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on the  
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**FROM BILLIONS TO TRILLIONS: TRANSFORMING DEVELOPMENT FINANCE**  
**POST-2015 FINANCING FOR DEVELOPMENT: MULTILATERAL DEVELOPMENT**  
**FINANCE**

Attached is a document entitled “From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance” prepared jointly by the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Monetary Fund, and the World Bank Group for the April 18, 2015 Development Committee meeting.

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From Billions to Trillions: Transforming Development Finance  
*Post-2015 Financing for Development: Multilateral Development Finance*

Development Committee Discussion Note

Prepared jointly by

*African Development Bank*

*Asian Development Bank*

*European Bank for Reconstruction and Development*

*European Investment Bank*

*Inter-American Development Bank*

*International Monetary Fund*

*and*

*World Bank Group*

## Abbreviations and Acronyms

BEPS	Base Erosion and Profit Shifting
BRICS	Brazil, Russia, India, China and South Africa
CIT	Corporate Income Tax
COP21	21 <sup>st</sup> Conference of the Parties
DRM	Domestic Resource Mobilization
EOI	Exchange of Information
ESG	Environmental Social and Governance
FCS	Fragile and Conflict States
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GPGs	Global Public Goods
IMF	International Monetary Fund
LICs	Low-Income Countries
LMICs	Lower Middle Income Countries
MDBs	Multilateral Development Banks
MDGs	Millennium Development Goals
MICs	Middle-Income Countries
MSME	Micro, Small and Medium-sized Enterprise
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OOF	Other Official Flows
PIT	Personal Income Tax
PPP	Public-Private Partnership
RPGs	Regional Public Goods
SDGs	Sustainable Development Goals
UMICs	Upper Middle Income Countries
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change
VAT	Value-Added Tax
WBG	World Bank Group

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## **From Billions to Trillions: Transforming Development Finance**

**To meet the investment needs of the Sustainable Development Goals, the global community needs to move the discussion from “Billions” in ODA to “Trillions” in investments of all kinds: public and private, national and global, in both capital and capacity.**

**Globally, achieving the proposed SDGs will require the best possible use of each grant dollar, beginning with some US\$ 135 billion in ODA. Yet flows for development include philanthropy, remittances, South-South flows and other official assistance, and foreign direct investment— together these sources amount to nearly US\$ 1 trillion that needs to be used just as effectively. The most substantial development spending happens at the national level in the form of public resources, while the largest potential is from private sector business, finance and investment. This is the trajectory from billions to trillions, which each country and the global community must support together to finance and achieve the transformative vision of the SDGs.**

**“Billions to trillions” is shorthand for the realization that achieving the SDGs will require more than money. It needs a global change of mindsets, approaches and accountabilities to reflect and transform the new reality of a developing world with highly varied country contexts.**

*This Development Committee Discussion Note is the joint product of the African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, International Monetary Fund, and World Bank Group. In this critical year for development, we have come together to explore and confirm what we can do, within our respective institutional mandates, to support, and in particular finance, the eventual achievement of the proposed post-2015 Sustainable Development Goals (SDGs). We are financial institutions committed to eradicate poverty and inequality, able to leverage and catalyze public and private development finance as well as to provide technical assistance, learning opportunities and policy advice to our clients.*

*The Third International Conference on Financing for Development in Addis Ababa in July<sup>1</sup> will be an important milestone in the post-2015 global effort to achieve universal and sustainable development, underpinning the expected adoption of the SDGs at the UN Special Summit for Sustainable Development in New York in September. This trajectory will continue with the World Bank Group— International Monetary Fund Annual Meetings in Lima in October, and with the 21<sup>st</sup> Conference of the Parties (COP21) to the United Nations Framework Convention on Climate Change in Paris in December, which seeks a new international agreement on climate change. In short, 2015 will create a platform to support global development aspirations for the next 15 years.*

*This note proposes a preliminary vision for the collective role of our institutions looking toward the Addis Financing for Development Conference and beyond. Guidance is sought from Development Committee members, who include shareholders from each of our institutions, on how the Multilateral Development Banks (MDBs) and the International Monetary Fund (IMF) might best cooperate with respect to our individual and shared responsibilities and activities to support country clients in financing the Sustainable Development Goals.*

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<sup>1</sup> The Zero Draft of the Outcome Document for the Third International Conference on Financing for Development may be found at <http://www.un.org/esa/ffd/wp-content/uploads/2015/03/1ds-zero-draft-outcome.pdf>.

1. **The proposed SDGs are ambitious.** They aim to meet the dual challenge of overcoming poverty and protecting the planet. They will build on the experience acquired in pursuing the Millennium Development Goals (MDGs) and pick up the unfinished agenda,<sup>2</sup> but they go further, highlighting a comprehensive vision of sustainable development that embraces economic, social and environmental dimensions. The financing resources needed to achieve the SDGs will surpass current development financial flows.

2. **More financial resources are available globally,** but channeling them to support the SDGs will be a challenge. In principle, humanity has the resources to achieve the SDGs. Reflecting developments in the global economy over the last decade, large amounts of investable resources, mostly private, are available in advanced and emerging economies. In addition, domestic public resources, even in low-income countries, can be increased. However, not all available public and private resources will automatically be allocated and used effectively to support the SDGs. Nor are they programmable by—or responsive to—policy making bodies or conferences.

3. **A paradigm shift on how development will be financed is required to unlock the resources needed to achieve the SDGs.** The world needs intelligent development finance that goes well beyond filling financing gaps and that can be used strategically to unlock, leverage, and catalyze private flows and domestic resources. Official Development Assistance (ODA) will remain an important source of external public financing. ODA levels can and should rise as developed countries increase assistance levels – and all available grant funding is critical and should be used as effectively as possible. Yet ODA flows are only a small part of development flows. In the future, ODA must be targeted increasingly to crowd in other funding sources: (i) for Low-Income Countries (LICs), on the basis of poverty, vulnerability, and limited fiscal capacity; and (ii) for Middle-Income Countries (MICs), by playing an increasing role to leverage and catalyze public and private sources of financing.

