official development assistance (ODA) in the budgets of developing countries is declining. Financial and economic instruments help partner countries deploy their own resources and escape from the traditional donor-recipient relationship.
- IFD can help increase support for development cooperation by making it a provider of effective venture capital rather than what much of the general public sees as a bottomless pit.
- IFD involves non-traditional players (the business community and financial markets) in international cooperation.

How does IFD relate to ODA?

- Not all forms of IFD, for example guarantees on investments, fall under the current definition of ODA. These do, however, use public financing as catalysts to promote market activities.
- At present, the OECD reporting system cannot report on the leverage effect of innovative financing, as some IFD instruments are not considered ODA and are therefore classified as Other Official Flows (OOF). As these instruments are relevant to development, effectiveness and benefits should be the distinguishing criteria, not whether funding qualifies as ODA.
- Individual countries' strategies on using existing IFD instruments and developing new ones are largely determined by the principle of additionality.
- If IFD does fall under ODA, in countries with an ODA ceiling it will be used at the expense of other potential ODA funding. It is thus important to assess in each case whether IFD is more efficient or effective than conventional instruments.
- In 2015, the international community will establish a new definition of ODA. International consensus is required for a new definition offering greater scope for IFD. The Netherlands is playing an active role in this debate.

Does IFD involve any risks?

- Earmarking and conditionality are often inherent to IFD instruments but can make it more difficult for developing countries to acquire ownership. It is important to avoid double conditionality.
- IFD instruments can be pro-cyclical (i.e. they can fluctuate with the overall state of the economy), making it difficult to predict the flow of financing.
- Deploying new IFD instruments can lead to fragmentation and higher transaction costs, resulting in market distortion and higher debt. These and other financial and economic risks should be taken into account when developing new IFD instruments. They are inherent to innovative financing, which after all involves new mechanisms that have often not been previously tested.
- Ownership and coordination are crucial to achieving a sustainable return on innovative investments.
- IFD can be deployed to correct market failure, but care must be taken that IFD itself does not distort the market further.
- Financial and economic instruments are not always suitable for less developed/fragile countries due to their limited capacity to manage funds. Moreover, private investors still have little interest in many of these countries, so that ODA plays an important role.

Assessment framework

IFD should be deployed on the basis of an analysis per country. A thorough assessment framework needs to be developed on the basis of the following criteria:

1. **Catalytic or leverage effect.** How many euros in private investment is each euro of public money expected to generate?
2. **Effectiveness, policy and influence.** Does the instrument help to achieve development objectives more quickly? Can results be measured quickly and properly? Is causality demonstrable or can it be made plausible? Is the instrument in line with the Dutch policy priorities? Can the Netherlands use it to fill a niche? Does it involve new players in development?
3. **Efficiency and additionality.** Are the administrative and other transaction costs acceptable to both donor and partner? How efficient is the mechanism compared with regular forms of development cooperation? Does the instrument release funds which would not normally be available for development objectives, or are the costs simply shifted elsewhere? If the innovative financing instrument focuses on the private sector, is it additional to existing market activity (does it address market failure and not distort the market)?
4. **Risks.** Are the financial risks manageable at acceptable cost? What is the IFD's socioeconomic impact? To what extent is there good financial governance in the countries concerned? What are the consequences for debt sustainability if the instrument consists wholly or partly of loans?
5. **Demand responsiveness and ownership.** Does the instrument respond to the partner's needs and tie in with the partner's policy and administrative systems? Does it guarantee long-term sustainability and self-reliance?
6. **Sustainability and predictability.** Are the results sustainable and can they be achieved independently (i.e. without donor financing) in the longer term? Can the instrument be used elsewhere and eventually rolled out on a large scale? What is the recoverability of the project to be financed? To what extent are there, for instance, reflows which can be re-invested? Are the financing flows generated predictable and stable? Are they procyclical or countercyclical?

Section 1

Innovative Financing for Development

A new perspective on development cooperation

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Timor El-Dardiry
Hans de Voogd

Summary

What is innovative financing for development (IFD)?

1. IFD are financial and economic instruments often known about in the business sector, but not yet widely applied in development cooperation or still in development.
2. IFD is the use of non-traditional mechanisms for mobilising as well as spending resources for development.
3. IFD is a container concept: many types of financing mechanisms are considered to be IFD.
4. Well-known examples: financial guarantees, equity investments, advanced market commitments, public private partnerships.
5. Innovative financing has so far made a modest additional contribution to financing for development but its role can increase.

What possible benefits can IDF have?

- Some IDF mechanisms can achieve more development return, by reducing the costs as well as by increasing the revenue.
- Certain IFD mechanisms can potentially generate a lot of additional funds (crowding in): this is important in connection with financing Global Public Goods, including climate financing and for financing of the post-2015 agenda.
- IFD offers an innovative financial and economic toolset that dovetails well with a modern approach to international cooperation. Many development partners have considerable economic growth and demand more ownership. IFD offers them the instruments with which to build this but also places more responsibility for financing their development agenda with the developing countries themselves.
- Share of ODA in budgets of developing countries is decreasing. Financial and economic instruments give partner countries support in connection with the deployment of their own resources. This supports their exit from the traditional donor-recipient relationship.
- IFD deployment can contribute to increasing the support for development cooperation: developing countries as ‘effective venture investment’ instead of what is indicated by a large part of the general public as a ‘bottomless pit’.
- IFD involves non-traditional players in international cooperation: the business sector and financial markets.

How does IFD relate to the ODA definition?

- Under the current ODA definition not all forms of innovative financing are ODAble, for instance catalytic mechanisms stimulating private market activities by using public involvement such as guarantees on investments.
- For the time being it is not possible for the reporting system of the OECD to report about the leverage effect of innovative financing. The so-called Other Official Flows (OOF) which cover some of these instruments are not considered as ODA but are indeed relevant to development. It should not be the distinguishing criterion for the application: effectiveness and return should be the primary concern.
- The so-called additionality issue determines to a major extent the approach which individual donor countries select with regard to the use of existing IFD instruments and the development of new ones.
- If IFD relates to ODAble expenses, the use of innovative financing in countries with an ODA ceiling will be at the expense of other potential ODA expenses. That is why it should be weighed each time whether IFD expenses are more efficient/more effective than conventional instruments.
- In 2015 the international community will determine a new definition of ODA. International consensus is required for a new definition which offers more scope for IFD. The Netherlands takes an active position in this debate.

Are there any risks?

- Earmarking and conditionality are often inherent to IFD instruments but can render ownership by developing countries more difficult. One should also beware of double conditionality.
- IFD instruments can be pro-cyclical by nature which puts the predictability of the financing flow at stake.
- In deploying new IFD instruments fragmentation and higher transaction costs lie in wait. This may lead to market distortion and/or higher debts. When developing new IFD instruments this should explicitly be taken into account.
- This is inherent to innovative financing: after all it involves new mechanisms often not previously tested. Ownership and coordination are crucial to achieving sustainable return on innovative investments.
- IFD involves financial and economic risks which should be taken into account in developing new instruments.
- IFD can be deployed to correct market failure, whereby care must be taken that IFD itself does not lead to further distortion of the market.
- For poorly developed/fragile countries the deployment of a financial and economic toolset does not always appear to be suitable due to limited capacity in the receiving country to manage funds. Moreover, private financers still have little interest in many of these countries, so that ODA plays a big role here.

There is a need for a weighing framework

- IFO should be deployment on the basis of analysis per country. A sound weighing framework needs to be developed and should include the following criteria:
  1. **Catalytic or leverage effect.** How many euros of private investment is each euro of public money expected to trigger?
  2. **Effectiveness, policy and influence.** Does the instrument help to achieve development objectives more quickly? Can results be measured quickly and properly? Is causality demonstrable or can it be made plausible? Is the instrument in line with the Dutch policy priorities? Can the Netherlands fill a niche with the instrument? Does the instrument involve new players in development?
  3. **Efficiency and additionality.** Are the administrative and other transaction costs acceptable to donor and partner? How efficient is the mechanism compared with regular forms of development cooperation? Does the instrument release resources which would not normally be available for development objectives, or is the burden placed at another level? If the innovative financing instrument is focussed on the private sector: is the instrument additional to existing market activity (does it address market failure and is it not distorting the market)?
  4. **Risks.** Are the financial risks manageable at acceptable cost? What is the socio-economic impact? To what extent is there financial good governance in the respective countries? What are the consequences for debt sustainability if the instrument consists (partly) of loans?
  5. **Demand and ownership.** Is the instrument suitable for the needs of the partner and does the instrument fit into the policy and administrative systems of the partner? Are long-term sustainability and independence guaranteed?
  6. **Sustainability and predictability.** Are the results sustainable and can they be achieved independently in the future (without donor financing)? Can the instrument be repeated elsewhere and (in the end) be launched on a large scale? What is the recoverability of the project to be financed? To what extent are there for instance reflows which can be re-invested? Are the financing flows generated by the instrument predictable and stable? Are they pro- or counter-cyclical by nature?

Introduction

This paper[1] provides an initial assessment and impetus for an overall policy. To this end the following questions have been answered:

- What is Innovative Financing for Development (IFD)?
- How is IFD related to the more traditional forms of development cooperation?
- Does IFD have to form part of the Dutch policy for international cooperation?

The end date for the Millennium Development Goals (MDGs) in 2015 is coming ever closer, whereby it is already clear that many development challenges will still be left over. A major proportion of the goals formulated in 2000 will not be achieved, especially in sub-Saharan Africa. That is why the current international development discourse is often already focussed on the future of development cooperation and on the way in which more financing can be generated for the needs which many developing countries still have. At the same time a debate is raging about the way in which development financing can be deployed more efficiently and effectively. After all, the public support for development cooperation is decreasing in several donor countries and the call for more conditional provision of aid is becoming louder.

On their part many developing countries express dissatisfaction with regard to the - in their eyes - paternalistic attitude of traditional donors and they focus on less conditional financing by BRICS countries. It is also becoming increasingly evident that large quantities of extra money will be required to finance Global Public Goods, in particular climate. Existing and estimated future ODA expenses are insufficient to be able to finance the international agreements. So all countries will have to add more money and financing international cooperation will not consist solely of ODA.

In this international debate about how more and more effective financing for development and global public goods can be organised, the term Innovative Financing for Development (IFD) can be heard more often. This term which emerged for the first time at the UN Monterrey Consensus of 2002 is used for non-conventional forms of financing of development cooperation. Well-known examples in this connection are the Solidarity Levy for Airline Tickets, Advanced Market Commitments, Debt2Health swaps and, in the area of climate financing, the Clean Development Mechanism.

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[1] This paper was written in 2012 as the outcome document of the Innovative Financing for Development project group which was headed by Nicole Bollen. The authors thank Robert Dijksterhuis, David Kuijper, Antonie de Kemp, André Loozekoot , Ronald Siebes, Jacob Waslander and Marijke Wijnroks.

Various IFD mechanisms are already being used in Dutch development cooperation. For instance, the Dutch Ministry of Foreign Affairs supports 'The Currency Exchange Fund' (TCX), a Dutch initiative which protects local entrepreneurs in developing countries against currency risks and Private Infrastructure Development Group (PIDG) which mobilises private investors for infrastructure works in developing countries, whereby each dollar yields more than 30 dollars of private investment. Currently there are a total of 50 Public Private Partnerships (PPP). Not everyone knows that these instruments can be considered as IFD. It is also often not known what others are doing in this area: expertise and experience are not always shared. There is still no overall Dutch policy and assessment framework for IFD. But specifically for PPPs progress has been made in this respect. Examples are PPPs in the food security sector and the water sector with the objective that every euro of public investment mobilises 0.50 euro of private funds. Furthermore, The Netherlands also contributes to the 'International Finance Facility for Immunisation' (IFFIm), with which vaccinations in developing countries can be brought forward.

The paper is set up as follows:

- Chapter 1 describes what IFD entails.
- Chapter 2 describes the advantages of IFD instruments.
- Chapter 3 deals with the position of IFD instruments compared with the current ODA definition of the OECD/DAC.
- Chapter 4 discusses several risks and challenges of IFD and a weighing framework is formulated in this chapter to assess IFD instruments.
- Conclusions and Recommendations
- Sources consulted

This paper was written in 2012 as the outcome document of the Innovative Financing for Development project group which was headed by Nicole Bollen. The authors thank Robert Dijksterhuis, David Kuijper, Antonie de Kemp, André Loozekoot , Ronald Siebes, Jacob Waslander and Marijke Wijnroks.

Chapter 1
What is Innovative Financing for Development?

1.1 IFD: a container concept

Innovative Financing for Development (IFD) is a concept that has emerged since the beginning of the previous decade. The concept was often used to indicate a number of unconventional forms of development financing still very limited at that time. However, the number of IFD instruments increased rapidly and covered a wide range of sectors and sources. As a result, several parties used the term in different ways and over time IFD has grown into a container concept for the deployment of an innovative financial and economic toolset for development cooperation. In this connection it is characteristic that the instruments are often new to development cooperation (or are being re-introduced such as loans), but that comparable forms have already been used much longer in the private sector and in the financial world. In that sense with the emergence of IFD, instruments from the business sector are increasingly being deployed more often in order to achieve development objectives.

There is still no unequivocal international definition of IFD. The UN, OECD, World Bank and the Leading Group on Innovative Financing for Development[2] (LG) all apply a different definition (see Annex I). Because the aim of this paper is to be an initial exploration and to give an impetus to a policy, we chose to use the broad and actual definition of IFD as also applied by the World Bank:

Innovative financing includes non-traditional mechanisms for realising financing for development or offering creative financial solutions for concrete development issues. This innovation can be applicable to the mobilisation of resources as well as to the way in which resources are spent.

This definition enables a wide angle approach to IFD. 'Innovation' can be applicable to the mobilisation of resources as well as to the way in which resources are spent. Innovative financing is opposed to the more traditional financing for development: as an example, the budgetary expenses of established donors or bonds issued by development banks by which gifts or loans are provided (Girishankar, 2009 p. i).

[2] The Leading Group is a platform of 63 member states and observers (low, medium as well as high income countries) of which international organisations as well as NGOs are a member. The aim of the LG is to promote the introduction and definition of mechanisms for innovative financing worldwide. The Netherlands is a member of LG as an observer. The secretariat is placed with the French Ministry of Foreign Affairs in Paris.

Because IFD is a container concept, it is impossible to draw a concrete picture of IFD without looking at the individual instruments and their practical application. That is why Annex II includes a (non-exhaustive) list of IFD instruments applied by the Netherlands; Annex III offers a summary of instruments used internationally.

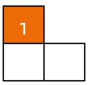
1.2 Categorising IFD

Despite the fact that IFD is a container concept and it is therefore necessary to look at the nature, objectives and the application of the mechanism in order to be able to identify the specific innovative character, IFD instruments can be classified by means of a framework developed by the World Bank (Girishankar, 2009). It classifies IFD instruments on the basis of the financing *source* and its *application*.

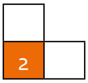
	APPLICATION	
	Public	***Private***
Private	**1.** Public-private mechanisms Private financing for public services and other public functions	**4.** Private financing Initiatives in the market and civil society
SOURCES ***Public***	**2.** International cooperation New financing for development aid	**3.** Catalytic mechanisms Public support of market development

Figure 1: Classification of innovative financing mechanisms

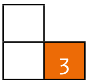
Innovative financing plays a role in the coloured quadrants of the matrix. The quadrant that completely consists of private financing is not taken into account here. This quadrant includes for instance social-ethical investments (impact investment) by private parties.



