Briefing Document

Innovative Financing Mechanisms for Sustainable Development

Wednesday, 2 April 2014, 14:00 – 16:00 (followed by an Aperitif)

SDC, Freiburgstrasse 130, Bern (Room A2023)

Context: From eradicating poverty to sustainable development: the provision of a coherent overall financing framework integrating all three dimensions of sustainable development – social, economic and environmental – has emerged as a central issue in the post-2015 discussion.[1] In this context, there is growing consensus on the need to mobilise financing for sustainable development from public and private, domestic and international sources. This traverse event will focus on the potential contribution of innovative mechanisms in this regard.

Needs: What does the implementation of such a sustainable development framework cost? There have not been any systematic assessments of post-2015 development financing needs. However, the UNTT Working Group on Sustainable Development Financing's report (2013) has compiled a range of best available sector estimates. Unsurprisingly, estimates of financing needs are enormous across all sectors.[2] As the needs are huge, there is space for every actor and financial source to contribute to this endeavour.

Terminology: There is no universally agreed definition of "innovative financing mechanisms". The European Commission (2012) distinguishes between a) funding sources and b) mechanisms:

a) The term initially referred to new *sources* of development financing that could complement official development assistance (ODA) in a stable and predictable way (e.g. airline ticket tax, financial transaction tax).

b) The definition has progressively been expanded to include innovative financial mechanisms aimed at enhancing the impact, effectiveness and efficiency of development finance. Innovative financing mechanisms are, thus, *funds and instruments* that are designed and run by donors to have a leveraging or catalysing effect by *providing part of the total requisite funding as ODA* (e.g. through using loans, equity investment, mezzanine finance or guarantees) in order *to attract additional funding*, notably from private companies, to invest in projects and initiatives in developing countries with explicit development impact objectives. Beyond financial leverage and risk sharing, the private sector can add value by providing its expertise and technical know-how thus realising efficiency gains and long-term growth. Thus, such engagement of the private sector for development requires ODA to be spent smarter to foster such leverage effects and efficiency gains. These are "innovative" mechanisms because they differ from traditional donor approaches.

Donor countries' approach to innovative mechanisms: Comparing strategies and instruments applied by the EU, Germany, Sweden and the UK to use ODA in order to leverage additional private sector funding by using innovative mechanism illustrates the following patterns (ECDPM study on behalf of SDC): Donors appear to agree on the objective of using ODA to catalyse private sector finance (i.e. recognise the potential additionality of private investment leveraged through ODA), they all use standardised frameworks to assess and evaluate investment projects at their inception and can furthermore demonstrate some measure of leverage. However, they do not (yet) have common or clear strategies for this type of ODA spending, nor developed systems to measure amounts invested or, crucially, assess the development results and impact of these projects. The development impact of investment projects by bilateral donors is generally

[1] UN High Level Panel Report (2013); Outcome Document of the special event of MDG follow up (A/68/L.4); Secretary General report "A life of dignity for all"(2013)

[2] Examples for *annual* investment requirements of up to 100bn$ each for oceans, forests, universal energy access, land and agriculture; 1000bn$ both for climate change mitigation or non-energy infrastructure; 80-300bn $ for the MDGs (UNTT); 5.7trillion$ for a low carbon economy (WEF, 2013)

measured according to the number of jobs created, tax and export earnings raised or reductions in emissions on a case-by-case basis. While these are important proxies for impact on wider development goals, investments projects' contribution to broader poverty reduction and sustainable development is implied rather than demonstrated. Moreover, the additionality of ODA provided, as in facilitating new or pioneer projects, is an opportunity as much as a continuing challenge: are projects funded that would have taken place anyway (are they subsidised) or are private investors discouraged to enter the market owing to the presence of a foreign donor (crowding-out effect)?[3] If there is no additionality there is no development impact. Most of the innovative financing mechanisms assume commercial viability over time and build on the notion that the current perceived risk is higher than the actual risk. Innovative financing mechanisms while successful in leveraging money have yet to prove successful results and exits.