4. To help generate the needed flows—domestic public resources and private finance—**MDBs and the IMF have two primary functions: providing policy guidance, and development finance and financial support to clients.** The business models of the MDBs and the IMF reflect shared attributes including:

1) **Financial leverage:** The financial structure and financing capabilities of the MDBs and the IMF enable them to leverage their capital to provide finance in many forms (from grants to “blended” concessional finance to loans to guarantees to equity investment) and purposes. The non-concessional institutions/windows of the MDBs are funded efficiently by small amounts of paid-in capital, in many cases backed by callable capital.<sup>3</sup> Leveraging these amounts, the banking model of the MDBs mobilizes substantial resources from the capital markets at interest rates reflecting their strong financial structure and high ratings. In addition, grant and concessional funding from shareholders and other development partners supports concessional financing for the poorest, fragile and conflict-affected states. The MDBs received inflows from their shareholders of around US\$ 38 billion in 2012.<sup>4</sup> These flows allowed the MDBs to make public and private disbursements of US\$ 99 billion in developing countries in 2013, and to approve new commitments for US\$ 173 billion.<sup>5</sup>

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<sup>2</sup> World Bank Group, “Global Monitoring Report 2014/2015: Ending Poverty and Sharing Prosperity,” 2015

<sup>3</sup> The MDBs provide non-concessional financial assistance to MICs and some creditworthy LICs on market-based terms. They also provide concessional assistance to LICs, including grants and loans at below-market interest rates.

<sup>4</sup> OECD DAC report “What do we know about multilateral aid?” page 3, 2012

<sup>5</sup> Disbursement and commitment figures taken from 2013 Annual Reports of respective MDBs and IMF.

- 2) **Policy guidance and technical assistance:** In their direct engagements with shareholder client countries, MDBs help to design and implement demand-based, country-driven, cross-sectoral technical and financial development solutions; while the IMF provides macroeconomic and financial sector policy advice and customized technical assistance. Working with developing countries through national policy dialogue and financial support, the MDBs support investment in systems, institutions, markets and capacity that underpin development interventions, and provide a collaboration platform for development partners to come in behind country-owned programs and priorities; IMF financing supports government economic programs to maintain or restore macroeconomic stability and growth.
- 3) **Private finance and investment:** Private resources move in directions determined by risk-reward considerations, which in turn are driven by public policies in both host and source countries. Shifting the allocation of investable funds to better meet development needs is thus an issue of “getting policies right” – whether at the national or international level. Much of the work of the MDBs engaged in policy-based lending, and of the IMF in its country engagement, focuses on getting domestic policies right. In addition, MDBs are innovators, intermediaries and co-investors, acting as honest brokers between public and private actors and able to leverage and crowd in essential private finance and investment and to support the efforts of governments to strengthen investment climates. Several MDBs have specific mandates focused on private sector engagement, others have private sector “windows” and work streams that demonstrate that private investments in developing economies can be profitable, and that incentivize and build market solutions. MDB investment and financing attracts and mobilizes private capital to invest alongside the MDBs themselves.
- 4) **Global/regional development issues:** The entire international community is involved in global development issues. The primary role of the MDBs and the IMF is to provide financing and technical support to countries both directly and, for MDBs, through global programs they administer and implement. For climate change, MDBs have put in place a wide range of innovative national and global approaches to adaptation and mitigation. The IMF supports the workings of the international monetary system and, more widely, promotes the cooperation across countries needed to ensure global economic and financial stability; this has included the provision of a global financial safety net, supported by credit lines from its financially strongest members.

5. **The MDBs and the IMF will work with clients and development partners to help translate the SDGs into country level targets, policies and programs and to finance their implementation, committing to:**

- 1) **Explore increasing available financial resources:** Each of the MDBs can explore how to make best use of its specific financial model and circumstances to increase available funds, including by supplementing scarce concessional assistance to the Lower Middle Income Countries (LMICs) with additional development financing at non-concessional terms. MDBs can explore new or different uses of their balance sheets, such as leveraging the concessional windows in innovative ways; assessing whether any existing financial capacity could be re-deployed; freeing up financial capacity by mitigating risks (including increasing analysis of concentration risks and how they are managed); or adjusting or exchanging existing exposure to increase “headroom” capacity for countries where lending is currently limited. In due course and in response to client demand, additional capital would allow these institutions to do more.

- 2) **Expand policy guidance and technical assistance for domestic resource mobilization and spending:** In the critical area of increasing domestic resources for development, the MDBs and the IMF can deepen their capacity and commitment to provide advice, build capacity, and help client countries at both the national and subnational levels increase tax revenues, improve the quality of expenditures, and manage risks.
- 3) **Promote and catalyze private investment:** Equity investment in developing country enterprises is fundamental. In the context of the withdrawal of investment interest in many development countries from multinational banks, MDBs can provide new and expanded channels to address risk and uncertainty, and thus mobilize resources and co-investment from both existing and non-traditional sources of capital such as pension funds, sovereign wealth funds, and insurance companies. MDBs also provide support for well-designed risk-taking to encourage and enhance innovation. Through their investment, engagement and policy guidance, MDBs can help countries establish a supportive investment climate to mobilize private capital for investment in development. MDBs can also intensify work on financial arrangements that catalyze and leverage traditional as well as private sources of financing.
- 4) **Support international action on global/regional development issues:** MDBs can help design and coordinate approaches relating to core global and regional development issues such as gender equality, youth and excluded populations, trade and integration. The IMF, through its multilateral surveillance and related policy work, supports international efforts to ensure global macroeconomic and financial stability. For climate change in particular, MDBs can support the collective financing ambition that needs to be agreed in 2015, as well as demonstrate ways in which development objectives and climate finance complement each other and reinforce their respective impacts. Working with country clients, MDBs can help design and implement climate actions that generate multiple local health, agricultural, employment and resilience benefits. The IMF and some MDBs can also provide policy advice and technical assistance on environmentally-linked tax measures, notably on fossil fuels.
- 5) **Further improve coordination and alignment:** The MDBs and the IMF can work together more closely to support implementation of the post-2015 development agenda. The MDBs already coordinate with each other through many working groups that tackle practical issues across the development landscape, and they support and engage in partnerships and platforms for South-South and broader cooperation across multilateral, regional, national, and bilateral development institutions and civil society organizations. The MDBs and the IMF commit to continue to improve coordination and to strengthen working relationships with each other, particularly in providing financial and non-financial support at the regional, country, and subnational levels. Continued joint work on infrastructure project preparation and financing, where the needs are vast, can benefit from even greater coordination and information exchange to improve design and reduce the burden on countries. Joint efforts to shape the post-2015 data agenda, mobilize technical and financial support, and foster coherent methodologies and data management will be enhanced.<sup>6</sup> The MDBs are working together with bilateral development banks to build effective ways to mainstream climate change into development, including developing joint principles to track mitigation and adaptation finance and to measure leverage in the lead-up to COP 21.