In the event of public-private partnerships the contribution of the public sector is being used to attract private funding for projects with public objectives such as infrastructural investments and health services. One example of this is the International Finance Facility for Immunisation (IFFIm). The IFFIm issues bonds on the international capital market which are supported by binding commitments of donors over a longer period. Vaccinations can be immediately financed by GAVI with the revenue.



Innovative financing is used to generate new public funding flows for development cooperation, such as a tax which yields earmarked financing for development or climate. Any deployment of so called Other Official Flows (OOF, see also under 3.3) also falls in this quadrant. Examples of this include Debt2Health Swaps, whereby outstanding debts to developing countries are swapped by the respective country for investments in the Global Fund, whereby part of the debt will be acquitted.



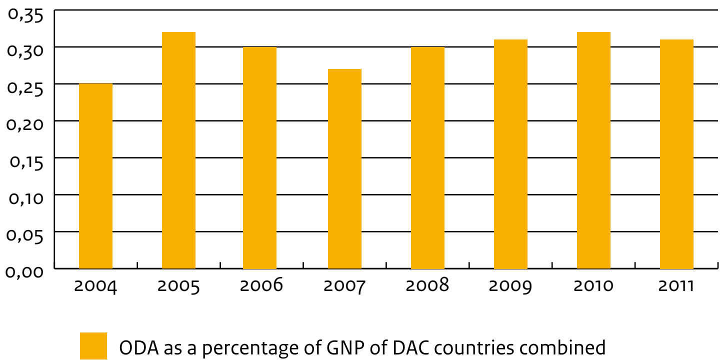
Finally public funding can be deployed for private sector development in developing countries when public resources act as a catalyst to create markets and to encourage private parties to actually access these markets. One example is the issue of guarantees reducing the risk for the private sector so that investments increase. Tax exemptions for certain investments also come to mind. Other examples of such mechanisms are HIF, GAFSP and TCX.

This classification of IFD instruments based on source and application is very important in determining whether the deployment of a certain mechanism qualifies as ODA. It also has an impact on the practicality of the IFD toolset for individual donors. Chapter 3 will give explanations in this connection.

Chapter 2
What benefits does IFD offer?

2.1 IFD can mobilise more money

As a result of the financial and economic crisis and the subsequent cuts, the worldwide volume of net ODA (constant price level) in 2011 decreased by three percent to USD 133.5 billion, or 0.31 percent of the combined GNP of DAC donors (UN MDG Gap Task Force Report 2012). It is the first time for 10 years that the volume of ODA has decreased compared with previous years. The delivery gap between promises and realisation is thereby becoming bigger. The ODA objective of the UN for 2011 was USD 300 billion (0.7 percent GNP of DAC donors), a gap of USD 166.5 billion.



Figuur 2: ODA als percentage bnp van de DAC-landen gecombineerd (berekend met OESO/DAC gegevens 2012)
Figure 2: ODA as a percentage of the GNP of the DAC countries combined (calculated with OECD/DAC data 2012)

The UN has calculated that in order to achieve the MDGs, 0.54 percent of the combined GNP of DAC donors will be necessary in 2015. This means nearly doubling the current level and then other priorities such as banishing poverty and sustainable economic growth of developing countries are still not taken into account. This would require 0.7 percent of the combined GNP as calculated by the Millennium Project Study. So a substantial scaling up of development financing is necessary, also for the financing of international public goods (see 3.4).

At the same time ODA is under pressure in several donor countries because the public support for development cooperation is decreasing partly due to the financial crisis. Developing countries are indicating a large financing need whereas under the pressure of public opinion donors are making the conditions heavier so that less financing is available and it is available less regularly. That is why they obtain financing increasingly from the markets and from the BRICS countries.

Various instruments considered to be IFD might start to play a major role in these financing issues. Proponents of specially earmarked levies have for instance the possibility to collect tens, if not hundreds of billions for development objectives. The levies on CO_2 emissions and a levy on financial and/or currency transactions (FTT/CTT) come to mind. UN/DESA estimates the possible proceeds of such an emission levy at USD 250 billion per annum and the proceeds of a FTT at USD 15-75 billion per annum (UN/DESA 2012, p. vii). However, internationally and also in the Netherlands there are objections to these special purpose levies.

In social sectors such as health, innovative public-private cooperation can also mean a lot. Advanced Market Commitments (AMCs)form a striking example whereby donors encourage the development of new vaccines by means of buying guarantees (if the product meets the requirements with regard to the quality and pricing agreed in advance). So far USD 1.5 billion has been pledged to AMCs. Another example is the APOC Programme supported by the Netherlands where contributions from the business sector (Merck & Co) and donors are placed as a pool in a trust fund with the IBRD/World Bank. For instance, in 2011 the investments of the pooled funds by IBRD yielded about 5.9 million dollars of extra income for the fund.

Yet a *reality check* is in place here. Compared with the claims about potential revenue from IFD concrete innovative mechanisms have so far provided a relatively low financial contribution. The World Bank (Girishankar 2009, p. i) estimates that between 2000 and 2008 innovative financing yielded or channelled over USD 110 billion for development, or about 10% of gross ODA and loans from international financial institutions. UN/DESA estimates the current innovative flows at USD 2 billion per annum at most (UN/DESA, 2012, pp. vii-viii), of which several hundreds of millions are actually additional to the existing ODA. Special levies have until now been more discussed than introduced and earmarking for development objectives is not determined in advance. The most successful initiative, a levy on airline tickets to finance UNITAID is effective in nine countries and yields annually about USD 250 million (UNITAID, 2012).

In conclusion: IFD instruments generating large quantities of extra financing are still in their infancy. The importance of new IFD instruments is expected to increase considering the decreasing share of traditional ODA and the growing need for financing international public goods.

2.2 IFD can increase the return of development cooperation

Apart from helping create new money flows IFD can help finance more development with the same or less money and therefore create a larger (development) return. This is important for donors such as the Netherlands which apply an ODA standard. Because ODAble IFD expenses will partly supplant traditional forms of financing, there should be an added value compared with those regular methods (in order to exceed the so-called *opportunity costs*). Various IFD instruments appear to be able to bring this about.

The net return can be improved in two ways: by reducing the costs and by increasing the revenue. The World Bank (2010, pp. 14-23) has described innovative instruments which use development funds more efficiently. For instance, funds pledged with *frontloading* can be deployed immediately. It applies for instance to vaccinations that a euro which can be used now, has more value than a euro which will be released in five years. Because, in the meantime children can become ill due to infections which can be prevented by vaccinations. Every year 2.5 million children die in low-income countries due to preventable diseases.

Frontloading is impossible with traditional ODA but by issuing bonds on the capital market IFFIm ensures that binding donor pledges over a longer period can be discounted immediately. For instance, on the basis of pledges including by the Netherlands, children can be vaccinated immediately. In this way an estimated 1.4 million deaths due to polio, yellow fever and measles can be prevented by IFFIm providing this aid. *Frontloading* could also offer benefits for education but there are still no initiatives in this category for this sector.

Another initiative encouraging efficiency is the formation of capital markets in local currencies. This will reduce the costs and the exchange rate risks of loans and investments in developing countries which still often have to be transacted in euros and dollars. The World Bank and regional development banks such as the AfDB support bond issues in the local currencies of developing countries. The Netherlands is also active in this area: *The Currency Exchange Fund* (TXC) supported by the Netherlands offers entrepreneurs and banks in developing countries an insurance against the currency rate risk. Innovative instruments can also insure other risks. For instance, in 2006 together with the World Bank and the Ethiopian government WFP established an insurance which makes payments at an early stage to 300,000 Ethiopian farmers in the event of extreme droughts (World Bank, 2010). Such investments are more timely, more efficient and more effective than humanitarian aid because they can help to prevent crises.

The return from the development budget can also be increased by aiming at higher (development) revenue. This is possible via a greater leverage effect especially by mobilising money from the private sector as has already been described above in 2.1. It is also possible to choose a different risk profile for the deployment of financing. It is true that deployment of development cooperation as venture capital involves higher risks compared to traditional aid, but on the other hand it yields a higher return. This requires a certain change of mentality: not every euro will lead to a direct measurable result. Indeed: quite a lot of investments will fail. This is acceptable if the investments that indeed turn out to be successful can compensate for this and, moreover, can be sufficiently scaled up and repeated.

2.3 IFD can improve ownership of developing countries

The effectiveness and sustainability of development cooperation is determined to a major extent by the degree to which partner countries are the owners of their own development strategy (see for instance UNDP, 2012 and the Paris Declaration, 2005). This ownership has also increased in recent years because many of the traditional development partners (in Africa as well as in Asia) have a steady economic growth and because of this increasingly have their own financing and can obtain financing from the markets and non-traditional partners such as the BRICS countries. This causes the ODA share in the budgets and thereby the donor dependence of many development countries to decrease sharply and their self-awareness to increase.

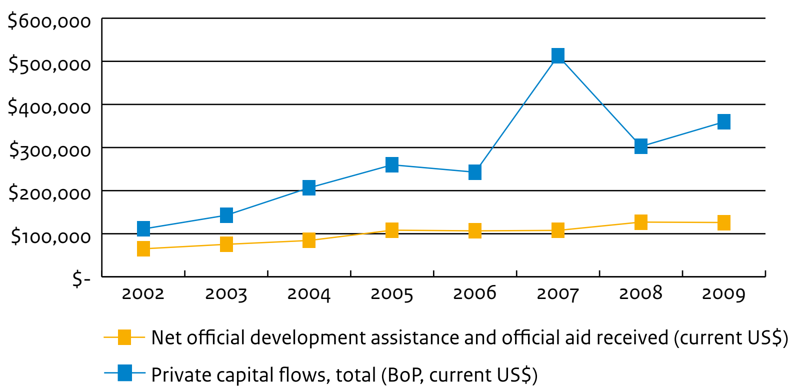
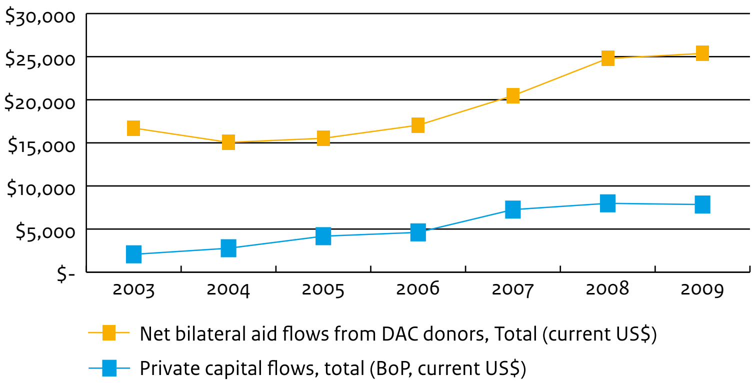


Figure 3: Net ODA flows versus private capital flows in low and medium income countries, 2002-2009, amounts in millions of USD (calculated with World Bank Data 2012)

Aggregated data for low and medium income countries show that private capital flows are increasing compared with ODA. However, it is a different picture for low income countries; ODA still forms a considerably larger amount than private capital flows. The World Bank (2011) worked out in figures that low income countries are still dependent on ODA for 50% of their financial *inflows* (and for 7% of Other Official Flows), whereas only 4% of the *inflows* of medium income countries still consist of ODA (and 5% of OOF).



Figuur 4: Netto ODA-stromen versus private kapitaalstromen in lage inkomenslanden 2002-2009, bedragen in miljarden USD (World Bank Development Indicators 2012)

For the Dutch partner countries that picture looks as follows (data for Palestinian Areas and Southern Sudan are omitted):

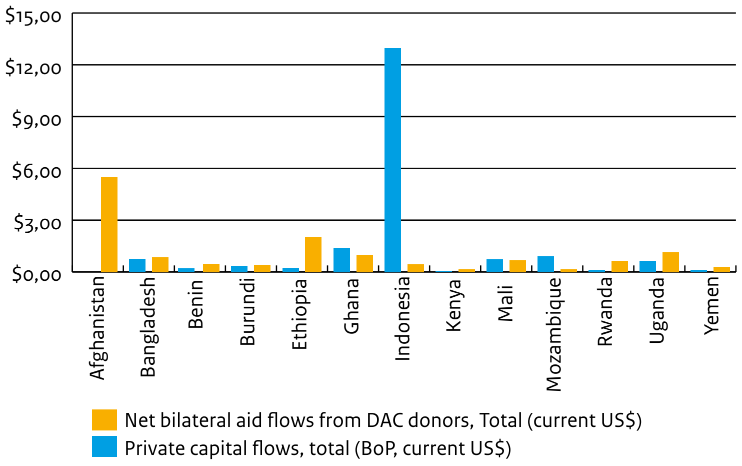


Figure 5: Net ODA flows and private capital flows in Dutch partner countries in 2009, amounts in billions of USD (World Bank Development Indicators 2012)

It appears sensible by means of IFD to join the movement of 'traditional aid' in the form of gifts to the more 'modern investments'. As described above IFD can generate more financing for development and make development cooperation more effective and more efficient. The developing countries themselves are also financially involved with regard to many instruments. The GAVI Alliance requires for instance that receiving countries co-finance by contributing to capacity. In this connection IFD instruments would have to go hand in hand with capacity building in the area of financial and economic management, for instance in the field of public finance management and economic governance. This puts more responsibility on the developing countries themselves for financing their development agenda and for these countries this also forms a healthy incentive to properly manage the available resources, while donors provide financial and economic expertise to help consolidate the investments made by the country. Recent 'cash on delivery' projects are in line with this.

This approach of international cooperation is particularly relevant at the moment for the fast growing low income countries (for instance Ethiopia, Rwanda, Uganda) and the low-medium income countries with which the Netherlands will phase out the bilateral development relationship in the long term or is busy doing so at the moment (for instance Ghana, Zambia) and of which the future commercial interest is increasing. In the high medium income countries the Netherlands has already switched over to the commercial agenda - with the exception of countries with which the Netherlands has a historical and cultural connection. At the same time it is clear that such an approach is not applicable everywhere and not from one day to the next. Many countries lack management capacity and absorption capacity and it may take longer for fragile countries to be ready for a more financial-economic approach. In addition, large income differences and large numbers of the poor will continue to exist in many countries.

At the same time this offers opportunities to innovate the existing toolset. IFD instruments such as Social Cash Transfers come to mind (providing direct benefits to the poorest).

In any case, it is very important that our development partners make a considerable upwards move with public finance management and economic governance in the public sector. After all, the development contribution of donor countries pales in comparison with the enormous amounts which leave the developing countries as 'illicit financial flows' (according to the UN USD 8.4 billion between 2000 and 2009, see UNDP 2012) as a result of corruption, criminality and tax avoidance and the large amount of potential tax revenue (estimated at EUR 200-250 billion per annum, see UN/DESA 2012) which many developing countries omit to collect due to lack of capacity and corruption. In addition, to continue with gifts to sector programmes when developing countries themselves can provide a major contribution to the financing of their own development, is increasingly difficult to sustain.

