Financing for Sustainable Development

From Billions to Trillions - What Will it Take?

Rotterdam, The Netherlands
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Executive Summary

In April 2015, the Multilateral Development Banks and the IMF presented a joint paper to position these institutions in the lead-up to the Third Financing for Development Conference in Addis Ababa, which will be an important milestone in the effort to achieve universal sustainable and inclusive development post 2015.

The note, ‘From Billions to Trillions: Transforming Development Finance’ captures their joint vision on sustainable and inclusive development. The note is also part of a transformative process to enable these institutions to unlock the additional public and private resources needed to finance the Sustainable Development Goals (SDGs). The MDBs and the IMF, as global and regional knowledge and financial intermediaries, can help the public and private sectors pursue policies and risk mitigation investment strategies that contribute to sustainable and inclusive development. This aspiration to support the effective allocation of additional public and private sources of finance towards achieving the SDGs cannot take place without close collaboration and consultation with shareholders, partners and client countries.

In this context, as first step to act on the joint “Billions to Trillions” vision, on May 21-22, 2015, the World Bank Group organized the Development Finance Forum (DFF) in Rotterdam, the Netherlands. At this event, a diverse group of stakeholders from the public and private sector convened to provide input into a future shared agenda to finance the achievement of the proposed Sustainable Development Goals. The Forum was designed to make optimal use of the knowledge and experience of the participants, through in-depth and focused discussions on how to accelerate momentum and shape strategies and partnerships on the basis of lessons learned and best practices.

The discussions are summarized along six subthemes:

• Business Climate, Inclusiveness and Growth
• Domestic Resource Mobilization
• Deepening Local Financial Markets
• Risk Mitigation and Crowding In Private Sector Investment
• Public Expenditure Efficiency
• The Future of Concessional Finance and ODA.

In this report, a rich and interconnected set of actions and recommendations is presented, reflecting the consensus among participants that achievement of the Sustainable Development Goals requires more than a significant increase in investments. Such increase needs to be accompanied by a change of mindsets, a willingness to try different approaches and to share risks and accountabilities.

The Rotterdam Development Finance Forum has created a connected cluster of representatives from the public and private sector that can give substance to the joint “Billions to Trillions” vision and its constituent elements. As this joint vision is being operationalized through the future portfolios of the MDBs, the group that was assembled in Rotterdam will be a much-needed sounding board to strengthen existing partnerships and identify new opportunities that can help scale up the financial resources needed to attain the SDGs and end extreme poverty in less than a generation.
Main Messages and Highlights

Over the course of a day and a half, more than 200 participants were actively involved in over 70 different discussions, organized around the six subthemes of the Development Finance Forum. The discussions were designed and facilitated in an interactive way to ensure an effective exchange of ideas and experiences and create the kind of collaborative engagement needed for consensus on joint entrepreneurial actions and initiatives.

This summary report captures the dynamics and outcomes of these sessions. Each session produced valuable actions and initiatives to tackle the challenges in the six topic areas. Several recurring themes surfaced in each session. In our view, these common threads represent the fundamental building blocks of future collaborative approaches in which MDBs, public and private sector work together to create social, environmental and economic benefits for their citizens and clients.

Risk, risk management and risk mitigation featured prominently in each session and under each theme. Participants of the DFF called for a significant better and joint understanding of the risks involved in investments and policy initiatives. This requires more transparency, better data and access to data and adequate analytical capacity. Subsequently, for the public and private sector to confront risks successfully requires shared action and shared responsibility for risk allocation. Such shared action can unleash the opportunities for sustainable and inclusive development. In several sessions initiatives and proposals that reflect this shared action came to the fore, such as the Transparency for Development initiative that provides transparency in public-private contracts, especially in the provision of basic needs. Or the proposal to develop programmatic political risk insurance products per country or per sector, rather than project-by-project.

The need for reliable and actionable data came up in each of the sessions and was part of many proposals. Data provision and governance occupies a central role in the Financing for Development agenda, whether in the design of better service delivery in basic needs, the development of local capital markets, or in improving the accountability of governments and businesses. Current technology provides a strong opportunity to create a paradigm shift in the production and real-time accessibility of data but technology deployment requires additional resources and willingness from public and private sectors to increase access and lower the cost of data. Proposals in Rotterdam include investing in better and reliable data provision in local financial markets in order to spur the development of local
institutional investors as well as improving the business climate by revolutionizing business data, for example through the creation a Global Financial Exchange to increase deal flow and reduce transaction costs.