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<sup>6</sup> MDBs, IMF and the UN signed a Memorandum of Understanding to strengthen inter-agency sharing and collaboration on issues related to data and statistical capacity building, October 2013



6. **The MDBs use development financing solutions** beyond traditional loans that can be grouped into four broad categories: (1) *adding, pooling* and *enabling* instruments to generate new flows, or more results for the same money; (2) *debt-based/right-timing* instruments that match flows to when cash is needed; (3) *risk management* instruments to manage or reduce risk for investors (correcting market failures, reducing regulatory risk) or consumers (e.g., weather insurance for farmers, local currency matching for micro, small and medium-sized enterprises (MSMEs)); and (4) *results-based financing* where payments are made specifically for desired results. Specific financing solutions can be customized to solve specific issues, or designed to be replicated or taken to scale. A catalogue of financing solutions will be made available online in due course.

7. The framing of this Discussion Note reflects the approach to financing for development taken in UN documents going back to the 2002 Monterrey Consensus, with its emphasis on public and private, domestic and international financing to support countries—each of which has primary responsibility for its own economic and social development. **Section I** of this paper provides a snapshot of the current global financial development landscape. **Section II** reviews public and private sector roles in financing the development agenda, including on delivering global and regional public goods that are critical to development. **Section III** briefly categorizes development financing solutions deployed by the MDBs to increase leverage and crowd in private and public financial flows towards sustainable development initiatives.

## **I. Global Financial Flows for Development**

8. The global development landscape has changed since the MDGs were adopted in 2000. The six largest MICs now account for roughly the same share of global GDP as the six largest high-income countries. At the same time, inequality within many countries is on the rise and there is a growing gap between the richest and poorest countries, with some of the poorest countries caught in a “poverty trap”.

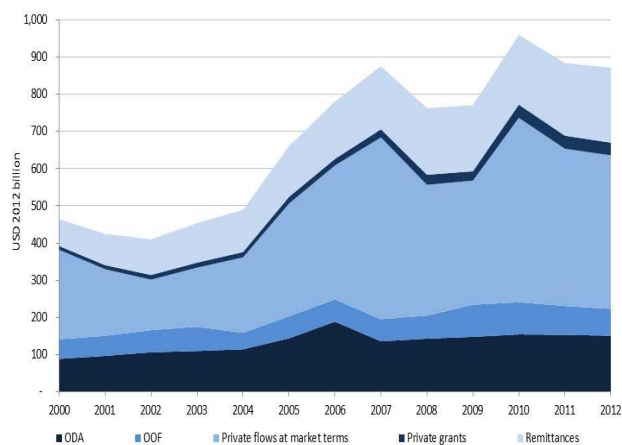
9. The past decade has seen significant increases in the level of financial flows to developing countries (Figure 1). This reflects the growing importance of: (i) international private finance, particularly increased flows to MICs in the form of foreign direct investments (FDI), bonds and syndicated bank-lending with at least five years of maturity; (ii) migrant remittances; (iii) private philanthropy, such as from foundations and corporations; and (iv) other official financing, in particular from the BRICS.<sup>7</sup> ODA levels reached US\$ 135 billion in 2013, but their pattern has been uneven.<sup>8</sup> For example, ODA flows to Africa have declined in real terms over the last several years. If all OECD-DAC countries were to reach the 0.7 percent of GNI target, annual ODA levels would more than double.

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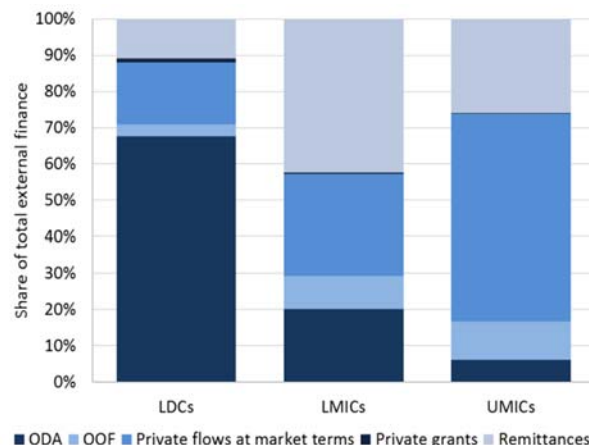
<sup>7</sup> Brazil, Russia, India, China and South Africa.

<sup>8</sup> OECD DAC Definition of ODA at <http://www.oecd.org/dac/OECD%20DAC%20HLM%20Communique.pdf>

**Figure 1: Financial Flows to Developing Countries**



**Figure 2: Composition of Financial Flows to Developing Countries – in 2012**



Note: ODA=Official Development Assistance; OOF=Other Official Flows; LMICs=Lower Middle Income Countries; UMICs=Upper Middle Income Countries; LDCs= Least Developed Countries. *Source: OECD*

10. A new development finance architecture has emerged across countries at different stages of development, presenting specific financing challenges and opportunities (Figure 2). ODA remains a significant source of finance for LICs and fragile and conflict states (FCS). While the share of ODA in overall external financing for Upper Middle Income Countries (UMICs) is relatively small—they now rely primarily on private flows (FDI and bonds)—they receive 40 percent of ODA grants, given significant and persistent poverty and inequality within many of these countries. As LICs lose access to concessional loan funding, they show a pattern that is of concern, where growth is constrained because domestic taxes and foreign private and market-related public borrowings do not expand enough to compensate for declining ODA flows.<sup>9</sup> Debt sustainability, an essential condition for robust growth, can also become an issue.

11. Beyond the financial flows depicted in Figure 1, domestic resource mobilization (DRM) has increasingly become a key source for funding national development plans. Reflecting positive global growth trends, DRM of emerging and developing economies amounted to US\$ 7.7 trillion in 2012. That is, developing country treasuries now receive over US\$ 6 trillion more each year than in 2000,<sup>10</sup> helping lower aid dependency and raise creditworthiness in many countries. However, increasing revenue mobilization remains a challenge for many governments, particularly in LICs. Moreover, some of the recent revenue gains in LICs reflect increased global demand for natural resources, and remain volatile.

12. In a post-2015 world, ODA and DRM will remain essential to accelerating economic growth and lifting people from extreme poverty, particularly in many LICs where private investment remains limited. However, they will not be enough to finance the global ambitions of the SDGs. Increasing amounts of private resources, such as FDI, bond issuance, and financing from institutional investors, will have to be mobilized. The challenge—against a backdrop of cautious market investment—will be

<sup>9</sup> “Financing the post-2015 Sustainable Development Goals,” Kharas, Prizzon and Rogerson, 2014

<sup>10</sup> “Financing for Development Post-2015,” World Bank, 2013

to shift current development financing and investment patterns. In moving forward, better and smarter ODA can help catalyze and leverage financing from these diverse sources towards the SDGs.