In this connection it is positive that many development countries themselves express their great interest in the further development of IFD. This is also evident from the fact that more than half the membership of the Leading Group on Innovative Financing for Development consists of developing countries. Developing countries are also well represented in several other forums and boards of organisations involved in innovative financing such as GAVI (developing countries have five seats, as many as donor countries) and the Adaptation Fund (developing countries have over two thirds of the seats) (UNDP, 2012).

2.4 IFD can involve new players in development

Innovative financing can help to involve non-traditional players more directly in international cooperation. This represents a 'buy-in' by new actors, shared interests are created and the theme will more quickly transcend the circle of civil servants and professionals. For instance, the Dutch business sector can become more involved in development cooperation via innovative financing for private sector development.
Apart from this some countries use 'solidarity levies' such as a small tax on airline tickets (for instance France but also several developing countries) and a CO_2 tax earmarked for development (Norway). One of the ideas behind these initiatives is that this makes it immediately clear to people how the revenue from a certain tax is spent.

The Netherlands is already actively seeking cooperation with the business sector. This is for instance taking place in the Public Private Partnership (PPP) area by means of the Expertise Centre for Cooperation with PPPs and the Business Sector. A lot of experience in this was gained in starting up PPPs, scaling up existing PPPs, a dialogue with the private sector, legal forms, training and contacts with Dutch and international knowledge institutions and organisations active in this area. In addition, the Ministry of Foreign Affairs has planned a workshop whereby the business sector and the ministry will analyse the possibilities for further IFD cooperation in the area of PSD.
The most successful innovative financing instruments which have generated a lot of positive attention to date are in the health sector. There is for instance the Health Insurance Fund of which the Netherlands is the initiator, and a new fund, the Dutch Good Growth Fund is in the making.

Moreover, dedicated articles on the vaccination programmes of IFFIm and GAVI (IFFIm, 2012) for instance in The New York Times, Wall Street Journal, Guardian and Financial Times, reached a general public (i.e. the financial sector) traditionally not much involved with development or international cooperation. It is also interesting that on issuing the IFFIm bonds the connection with a development objective appeared to be a bigger explanatory factor for the enormous interest of buyers than the financial instruments per se.

Chapter 3
How does IFD relate to ODA?

3.1 IFD versus the OECD/DAC definition of ODA

Innovative Financing for Development cannot always be fitted easily into the current ODA definition and the current ODA *reporting system* of the OECD-DAC. According to the OECD a money flow is ODAble if there is a donor contribution 1) in the form of a gift or a concessional loan, 2) to a country or organisation on the OECD-DAC list and 3) whereby the expenditure has a development objective. In practice, whether IFD is ODAble is mainly determined by the criteria for the concessional nature of the flow, the characteristics of the flow and the ODAbility of so-called *intermediaries* (ECDPM, 2012). *Intermediaries* are used to absorb the risks of private investments. As long as they are not acknowledged by the OECD/DAC, this will have consequences for the ODAbility of the flow. Private contributions cannot be qualified as ODA either.

There are also tensions with the current OECD/DAC definition of ODA with regard to IFD instruments involving loans. According to the current definition, the criteria for the gift element of development loans imply that a loan is ODAble if it is furnished under more favourable conditions than conditions in line with the market. At least 25 percent of the loan should consist of a gift. This definition is often considered as random and there is discussion about whether in practice loans should always be compared with loans in the market and about how close a loan is allowed to be to the market rate and still be defined as 'favourable'.

For illustration purposes the ODAbility of several existing initiatives has been featured in the table below. Catalytic mechanisms appear particularly difficult to fit in with in the current ODA definition, even though these forms of financing have the potential to generate new financing flows from the private sector which are indeed additional to ODA (*leverage*). However, for now the OECD *reporting system* does not offer any possibility of reporting on the leverage effect.

Table 1: ODAbility of IFD instruments (OECD/DAC 2011, ECDPM 2012)

Category	Name	Initiative	Financial flow	ODAbility
Public-Private Mechanisms	International Finance Facility for Immunisation	IFFIm issues bonds on the international capital market which are supported by binding pledges of donors over a longer period. With the revenue vaccinations can immediately be financed by GAVI.	USD 5.9 billion of pledges at the end of 2010	Official contributions of donors are ODAble at the moment that donors transfer funds to IFFIm.
	Index-based Weather Derivative for Malawi	An option on an index in which rainfall and maize production are linked to each other. When the index drops below 10 percent of the historic average, a payment to the Malawi government will be made so that public services can remain at a certain level. The premium is financed by a donor.	The contract for 2009/2010 covered USD 4.4 million	Payment of the premium by the donor (in this case the UK) is ODAble.
New public financing	Clean Development Mechanism	Countries invest in emission reduction projects in developing countries whereby Certified Emission Reduction credits are achieved. These CERs contribute to achieving the Kyoto target.	USD 25 billion of agreements between 2004 and 2009	Official concessional support for CDM is ODAble but the price for the CERs earned must be deducted from that amount.
	Solidarity Levy for Airline Tickets	Solidarity Levy for Airline Tickets	France: EUR 544 million between 2006 and 2009. Other countries: EUR 29 million between 2006 and 2009	ODAble at the moment the expenses for development cooperation are made.
	Debt2Health	Outstanding debts to developing countries are swapped for investments in the Global Fund by the respective country whereby a part of the debt is acquitted.	EUR 160 million of Debt2Health swaps realised (2010)	The remittance is ODA (debt forgiveness). The debt swap is ODAble. The conversion of the interest is ODAble depending on the origin of the debt (ODA or private).

Category	Name	Initiative	Financial flow	ODAbility
Catalytic Mechanisms		Financial Guarantees	Financial guarantees reducing the risk for private sector investors, can have an impact on the interest that is comparable with a direct interest subsidy. The number of investments is therefore increasing	No aggregated data is available
	Equity investments	Direct investments in companies which are considered by the private sector as too risky (for instance the small and medium enterprises sector)	No data available	ODA performance is net, therefore equity investments press on the ODA performance. An interest of not more than 10 percent can be taken in a business in order to remain ODAble. Dividend is considered as negative ODA.

3.2 Additionality of IFD?

Several organisations (UN, Leading Group) adopt the position that innovative financing should be complementary to existing ODA whereby the resources generated by means of IFD, if they can be registered as ODA according to the DAC, should be additional to the existing flows. The underlying thought is that innovative financing should not detract from the international pursuit of 0.7% ODA.

This so-called *additionality issue* significantly determines the approach which individual donor countries choose to adopt with regard to the use of existing and the development of new IFD instruments. For countries which do not yet meet the international ODA standard of 0.7% GNI, the use of IFD instruments can be attractive if they are covered by the ODA definition. However, this also applies the other way around; if IFD instruments cannot be covered by the current ODA definition, certain donor countries will find it less attractive to develop IFD instruments.

A limited number of countries already meets this 0.7% GNI standard and applies it (or a lower percentage) as an ODA ceiling. Therefore these countries have another incentive: due to the ODA standard ODAble IFD will always replace other ODA expenses. That is why these countries mainly look at the efficiency and effectiveness of these new forms of financing: they must demonstrably lead to better results since they are at the expense of more traditional ODA expenses (Benn et al, 2011, p. 2). In addition, the possibilities are considered in order to release resources elsewhere by means of IFD. This is for instance possible by realising a big leverage effect.

The current objective of the OECD-DAC is to achieve the 0.7% standard for ODA in 2015. It is very doubtful whether this can be achieved. It appears that various donors do not intend to increase their expenditure sharply in order to achieve this standard. However, going past this date could also be a reason to hold the current ODA system up to the light, whereby the current ODA definition could possibly be reviewed in order to create scope for new methods of financing development cooperation. Various options for post 2015 are already being explored, for instance in a report by the ECDPM (2012). Obviously, international consensus is required for a new framework and this discussion will be very much of a political nature; apart from IFD this includes the financing of Global Public Goods such as climate financing (see paragraph 2.4 below) and expenditure for peace and safety. Moreover, the discussion about a new ODA definition is under pressure from the various national interests of the OECD/DAC countries and the emergence of non-traditional donors experiencing difficulties with a framework that has mainly been formulated by Western countries.

This discussion also includes the position of expenses which are strictly speaking not covered by the ODA definition but which are nevertheless development relevant, the so-called Other Official Flows.

3.3 IFD versus OOF

The international process of reviewing the ODA definition is expected to become a complex and probably long-winded process. Nevertheless it appears to be important in connection with an increasing need for and the increasing use in development cooperation of an innovative financial and economic toolset in order to give it a clear and recognised position in the international system. In doing this, the instruments that are demonstrably effective and relevant to development should be particularly considered. The question of how this expenditure is registered by the OECD should really only follow afterwards. After all, if an instrument really contributes demonstrably to development this should be the most important point.

But we are not there yet. At the moment the OECD/DAC, apart from ODA, applies two other categories for financial flows which do not meet the ODA definition but which do have development relevance: Other Official Flows (OOF) and Private Flows (PRIVATE). With a view to innovative financing OOF can be interesting. After all, many IFD instruments are covered by this OOF, but despite their development relevance such expenses are not yet being reported by all donors. However, international agreements about their registration could give insight into which contributions donors provide to development processes in addition to ODA. This could also enhance the deployment and development of IFD instruments.

In the current OECD system OOF are financial flows which only meet the first and second criterion of the ODA definition: this involves transfers (flows) from ODA donors to ODA receivers (authorities or multinational organisations) which do not have social or economic development as their objective and/or are non-concessional. However, the OECD-DAC does not yet offer a possibility to report on the catalytic effect that occurs if the private money flows to developing countries are multiplied by ODA/OOF transfers.

At present the Netherlands does not calculate the total OOF annually being realised from the Netherlands. However, from the point of view of IFD but also from the point of view of the wider discussion about the amount of the Dutch development contribution, this could be interesting: it would create more insight into all the development-relevant expenditure by the Netherlands.

3.4 Global Public Goods and IFD: climate financing

In the discussion about the review of the ODA definition, the additionality issue and OOF versus ODA, the financing of global public goods and in particular climate financing, occupy a special place. After all, existing and estimated future ODA are insufficient to be able to finance the international agreements about climate.

Therefore more money is required from all the countries and financing will not take place only from ODA because global objectives with global application are often involved and it is therefore not only applicable to developing countries.

The financing of global public goods is therefore a subject for international cooperation in a broad sense, and not only in the area of development cooperation to which this paper relates. Nevertheless, due to the potential to generate extra money, innovative financing is expected to play a major role, particularly in the area of climate, and climate financing and development financing cannot be considered independently from each other. This has also become clear from the international discussions about climate financing of recent years: since 2009 climate financing has been high on the international agenda. In 2009 the UN Copenhagen climate change conference pledged an amount of USD 100 billion per annum from 2020 onwards. With these amounts emissions must be reduced (mitigation) in developing countries and emerging markets and countries supported in adjusting to climate change (adaptation). It was agreed in Copenhagen that the USD 100 billion financing would come from public, private and new international sources. It was also agreed in the Copenhagen Accord to accelerate the scaling up of public climate financing to USD 30 billion in the period 2010-2012. The Netherlands contributed EUR 300 million to this.

In the meantime it became apparent from EU reports in 2010 and 2011 that practically all the ODA growth is being deployed as climate financing in order to be able to fulfil the agreements made in Copenhagen. This is happening despite the fact that the European Council indicated in 2009 that climate financing "*shall not undermine or endanger combating poverty and further work on the millennium objectives for development. Innovative financing can play a role in guaranteeing predictable financing flows for sustainable development, particularly to the poorest and most vulnerable countries.*"[3] Therefore in the coming years it is crucial that Europe is committed to finding new sources of climate financing. This can be done by 1) developing other channels for climate financing which do not have to be ODAble per se, 2) by being much more committed to mobilising and leveraging private capital and 3) by playing a pioneering role in the development of new international (market) mechanisms.

An initial step in the discussion about the use of innovative financing sources has already been made by the UN High Level Advisory Group on Climate Change Financing (2010). For instance, one major conclusion was that pricing emissions should be higher up the national and international agendas. That is the most important incentive to offset market failure in the future and to finance effective climate policy. On the one hand because it gives the public and the business sector the right incentive to invest and on the other hand because money will be mobilised that can be deployed to fulfil climate agreements. A good example is the EU emission trading system (ETS). The European ETS Regulation summons member states to use half the auction revenue (or its equivalent) for national and international climate policy.

In addition, climate-relevant investments will increase in the future and Dutch companies are preparing themselves for this growth market. Here synergy is possible between international climate policy and making the economic toolset greener. Major sectors are for instance agro-food, water, energy and construction.

[3] European Council, CONCL3-15265/09, art 23. 30 October 2009

Chapter 4
Risks and challenges in the use of IFD

4.1 Beware of earmarking and too much conditionality

Many current IFD forms are earmarked for a specific purpose: health, climate, private sector development, etc. This is inherent to the setup of these instruments as in the case of *debt swaps* for health or education or in securitisation of donor commitments for vaccines. However, earmarking also restricts the extent to which developing countries can steer their development process (UNDP, 2012 p.29). Moreover, some mechanisms have a 'double conditionality' whereby earmarking as well as conditional payment are applicable. For instance, UN/DESA considers that the vertical health funds involve the risk of making the establishment of properly operating, wide-ranging health systems in developing countries more difficult if the planning is not carried out carefully (UN/DESA 2012, p.124). They can also compete for donor funds for the setup of wide-ranging health systems. However, others disagree with this. Innovation means precisely that you work with other partners outside the traditional group of Western donors. For instance, GAVI and GFATM form a part of the OECD/DAC discussions and are closely connected to the UN system. The coordination with these funds has improved enormously and this decreases the risks identified by UN/DESA.

On the one hand the deployment of IFD instruments will have to coordinate well with the plans and requirements of the developing countries, and on the other hand there should also be a greater responsibility of the countries themselves. In this connection capacity building is crucial (UNDP, 2012, p.33). If donors have sufficient confidence there should also be less conditionality with regard to innovative financing.

4.2 Take the volatility of the economy into account

As mentioned before, IFD can release extra resources for development but there is a risk that the revenue is volatile due to circumstances which development partners cannot influence directly. For instance, the willingness to invest is determined to a high degree by the economy. In other words, innovative instruments can have a pro-cyclical nature: during recessions the financial flows decrease, precisely when the need is the highest. Obviously traditional ODA is also vulnerable to economic fluctuations especially when it is linked to the GNI such as in the Netherlands. However, this does not mean that stability of money flows is a major focus of attention when estimating the value of and developing new financing instruments.

Because of the economic downturn, a pilot for MASSIVEGOOD, a mechanism to enable micro-donations by private persons (UNDP, 2012 p. 34), was terminated in 2011. Another example was the credit assessment of IFFIm which was adjusted downwards by S&P in the beginning of 2012 due to the lower ratings of several big donors (IFFIm, 2012). Because of this IFFIm had to issue bonds on the capital market under less favourable conditions. The revenue of levies also depends on the underlying economic activity. For that matter it is positive in this connection that some IFD instruments are counter-cyclical by nature, such as insurances making payments in the event of extreme drought.

4.3 Cooperation is crucial to combat fragmentation and transaction costs

Fragmentation is partly inherent to innovative financing: after all it involves mechanisms that are new and often not previously tested. Moreover, many of the current IFD instruments are focussed on a certain theme whereby a large number of small projects are supported by a large number of donors but there is still insufficient mutual coordination.