**Financing for sustainable development requires more patient capital and better programmatic approaches.** Long-term finance, i.e. extending the maturity structure of finance, plays a critical role in sustainable and inclusive growth. By decreasing the rollover risks inherent in short-term finance, the investment horizon can be extended to long-term assets, particular in climate-resilient infrastructure. An increased availability of long-term financial instruments will also help the agenda of inclusiveness as it will increase the availability of ‘life-cycle’ financial instruments for households such as mortgages and education loans. In Rotterdam, various breakout groups discussed extensively the roles of partnerships and governments to correct scarcity in long-term finance and improve the resilience and performance of firms and households. They recommended scaling-up and replicating project preparation facilities, risk mitigation tools and co-investment platforms such as the Global Infrastructure Fund (GIF) that integrate the efforts of MDBs, investors, financiers, and governments. But most of all, participants advocated for the development of an asset class approach to reflect the different risk and return characteristics of investments in sustainable development. For example, the introduction of a new asset class of Sustainable Infrastructure would help attract institutional investors with ‘sticky’ capital and substantially increase the finance available to transform infrastructure, particularly in urban centers.

**Official Development Assistance remains a core tool for sustainable development and can improve its leverage through blended finance.** Targeting (international) public resources to support private sector investment can help reduce the risks and costs of high-impact investments. Participants called on multilateral providers of concessional finance, such as the International Development Association (IDA) of the World Bank Group and of bilateral ODA to adopt a more structured approach to blended finance, by creating functional models for crowding in private and domestic public resources. These models should be based on appropriate measurement frameworks and be connected to national investment plans, such as a Social Development Investment Plan. Such work could be supported by creating knowledge platforms for sharing best practices and help build capacity with all actors involved.

**The power of partnerships must be harnessed and MDBs need to further strengthen their convening role.** Throughout the Forum, participants from all backgrounds emphasized the need for all stakeholders to improve their capacity to partner. All initiatives and recommendations that were brought up require the kind of partnerships that create complementarity of roles and responsibilities and help each partner to transform to better serve the objectives of sustainable development. In many instances, the MDBs were seen as best equipped to provide platforms for partnerships that can bring in the private sector. Many calls went out to the MDBs to strengthen its convening role and ensure that organizational incentives are conducive to enable operational partnerships that can turn ambition into action. Strengthening the capacity to partner will further improve the leveraging and catalyzing force of the concessional and non-concessional windows of the MDBs. As one of the participants in Rotterdam said, if you want to go fast, go alone – if you want to go far, go together.”
Summary

Participants discussed how to promote business models that provide income generating opportunities while delivering products and services where they were previously unaffordable or unavailable. They weighed approaches to foster predictable tax regimes, investment frameworks, and regulations necessary to support open competition and well-functioning labor markets. Clear consensus emerged that improved coordination between international actors, civil society organizations, sovereign governments, and the private sector can bridge the public-private sector divide and reduce fragmentation of efforts to achieve the SDGs.

A “country-local approach” surfaced, characterized by scaling up resources that facilitate risk sharing, in-country capacity building, facilitation of an inclusive dialogue and the creation of blended finance structures strongly linked to corporate social responsibility and SDG compatibility.

Proposed actions and recommendations include:

**Design an Inclusive Business Accelerator for sectors with high inclusiveness potential**
- Call on Fortune 1000 companies to propose specific sectoral value chains and country engagement strategies

**Crowding in grants and venture capital at three business levels:**
- Proof of concept, and pilots, including market development support
- Proof of sustainable business model/financial viability
- Proof of replicability, scalability, and access to financial capital.

**Revolutionizing business data:**
- Use the international community to enhance data demand and an “ecosystem approach” to lower the cost of access to critical information.
- Set up a research program for a coalition of MDBs, academia and analytics firms to evaluate investments for their return on the SDGs
- Create a Global Financial Exchange to increase deal flow and reduce transaction costs

**Scale up the use of technology to:**
- Help businesses to discover market opportunities through knowledge dissemination, learning from successes and failures, and partnering for vocational training.
- Support global value chains focused on innovation and including local government.
Incentivize R&D to assist individual companies looking to find opportunities in countries. Focus on organizing knowledge transfer of sustainable business models, and profitability in new and frontier areas.