Developing countries' perspectives: Virtually without exception, developing countries are keen to attract private investments as important drivers of efforts to transform their economies, create decent jobs and achieve inclusive, sustainable growth. For example, in 2007 Ghana, Gabon and Senegal (2009, 2011) succeeded in raising funds on private capital markets. However, most developing countries, in particular least developed (LDCs) and fragile countries, have no access to such markets or other flows of private investment (ECDPM, OECD). Commercial, political and juridical risks tend to prevent the private sector from investing in development-relevant projects in developing countries. Nevertheless, an OECD (2014) study on lower middle income countries such as Ghana, Senegal and Timor-Leste illustrates that they welcome more and diversified sources and financial instruments. However, it seems difficult to align such (private) investments to the national development strategy, to ensure transparency and accountability of the different flows, and to guarantee private flows' development impact.

Relevance to Swiss development cooperation: Fostering private and financial sector development can generate significant resources for sustainable development: income for the people and revenues for the state. The SDC and SECO have long-standing experience in this regard. Grant-based ODA remains the main instrument in Swiss development cooperation. Innovative financing mechanisms are applied on a small scale: an example of leveraging private capital flows where commercial investors are unprepared to act alone is the Swiss Investment Fund for Emerging Market SIFEM (for more examples of innovative mechanisms, see Annex). Looking at the future it is worth continuing to examine ways of such "smart" use of ODA to leverage additional resources in particular from the private sector, through grants and possibly other public finance instruments (loans, guarantees, etc.). In this regard, innovative financing mechanisms are undeniably relevant to the work of development cooperation agencies and need to be explored further.

Relevant questions

Against this background and in light of international discussions, the panel of experts will address the following questions in particular:

1) What are innovative financing mechanisms compared with traditional ODA instruments? What innovative financing instruments are used? What are their risks and benefits as compared with traditional ones? Where can they be applied? How should the incentives be set so that public money (ODA) is not used to "subsidise" the private sector?

2) What development results did Development Finance Institutions (DFIs) such as the German KfW Development Bank achieve by using innovative finance mechanisms? What instruments and projects have successfully leveraged additional finance for sustainable development? What preconditions work in favour of successful innovative development finance? What are the risks?

3) How can the private investors' rationale be combined with sustainable development in developing markets? What framework conditions need to be in place both in developing and developed countries? What is the crowding out issue due to favourable conditions set by public agencies?

We look forward to a lively debate! SDC Analysis and Policy Division, 28 March 2014

[3] DIE, 2013; BBR, 2013; EDR, 2013

Panellists:

Annette DETKEN, Head of Division - KfW Development Bank (Kreditanstalt für Wiederaufbau)
On behalf of the Federal Government of Germany, KfW carries out financial cooperation (FC). The German bilateral development cooperation consists of KfW's FC and the Deutsche Gesellschaft für Internationale Zusammenarbeit's (GIZ) "technical cooperation".

Since January 2014 Annette Detken has headed the Competence Centre Financial Sector within the Directorate Development and Climate. The Competence Centre is responsible for all political and strategic issues regarding KfW's activities in financial sector development in developing countries. She has headed different teams within the domestic as well as the international business area of KfW. Before joining the Development and Climate Directorate of KfW Development Bank, she was responsible for the acquisition team of KfW Carbon Fund managing KfW's purchase activities related to carbon credits. Ms Detken studied economics and finance at the University of St. Gallen and NYU Stern School of Business. After her PhD studies at the University of Basel and the Study Centre Gerzensee she joined the economic research department of KfW Bankengruppe in 1999.

Owen BARDER, Senior Fellow - Centre for Global Development (CGD)
Owen Barder is Senior Fellow and Director for Europe at the CGD think tank. During 2004-2006 Barder worked at CGD, mainly on the Advance Markets Commitment for vaccines.
He was a British civil servant from 1988 to 2010 and worked among other positions as Private Secretary to the Prime Minister as well as in the Department for International Development, where he was Director of International Finance and Global Development Effectiveness, Director of Communications and Information and Head of Africa Policy and Economics Department. Mr Barder has also worked in the South African Treasury on budget strategy and was a visiting scholar in economics at the University of California, Berkeley. Mr Barder is member of the Advisory Group of Twaweza, the Board of Publish What You Fund, and a member of the UK Government International Development Sector Transparency Panel.