An example of this is the IFD which benefits vertical funds such as GFATM and GAVI which in the past were practically independent of the rest of the aid architecture. Although the initiatives referred to have in the meantime managed to pool their forces better with each other and with other organisations, such fragmentation will remain a challenge to innovative financing. UN/DESA (pp. 95-96) and UNDP (2012, p. 33) are for instance very critical about the large variety of funds for climate financing. UNDP refers to a study which shows that between 2008 and 2010 a new climate fund was established on average every two months.

From the point of view of the receivers there are concerns that the increasing use of innovative mechanisms will burden them with high costs, especially due to fragmentation, reporting requirements and other conditionalities. These so-called transaction costs of innovative development cooperation can be high because the priorities and activities are difficult to synchronise with national programmes (UN/DESA, 2012 p. 120). In addition, various innovative financing mechanisms can each apply their own reporting and monitoring system. Ultimately, high transaction costs are also a disadvantage for donor countries since the return on development cooperation turns out to be less because of this. For the Netherlands the high transaction costs for the donor as well as for the partner country has for instance in the past been one of the reasons to discontinue *debt swaps*. Transaction costs are also important in assessing new international (special purpose) levies. In an economic sense it is more efficient to reserve resources for certain development expenses or global public goods in national budgets than to introduce a specific levy internationally.

It is logical and even sound practice to try out IFD initiatives initially on a small scale. There is a particular challenge at the stage in which successful instruments are scaled up. At that moment it will be important to seek a connection with other donors and existing structures as soon as possible and in an international context. In this respect a forum such as the Leading Group will fulfil a major role: the various development partners in this group will keep each other informed of interesting initiatives which can be applied jointly on a broader scale.

4.4 Financial and economic risks

The use of innovative financing as a catalyst to encourage private investments offers opportunities for a higher development return but this involves financial and economic risks. After all, governments are trying to increase security for private investors in developing countries by undertaking a part of the risk, for instance by issuing guarantees. Donor as well as receiving countries should take this into account. Unless market parties wrongly have the perception that there are high risks, government involvement by means of catalytic mechanisms will always lead to a *shift* of a part of the market risk onto the public sector. Access to new financing sources not always consisting of gifts (ODA) can entail a risk for developing countries in terms of debt sustainability. A lack of international coordination with regard to the various instruments increases this risk. In addition, a large offer of (innovative) financing can lead to non-profitable investments and a reduced willingness to reform (World Bank, 2011 p. 35). In the end this debt sustainability risk also relates to emerging and donor countries, if repayment of loans is at a risk.

4.5 Market distortion

The aim of certain forms of IFD is to correct market failure: for instance, parties are unable to take out sufficient insurance against certain setbacks (such as continuous drought) or the investments by medicine developers are too low due to the low payment capacity of the end users. However, it is important that public involvement is additional to existing markets. If this would not be the case then subsidies, guarantees and the like could lead to undesired market distortion and unfair competition (EL&I, 2012 p.12). Often there will be a trade-off between additionality on the one hand and financial and economic risks on the other. This makes it a challenge to deploy (revolving) market instruments in the poorest countries.

The risk of market distortion also exists with regard to IFD instruments consisting of tax/levies. Earmarked levies by definition distort existing markets, depending on the severity of the tax and the type of activity being taxed. If they are not introduced globally, the taxable activities will (partly) move to countries where the levy is not applicable. This is a real risk for instance for the proposed levy on financial transactions (CPB, 2012 p. 6). In the case of taxing activities which are considered as harmful (such as the production of greenhouse gases) a behaviour-altering effect is obviously exactly what is wanted. However, it is impossible to optimally pursue two different objectives with a single instrument: there will then be a trade-off between the wish to mobilise as much money for development as possible and the wish to discourage harmful behaviour as much as possible.

4.6 Lack of capacity

Innovative financing often includes the use of complex financial instruments. Governments in donor and developing countries do not always have the right in-house expertise to be able to work with this. That is why it is not always possible to offer sufficient counterweight to the professional counterparties in the private sector. This can have consequences for the effectiveness of the instruments but also for the risk allocation between the public and the private sector.

That is why it is important that donor organisations obtain the right in-house financial and economic expertise or engage external organisations that undertake the management and execution of IFD instruments. Building expertise and capacity is also important for developing countries as this increases the participation in and responsibility for the investments made.

4.7 Weighing framework

Chapter 2 discussed the benefits of IFD. Chapter 4 indicated the risks IFD might entail. This makes it possible to formulate a weighing framework that can be used to assess specific IFD instruments. The following questions should be included.

Catalytic or leverage effect. How many euros of private investment is each euro of public money expected to trigger?

Effectiveness, policy and influence. Does the instrument help to achieve development objectives more quickly? Can results be measured quickly and properly? Is causality demonstrable or can it be made plausible? Is the instrument in line with the Dutch policy priorities? Can the Netherlands fill a niche with the instrument? Does the instrument involve new players in development?

Efficiency and additionality. Are the administrative and other transaction costs acceptable to donor and partner? How efficient is the mechanism compared with regular forms of development cooperation? Does the instrument release resources which would not normally be available for development objectives, or is the burden placed at a different level? If the innovative financing instrument is focussed on the private sector: is the instrument additional to existing market activity (does it address market failure and is it not distorting the market)?

Risks. Are the financial risks manageable at acceptable cost? What is the socio-economic impact? To what extent is there financial good governance in the respective countries? What are the consequences for debt sustainability if the instrument consists (partly) of loans?

Demand and ownership. Is the instrument suitable for the needs of the partner and does the instrument fit into the policy and administrative systems of the partner? Are long-term sustainability and independence guaranteed?

Sustainability and predictability. Are the results sustainable and can they be achieved independently in the long term (without donor financing)? Can the instrument be repeated elsewhere and (ultimately) be launched on a large scale? What is the recoverability of the project to be financed? To what extent are there for instance reflows which can be re-invested? Are the financing flows generated by the instrument predictable and stable? Are they pro- or counter-cyclical in nature?

Conclusions and recommendations

Conclusions

It has become clear from this paper that it is difficult to talk unequivocally about IFD since it involves a wide range of financial and economic mechanisms, there is no internationally accepted definition and each instrument has its advantages and disadvantages. In addition, many instruments are known from the business sector but are sometimes new in the context of development cooperation. Moreover, an overall strategic policy for the deployment of IFD has so far been lacking.

Despite these difficulties this paper comes to a positive final opinion: the advantages of the deployment of this type of customised financial and economic toolset alongside more traditional instruments by far outweigh the disadvantages. With many mechanisms more development return/efficiency can be achieved by reducing the costs as well as by increasing the revenue. In addition, certain IFD mechanisms can generate a lot of additional money (crowding in): important in financing Global Public Goods, including climate financing. Moreover, the deployment of this toolset is in line with the requirements of developing countries: more ownership, more financial and economic support, less involvement with traditional DC sectors. What's more, the share of ODA in the budgets of many DC countries has decreased sharply in recent years. The deployment of a financial and economic toolset gives them support in the deployment of their own resources and thereby forms a part of their exit from traditional development relationships. This turns development cooperation into international cooperation. The additional effect of the deployment of IFD can thereby also contribute to increased support for development cooperation: DC as 'effective venture investment' instead of what is indicated by a part of the general public as a 'bottomless pit'. IFD also involves non-traditional players in international development cooperation: the business sector and financial markets.

But caution is required. Considerable disadvantages can be attached to the deployment of IFD. There is for instance a risk of fragmentation and higher transaction costs. This is, however, in a certain sense inherent to innovative financing: after all new and often previously untested mechanisms are involved. In addition, close attention should be paid to financial and economic risks: the deployment of IFD can be volatile and of a pro-cyclical nature, distort the market (a concern present in the business sector) and lead to higher debts. In developing new IFD instruments this should be explicitly taken into account. On top of this, the deployment of a financial and economic toolset for poorly developed and fragile countries does not always appear suitable due to the limited capacity of the receiving country to manage funds. Moreover, a reality check would be in order here: the IFD policy must be further detailed and therefore cannot be applied immediately on a large scale.

With a view to these disadvantages, when deploying the IFD toolset a proper analysis should always be conducted for each instrument into the context in which the instrument is to be deployed and what 'return on investment' is expected compared with possible risks. To this

end a weighing framework can be deployed with which 'quality at entry' of the deployment of IFD mechanisms can be guaranteed.
One difficult point in connection with the deployment of IFD is the relationship to the ODA definition. Not all IFD instruments are covered by the current ODA definition of the OECD/DAC. The deployment of these instruments is usually registered by the OECD/DAC as Other Official Flows. This paper argues that the way in which the OECD registers this should not be the distinguishing criterion for its application: the effectiveness and return should be the primary concern. Moreover, the mechanisms contribute demonstrably to development, for instance due to a leverage effect. In 2015 the international community will determine how development-relevant expenses will be registered in the future. Whether a new ODA definition will be created is still unclear and international consensus is required for a new definition offering more scope for IFD. Due to its many advantages the Netherlands would need to champion a satisfactory system with regard to this type of instrument.

As already indicated in the introduction, the major aim of this paper was to give an initial impetus to the creation of a policy in the area of innovative financing for development (IFD). The authors of this document would like to emphasise here that this paper is only an initial exploration and that much more work is still to be carried out to be able to bring the IFD policy into practice. We advise to develop a toolkit that will support policy officers when they have to advise on giving financial support to innovative financing instruments.

However, we are convinced that more development return and more efficiency can be achieved by the IFD input and that this deployment of financial and economic instruments, including the involvement of the business sector, is in line with a modern approach to international cooperation. That is why we hope that this paper will form a reason for the new Minister of Foreign Trade and Development Cooperation to deploy a strategic IFD policy in the coming period.

Recommendations

- Further detail the IFD policy. Develop an idea of the restrictions along with the opportunities.
- Invest in capacity at the Ministry of Foreign Affairs to coordinate this policy and to set up a Ministry-wide strategy by creating a small team. Ensure that this team pools and expands the expertise already present in the department.
- The deployment of IFD must take place on the basis of an analysis by country, sector and activity, and by means of a sound weighing framework to be developed ('quality at entry'). Major criteria: efficiency, financial and economic risks, socio-economic impact, ownership, effectiveness, economic rate of return, good financial governance.
- The Netherlands should not do this on its own but also seek out cooperation with other donors as well as our development partners. Strengthening international cooperation in connection with the deployment and development of IFD is crucial. In this respect too a lot of experience has been gained in the area of PPPs and the Netherlands already has a recognised pioneering role.
- In the coming period the Netherlands has to take up its position in connection with the international decision about the future of ODA in 2015. In this respect the place of IFD in the future system of development-relevant spending is important. The Netherlands could champion the recognition of the development contribution of IFD.

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Section 2
IFD toolbox

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Introduction to the IFD toolbox

The aim of the toolbox is to help to weigh whether the Dutch government wants to participate in an innovative financing instrument. Although the toolbox is not a formal requirement, it offers tools to help policy makers ask critical questions with regard to an instrument. The toolbox can also be helpful when thinking about a new activity. If a positive opinion is derived from any weighing, the toolbox can also be an aid in connection with thinking about optimisation of the design of the instrument and thereby make the instrument (even) more successful.

In most cases the toolbox will not give an unequivocal answer to the question of whether the Dutch government should or should not financially support an innovative instrument. But the toolbox does help the policy maker in asking the questions which are essential when thinking about this.

The set-up of the toolbox is in line with the format of the Dutch appraisal document, the decision-making memorandum (see figure 1) in order to support the thinking process in connection with the set-up of a decision-making memorandum . An instrument scores on impact, outcome, output and input. With this structure it is important to keep in mind the benchmark: it is all about what the impact of the innovative financing instrument will be compared with doing nothing. ODAble IFD expenditure will replace traditional forms of financing if they have demonstrably added value compared with the traditional approach. So, logically, the benchmark should be the impact of the innovative instrument compared with the traditional ODA. However, because this is not a feasible analysis, the question is asked at the beginning of the toolbox: why has an innovative way of financing been chosen? If a sufficiently clear answer can be formulated to this question, it is assumed that an innovative financing is more suitable than the traditional one and the added value of the innovative instrument can be assessed compared with doing nothing. This added value can occur at three levels: relevance, effectiveness and efficiency, see figure 1.

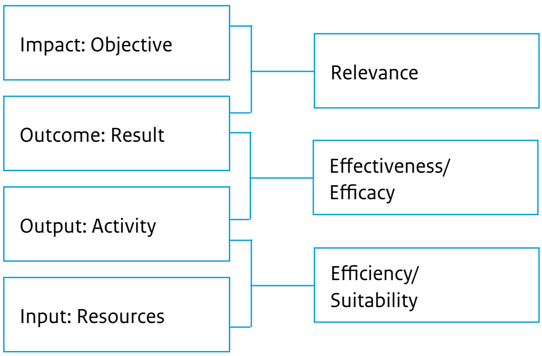

Figure 1: Set-up of the toolbox

The toolbox is a generic framework for all types of innovative financing instruments. In some cases the innovation is in the mobilisation of resources (the income side), in other cases the innovation is in the way of spending (the expenditure side). An example of generating resources in an innovative way is the IFFIm, an example of using resources in an innovative way is the Massif Fund. The source as well as the use of innovative financing instruments can be both public as well as private (see figure 1) and innovative financing can be committed via the bilateral as well as the multilateral channel. This toolbox is applicable to all these forms of innovative financing, although not all questions are applicable to all types of instruments. Which questions are only applicable to specific instruments is clearly indicated in the toolbox.

Throughout the toolbox examples are given of existing innovative financing instruments. Three instruments return regularly. These are instruments in which the Netherlands participates, but which are otherwise very diverse - with regard to set-up as well as to objectives - to give a representative image of how innovative financing can look. These three instruments are explained in the table below. Annex II and III show which donors participate even more in IFD and via which instruments, and what else the Netherlands is doing in the area of IFD.

Instrument	Mechanism	Quantity
International Finance Facility for Immunisation (IFFIm)	The IFFIm mobilises resources by issuing bonds on international capital markets. This enables more development resources to become available in the present. The IFFIm repays the bond holders over a period of not more than 20 years with (legally binding) ODA commitments of donor governments. So this scheme provides a 'buy now, pay later' construction - after all, ODA resources become available sooner. The instrument was established in 2006 by six donor governments (France, Italy, Norway, Spain, United Kingdom, Sweden). The Netherlands, Australia, Brazil and South-Africa joined at a later stage.	*Multinational* Total commitments of the donors: USD 6.4 billion The Netherlands: via GAVI (Global Alliance for Vaccines and Immunisation) EUR 80 million over eight years.
TCX Fund ('first loss' position)	The Currency Exchange Fund (TCX) is the first instrument in the world to offer a solution to exchange rate risks to which local enterprises and financial institutions in developing countries are often exposed. Their local economy is largely financed by euros and dollars whereas their income is in local currency. The Minister of Foreign Affairs supported the Fund with EUR 50 million in a 'first loss' position. TCX generated over USD 700 million for development mainly via financial institutions, but also via private parties including RBS. With these resources the Fund has facilitated over USD 1.5 billion of long-term loans in local currencies since its establishment.	*Bilateral* The Netherlands: EUR 50 million (non-ODA, convertible subordinated loan)
Massif Fund	The Massif Fund was created in 2006 by an amalgamation of three FMO funds and is primarily focussed on financial institutions serving as intermediaries to increase local access to financial service provision. The fund resources are deployed for taking risks which 'FMO-A' - the company limited by shares ('N.V.') without public funds - cannot include in its balance sheet on the basis of its ordinary business operations. Massif offers three categories of financing: equity funding (venture capital, equity capital and mezzanine for taking participations), borrowed capital (credit lines) and guarantees. At the close of 2011 the total size of the Massif Fund amounted to EUR 309 million.	*Bilateral* The Netherlands: EUR 284 million (ODA)

Impact - Object of the Instrument

1. The logic of the intervention

1.1 What is the logic of the instrument's intervention?

Describe the problem with its underlying causes (preferably substantiated by figures on the basis of studies), objective(s) and outcomes of the instrument. Verify whether the objective(s) and outcomes of the instrument offer a solution to the problem identified. On the basis of this analysis determine whether the proposed intervention is logical and whether the instrument is designed thus that it is probable that the foreseen outcomes will actually be achieved.