## **II. Sources of Development Finance**

### **A. Strengthening Domestic Resource Mobilization and Public Expenditures**

13. For most countries, DRM is the largest resource available to fund their national development plans. A country's ability to mobilize domestic resources and spend them effectively—at the national, sub-national and municipal levels—lies at the crux of financing for development.

14. Countries must lead in mobilizing and spending their domestic resources. Effective domestic public policy helps increase equity (including gender) through poverty eradication, providing public goods and services, and, at the national level, managing macroeconomic stability. It also reinforces a country's ownership of public policies, reduces aid dependency and can raise creditworthiness. However, measures to improve DRM and public expenditures can vary across countries, and their implementation may be beset by political economy constraints.

15. Experience has shown that the combination of technical assistance and increased financing for capacity building can play a vital role in strengthening DRM and increase public expenditure efficiency and effectiveness. As countries commit to strengthening their efforts in these areas, it is important that the MDBs and the IMF, in line with their differing expertise and experience, be in a position to support them. Key engagement tools include policy lending and technical advice, institutional capacity building, coordination and research.

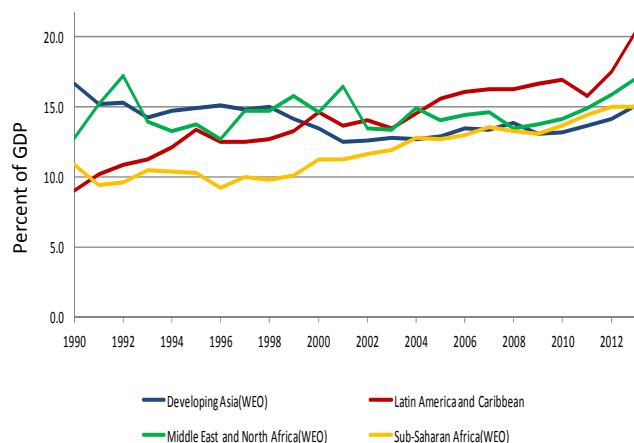
#### **1) Domestic Resource Mobilization – increasing available public funds**

16. Tax ratios in LICs (revenue as a share of GDP) have been on a modest upward trend since the turn of the century, showing marked resilience during the global financial crisis in most countries (Figure 3). Experience has varied across countries and regions, but now around half of all developing countries have tax to GDP ratios above 15 percent. By the same token, the other half do not achieve this fairly modest tax-GDP ratio, suggesting that there is significant scope and need to do more.<sup>11</sup>

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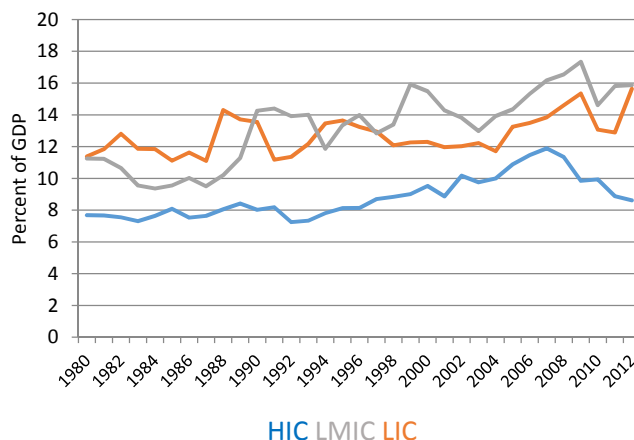
<sup>11</sup> IMF, 2011

**Figure 3: Trends in Tax Ratios in Developing Countries**



Source: IMF data. Note: Low income and lower middle income countries only.

**Figure 4: Revenue from Corporate Taxation, by income group**



Source: IMF data. Note: Excludes resource-rich countries.

17. It is not only the level of taxation that matters, but also its structure—which can have powerful effects on both efficiency and fairness. On this, the key trends<sup>12</sup> have been a continued increase in revenue from the value-added tax (VAT), a continued decline in tariff revenues, and a resilience (to some extent surprising, as will be seen) of revenue from the corporate income tax (CIT). The continued weakness of the personal income tax (PIT) also stands out. While it makes little sense to look at the progressivity of the tax system without also taking into account the distributional impact of the spending it finances, it is nonetheless a concern that the tax instrument that most directly addresses equity concerns remains underdeveloped.

18. Revenue targets are widely used and can play a useful role in galvanizing DRM. But a single-minded focus on levels collected, without paying adequate attention to the tax structure that produces these revenues, would be misplaced: development needs are unlikely to be best served by, for instance, denying or delaying VAT refunds which distorts economic activity, or increasing tax rates on trade which discourages trade openness and growth.

19. **Challenges.** Many of the challenges developing countries face in boosting revenues are long-established. These include: compliance problems in dealing with the hard-to-tax (not only small businesses but also, for instance, professionals); reduced tariff revenues due to trade liberalization, including regional integration; weak revenue administrations, low taxpayer morale and poor governance (corruption indicators are strongly associated with low revenue); and shallow use of financial institutions, potentially a valuable source of tax-relevant information.

20. Another set of challenges—far from new, but now more widely recognized—is posed by tax avoidance activities of international corporations. These are the subject of the ambitious G20-OECD Action Plan on ‘Base Erosion and Profit Shifting’ (BEPS), which is intended to bolster the international tax system. These challenges are no less important for developing countries than for advanced economies: the former are, if anything, more reliant on CIT revenue (Figure 4). Single tax cases can

<sup>12</sup> More recent data confirm the continuation of these trends, which are discussed in IMF, 2011

represent a significant proportion of all tax revenue; and the evidence points to the importance of spillovers from tax policy measures in other countries.<sup>13</sup> It is critical that the avenues now being developed by the OECD and others for the direct participation of developing countries in the BEPS process are fully exploited, and that the shaping of the international tax system is sensitive to their particular circumstances and capacities. Finally, even a successful outcome to the BEPS process, in terms of addressing some of the most egregious forms of tax avoidance, may not address the deeper challenges to revenue collection posed by international tax competition.

21. Current international initiatives to promote exchange of information (EOI) between tax administrations can potentially enhance the enforcement capacity of national tax administrations, including in taxing residents' holdings of assets abroad. As with BEPS issues, however, it will be important to be realistic as to the likely revenue gains from these sources and retain focus on core efforts to improve domestic tax systems and administrations.

22. An area of importance is the category of resources known as "illicit financial flows". There is no agreed definition of what constitutes illicit flows. In general, the focus is on: the proceeds of commercial tax evasion; revenues from criminal activities; and public corruption. Each of these components, as well as a number of their sub-components, raises different issues that need to be addressed differently as appropriate. While the amount of money lost to "illicit financial flows" is hard to verify, available evidence emphasizes that the amounts are significant and pose systemic problems, particularly in resource-rich countries and FCS. With respect to transparency, civil society can play an important role in creating and raising trust in public institutions, which indirectly encourages investment. Citizen engagement can help both increase DRM and better channel it to development outcomes.