Businesses set corporate-level vision, inclusive business targets, and innovation unit hubs that:

- Identify base of pyramid needs
- Combine disruptive products with business model innovations
- Protect these products from having to comply to mainstream business standards while also proving their long-term viability.
Summary

“Be ambitious” sums up the message of this group. Ambitious in removing the road blocks to private sector engagement in development. Ambitious in improving the availability of data and information to eliminate the gaps between perceived and actual risks at regional, local and project levels. And ambitious in building capacity of investors to assess risks correctly in developing countries. Above all, the group emphasized the importance of moving from a project to a program approach. Access to data, transparency of actions and operational platforms for partnerships are core to this agenda.

The group identified important impediments to enhancing private flows and investments in developing countries, including a dearth of bankable projects with suitable risk/return profiles, uncertainties due to policy changes and reforms needed to sustain private investments, and a lack of capacity among institutional investors to evaluate and monitor project risks. Governments’ critical role in providing a conducive investment climate was emphasized.

The group gave considerable attention to risk mitigation mechanisms, how to scale them and the need for MDBs to collaborate in this area. In this respect, the group stressed the need for MDBs to not compete with the private sector. Finally, the group identified the monetary policies of advanced economies as an important lever of change and discussed the unintended consequences of regulation such as Basel III, which diminished banks’ appetite for investing in emerging markets.

Proposed actions and recommendations include:

**Increase the capacity of the multilateral system to help foster a program approach and mitigate the risks for private investments:**

- Support and invest in project development, pooling and risk-sharing platforms such as GIF, Africa50, AMC, as well as create and scale up blending programs such as SIDA-Citi, IFC’s Technology Accelerator
- Build on and scale up MDBs capacity to provide risk mitigation guarantees
- Explore and facilitate the development of new asset classes to reflect the different risk and return characteristics of investing in sustainable development and attract institutional investors with ‘sticky’ capital that can underpin sustainable growth
- Create a rating agencies for ‘breach of contract’ risk ratings for countries
- Invest in collecting and disseminating what has worked practically including data on returns and approaches to understanding local risks in a systematic way
- Explore investor data pools
Support building a positive ecosystem for inclusive business with clear roles for each partner:

- Scale up technical assistance to governments in developing countries to build enabling environments for business with sound governance structures and instruments that support SMEs, financial inclusion and the deepening of local capital markets
- Build and strengthen capital market infrastructure to facilitate efficient access to resources and information, increased liquidity, secondary markets
- Build criteria to help differentiate between crowding-in and crowding-out
- Help build local currency markets and promote long-term local currency financing through reducing the market risks associated with currency mismatches
Summary

Banks and non-bank financial institutions are a vital source of stable finance, which fosters economic growth and creates jobs. With insufficient information or capacity to take on unfamiliar risks, domestic financial intermediaries may have limited incentives to lend to the real economy, particularly to micro-, small- and medium enterprises (MSMEs) and underserved individuals. The group advocated that international and local actors need to harmonize their approaches to create a viable local financial market that can serve sustainable and inclusive development.

The group discussed the best approaches to developing capital markets and analyzed major issues hindering access of capital by MSMEs. The current role of MDBs was seen as too limited. MDBs were encouraged to scale up, take on more risks and set goals for their collaboration in this area. The group emphasized the need for a more programmatic approach over the current project-by-project approach. In such a programmatic approach, ODA can play a critical role in mitigating the risks, as part of a larger policy reform for systemic risk reduction. Participants emphasized the importance to focus on women as agents of change in local economies. They stressed that financial intermediaries should involve economic and social safeguards, which would help create trust and the necessary mindset change among local actors. Currently, not enough has been done by governments and MDBs to embed these safeguards.

Local currency sources of finance are essential for private business and governments to avoid the risks associated with foreign currency borrowing. Emerging market local currency options (especially government bond markets) have been growing rapidly, but remain heavily concentrated in a few countries. The group called for a focus on local currency bond markets while underscoring the need for prudent regulatory capacity and an infrastructure conducive to producing reliable data for investors.

Proposed actions and recommendations include:

**Improve access of MSMEs to markets, knowledge and technology**
- create business development services
- harmonize approaches across the value chain, connect to larger companies
- improve financial literacy

‘Sustainability reloaded’: empowering MSMEs through platform-based marketplaces
- design simple feedback and transparent rating mechanisms for MSME-support mechanisms, ensure MDBs and bilateral donors agree to use these rating mechanisms
Promote Regional Financial Integration to bring financial markets to scale and create synergy among them

Develop Local Institutional Investors by:
- setting up regulatory frameworks for mutual funds, insurance services, and pension funds
- empowering a regulatory agency
- developing the financial infrastructure, including reliable and accountable data provision

Develop Local Currency Capital Markets through MDBs scaling up local currency lending and issuing more local currency bonds in a broader set of emerging markets
Summary

This session explored what it takes to mobilize more domestic resources for sustainable and inclusive development. The group focused on formulating national and international actions to increase tax-to-GDP ratios to levels that create a virtuous cycle of sustained public expenditures, space for public investments to catalyze sustainable and inclusive growth, a structure of taxation that nurtures efficiency and fairness, leading to further attraction of private flows.