Logic of the intervention:

High (4) ☐ **Substantial (3)** ☐ **Reasonable (2)** ☐ **Low (1)** ☐ **Hardly (0)** ☐

Explanation:

1.2 Why has an innovative approach been chosen and not a traditional method of financing?

Make it plausible whether traditional ODA can or cannot offer a solution for the problem (as you described above in connection with the logic of the intervention) and if so, why innovative financing has nevertheless been opted for.

Logic of the intervention:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

2. Policy

2.1 Is the instrument in harmony with Dutch policy priorities?

If the answer is in the affirmative, then explain clearly which area(s) of result this instrument is in harmony with, as formulated in the result sheet of the four primary targets.

Yes ☐ No ☐

Explanation:

2.2 Can the Netherlands fill a niche with the instrument?

Yes ☐ No ☐ Explanation:

3. Complementarity

Since the first innovative instruments were introduced a major subject of discussion has been the extent to which IFD is complementary to the already so fragmented aid architecture. This question becomes particularly pressing in sectors where the government itself plays a major implementing role. In these situations fragmentation is a concern for the receiving countries because the costs are high due to reporting and other administrative requirements (see also question 10.1 about transaction costs). Innovative financing can lead to fragmentation: after all, new and often previously untested mechanisms are involved. Moreover, many of the current IFD instruments are focussed on a certain theme whereby a large number of small projects are supported by a large number of donors but there is still insufficient coordination between them. When the Netherlands joins an existing initiative this obviously will not lead to more fragmentation. Fragmentation in the aid architecture is less problematical when sectors are involved which are strongly led by market principles (support of the private sector, agriculture). Markets are by definition fragmented by competition. Innovative financing often uses market mechanisms and establishes links with the market.Complementarity is translated here into the extent to which IFD has a market distorting effect. The concern is also associated with the question of whether there is sufficient government regulation for IFD. It is logical and even sensible initially to try out IFD initiatives on a small scale. The challenge arises particularly at the stage where successful instruments are scaled up. At that moment it is important to seek connection in the international context with other donors and existing structures as soon as possible.

3.1 Is the instrument proportionate to the country's own activities and those of other donors in the respective sector(s) and region(s)?

Illustrative examples:

In the past the GAVI Alliance was practically independent of the rest of the aid architecture. In the meantime the Alliance has become more connected with other organisations.
UN/DESA and UNDP are very critical of the wide range of funds for climate financing. UNDP refers to a study demonstrating that on average between 2008 and 2010 a new climate fund had been established every two months.

Extent of complementarity:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

4. Demand and ownership

The effectiveness and sustainability of development cooperation are determined to a major degree by the extent to which partner countries are owners of their development strategy. Ideally the innovative financing instrument should fit completely into the development strategies of the beneficiary country(ies).

4.1 Does the instrument synchronise with the needs of the beneficiary country(ies)?

Financing coordinates best with the need of the partner when this aid is not earmarked. However, in practice most innovative financing instruments followed the wider ODA trend of earmarking financing, often via vertical funds (vertical funds/vertical programmes/global programmes). These are funds focussed on specific intervention areas such as HIV/aids, malaria or climate change. Earmarking financing can have a negative impact on the implementation and priorities of national development strategies.
The governance structure of the financing instrument is also a major indicator of ownership by the receiving country or of certain representatives of (sub-)sectors in the country. For instance, the structure of the Executive Board of vertical funds has an effect on the policy priorities which are chosen and on the division of the resources.
Make sure that the governance structure of the income generating side can be different from that of the expenditure side.

On the income side decisions are often taken by donors although in a framework of international cooperation. On the expenditure side the vertical funds must be properly analysed.
Finally, it is important to consider whether some stakeholders were from the outset able to participate in the decision-making process in an equal and a genuinely meaningful way. It may be the case that major decisions such as the ones about development priorities have already been taken before some stakeholders are invited to participate.

Illustrative examples:

A wide range of stakeholders is represented in the GAVI alliance. For instance, developed as well as developing countries, research and technical health institutes, the vaccination industry of developed as well as developing countries, independent experts, civil society representatives, the Gates Foundation, UNICEF, WHO and the World Bank are represented on its Board.
UNITAID's executive board consists of 12 members representing the five founders (Brazil, Chile, France, Norway and the United Kingdom), one representative each from Africa and Asia, two civil society representatives, one representative of private foundations and one representative of the WHO.

Extent of synchronisation with the needs of the beneficiary country(ies):

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

4.2 Does the instrument fit in with the policy of the beneficiary country(ies)?

Verify what the development priorities of the respective country(ies) are and whether the instrument coordinates with these. With regard to some instruments countries can register themselves to receive aid via the respective instrument. Make sure that when an instrument uses such a registration process, it does not automatically mean that the instrument coordinates with the policy of the country making the application.
Registration processes are meant to increase the ownership and responsibility of the receiving country for results and to allow projects to fit in with the long-term development objectives of that country. However, registration processes for earmarked financing can be complex and demand too much from governments of developing countries. The result is that some countries use external expertise for such processes and rely heavily on this.

Extent of synchronisation with the policy of the beneficiary country(ies):

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

Outcome - Result and Risk

5. Financial risk management

Financial risk management is a major part of innovative financing. This is because considerable financial risks can be associated with innovative financing instruments. In addition, substantial amounts are often involved. For instance, the contribution by the Netherlands to the Infrastructure Development Fund amounts to EUR 256 million, to IFFIm EUR 80 million and to the Health Insurance Fund (HIF) EUR 100 million.

5.1 Are the financial risks manageable at an acceptable cost and are they budgeted?

Many innovative financing instruments involve financial risks. The exact nature of these financial risks depends on the type of instrument. The diversity of instruments is too great to map the risks for each instrument in this toolbox. However, it is of major importance to carry out such a financial risk analysis for your instrument. Apart from mapping the risks it is also important to make an analysis of the extent that these risks can be mitigated and to verify whether this is budgeted for. It is recommended that these risk analyses are carried out jointly with an expert.

Considerations which are or can be important for the financial risk analysis are:
- What type of financial risk(s) does the instrument have and how great is this risk?
- What is the total risk of the instrument and what is the end date of the risk?
- Are the financial risks sufficiently mitigatable?
- What is the recoverability of the project to be financed? For instance, to what extent are there reflows which can be re-invested?
- Is there sufficient capacity to assess financial and economic risks and to hedge them on the part of the donor as well as on the part of the beneficiary country(ies)?
- To what extent is there financial good governance in the respective countries?

The figure below represents diagrammatically financial risks which often occur in connection with innovative financing for development. The list is not exhaustive. Other financial risks might also be associated with your instrument.

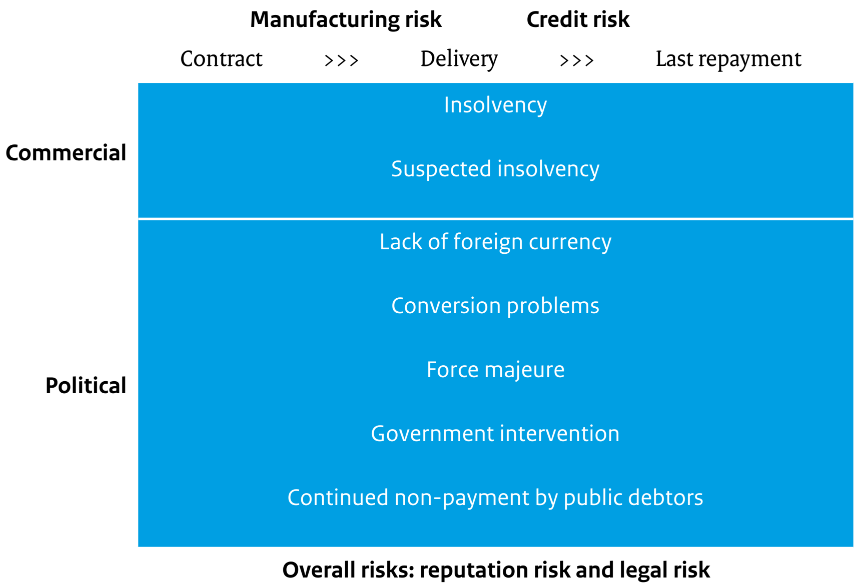

Figure 1: Common financial risks with regard to innovative financing instruments

The figure makes a distinction between commercial and political risks. A commercial risk means a loss caused by the debtor. A political risk is a financial loss caused beyond the debtor. If a risk occurs in the manufacturing period - the period between signing the contract and the delivery of the goods - this is covered by manufacturing risk. If a risk occurs in the period between the delivery of the goods and the final repayment, it is covered by credit risk (also called payment risk). The risks entail the following:

Commercial risks:
- Insolvency: established inability to pay off the debtor, for instance in cases of bankruptcy.
- Suspected insolvency: suspected inability to pay of the debtor. This also includes a refusal by the debtor to pay despite a possible ability to pay. With a poorly developed legal system this is dangerous: there will then be a great risk that pressure cannot be exerted to get money back.

Political risks:
- Lack of foreign currency: these are payment instruments in sound convertible foreign currencies such as euros and American dollars. A lack of foreign currency can arise due to:
  - A moratorium: a general deferment of payment of debts announced by the government of the debtor's country or by the government of another country via which the payment must be made.

  - Transfer problems: the debtor does have the financial means to pay but does not manage to have them paid into a Dutch account. This can be through statutory or administrative measures outside the Netherlands prohibiting local payment. Transfer problems also include the situation in which the transfer of the amounts paid by the debtor is prevented or delayed as a result of political events, economic difficulties or lack of foreign currency.
- Conversion problems: exchange rate risks when the debtor is converting currency x into currency y. Currency x is the local currency, currency y a sound convertible currency such as the euro or American dollar. It could be a payment by the debtor which is sufficient in the local currency but which yields less than the amount of the claim as a result of an exchange rate change in connection with the transfer. There can also be a situation in which the government of the debtor's country applies a conversion rate which is more unfavourable than the reference rate generally applied to conversion of the local currency into a convertible currency.
- Force majeure: the risk that the debtor cannot repay as a result of an occurrence outside the Netherlands for instance war (as well as civil war, revolution, rebellion, terrorism and sabotage), a general strike, a catastrophe (hurricane, earthquake, flooding or other forms of natural disasters), a nuclear disaster or an epidemic.
- Government intervention: the risk that the debtor cannot pay as a result of measures, acts, decisions or omissions by a foreign government. This does not cover a moratorium, transfer problems, conversion problems and force majeure
- Continued non-payment by public debtors: this takes place if the debtor has not yet paid after the date agreed for the last payment and the non-payment is not a result of insolvency, a moratorium, transfer problems, conversion problems, force majeure or government intervention.

In addition, there are overall risks the major ones of which are:
- Reputation risk: this entails what the consequence will be for your reputation if something goes wrong with the instrument. In this connection reason on the basis of the worst case scenario. If something goes wrong will you have a good story for the Lower House? Can you substantiate that all the risks were sufficiently mitigated and therefore were acceptable?
- Legal/contractual risks: both developing countries as well as transitional countries often have a less developed rule of law. Acts are often ambiguous for foreign parties and sometimes intended to be broadly interpreted. It is therefore recommended to obtain legal advice before entering into contracts.

Illustrative examples

- **Catalytic mechanisms:** Government involvement via catalytic mechanisms will always lead to a shift of a part of the risk of the market to the public sector. This also means that revolving funds of a catalytic nature probably cannot keep themselves fully operative with repayments: this is due to the risk that a part of the capital lent will not be repaid and therefore extra payments will have to be made now and then unless bonuses and/or investment returns set this off fully.

- **TCX Fund:** The business of TCX is to hedge conversion risks. The currencies involved can be extremely volatile and therefore be high-risk. TCX mitigated the risks by spreading the risk: the Fund hedges risks for 70 currencies in Northern and sub-Saharan Africa, Eastern Europe, the Middle-East, Central and South-East Asia and Latin America. However, in a market downturn the possibilities of the Fund to manage risks and therefore to avoid losses are very limited.

- **Guarantees:** All guarantees must be budgeted whereby the risk materialising is given a ceiling so that there are no implicit guarantees on the side of the donor as well as on the side of the receiver. Here hidden risks come to mind such as too broad a legal definition of the scope of the guarantees and the frameworks within which these can be invoked.

Extent of mitigatability of the financial risks:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

5.2 What are the consequences for the debt sustainability of the beneficiary country?

This criterion only applies with regard to instruments creating a public loan. They not only relate to a loan whereby the Ministry of Finance of the beneficiary country is involved, but also for instance to a loan to a local authority or a state enterprise. Access to new financing sources, not always consisting of gifts such as in the case of innovative financing, can form a risk to the debt sustainability of developing countries. A lack of international coordination with regard to the various instruments increases this risk. Moreover, a large supply of (innovative) financing can lead to unprofitable investments and reduced willingness to reform.

However, there are also innovative financing instruments which are aimed at improving debt sustainability. Loans in local currency have the aim of hedging the currency risk associated with borrowing in foreign currency. This form of financing is much used by regional development banks. Counter-cyclical loans reduce interest payments when big economic shocks occur.

The use of counter-cyclical loans has until now remained limited to Heavily Indebted Poor Countries (HIPCs). These are countries which have had problems repaying loans.

Illustrative examples

- Diaspora bonds and financing collected via the Eco notes and Green bonds of the World Bank all create a public debt. The conditions for repayment will depend on the market conditions amongst other things.
- Debt swaps (for instance Debt2Health) are designed to support once only projects and in the short term and not to solve problems involving debt sustainability.

Consequences of the instrument for the debt sustainability of the beneficiary country:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

6. Development relevance

The major rationale of innovative financing instruments is that they increase the quantity and quality of development financing. Apart from generating new money flows, IFD can help to finance more development with the same or less money and therefore create a higher (development) return than with traditional instruments.

Regardless of the origin of the financing - whether private or public - all investments will have to generate a certain (development) return. Just as a private party analyses the financial feasibility before making the investment, as a public party you will analyse the social and economic feasibility. Therefore the costs of the instrument must be weighed against the benefits.

The benefits are broken down into four categories: economic relevance, relevance to private sector development, relevance to the poor and women's rights/gender equality, and social and environmental effects. Your instrument does not have to be relevant to all these areas. It is about the instrument having sufficient positive impact on at least one of these areas. Consider further that the instrument should have no negative influence on these areas. For instance, the instrument should meet several environmental standards, even though the instrument is not intended to improve the environment or climate.