23. One area where new tax initiatives will be needed is in containing the adverse environmental impact of some forms of economic activity, through taxes that "get prices right" in terms of fully reflecting environmental costs. Calibrated taxation of energy prices will be particularly important in containing the extensive local pollution damage and congestion problems in many developing countries, as well as in reducing CO<sub>2</sub> emissions.

24. In addition to tax and revenue initiatives, mobilizing domestic financial resources through increased domestic borrowing has been a trend in emerging market economies over the last decade. Within the context of a prudent medium-term fiscal framework and public debt management strategy, countries may have room to mobilize additional resources from this source as their economies expand. In addition, when managed appropriately, such borrowing has a catalytic impact on domestic financial sector development, as outlined in Section II-B-2 below. Caution may be in order with regard to rapid accumulation of debt and the associated risk of experiencing debt distress, which is a concern in some developing countries.

25. ***The Way Ahead.*** A strategy to strengthen DRM should focus on mutually reinforcing core elements: stronger administrations, simpler revenue systems, and collective action to address international tax issues, evasion and avoidance more widely. Noting and responding to significant differences among developing countries, key elements of this strategy would include (with accompanying spending measures as needed):<sup>14</sup>

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<sup>13</sup> IMF, 2014

<sup>14</sup> For instance, to protect the poorest when the VAT base is expanded.

- The unspectacular but critical work of building effective and trusted tax administrations;
- Eliminating exemptions and incentives that forego revenue to little useful end;
- Implementing broad-based and simple VATs, complemented with excises on a limited number of items to address other policy priorities such as public health;
- Building a broad-based and fair PIT;
- Establishing a broad-based CIT, at rates competitive by international standards;
- Implementing simplified tax regimes for micro and small enterprises;
- Designing and implementing international tax rules, in relation to both BEPS and EOI, that are sensitive to the circumstances and capacities of LICs and supported by coordinated international action; and
- Establishing fiscal regimes for extractive industries that provide investors with confidence while ensuring that revenue collections respond appropriately to changing circumstances.

## **2) Public Expenditures – improving quality and efficiency to increase development impact**

26. A second, critically important route to expand the budgetary revenues available for development financing purposes is to improve the efficiency of government spending—cutting low priority or poorly-designed spending to free up resources (“fiscal space”) for additional development-focused outlays. With strong performance metrics and monitoring, public expenditures can have increasing impact and create higher quality, sustainable results. Outcomes can be tracked and improved over time when independent oversight structures are put in place to reinforce transparency and results. Reforms in subsidy regimes and procurement can increase public expenditure efficiency.

27. Worldwide, it is estimated that subsidies cost US\$ 1.9 trillion, or 8 percent of total government spending. Energy subsidies alone are currently estimated at US\$ 300 billion.<sup>15</sup> Beyond subsidy and procurement reform, in many countries there is also significant scope for improving public sector administration and the efficiency of state owned enterprises. Efficiency and service delivery in the social sectors could be improved by more systemically measuring outputs and outcomes across service providers, and by targeting social spending more effectively. Developing countries have a good opportunity to learn from experience and evaluative work by embracing the ongoing “big data” revolution.

28. **Challenges.** Planning capacity in many countries is often inadequate. Policy implementation is often impaired by poor expenditure control, inadequate accounting systems, poor cash management, inadequate financial reporting, and poorly motivated staff. Poor policy design can give insufficient attention to setting appropriate incentives, relying unduly on the efficacy of centralized direction. Political economy concerns may be important. For example, political sensitivities including public resistance to the elimination of untargeted price subsidies (such as inefficient fuel subsidies) have prevented the shift to more efficient, narrowly targeted subsidies even when they are designed to protect the most vulnerable.

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<sup>15</sup> IMF, 2014

29. ***The Way Ahead.*** Reform efforts should follow key principles, including a) using targeted rather than across-the-board spending cuts, and b) for social spending, replacing generalized transfers (e.g., price subsidies) with targeted income transfers, accompanied by improvements in the core area of budget execution. This includes cash and treasury management to avoid cash bottlenecks and lower funding costs. Other important areas include:

- Developing evidence-based public programs, policies and public sector performance metrics (and investing in country data and national statistical systems);
- Enhancing public investment management capacity;
- Reducing and eliminating energy subsidies, and setting prices that internalize the environmental harm of energy use;
- Strengthening independent oversight arrangements, including in the areas of citizen participation, supreme audit institutions and parliaments;
- Strengthening public sector pay, performance and ethics;
- Developing nationwide fiscal responsibility laws that address inter alia frameworks for sustainable sub-national borrowing (relevant to section 3 on subnational finance); and
- Improving gender targeting of public expenditures.

### **3) Subnational Finance – vital link to the SDGs**

30. The role of subnational governments in delivering public goods and services is becoming increasingly important to achieving development goals, as more responsibilities for public investment and the provision of goods and services are transferred to states, provinces and cities. Notably, cities are central to the climate change issue: over 70 per cent of global GHG emissions and energy consumption occur in cities.<sup>16</sup> Transparent and prudent local financial management is critical for the integrity of the local public sector and to build and retain the trust of local residents.

31. ***Challenges.*** Sub-national governments typically rely heavily on transfers from the central government, collecting limited tax revenue for themselves. They often have limited flexibility with respect to both investment and expenditure decisions and limited independence with respect to financing options. Capacity weaknesses are usually more significant than at the national level, including the quality of governance and efficiency of spending.

32. ***The Way Ahead.*** The scale of decentralization and the extent of delegation of powers to sub-national governments varies markedly, and an unfinished agenda remains in many countries. Areas of focus include:

- Strengthening the capacity of local governments, including to raise their own revenues, to manage expenditures (including investment programming) and service delivery, and to borrow and manage debt prudently;
- Developing inter-government fiscal transfer arrangements that take into account investment needs of sub-national governments, equalize fiscal capacity and expenditure needs across levels of government, and clearly delineate spending responsibilities between the different layers of government;

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<sup>16</sup> “Financing the Transition: Sustainable Infrastructure in Cities” Z/Yen Group and WWF, 2015

- Implementing user-pays approaches that reduce the financing gap between the cost of needed investments and the level of revenue generation from users, while respecting affordability constraints; and
- Promoting access to long-term finance to minimize risks in the lifecycle of infrastructure investments.