Susanne GROSSMANN, managing Partner at BTS Investment Advisors
The BTS Investment Advisory is a private equity fund advising on Indo-European business ventures. BTS Private Equity Fund Ltd. is a USD 73.5 million fund with a mandate to invest in fast growing medium-sized businesses in India. The Fund includes both institutional and private investors based in Europe and Asia.

Susanne Grossmann is a managing partner at BTS Investment Advisors. Ms Grossmann is responsible for the private equity activities and social engagement of the BTS Group. She sits on the board and IC of Swiss Investment Fund for Emerging Markets (SIFEM) and is also engaged in social impact investing advisory services. From 2004 to 2007, before joining BTS, Ms Grossmann was a member of the management team of the Swiss Organisation for Facilitating Investments (SOFI), where she was responsible for all SOFI activities in Asia and Africa, encouraging private sector investments in these regions. From 1995 until 2004 she worked at SECO, among other positions within the Division for Economic Cooperation, where she was in charge of a number of private sector promotion initiatives focusing on venture capital funds and other financial intermediaries in developing and transition economies. Ms Grossmann holds a Master's degree in History and Economics and a Post Graduate Degree in European Integration from the University of Basel.

Moderator: Susanne BRUNNER, Swiss Radio and Television (SRF)
Since August 1 2006 Susanne Brunner has been the co-host of the popular current affairs interview programme "Tagesgespräch" on Radio SRF 1 and SRF 4 News. Ms Brunner has won several journalism awards (in Switzerland and the United States) and teaches at the Swiss Journalism School MAZ in Lucerne.

For a six-year term she was based in San Francisco as the Swiss Radio's U.S. correspondent. At the beginning of her career she joined the Swiss Television's evening news broadcast "10 vor 10" as a reporter and worked for the Swiss Public Radio. Ms Brunner studied journalism at Carleton University's School of Journalism in Ottawa, Canada.

ANNEX: Examples of innovative financing mechanisms:

Innovative financing mechanisms can be channelled both through the intermediary level by investing in structured funds but also though direct investments in development-relevant projects.

According to Eurodad in 2013, on average over 50% of public finance flowing from Development Finance Institutions (DFIs) to the private sector went to the financial sector, namely commercial banks and private equity funds. For instance, the Swiss Investment Fund for Emerging Markets (SIFEM AG), the Swiss DFI, offers long-term corporate financing by taking a financial stake in developing countries' venture capital funds, which then provide equity capital to small and medium enterprises, or by granting loans to local financial intermediaries (banks and microcredit institutions).

Large financing requirements in areas such as *infrastructure* have led to increased interest in involving private investors. An example of using aid to leverage private sector finance through "blending" in this area is the private Infrastructure Development Group (PIDG)[4]. Examples for *climate related* multi-donor mechanisms are the Climate Investment Fund's Clean Technology Fund (CIF CTF)[5] and the Global Climate Partnership Fund[6] founded by Germany.

[4] From 2002 to 2012 PIDG committed $1.49bn to infrastructure projects and technical support. Leverage effect: when fully operational, these projects are expected to have attracted $26.7bn private sector investment commitments. (PIDG)
[5] CIF has committed $4.5bn to the CTF. Leverage effect: $40bn in additional finance. Between January 2009 and June 2012 every $2 of CTF funding invested brought approximately $9 of co-funding. Private finance comprises about 36% of the financing for these projects on average. (GIF CTF)
[6] Between 12/09 and 12/12, the German Federal Ministry of the Environment had committed €32,5mn to GCPF. Leverage effect: the fund mobilised an additional €100mn for co-financing of renewable energy and energy efficiency projects. (GCPF)