Until now for the delivery of resources most of the innovative financing mechanisms have used thematic vertical funds focussed on specific intervention areas such as HIV/aids, malaria or climate change. Therefore innovative financing is usually earmarked for specific objectives. Vertical funds emerged in the nineties and have since then experienced an enormous growth, in quantity as well as in size.

Development results in the health sector are attributed to the possibilities which vertical funds offer. This is concerned with the economies of scale which these funds can develop and with meeting the needs and demand for services in situations where authorities don't have the capacity and/or resources to meet this.
However, earmarking financing, such as by way of vertical funds, is at best only partly effective. Earmarked financing has no effect if the financing in practice is a replacement for financing that the receiving country itself would spend on the respective objective. In addition, earmarking can create rigidity in public spending which leads to allocative inefficiency.

6.1. What is the economic relevance?

Economic benefits relate to all possible impacts on the real income of a country, region or group. Direct (1st order) as well as indirect (2nd order) effects can be distinguished which can differ by country, sector and instrument. The table below gives two examples of possible direct and indirect effects of interventions in various sectors. Ask yourself further how likely it is that the effects will occur. This is particularly important with regard to indirect effects, whereby the extent of development of other factors often also plays a major role.

Project example	Examples of direct effects	Examples of possible indirect effects
New water supply and distribution system in poor regions	Direct and continuous access to clean water. Less illness so that individual productivity increases. Less travel time to collect water.	Development of commercial activities depends on water. Increase in individual productivity is translated into more entrepreneurship. Time gained used to undertake other productive activities.
Vaccination project	Fewer illnesses and deaths. Increase in individual productivity.	Decrease in contamination of other people. Increase in individual productivity is translated into more entrepreneurship.

6.2 What is the relevance for private sector development?

Although private sector development is part of the economic impact analysis, special attention is given to it here. The fact is that a relatively large number of innovative financing instruments are specifically focussed on this. The following can be distinguished as the major obstructions for private sector development in developing countries:

- Lack of market information;
- Lack of legal certainty (for instance ownership rights) and more generally an environment with non-transparent regulation;
- Poorly developed physical infrastructure;
- Limited knowledge and skills;
- Limited access to financial services and (affordable) credit.

If one or more of these obstructions are (partly) addressed, it can have the following effects which contribute to private sector development:

- Higher productivity (for instance by knowledge transfer);
- (Improved) access to new or existing markets;
- Improvement of the entrepreneurial climate.

Sub-score of economic impact and private sector development:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

6.3 What is the pro-poor relevance and the relevance of the instrument to women's rights and gender equality?

An instrument is pro-poor if:

- There is a need for the impact/service amongst poor people.
- The impact/service is disproportionately available to poor people. For instance, if the impact/service is introduced in a region or country where 30% of the population is poor and 50% of the impact/service will benefit poor people, the instrument will be pro-poor. If less than 30% of the impact/service benefits poor people then the instrument is not pro-poor.
- You 'get value for money': this means that the instrument reaches an adequate number of the poor and has an adequate positive impact on their lives in relation to the investment.

Moreover, active promotion of gender equality increases the impact of development interventions. Therefore think about whether the instrument provides mechanisms encouraging equal participation by women as beneficiaries and in the decision-making process. The World Bank has warned that insufficient use of the skills, knowledge and experience of women involves high economic costs. Setting goals for gender equality has a positive effect on the wellbeing of poor households and on the national economy.

Sub-score of pro-poor relevance and relevance for women:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

6.4 What is the social and environmental effect?

If the instrument is not specifically focussed on social or environmental/climate problems, the instrument should at least meet the 'do no harm' principle. This is to say that it should meet the IFC Performance Standards on Environmental and Social Sustainability and the ILO International Labour Standards. If the instrument does not fully meet these standards, sufficient measures must be taken so that it will meet these standards. If the instrument is indeed specifically focussed on improving the social and/or environmental/climate circumstances such as the various climate funds, then not only the 'do no harm' principle but also the demonstrable positive impact on (one of) these components must be met.

Sub-score of social impact and environmental impact:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

Illustrative examples

- GAVI reported that at the end of 2010 it had supported the immunisation of 288 million extra children who otherwise probably would not have been vaccinated. According to GAVI this saved five million lives. Considering the fact that this involves earmarked financing, this means that it should be verified whether without the IFFIm and AMC the governments themselves would actually not have provided (part of) the vaccinations. However, this is often difficult to investigate.

- It has emerged from an evaluation that the development impact of TCX is very positive. This was also plausible when the fund was established. The fact is that the TCX Fund stimulates private sector developments by businesses in developing countries being able to make more long-term investments with the aid of the Fund. TCX also encourages the creation of capital markets in local currency. This enables a decrease in the costs and the currency exchange risks of loans and investments in the respective countries, which loans and investments are still often forced to be transacted in euros and dollars. Finally, it is very probable that the amount of EUR 50 million which the Dutch Ministry of Foreign Affairs placed in the Fund will flow back again to the ministry. So that in the future the 50 million euros can be invested again in international cooperation.

- The assessment of the development relevance of Massif projects is the responsibility of the FMO Supervisor. In this connection FMO considers for instance the economic, social and environmental impact. For each of these dimensions five to nine specific indicators are individually assessed and provided with a score. Due to the diversity of projects eligible for financing from the Massif Fund the impact could not initially be determined. Because of the development relevance tests referred to and applied by FMO it could reasonably be assumed that the impact of the Fund justifies the investments.

What is the development impact of the instrument (average of three sub-scores):

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

7. Additionality and catalytic capacity

In this case additionality means that public involvement is additional to the existing markets and/or that the instrument is market constructive.

7.1 Is the instrument additional to the existing market activity (does it address market failure and will it distort the market and/or have a constructive effect on the market)?

If the instrument is not additional to existing market activity, subsidies, guarantees and the like could lead to undesired market distortion and unfair competition. However, instruments consisting of taxes/levies can also distort the market. Earmarked levies by definition distort existing markets, depending on the severity of the tax and the type of activity being taxed. If they are not globally introduced, the taxable activities will move (partly) to countries where the levy is not applicable. This is a real risk for instance for the proposed levy on financial transactions.

Illustrative examples

- The IFFIm does not distort the market; after all, there is no obligation on private parties to buy IFFIm bonds. In addition, without GAVI the vaccinations would not have been provided by the market.
- One of the objectives of the Massif Fund is to operate additionally on the market. That this does indeed appear to be the case is for instance evident from the fact that the Massif Fund concentrates on investments involving such risks, which pursuant to its Articles the FMO Supervisor is not allowed to finance from its own resources.
- TCX provides its hedging products exclusively for currencies and durations which are not effectively covered by the market. TCX's mandate is not to compete with commercial providers but to contribute to the development of financial markets where they are thin or non-existent.

The extent of additionality to existing market activity:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

7.2 What is the catalytic capacity of the instrument (how many euros of private investments are expected to be generated by each euro of public funds)?

The amount of the catalytic or leverage effect depends on the type of instrument, the investment risks and the availability (and willingness) of private capital in the market in which the instrument is deployed.

Illustrative examples

- The Netherlands has deposited EUR 50 million in TCX with a 'first loss' position. This first loss position was sufficiently risk-mitigating for other investors to join the Fund as well as (mainly international) financial institutions for development and several specialised micro-financing institutions). Due to these investors the resources of the Fund grew to over USD 700 million and since its incorporation in February 2008 TCX has facilitated over USD 1.5 billion long-term loans in local currencies.

- The Public Private Partnership funds for food security and sustainable entrepreneurship (FDOV) and sustainable water (FDW) require a private contribution of at least 40-50%. The Dutch contribution of EUR 130 million has initiated projects to the value of EUR 280 million.

The extent of the catalytic effect:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

7.3 Does the instrument involve new players in development?

Innovative financing can help to involve non-traditional players more directly in international cooperation. In this way there is a 'buy-in' by new actors, shared interests are created and the theme will more quickly transcend the circle of civil servants and professionals. For instance, the Dutch business sector can become more involved in development cooperation via innovative financing for private sector development.
The Netherlands is already actively seeking cooperation with the business sector. This is for instance taking place in the PPP area by means of the Expertise Centre for Cooperation with PPPs and the Business Sector. A lot of experience in this was gained in starting up PPPs, scaling up existing PPPs, a dialogue with the private sector, legal forms, training and contacts with Dutch and international knowledge institutions and organisations active in this area.

Illustrative example

- The New York Times, Wall Street Journal, Guardian and Financial Times dedicated articles on the vaccination programmes of IFFIm and GAVI which reached a general public not traditionally much involved with development cooperation or international cooperation. In this case this was the financial sector. It is also interesting that on issuing the IFFIm bonds the connection with a development objective appeared to be a bigger explanatory factor for the enormous interest of buyers than the financial instrument per se.

The extent of involving new players in development:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

7.4 How is the pricing of services providing the instrument?

If the instrument provides services to private parties in the way that TCX does this, it is important that the prices the parties pay for the services are additional to the market so that any market-distorting elements which might cause displacement are avoided. If there is a market failure, market conformity is not an option and the price of the innovative financing should in the long-term at least cover the costs of the service. Because, if this would not be the case, the instrument will still have a distorting effect on the market. It is important that you consider properly how to ensure that the instrument is competitive.

For instance, the export credit insurance (ECI) covers risks which cannot be insured in the market. Where there is no market there will not be a market price either and thereby also no reference framework. The theoretical price for uninsurable risks can be sky-high. That is why the ECI offers a modelled price with a minimum level, agreed on an OECD basis. It is important that this price makes the ECI cost-covering at least in the long term. This will then be called the price in line with the market.

Finally the subsidy element of the instrument can be considered. In this connection think about questions such as: Are we not giving too much subsidy? Would the instrument work just as well with a lower subsidy? Is the business sector not unnecessarily supported? In order to determine the subsidy element information can be obtained from external experts such as fund managers.

The extent to which pricing is in line with the market:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

8. Financial sustainability

The extent to which the financing instrument is able to generate and provide resources in a stable and predictable way is an essential question. Unpredictable money flows can increase the financial management costs, deteriorate the composition of the investment and strengthen the fiscal effects of the business cycle. For instance, an unexpected deficit in financing often leads to governments moving expenditure of long-term investments to short-term consumption.

8.1 Are the financing flows generated by the instrument predictable and stable?

When determining the score and giving the explanation take the answers to the questions below into consideration.

8.1.1. What uncertainties are attached to the financial flows generated by the instrument?
Some initiatives clearly score better than others with regard to predictability but most remain vulnerable to different forms of uncertainty or shock. Initiatives which are for instance dependent on ongoing donor commitments or top-up rounds (such as IFFIm, AMC etc.), might only be able to generate resources in a predictable way for a certain period (until donors make new commitments with regard to the initiative). No single initiative is completely immune to external shocks. Even initiatives based on tax levies, such as airline ticket tax, are vulnerable to fluctuations in global economic or other circumstances. For instance, passenger transport dropped sharply after the 11 September attacks on the Twin Towers and at the end of 2008 and 2009 when the global financial crisis started to unfold. However, the airline ticket tax and emission trading systems have overall generated more constant and predictable revenue for development than traditional ODA resources.

8.1.2. Are the financing flows generated by the instrument of a pro-cyclical nature and does this form a risk?
Verify whether the resources generated by the instrument will increase/decrease with a growing/shrinking economy. Just like conventional ODA, revenue from innovative financing instruments is often of a pro-cyclical nature - they generate more resources in good economic times than in bad ones. If the resources generated by the instrument are of a pro-cyclical nature, then ask yourself whether this has been taken into account in designing the delivery modality. It might for instance be desirable to adjust the delivery modality so that more financing is made available in difficult economic times and less in good times, therefore providing the financing on a counter-cyclical basis. The predictability of the delivery modality is further dealt with under question 8.2.

Ask yourself whether some instruments are intentionally designed to be of a counter-cyclical nature. One example is counter-cyclical loans. They reduce interest payments if big economic shocks occur.

Illustrative examples

- The predictability of generating resources was presented in a GAVI report from 2011 as one of the benefits of the IFFIm. However, the resources generated by the IFFIm are less predictable than was foreseen when the instrument was set up. This is caused by a dependency on market circumstances at the moment bonds are issued. In addition, IFFIm also depends on the donor commitments but in the event of IFFIm this involves relatively low commitments. Over half the resources have been committed for 20 years and the other part for between 5 and 15 years. All in all the resources which IFFIm generates are sufficiently stable.
  But it should be noted that there is a substantial difference in the quantity of resources generated by IFFIm and the quantity which can be issued by GAVI. This is caused in the first place by the Treasury Management Agreement with the World Bank which prescribes that IFFIm must retain 30.3 percent of the resources as a financial buffer to maintain the credit status (which was unsuccessful). The 69.7 percent then remaining cannot be completely deployed either due to the annual ceilings of IFFIm expenditure. These have been established by donors under the Finance Framework Agreement

- MassiveGood, established in 2010, consisted of a voluntary micro contribution (USD 2 or more) by people making a travel reservation which was paid into the UNITAID fund. However, MassiveGood was discontinued because it generated insufficiently predictable money flows due to the economic and financial crisis.

The extent of stability of financing generated by the instrument:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

8.2 Is the financing provided by the instrument predictable and stable?

If it comes to the predictability of funds it is even more important through which channel the financing is delivered.

Innovative financing is often delivered via vertical programmes. A lot of these programmes work with an allocation process based on results (result-based finance). Their aim is to reward effective deployment of resources by authorities for positive development outcomes and effective use of resources. Examples of such initiatives are the Global Fund, which receives resources via Product (RED) and the Debt2Health initiative. The underlying idea of result-based finance is that it creates incentives for countries to improve their performance. But there are also several risks attached to this form of financing. Firstly, it can reduce the predictability of financing and this undermines its effectiveness. This risk is highest in the poorest countries. Research by the OECD (2010) indicates that in many developing countries - regardless of which sector is involved - result-based finance does not enhance the predictability of the financing. Secondly, this form of financing creates an incentive to report outcomes inaccurately. A third issue with financing based on results is that it raises the question of which performance indicators and development outcomes are most suitable to measure and who decides this. The consequence can be that rendering account is passed on to the donors instead of to the beneficiary country and this is at the expense of ownership. With regard to large instruments it may be the case that a delivery mechanism based on results is unsuitable.

Illustrative example

Statistical material indicates that the delivery of resources by the GAVI Alliance is just somewhat less stable than regular ODA spending. However, there is quite some bias in these measurements. This is firstly caused by the relative short period in which measurements are taken and secondly by the fact that many more projects are financed with regular ODA funds per country so that fluctuations are cancelled out more in the measurements. Moreover, it is important to verify what the reasons are for the fluctuations. In the case of the GAVI Alliance this is often caused by underspending (for instance by delay in a project), which means that there are sufficient resources available to carry out the project. It can also be simply planned that in a certain year no money at all is spent on projects. Finally, GAVI sometimes supports one-off spending resulting in a spending peak. In such cases the volatility in spending has no negative consequences either. All in all, the financing delivered by GAVI is sufficiently stable.

The extent of stability of financing delivered by the instrument:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

9. Sustainability and predictability

A major rationale of innovative financing is that it offers routes to mobilising resources which are (in the long term) not dependent on donors and it thereby realises sustainable development. Sustainability and effectiveness are thereby closely associated with each other.