#### **4) Policy Guidance and Technical Assistance – expanding support to public resource mobilization and expenditure**

33. New diagnostic tools are being developed for tax administration, public expenditure efficiency, financial integrity to combat corruption, and debt management to support countries in taking the lead with mobilizing their domestic resources. To provide increased support to developing countries in their efforts to enhance country capacity in these areas, the MDBs and the IMF commit to:

- Improve coordination with each other, donors and client countries in the provision of policy guidance and capacity building services for DRM and public expenditure to address the “way ahead” measures described in this section.
- Strengthen collaboration on international tax issues with the OECD and the United Nations;
- Support policy networks at the sub-regional, regional and global level, to share experience and good practices, and knowledge and standards for domestic reform efforts;
- Scale up practicable guidance and tool-kits in key areas, e.g. cost/effectiveness analysis in adopting and assessing tax breaks and subsidy reforms and regular review of assumptions and impact
- Support the adoption of sound practice guidelines and analytical tools in the area of public debt management; and
- Enhance collaboration in supporting countries and facilitate inter-agency planning, in sharing tools, standards, and analysis for capacity building to improve data and statistical systems to monitor tax collection and the impact of public expenditures.

#### **B. Engaging and Incentivizing Private Finance**

34. The private sector will play a pivotal role in financing the post-2015 development agenda. As recognized in the Monterrey Consensus, private investment underpins economic growth, know-how and technology transfer, job creation, and productivity gains. Ultimately, functioning, self-sustaining private sector markets that respond to economic demands are central to the sustainability of development gains.

35. The drivers of private finance are distinctly different from the motivations of domestic public finance. Private sector firms seek investment opportunities based on risk-return considerations. To be effective, public sector measures to encourage private investment need either to decrease perceived risk or increase anticipated returns. Governments play a critical role in providing a conducive investment climate through supportive governance structures, competition policy, hard and soft infrastructure and instruments that foster healthy, commercially sustainable markets.

36. At the same time, businesses realize that unmet societal needs, not just economic needs, define markets. Consequently, business success occurs alongside societal progress. Risk-return considerations increasingly take into account, for instance, the need to ensure sustainability throughout supply chains, and the benefits of increasing the customer base to include unserved customers at the base of the pyramid. More and more examples of business solutions to development challenges are



surfacing to demonstrate how private business can deliver profit and development impact simultaneously. A growing class of international investors make investment to generate measurable positive social or environmental impact alongside a financial return.

37. The overarching context for MDB and IMF engagement to support private development finance is based on policy guidance to countries to build strong macroeconomic and investment climates; and for the MDBs, leveraging and crowding in private investment in their capacity as innovators, intermediaries and co-investors, based on their principles of engagement.

38. ***Role of MDBs and the IMF: policy guidance to countries.*** A supportive business environment and a sound macroeconomic framework are critical to attract private capital flows, including foreign direct investment. Private finance flows more readily to markets when policymakers establish a predictable, transparent, and conducive investment climate that provides opportunities and incentives for firms to invest productively. The policy measures to attract investment vary according to country needs and circumstances, but can include:

- A clear and predictable tax regime;
- Reasonably open trade policy;
- A sound monetary policy framework and sustainable exchange rate policy;
- Streamlined and consistent administrative and regulatory processes;
- Predictable investment framework and rule of law;
- A regulatory framework that supports open competition and well-functioning labor markets; and
- Structures that support entrepreneurship and innovation.

39. Many countries are making progress on improving their investment climate, but challenges remain. At the interface of the public and private sectors, MDBs and the IMF contribute to legal and policy reforms and programs to improve the investment climate, and, for MDBs, acting as technical advisers and as honest brokers between commercial interests and policymakers. MDBs can build platforms connecting private sector corporations and financial institutions with policymakers and official agencies, to identify and put in place or revise the most important policies.

40. ***MDB principles of engagement.*** MDBs work on the ground to support the full life cycle of investments—from advice on sectoral and business climate reforms, to project preparation, transaction structuring and financing, implementation, and monitoring and evaluation of development impact. The fundamental approach of MDBs is to identify areas of market failure or areas where markets are yet non-existent, and then to structure commercially viable projects in these areas. MDBs work to provide the necessary incentives (political comfort, appropriate pricing structures, regulatory advice, advisory funds, risk sharing, co-investments, etc.) to address risk-return requirements of the private sector while encouraging inclusion and high standards.

41. For MDBs, mobilizing private finance must avoid undermining the formation of sustainable markets. Principles developed by international finance institutions guide successful engagement with the private sector:

- Ensuring that MDB support of the private sector provides a contribution beyond what is available from the market;
- Catalyzing actions and investments by other market participants as much as possible;
- Supporting projects that are commercially sustainable;

- Reinforcing markets;
- Promoting high standards in areas such as transparency in project award, procurement, and safeguards; and
- Promoting gender equality and women’s full participation as economic agents.

42. The engagement principles are applied sensibly. For example, in some instances it may be important to support projects that will not be commercially sustainable, at least in the near term. Subsidies or concessionality may be justified when there are clearly identified market or institutional failures, such as when costs related to certain externalities are not internalized (e.g. CO<sub>2</sub> emissions, congestion delays, and road accidents). In these cases, concessional or blended finance, used transparently and designed to be phased out over time, can be supportive of sustainable private sector development.

43. Within the context of a supportive investment climate and strong principles for engaging with the private sector, there are a number of critical areas where MDBs can strengthen private capital flows in support of development, discussed below.

### **1) Enhancing project preparation and risk mitigation to catalyze investment flows**

44. **Challenges.** The regulatory changes in response to the 2008 global financial crisis improved global financial stability, but also have had some unintended negative consequences, reducing incentives for large multinational financial institutions to invest in developing countries. Large banks were particularly affected; institutional investors need to step in, but this won’t occur automatically. Existing and emerging pools of capital (such as sovereign wealth funds, insurance company resources and pension funds) could be important financing sources for emerging markets, particularly for large infrastructure and energy investments. Impediments to tapping these sources include a dearth of well-prepared, bankable projects with suitable risk/return profiles, a lack of certainty in many countries due to policy changes and reforms needed to sustain private investments (especially pertinent to the long-lived infrastructure sector), and a lack of capacity among institutional investors to evaluate and monitor individual project risk.