The group agreed that the case for Domestic Resource Mobilization is clear: for many countries previously dependent on aid, finance generated by domestic resources has become the largest funding source for development. Progress made is most visible in the modest but steady increase of tax-GDP ratios in LICs since 2000. Over half of these countries have reached the modest ratio of 15%. Yet, in a context of pervasive low trust and imperfect accountability structures, tax revenues often remain volatile and fail to contribute to the creation of a sustainable and inclusive economy. The group identified prominent factors that contribute to that volatility, such as (i) the lack of political will, nationally and internationally, to create international action to stem the volume of illicit financial flows (IFF), (ii) a rent-seeking mindset of socio-political elites, creating tolerance for corruption, (iii) erosion of the tax base through profit shifting and corporations seeking double non-taxation, (iv) tax competition with neighboring countries, (v) a narrow tax base due to tax collection in volatile sectors and (vi) less than robust tax design and administration capacity. These national and international factors generally increase the risks and risk perceptions of citizens and companies and make it hard to reach sustainable tax levels. Addressing these factors will contribute to the design of robust tax systems that promote inclusiveness, and increase the resilience and sustainable growth potential of a country’s economy.

Proposed actions and recommendations include:

Increase transparency and better access to data by:
- a drastic scaling-up of international financial support to build and strengthen tax systems, starting with focused attention to transparency, human resources and IT
- creation of an expertise hub (possibly at the MDBs) to support companies in developing tax transparency reporting and tax strategies that are integrated in business strategies
Improve the capacity to set rules and enforce compliance, nationally and internationally by:

- Setting up an international initiative to cooperate on tax and illicit flows, responsible for creating a common set of rules and principles, including for information sharing
- Developing global guidelines for effective taxation on extractive industries
- Focusing support on country capacity to negotiate tax treaties and double taxation agreements
- Strengthening country capacity at all levels with regard to domestic resource mobilization and scaling up technical capacity building programs, through multi- and bilateral resources.
- Strengthening the capacity of MDBs to deliver tax advice and technical assistance, in collaboration with OECD, UN, IMF.
Summary

Participants discussed how to increase complementarity between public and private expenditure. They identified core underlying issues that hinder such complementarity and considered actions and initiatives related to public expenditure that can help create higher and better returns on sustainable and inclusive development, through more and better private and public investments and spending.

Ideas surfaced included tackling corruption and waste, improving the availability of useful policy and monitoring data, and working together to improve government capacity, in particular at local level. These were all recurring themes in the floor discussions. Involvement of the private sector in service delivery was welcomed in principle but it was felt that data and evidence were missing to determine how best to design private and public involvement in the provision of basic needs services and public goods. Participants fully endorsed the use of action-oriented multi-stakeholder platforms and the use of public-private partnership assessments for comparative analyses on when public and private sectors should work together. With these assessments, crowd-in and crowd-out mechanisms can be more intelligently designed. The capacity of governments to channel through, and sub-contract to, the private sector when appropriate, can be facilitated by state regulation and partial funding. However it was noted that contracting will need to be improved if corruption is to be minimized. The MDBs can play a catalyzing role to bring involvement of the private sector to scale, particularly in post-conflict states. The group also emphasized the need for the MDBs to join efforts to build capacity and ensure better data availability to improve public expenditure.

Proposed actions and recommendations include:

**Country strategic framework:**
- Establish a multi-stakeholder platform with private sector, civil society and sub-national participation under government leadership to help align country priorities with the SDGs through a National Development Plan and the national budget. The platform includes thematic working groups as well as review and monitoring mechanisms.