9.1 Are the results sustainable and can they be achieved independently (without donor financing) in the long term?

Illustrative example

- TCX expects that the contribution of the Netherlands will no longer be needed in the medium-long term. The TCX instrument is unique and initially investors only ventured to join because of the first loss position of the Netherlands. Over five years later it appears that TCX is sufficiently profitable and that the Netherlands' amount of EUR 50 million has not yet been used. This situation is expected to continue and in the future investors will also want to invest in TCX without the donor funds of the Netherlands.

The extent of sustainability results:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

9.2 Does the instrument contribute to capacity building?

Developing local capacity building is essential in order to ensure that results are maintained in the long term. That is why the innovative financing instrument must use as much as possible the systems and resources of the receiving country - manpower, skills, knowledge, technologies and institutions. Autonomous project implementation units must be discouraged. They are often used 'to get the job done'. This ignores national systems and therefore capacity building.

If national systems are not strong enough, it is highly preferable to reform and strengthen them instead of avoiding them. Until now most of the innovative financing mechanisms have not contributed to international commitments to use and strengthen country systems.

Illustrative examples

Some vertical funds nowadays integrate capacity building into their activities. For instance, the GAVI Alliance has invested in health systems. The reason for this is that immunisation cover is often restricted by deficiencies in health systems which are not immunisation specific.

In Benin the government exposed to the Global Fund Programmes the lack of involvement of the Ministry of Health (UNDP Benin 2011).

The extent of contribution to capacity building of the instrument:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

9.3 Can the instrument be repeated elsewhere and (in the end) be launched on a large scale?

The enormous quantity of resources required to finance development and climate issues, ensures that innovative financing instruments with the potential to be launched on a large scale are extra attractive. Some initiatives have clearly more potential in this area than others.

From the initiatives which have been implemented until now it appears that it is difficult to reach international agreement about implementation in a coordinated way.

Coordination often takes years of international negotiations followed by national measures. This means that the implementation of smaller initiatives by individual countries will often only be taken over by like-minded countries.

Illustrative examples

It is not likely that IFFIm will expand considerably. This is partly due to the nature of the mechanism of frontloading resources instead of generating additional resources. In the current economic circumstances donors are unlikely to want to engage in ODA commitments to expand IFFIm considerably. In addition, the IFFIm model is not easily understood by the broader development community and it is vulnerable to financial risks and restrictions (see financial sustainability).

Debt conversions could be introduced in a more systematic way focussed especially on developing countries with the heaviest debt burden. Multi-creditor debt conversions also have potential. However, this type of initiative will probably remain small and serve as an addition to other forms of development cooperation.

The airline ticket tax can be easily introduced by other countries, by developed as well as developing countries.

Diaspora bonds can also be issued in multiple countries.

The extent of potential the instrument has to be launched on a large scale:
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

Output - Instrument

10. Manageability

It generally applies that the more the resources generated by an instrument are earmarked the more management charges there are.

10.1 Do the donor and beneficiary country(ies) have sufficient management capacity?

10.1.1 Does the instrument fit into the administrative systems of the beneficiary country(ies) and are there sufficient financial resources for management?

Until now most innovative financing mechanisms for delivery of resources used thematic vertical funds focussed on specific intervention areas such as HIV/aids, malaria or climate change. This is a form of earmarking expenditure. Earmarking can lead to higher transaction or administrative costs. The fact is that earmarked resources often demand special application, monitoring and reporting mechanisms which are different from the systems applied nationally.

10.1.2 Is there sufficient management knowledge in the donor and beneficiary country(ies)?

Innovative financing often includes the use of complex financial instruments. Authorities do not always have the correct in-house expertise to be able to work with these. That is why sufficient counterweight cannot always be offered to the counterparties in the private sector. This can have consequences for the risk allocation between the private and public sector.

Management capacity of beneficiary country(ies):
High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐
Explanation:

Management capacity of donor:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

10.2 Can results be measured properly?

There are great differences in the measurability of results between different innovative financing instruments. In addition, it should be taken into account that the quality and availability of data can differ from country to country. For instance, in the climate/environment sector the results of vertical funds are often difficult to measure and, moreover, it often takes longer before there are any results. On the other hand in the health sector the results of the vertical funds are often well measurable. The questions below assist in thinking about the measurability of results:

- How is the information obtained which is necessary to be able to carry out the evaluation (periodically and after termination) of the arrangement?
- Can the causality be demonstrated and made plausible? It may be difficult to attribute a development outcome to one specific intervention since that often affects progress (deterioration) in a certain area.
- Does the partner as well as the donor have sufficient capacity for ex-ante (assessment) as well as ex-post (monitoring and evaluation after termination)?

Illustrative example

The GAVI Alliance applies a comprehensive system of indicators for different objectives to monitor the progress of the five-year strategy. It meticulously details how all these indicators are measured, including the strong and weak sides of these measurements.

Extent of measurability of results:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

Input - Resources

11. Efficiency

Efficiency means the quantity of resources deployed to achieve the development objective. More efficient use of resources means that more impact can be achieved with the same quantity or less resources. In this connection resources relate to time as well as money.

11.1 Does the instrument help to achieve development objectives sufficiently quickly?

It is important that the motive of achieving results quickly with innovative financing can be considered in a balanced way. Not all results are quick to bloom. This is certainly relevant in connection with financing based on results or conditional payment. Such an approach will mean payment only takes place when targets agreed in advance have been achieved. This can lead to a focus on 'quick wins' at the expense of longer-term investment challenges.

Illustrative example

GAVI reported that at the end of 2010 it had supported the immunisation of 288 million extra children who otherwise would probably not have been vaccinated. Of the resources deployed by GAVI about one third is derived from innovative financing, namely from IFFIm and AMC. These instruments 'frontload' ODA - that is to say that they make resources available earlier. In the case of vaccination programmes this frontloading can achieve the development objective more quickly. In fact when the immunisation extent is sufficiently high (estimated between 75 and 95 percent), the immunisation not only protects those vaccinated but also people who did not have vaccinations because there are fewer infected people. This is a strong argument for frontloading resources.

Extent of achieving more quickly the development objectives:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

11.2 Are the transaction costs acceptable for the donor and the beneficiary country(ies)?

The transaction costs of large-scale initiatives are generally relatively lower than those of smaller initiatives. Transaction costs for innovative financing can be high because the priorities and activities are difficult to fit in with national programmes (see to this end criterion 4: Demand and ownership).

Transaction costs are also important in assessing new international (special purpose) levies. In an economic sense it is more efficient to reserve resources for certain development expenses or global goods in national budgets than to introduce a special levy internationally.

Illustrative example

For the Netherlands the high transaction costs for the donor as well as the partner country was in the past one of the reasons to discontinue debt swaps.

Extent of acceptable transaction costs:

High (4) ☐ Substantial (3) ☐ Reasonable (2) ☐ Low (1) ☐ Hardly (0) ☐

Explanation:

Annexes

Annex I
IFD Definitions

United Nations (General Meeting, Resolution A/RES/65/146, 4 February 2011)
[I]nnovative mechanisms of financing can make a positive contribution in assisting developing countries in mobilizing additional resources for development on a stable, predictable and voluntary basis; (...) such voluntary 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.

Leading Group on Innovative Financing for Development
Innovative financing is complementary to ODA. [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 globalization (Meimon, 2011).
[Innovative financing mechanisms] are innovative in three ways: (1) their stable and predictable collection mode; (2) they are complementary to ODA; (3) the multilateral management of mobilized resources (LG Secretariaat, 2012).

World Bank (Girishankar, 2009 p. 1)
Any financing approach that helps to:
- Generate additional development funds by tapping new funding sources or by engaging new partners.
- Enhance the efficiency of financial flows, by reducing delivery time and/or costs, especially for emergency needs and in crisis situations.
- Make financial flows more results-oriented, by explicitly linking funding flows to measurable performance on the ground.

Innovative finance refers to a range of non-traditional mechanisms to raise additional funds for development aid through "innovative" projects such as micro-contributions, taxes, public-private partnerships and market-based financial transactions.
Innovative financing involves non-traditional applications of solidarity, PPPs, and catalytic mechanisms that (i) support fund-raising by tapping new sources and engaging investors beyond the financial dimension of transactions, as partners and stakeholders in development; or (ii) deliver financial solutions to development problems on the ground.

OECD (2009)
Mechanisms of raising funds or stimulating actions in support of international development that go beyond traditional spending approaches by either the offical or private sectors, such as: new approaches for pooling private and public revenue streams; new revenue streams; new incentives…we exclude innovative uses of traditional development finance, such as counter-cyclical lending, debt swaps and debt conversions or issuing guarantees to leverage private investment in partner countries. [We also exclude] innovative delivery mechanisms such as "results-based aid" and "cash-on-delivery".

Annex II
Summary (non-exhaustive) of IFD instruments supported by the Netherlands

Facility	Mechanism	Amount	Status
Dutch commitment through the bilateral channel			
Dutch Good Growth Fund (DGGF)	The objective of the Dutch Good Growth Fund (DGGF) is to step up development-related investments in and trade with low- and middle-income countries. To this end, the fund will offer finance to SMEs in low- and middle-income countries (through intermediaries) and to Dutch SMEs. The DGGF will provide financial support in the form of loans, guarantees and equity investments. It will be a revolving fund, aiming for 100% repayment. The fund will actively use local knowledge and expertise at Dutch embassies, Dutch companies operating locally, banks and investment funds, NGOs and research organisations, in order to make a sound, detailed assessment of risks and returns. The extra efforts made to gather knowledge and information will offer more certainty, and allow the fund to work with a different risk profile than private finance providers. Besides investment capital, there will also be funding for technical assistance. This money is intended mainly to help set up investments in new markets and innovative programmes, to reduce the risks of investment and increase returns, for example by offering training of local staff. The DGGF consists of 3 parts: 1. NL Agency will be the fund manager with regard to support for development-related investments by Dutch businesses in low- and middle-income countries. 2. Intermediaries will be brought in to manage the funds available for support for direct investment in SMEs in low- and middle-income countries. These intermediaries will be specialised commercial organisations like investment funds and banks from both the Netherlands and low- and middle-income countries. A fund manager will be appointed from the commercial sector to coordinate this part of the programme. 3. A specialist commercial organisation, Atradius Dutch State Business, will act as fund manager with regard to support for development-related exports by Dutch businesses All activities that are financed from the DGGF must contribute to the development of low- and middle-income countries and must practise corporate social responsibility. Special focus will be on businesses in fragile states, young entrepreneurs and female entrepreneurs.	Total budget is €750 million for 2014-2017. €175 million will be allocated to each part of the fund. The remaining €225 million will be kept separate. Part of this sum will be allocated to the fund managers on the basis of a mid-term review end 2015. Besides the investment capital of €750 million, up to €75 million extra will be made available for technical assistance.	In prepara-tion. Start July 1st 2014.

Facility	Mechanism	Amount	Status
Health Insurance Fund (HIF)/ Investment Fund for Health in Africa (IFHA)/ Medical Credit Fund (subsidised insurance premiums)	A funding mechanism for developing health insurance for people on low incomes or working in the informal sector, and for improving and expanding healthcare capacity. Pharm Access is carrying out the programme for the Health Insurance Fund, in collaboration with local insurance companies. To start with, grants from the HIF will help people in low-income groups to pay their premiums. In tandem with the HIF, which is funded from the public purse, the private sector has set up the Investment Fund for Health in Africa (IFHA). This fund aims to improve quality and reduce costs by investing in various parts of the healthcare chain. Revenue from premiums, partly funded by the HIF, ensures the stable income needed to attract private investment. The Medical Credit Fund (MCF) was also initiated by Pharm Access, and is linked to the above Fund. This facility is a credit fund for self-employed professionals (doctors, pharmacists and so on) in the medical sector. With assistance from the MCF, they gain better access to commercial credit, enabling them to improve and enhance their services. In order to improve the quality of care, standards of quality have been developed with which they must comply before they can obtain credit. The overall concept aims to use public funds to leverage private sector investment. This is the first time that private funds are being invested on such a large scale in health care in Kenya, Nigeria and Tanzania.	Contribution NL government (for HIF): EUR 100 million up to 2013 Investors in IFHA: the first round produced EUR 50 million from, for example, Goldman Sachs, Pfizer, FMO and IFC. Aegon, Achmea, SNS-Reaal, Shell, Unilever and Heineken set up a joint start-up fund which helped enable establishment of the IFHA.	Operational
TCX Fonds ('first loss' position)	The Currency Exchange Fund (TCX) is the first facility in the world to provide a solution to the currency risk to which local entrepreneurs and financial institutions in developing countries are often exposed; their economy is largely funded by dollars and euros, while their revenues are in local currency. Initiated by the Netherlands Development Finance Company (FMO) in 2007, and supported by the Ministry of Foreign Affairs (with a EUR 50 million 'first loss' position) TCX has generated over USD 700 million from development banks and private parties, including ABN AMRO (now RBS) and Oikocredit. With the capital at its disposal, TCX can facilitate long-term loans in local currency worth a total of USD 2 to 3 billion. The fund is active in around 80 countries. For more information, see: https://www.tcxfund.com	Contribution NL government: EUR 50 million (non-ODA, convertible subordinated loan). Contribution Germany: EUR 40 million (convertible subordinated loan through KfW)	Operational

Facility	Mechanism	Amount	Status
TREFI (Capital Tools Company) (Start-up capital and Technical Assistance)	The Capital Tool Company, a private institution, has developed a web-based system that combines credit collection with finance tools, allowing suppliers and financiers to support SMEs. The model is innovative in the way it allows suppliers to extend financing to SMEs at a greatly reduced cost (through a web-based platform). The system also aggregates suppliers' knowledge of their clients, enabling the creation of risk ratings for SMEs, which are then available to other finance providers. The model benefits from a network effect, improving as the number of participating SMEs and suppliers increases. The system currently covers 70,000 SMEs in Peru and is projected to grow to over 250,000 in three years. Being web-based, the model is inherently scalable. This initiative was initially subsidised by the Capacity Development Fund, operated jointly by the Dutch government and the FMO. It was one of the 14 winners of the G20 SME Finance Challenge.	Support NL government: EUR 450,000	Operational
NOTS Microfinance fund (issue of bonds in combination with FMO/IFC guarantee)	An initiative of FMO and the Dutch government to issue bonds for investment in microfinance institutions, with a contribution of EUR 5 million from the Ministry of Foreign Affairs aimed at leveraging five times as much in private investment. NOTS is a structured fund with a first-loss tranche of EUR 5 million, a subordinated tranche (via FMO) of EUR 7 million and a senior tranche of EUR 28 million. Private investors need to be found for this final tranche. Bonds will thus be issued, and NOTS is currently in talks with a number of banks and family foundations. The envisaged EUR 40 million will be invested through Triple Jump in tier 2 and 3 microfinance institutions, mainly in the form of loans.	Contribution NL government: EUR 5 million Contribution FMO: EUR 7 million	Under preparation
FMO Funds	**Infrastructure Development Fund (IDF)** The aim of the Infrastructure Development Fund (IDF) is to encourage the private sector to invest in private or public-private infrastructure projects in developing countries. IDF supports the development and improvement of infrastructure in these countries by providing risk capital (for up to 20 years) in the form of loans, shares, investment in international or multilateral infrastructure funds and development grants (which are converted into shares if the project is successful). The IDF's leverage is EUR 1 to EUR 5.4. The Fund supports infrastructure initiatives such as an irrigation project in Zambia, a municipal solid waste recycling project in Vietnam and a Sudanese water purification facility.	Contribution NL government: EUR 256 million to 2013	Operational
	Access to Energy Fund (AEF) The aim of the AEF is to connect 2.1 million people to modern sources of energy. It provides equity finance and loans for (renewable) energy projects which would not otherwise receive funding owing to investors' perception that the risks are too high. The fund's leverage is comparable to the IDF's	Contribution NL government: EUR 70 million to 2013	Operational