45. **Along with direct financing and investment (and often by mobilizing non-reimbursable resources from donor-funded trust funds), MDBs can provide technical and financing services to alleviate these obstacles:**

- **Project preparation support** – MDBs work in every region to build up a pipeline of bankable, investment-ready projects. Dedicated Project Preparation Facilities at the national, regional and global levels provide technical expertise to shorten timelines, ensure project structures are appealing to investors and financiers active in the sector, and help address regulatory and policy environment issues important to potential investors.
- **Credit enhancement and risk mitigation** – MDBs have a role to play as client governments and official entities engage at the individual project level to mitigate risks and support innovative financing. This role may involve bringing together public and private sector partners and developing individual Public-Private Partnership (PPP) transactions<sup>17</sup> with relevant guarantees,

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<sup>17</sup> Public-Private Partnerships are an important example of where an effective and supportive business enabling environment is fundamental to success. *World Bank Group Support to Public-Private Partnerships: Lessons from Experience in Client Countries*, WBG Independent Evaluation Group, 2014

risk insurance, blended finance, and other risk mitigation measures (e.g. structured finance, tapping investors with higher risk tolerance for instance through diaspora bonds). Many programs along these lines have been successfully implemented, and sharing South-South and Triangular knowledge via MDBs can be a significant way of scaling successful models.

- ***Pooled vehicles*** (or co-investment platforms) can be structured (with MDB expertise, financing and/or management) at the national and multilateral levels. Pooled vehicles help catalyze private capital, reducing individual investor costs for project preparation and execution. They provide credit enhancement and allow risks to be shared with official entities, and are a source of project structuring advice to strengthen project pipelines. Investors can participate in MDB loans and equity portfolios, or infrastructure funds and platforms.

## **2) Promoting local capital markets and facilitating greater access to local currency finance**

46. ***Challenges.*** Local currency sources of finance are essential for private business and governments to avoid the risks associated with foreign currency borrowings. Emerging market local currency options (especially government bond markets) have been growing rapidly, but remain heavily concentrated in a few countries. Many developing countries lack well-functioning, liquid local currency bond markets and other local currency vehicles, particularly corporate bond markets.

47. **MDBs and the IMF play multiple roles:**

- ***Directly providing local currency finance*** to unhedged or vulnerable borrowers and their intermediaries. These activities depend on the ability of MDBs to access sources of local currency. Depending on the size of the market, MDBs can provide local currency financing through swap markets, issuance of local currency bonds, or in less developed markets, mechanisms arranged with central banks.
- ***Building up domestic capital markets.*** MDBs and the IMF encourage wider participation in domestic capital markets by providing technical and policy advice on institutions and regulations. MDBs also provide various forms of credit enhancement, structured finance, and hedging solutions to increase the attractiveness of bond offerings. In appropriate circumstances, MDBs develop regional bond funds that can provide greater operating scale to lower costs and diversify risks. Other important MDB contributions to local capital market development include addressing information asymmetry with benchmark and market data, and expanding the domestic investor base through growth of domestic insurance and pension funds.

## **3) Supporting local banking and other domestic finance to expand reach**

48. ***Challenges.*** Domestic financial intermediaries—banks and non-bank financial institutions—can be a vital source of stable, sustainable finance, which fosters growth and creates jobs. But with insufficient information or capacity to take on unfamiliar risks, banks and other financial intermediaries in many markets have limited incentive and ability to lend to the real economy, particularly MSMEs and under-served individuals.

- ***Support for Financial Inclusion through Micro, Small and Medium Enterprise (MSME) Finance*** - MDBs support financial inclusion through MSME finance and strengthening the domestic financial sector. They work through financial intermediaries such as local banks, microfinance institutions, private equity funds, and leasing companies to target under-served

customer segments. MDBs may support sound credit systems that allow banks to successfully move down-market to smaller companies; help non-regulated financial institutions to become regulated banks; promote innovative capital-enhancing debt-funding structures, such as securitization and portfolio risk-sharing; encourage the use of new lending methodologies to increase funding availability to MSMEs; provide equity injections to banks as well as to leasing and insurance companies; support regional private equity funds; and offer tailored credit lines for on-lending to MSMEs, women in business, and sustainable energy projects.

- ***Enhancing financial infrastructure to encourage lending to under-served parts of the economy*** - MDBs help build up deposit insurance agencies and credit bureaus, and develop new forms of collateral that allow more clients to become creditworthy.
- ***Dialogue with financial regulators to promote responsible growth in financial markets*** – MDBs and the IMF provide technical advice and assistance to financial regulators on how to maintain financial market stability while facilitating market deepening.
- ***Working with MSMEs to help them attract private finance*** - Since private finance flows according to expected risk-return, assessments of the viability of MSMEs will also drive their access to finance. Thus, strengthening MSMEs to make them more credit-worthy borrowers through interventions such as enabling environment reforms and capacity building advisory services are critical.
- ***Designing policies that promote financial inclusion and access to finance for individuals*** - Access to basic financial accounts for individuals, women in particular, has been shown to increase the amount households save and to contribute to improvements in preventive health, productivity, and income. Technology-enabled solutions, such as mobile money accounts, can be a major factor in reducing the number of unbanked individuals. MDBs have built a significant evidence-based body of knowledge on policies to promote financial inclusion. MDB project lending in support of innovative financial models can extend financial sector reach.
- ***Enhancing the flow and use of remittances*** – Remittances are individual, private flows used for a range of purposes including for development goals, and they represent very substantial private-to-private resources. MDBs play an important role in measuring and monitoring remittance flows and uses, and supporting government policies that foster efficient, low-cost transfers.

#### **4) Enhancing the impact of the private sector via inclusion and sustainability**

49. ***Challenges.*** There is a critical need for inclusive and sustainable business models. Inclusive business models that involve low-income consumers, distributors and suppliers can bring income-generating opportunities and provide products and services where they were previously unaffordable or unavailable. A growing number of innovative business models are reaching under-served populations in financially sustainable ways at the “base of the pyramid”, representing an annual US\$ 5 trillion market (in purchasing power parity terms) with over 4.5 billion people. Meanwhile, companies are increasingly including in their long term strategies sustainability considerations related to the environment, society and governance (ESG). Companies face a more complex array of tradeoffs and risks and increasingly recognize that their ESG responsibilities are integral to their long-term financial success and development goals.

- ***Support for regulatory frameworks and institutions that promote inclusive business and inclusive growth*** - MDBs can help governments develop regulations and institutions that support an inclusive business environment, and can help identify characteristics of low-income market segments. MDBs use their platforms to facilitate knowledge transfer on commercially viable business models (e.g. supporting South-South replication of proven business models) and can

provide financing for innovative approaches. Support from official actors is critical to help the private sector broaden its inclusive growth.