**Data collection initiative:**
- Open development data that harmonizes sub-national data, addresses the need to consolidate MDB efforts, and complies with IATI-Plus.
Transparency for Development (T4D): Provides transparency in public private contracts, especially in the provision of basic needs. Constituent elements of T4D include:

- UN Envoys comprised of UN agencies, regulatory bodies, MDBs, private sector, governments, and CSOs convene dialogues to:
  - Define standards, aims, and timelines
  - Facilitate national and international adoption
  - Provide implementation, legislation, and technical support
  - Evaluate, monitor, report, and adjust.
- Advice and design support from the International Aid Transparency Initiative (IATI).
- National governments adopt, legislate and implement
- MDBs and DAC donors support, recognize, and incentivize compliance while also facilitating data management and analysis
- Private sector and regulators assist with ratings, incentives, and bank regulations.

Public Private Dialogue at country level: such a dialogue fosters sustainability, reduces formality and reduce transaction costs. For a successful platform it is necessary to create a “coalition of the willing” with cross-sector representation, high level political and business champions, and resource mobilization support through technical support and seed finance. The dialogue can be supported by:

- Linking best practices with local specifics via pilot programs/laboratories
- Clearer rules in bringing public and private together on innovative finance
- Peer-to-peer programs on good governance
- Toolkits for PPP design and best standards
- Global mechanisms for “training” public servants by matching them to peers elsewhere and “coaching” ministers by peers in other countries to learn from best practices.
Summary

Over the last few decades ‘aid’, or concessional finance, has played an essential role in helping LICs to accelerate economic growth and lift people from extreme poverty. Concessional finance represents around 1.5% of total resources currently available for the developing countries on average. This is a relatively small but valuable amount. What matters most for concessional finance is its ‘intelligence’ to leverage and catalyze other sources of development finance. In the context of the SDG-agenda, such leverage extends to the massive potential of private finance for sustainable and inclusive development.

The group discussed the priority uses for concessional resources, such as deployment in Least-Developed Countries (LDC), in fragile and post-conflict states and for Global Public Goods (GPG). Participants also discussed better ways to manage ‘graduation’ and prevent countries from staggered access to international finance after graduation from concessional finance windows. Considerations and measures to increase the concessional ‘firepower’ of the MDBs were considered as well as the need for the providers of concessional finance to forge operational partnerships with other existing and new providers of concessional finance, such as the National Development Banks and the fledgling Asian Infrastructure Investment Bank. To improve both leverage and volume of ODA, the group placed strong emphasis on the need to create more adherence to the 0.7% (gross GDP) commitment.

Proposed actions and recommendations include:

**Reorient ODA to Results-based financing (RBF) by:**
- Creating optimal risk allocation mechanisms to those best able to manage/absorb risks
- Exploring RBF through pilots with a view to replicate and scale-up

**Blend!**
- Create functional models that crowd in private finance and domestic resources and are based on appropriate measurement framework and an SDIP, a Social Development Investment Plan
- Focus on mobilizing resources through blended models for *inter alia* PPPs, climate finance, technology and health outcomes
- Create knowledge sharing platform to share experiences with blending and help build capacity with all actors involved, including the National Development Banks

**Increase the cooperation with National Development Banks (members of the International Development Finance Club, IDFC), new players such as the AIIB and BRICS Bank and create linkages with bilateral South-South initiatives**
**Boost concessional firepower of MDBs by**
- Optimizing existing instruments through blending, while taking into account debt sustainability
- Creating incentives for engaging in partnerships, in particular with new providers
- Increasing the capital base of Multilateral Development Banks
- Mobilizing additional resources through leverage of the equity of concessional instruments such as IDA

**Increase the leverage capacity of ODA by**
- increasing volume through better adherence to the 0.7% commitment
- reach an agreement on more expansive definition of ODA (or TOSD)
- improving ODA-targeting to institutional capacity building and robust tax, debt and expenditure management
- strengthening incentives to provide bilateral guarantees
- improving analysis and monitoring of the inherent risks of leverage (substitution and unsustainable debt burdens)
- developing risk mitigation instruments to catalyze additional flows from private sector and institutional investors
- improving coordination of ODA-providers

**Tailor concessionality by**
- Increasing ODA-flows to LDCs, set a goal of 0.20% of gross National GDP to LDCs and set a time table to reach that goal
- Improving a more targeted use of scarce multilateral concessional resources for LDCs by creating higher volumes of non-concessional finance on competitive terms for the benefit of gap- and blend countries, while freeing up concessional resources for IDA-only countries
- Ensuring a smooth transition from concessional to non-concessional finance by reconsidering the threshold for IDA-eligibility
- Creating incentives for ‘topic-based’ innovative partnerships around global public goods (GFF, PEF) with inbuilt connections to ‘horizontal’ country implementation through national public investment plans and on-budget transfers