Facility	Mechanism	Amount	Status
Public-Private Partnerships for Renewable Energy	Partnership with Nuon in the **Foundation for Rural Energy Services** (FRES). In this PPP both public and private (Nuon) funds are being used to install solar home systems for the poor in several African countries and to install mini-grids at the village level. The funds should enable FRES to generate more private funds via commercial loans once the PPP has evolved into a viable business model. FRES is innovatieve by involving a private energy company from Europe in renewable energy in Africa, and by supporting energy enterprises in Mali, Uganda and South Africa.	Contribution NL govern-ment: EUR 10 million Contribution Nuon: EUR 9 million	Operational
	In partnership with Philips, public and private funds are used to create distribution channels in Africa for the solar lantern created by Philips. In this way, public funds can give commercial enterprises like Philips an extra push to help them enter a difficult market (Africa) that it did not enter before. This way, the world's largest producer of LEDs becomes involved in developing energy-saving LEDs aimed at the bottom-of-the-pyramid in various countries. The expectation is that Philips will develop a new product which meets rural consumers' and small businesses' needs. Various products exist, yet none of these fully meet consumers' demands in terms of price, quality, ease of use, safety and robustness.	Contribution NL govern-ment: EUR 3 million Contribution Philips: EUR 3 million	Operational
	The ICCO **Fair Climate Fund** (FCF) builds biodigesters in India and South Africa for which it generates Emission Trading Rights (VERs and CERs). These are then sold to or traded with private investors. The revenues flow back into a fund which is used to build new biodigesters. Public funds are used to scale up the total concept of the FCF with commercial loans and are subordinated to security provided by ICCO.	Contribution NL govern-ment: EUR 4.37 million Contribution ICCO: EUR 1.65 million Loan from ING: EUR 4.3 million	Operational
	The **Geothermal Alliance** is currently under preparation. Ten organisations including representatives of the Dutch private sector and Dutch knowledge institutes will support the development of geothermal technology in Indonesia. This PPP encompasses both education and development since it provides specialist courses at Indonesian universities and also helps the government plan and develop geothermal projects .	Contribution NL govern-ment: EUR 6 million	Under preparation

Facility	Mechanism	Amount	Status
Enterprise Challenge Funds for Renewable Energy	A challenge fund is a financial mechanism that allocates funds through public tender procedures to specifically defined themes, countries and organisations. The aim is to develop proper business cases. Here, the target area is the private sector and renewable energy. Applicants receive assistance to develop sound business plans and they have to fund at least 50% of the costs themselves.		
	Daey Ouwens Fund (DOF): The DOF aims to facilitate private sector investment in more widespread access to energy in LDCs by promoting projects related to renewable energy and job creation in the sector energy. DOF supports 29 projects run by various organisations in 17 countries.	Contribution NL govern-ment: EUR 25 million	Operational
	Sustainable Biomass Fund: This fund is similar to DOF and supports investment in the development of sustainable biomass production and trade. It is currently supporting 26 projects in 13 countries.	Contribution NL govern-ment: EUR 17.5 million	Operational
Global Agriculture and Food Security Program, private sector window	The Private Sector Window of GAFSP became operational in 2012 with the aim of funding private sector investments directed to increasing food production and small holders income in IDA-only countries. Six donors have raised $300 million to be used in blended finance operations parallel with IFC's own loan and equity operations for the period 2012-2021. The donor money is used for first loss guarantees, low interest rate loans and advisory activities on a revolving fund basis. The donor money enables IFC to finance loans and equity investments which would otherwise have been too risky for IFC and/or the investor (leveraging factor of the donor money is on average ten).	Total commitment of donors: USD 300 million The Netherlands: USD 140 million.	Operational
IFFIm	The International Finance Facility for Immunisation (IFFIm) is a large-scale advance funding mechanism that uses guaranteed bonds to ensure that around EUR 4 billion will be generated in capital over the next 20 years in order to carry out large-scale immunisation projects through GAVI (Global Alliance for Vaccines and Immunisation). The funds, which are guaranteed by governments/donors, are provided through the capital market by private investors. IFFIm was founded by the UK and France in 2006 to meet the urgent need to vaccinate children and prevent avoidable deaths from immunisable diseases. Many other donors, including the Netherlands, now support this initiative. The Facility entails front loading rather than long-term private investment, since private investors will ultimately be repaid by the public funds pledged.	Total commitment of several donors: USD 6,4 billion The Netherlands: via GAVI (Global Alliance for Vaccines & Immunisa-tion) EUR 80 million over 8 years	Operational

Facility	Mechanism	Amount	Status
Private Infrastructure Development Group (PIDG)	The PIDG is a multilateral infrastructure fund in the form of a trust fund from which various commercial projects and property development companies have been set up. The aim of these model companies is to mobilise private investors to fund infrastructure projects in developing countries. The PIDG works as a catalyst, with every dollar in donor funds generating 30 more in private investment. PIDG supports more than 60 projects. NL was PIDG's biggest donor after the UK in 2009. Examples of PIDG projects include power stations in various African countries, a cold-storage facility for agricultural products in Vietnam and a waste-water project in Egypt.	Contribution NL govern-ment: EUR 69.6 million. Total size of PIDG in 2009: EUR 360.96 million	Operational
EU-Africa Infrastructure Trust Fund	The EU-Africa Infrastructure Trust Fund (ITF) is a multilateral infrastructure fund operated by the EU member states and the European Commission. Its aim is to stimulate regional infrastructure projects in Africa in order to promote regional integration and economic growth. Examples of projects include the interconnection of energy networks in Ethiopia and Kenya, a hydraulic power station serving Senegal and Mali and an East African undersea telecoms cable. The fund uses a 'blending mechanism' which combines donations from the EU donors with long-term loans from the European Investment Bank and other European development banks. Examples of this mechanism include interest donations, funds for Technical Assistance, grants and insurance premiums. This mechanism gives the fund considerable leverage over other financiers since it reduces investment risks. In 2009 the EU-Africa ITF amounted to EUR 170.2 million.	Contribution NL govern-ment: EUR 2 million Total size of fund: EUR 170.2 million	Operational
Dutch commitment through the multilateral channel			
AECF-REACT (Enterprise Challenge Fund)	The African Enterprise Challenge Fund presents an innovative business model and will develop – with a dedicated contribution from the Netherlands – a specific funding window for Mozambique (€10m) on Renewable Energy and Adaptation to Climate Technologies (REACT) as already exists in a number of other East African countries. The Fund targets private-sector energy providers, financial services and agri-business to invest in clean, low-cost energy and climate adaptation technology and supply it to rural farms and businesses that have no access to the grid ('energising the food chain'). REACT could help to finance almost all elements of the supply chain. Financing mechanisms are mostly related to micro-finance systems. Enterprises have to invest 50% themselves. The development of climate insurance packages for agribusinesses is also an innovative element under examination.	Contribution NL govern-ment: EUR 10 million	Under preparation

Facility	Mechanism	Amount	Status
World Bank Forest Carbon Partnership Facility (FCPF)	The Netherlands supports this facility, aimed ultimately at persuading the private sector to purchase credits in the framework of Reducing Emissions from Deforestation and Forest Degradation (REDD). The FCPF is a global partnership focusing on reducing emissions from deforestation and forest degradation, conserving and enhancing forest carbon stock and promoting sustainable management of forests. The FCPF helps tropical and subtropical forest countries develop REDD systems and policies and provides them with performance-based payments for emission reductions. Thirty-seven REDD countries have been selected (14 in Africa, 15 in Latin America and the Caribbean, and eight in Asia and the Pacific).	Contribution NL government: EUR 15 million	Operational/ under preparation
FOM-OS	Financing for SMEs to make investments in developing countries with a development impact possible. No sector requirements but water and food security initiatives are preferred.	Maximum Fund size Euro 55 mln in 2015. Deal size between € 0.5 mln and € 5 mln	
PDPs	Nederland draagt bij aan Publiek Privaat Partnerschap voor productontwikkeling. PDP (PP) is een onafhankelijk wetenschappelijk 'secretariaat' dat namens Nederland en andere donoren de ontwikkeling van nieuwe geneesmiddelen, vaccins of diagnostica coördineert. Het gaat hierbij om producten voor armoede gerelateerde ziekten, waarbij de ' klanten' niet draagkrachtig genoeg zijn om commerciële ontwikkeling aantrekkelijk te maken. Zonder publiek geld zouden deze producten dus niet ontwikkeld worden. De PDPs contracteren onderzoekers en private organisaties, waarbij de toegankelijkheid van nieuwe producten door ontwikkelingslanden wordt gewaarborgd. Omdat de financiële bijdrage van de publieke sector hierbij wordt aangevuld met (soms forse) 'in kind' bijdragen vanuit de private sector kan dit in deze zin worden beschouwd als een innovatief financieringsmechanisme (waarbij additionele middelen van de private sector vrijkomen voor onderzoek naar geneesmiddelen, vaccins en diagnostica voor armoede gerelateerde ziekten).	Van 2006-2009 heeft Nederland € 80.8 miljoen bijgedragen aan een 8-tal PDPs. Voor de periode 2011-2014 heeft Nederland opnieuw € 70 miljoen voor PDPs gecommitteerd. Hiermee behoort Nederland tot de grotere publieke donoren wereldwijd	Operational
Public Private Partnership Facility for Food Security and Sustainable Development	Facility for public private partnerships working on food security issues or stimulating private sector development. First call for ideas launched in April 2012, more than 100 proposals received and currently 36 ideas are being worked out. Subsidy of the ministry is maximum 50 percent of total project budget, 50 percent of the budget needs to be invested by the partners, of which at least 25% needs to be private investment.	First call for ideas EUR 100 mln, min. budget per project EUR 2 mln and max budget EUR 40 mln	Operational

Annex III
Summary of international IFD instruments

Table O.1
Innovative sources of development finance and intermediation

	Description	*Current level of resources (billions of US dollars per year)*	*Approximate potential revenue (billions of US dollars per year)*	*Comment*
		New sources of finance		
Public sector revenue				
European Union Emission Trading Scheme (proceeds from initial allocations)	EU Governments auction: sell or allocate permits for emission allowances	0.2	1-5	Germany has agreed to allocate 15 per cent to international climate finance. The proportion for other countries is not specified Financing is additional to existing ODA
Proceeds from certified emission reduction (CER) trading (2 per cent tax on new issuance)	2 per cent tax on CERs under the Clean Development Mechanism	0.06	0.06-0.75	Additional financing for climate adaptation in developing countries
Solidarity levy on airline taxes	Small tax levied on airline tickets, proceeds earmarked for UNITAID	0.2	1-10	$1.0 billion was raised between 2006 and 2010. Although financing is additional to existing ODA it is still accounted for as ODA by Development Assistance Committee members
Norway's tax on CO_2 emissions from aviation fuel	Tax on CO_2 emissions from aviation fuel in Norway	0.02	0.02	Norway contributes a portion of the proceeds of a tax on CO_2 emissions from aviation fuels to UNITAID
Carbon tax (proposal)	Tax on use of fossil fuels and other products contributing to CO_2 emissions	-	250	A tax of $25 per ton of CO_2 emissions by developed countries. Allocation of revenue for international climate financing would likely require an international agreement. Financing is additional to existing ODA
Currency transaction tax (CTT) (proposal)	Tiny tax on major currency foreign-exchange transactions	-	40	Assumes 0.005 per cent tax. Revenue would be additional to existing ODA
Financial transaction tax (FTT) (proposal)	Tax on financial trans-actions, such as equity trades, bonds and derivatives. Includes CTTs	-	15-75 (excluding taxes on currencies)	A European Union FTT could raise €55 billion per year (excluding taxes on currencies), although it is unclear how much will go to development. Revenue would be additional to existing ODA
International billionaire's tax (proposal)	Tax of 1 per cent on individual wealth holdings of $1 billion or more	-	40-50	Proposal is not yet in any international agenda. Revenue would be additional to existing ODA
Capturing global resources				
New SDR issuance (proposal)	Regular annual allocations in favour of developing countries	-	160-270	Additional international liquidity would increase reserve availability and, while not a form of development financing, would free up domestic resources for development
Leveraging SDRs (proposal)	Idle SDR holdings of reserve-rich countries are leveraged for investment in development	-	100	Assumes $100 billion of annual allocation to developed countries would be made available to international financial institutions in a way that preserves their status as reserve asset

(cont'd)

Table O.1 (cont'd)

	Description	Current level of resources (billions of US dollars per year)	Approximate potential revenue (billions of US dollars per year)	Comment
		Intermediate financing mechanisms		
Capturing global resources				
Ownership of global resources (proposal)	Charge royalties for natural resource extraction beyond 100-mile exclusive economic zones	-	Unclear	Requires agreement on regimes for managing global commons, such as the International Seabed Authority. Revenue would be additional to existing ODA
Mechanisms that restructure cash flows				
International Finance Facility for Immunisation (IFFIm)	Future aid flows securitized to front-load resources to finance GAVI Alliance	0.6	0.6	Between 2006 and 2011, IFFIm raised $3.6 billion on the basis of donor commitments of $6.3 billion. IFFIm restructures existing ODA and as a result is not additional
Debt2Health	Donors grant debt relief in exchange for a commitment by the debtor to invest half of the debt relief in Global Fund local programmes	0.02	Limited scalability	Between 2007 and 2011, Debt2Health deals worth €170.2 million were concluded, one half of which countries contributed to the Global Fund. This is additional to existing ODA for countries that are current on their debt payments
Debt-for-nature swaps	Debt relief in exchange for local investments in the environment	0.05	Limited scalability	Has raised an estimated $1.1 billion-$1.5 billion since the late 1980s. This is additional to existing ODA for countries that are current on their debt payments
Mechanisms to manage risk				
Pilot advance market commitment for vaccines	Guaranteed future donor co-payments for vaccines	0.5	1.5 (committed)	Financing comes out of ODA budgets with small amount of additional financing provided by the Gates Foundation
Affordable Medicines Facility - malaria (AMFm)	A subsidy to drug manufacturers of malaria therapies (artemisinin-based combination therapies (ACTs))	0.2	Limited scalability	About half the financing comes from UNITAID. Based on the composition of UNITAID financing, in total, half of AMFm financing is from traditional ODA, 40 per cent from innovative financing and 10 per cent from philanthropy
Caribbean Catastrophe Risk Insurance Facility (CCRIF)	A regional catastrophe insurance pool	0	0.068	Donor countries and the World Bank capitalized the insurance fund. Initial payments came out of ODA budgets
Mechanisms that leverage citizen or private sector resources				
Product Red	A brand licensed to private firms	0.04	Limited scalability	Raises funds for the Global Fund. Financing comes from participating companies and is additional to ODA

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