- ***Building sound economic and regulatory frameworks to incentivize climate-friendly, resource-responsible entities*** - The public sector plays an important role in introducing sound economic and regulatory frameworks, for example, creating price signals that provide incentives for cleaner entities, or setting standards in climate and resource sectors.
- ***Support for private sector role in addressing sustainability challenges*** - Although many voluntary private sector efforts are already underway, they vary widely. MDB support of the private sector can help address sustainability challenges by 1) setting global environmental, social and corporate governance standards and requiring all companies financed to adhere to high standards; 2) financing to support or scale up enterprises that are aligned with those aims (such as projects in energy efficiency, renewable energy, climate adaptation, water efficiency and waste management); and 3) information sharing on profitable, sustainable practices in areas such as agribusiness, food security and water.

#### **5) Providing new and expanded channels to enhance private sector flows and expertise towards development**

50. The private sector can be a source of significant financial flows and expertise that MDBs can help channel towards development goals. MDBs also have a range of investment, advisory and convening capabilities that make them a strong partner for leveraging the private sector. They are increasing resources and efforts to promote development through private sector channels. Looking ahead, there are a number of opportunities for MDBs to enhance their support:

- ***Building upon substantial MDB direct private sector investments*** - Direct private sector investments in developing countries by MDBs have more than doubled over the last ten years, to over US\$ 30 billion in 2013 (not including syndications and other mobilization);
- ***MDBs strategy to expand their support for the private sector*** - The MDBs have or are putting in place strategies to expand their focus on the private sector, and are in the process of strengthening their capabilities both to provide investment climate advice and interventions (including technical assistance at the client level), and to invest directly in the private sector;
- ***Enhancing MDBs capabilities and operating model for greater impact*** - The MDBs are changing the way they do business and the structure of their operations in order to focus more on the private sector and to enhance the integration of public and private approaches for greater development impact; and
- ***Playing an honest public-private broker role at the country-level and on the global stage*** – MDBs are well positioned to design public-private investment solutions.

### C. International Public Finance: Global Issues, Regional and Global Public Goods

51. Together with their development partners in both developed and developing countries, UN agencies, single-sector funds, foundations, civil society organizations and others, the MDBs and the IMF work to understand emerging global and regional issues and to develop ways to address them. Global issues sometimes, but not always, involve global public goods (GPGs)—public goods can be national, regional or international in nature.<sup>18</sup>

52. Global economic stability is an example of a critical international public good that no one country can deliver. In the context of a global economy that is increasingly interconnected, measures to ensure that the international economic system is resilient in the face of shocks are of central importance. Strengthening global financial and economic stability requires better coordination of regulatory policies across countries, coupled with closer dialogue among national policy-makers to ensure that spillover effects of national policies on other countries are appropriately factored into national policy-setting. Providing analytical inputs and recommendations for these discussions is a primary output of IMF multilateral surveillance. In addition, some MDBs and the IMF advise international regulatory bodies on the needs and constraints of developing countries, and also provide support and technical assistance to developing countries on how best to manage and adapt to changing financial market conditions.

53. While the spectrum of GPGs that are important for sustainable development is quite broad, progress on GPGs is usually driven first and foremost at the country level, through government and private sector action. Indeed, many of the so-called “global” or “vertical” funds created since Monterrey to tackle specific MDGs are not focused on GPGs. They are instruments that are geared toward local and national impact, including primary education, smallholder welfare, or nutrition.<sup>19</sup> The global funds that do focus on GPGs, such as climate change mitigation and immunization, also provide financing primarily through nationally based processes and structures.

54. Addressing specific issues as a global effort and mobilizing the resources to finance them can be critical to make a difference (e.g. the establishment of the Global Fund to fight AIDS, Tuberculosis, and Malaria, in response to the HIV/AIDS crisis). The MDBs have experience in establishing, managing and implementing global funds; where global financing facilities are useful, there are lessons learned from the experience of the last 15 years.

- Global funds and financing facilities may be effective where there are multi-country benefits and international consensus about the issue, the needs and the planned response.
- Where a global response is necessary, working through and alongside existing instruments and institutions to the extent feasible makes sense. Creating new funds can be costly and time-consuming, and can further fragment the already complicated aid architecture.

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<sup>18</sup> “Technically, public goods are “those that share two rare qualities – non-excludability and non-rivalry, in economists’ jargon. This means, respectively, that when provided to one party, the public good is available to all, and consumption of the public good by one party does not reduce the amount available to the others to consume. Traditional examples of national public goods included traffic control systems and national security – goods that benefit all citizens and national private actors but that none could manage or supply on their own initiative.” *Meeting Global Challenges*, International Task Force on Global Public Goods, 2006

<sup>19</sup> *Global Funds in an Era of Aid Consolidation: What Systemic Challenges Lie Ahead?*, ODI, 2011

- When global issues need to be managed globally, coordinated and country-driven, cross-sectoral, integrated approaches remain critical. Work in one sector affects and is affected by others: education gains improve health outcomes, for example, and health gains create better students. New funds must be structured to complement and strengthen country systems and strategies.

55. Part of the core work of the MDBs and the IMF is providing analytical work and technical assistance to identify challenges and help countries find ways to address them. Identifying the critical gaps and possible solutions for the systems in each country can help develop the right strategy and plans. For example, a resilient health system that supports citizens effectively will also be able to respond more effectively to health crises, as revealed by the recent Ebola outbreak. Ultimately, when we do not invest in prevention and preparedness, catastrophic events like pandemics can have regional or global effects that are very costly.

### **Climate Change and implications for development**

56. To avoid rolling back decades of work toward ending poverty, development processes need to build in climate change considerations. Experience has shown that well-designed development actions can capture multiple local and global benefits, such as improved air quality and health, higher agricultural productivity, and increased employment, while addressing climate change.

57. With development finance expected to deliver sustainable results, and countries having to make strategic choices as to which of their development priorities should be supported, it is useful to look at how financing can meet development goals and deliver climate benefits.

58. **Resilient development is smart development:** Enhancing resilience (the ability of societies to resist, cope with, and recover from shocks) can reduce the impact of disasters and ensure development is robust to climate related shocks. From 1980 to 2012, disaster-related losses amounted to US\$ 3.8 trillion globally,<sup>20</sup> 87% due to weather extremes. Those communities facing the highest future poverty risk had the lowest capacity in climate risk preparedness.

59. It is critical to build climate and disaster resilience into national policies and development assistance going forward. While it is recognized that this comes with an upfront investment cost, well-designed actions can be more cost-effective in the long run than disaster relief.<sup>21</sup> The benefits of avoided and reduced losses can outweigh investment costs on average by about four to one.<sup>22</sup> In addition, more focus is needed on ex-ante adaptation to long term climate change. Over the past two decades only 4 cents of every dollar spent on development aid was invested in defending that aid from the impact of disasters.

60. **Capturing multiple benefits for development and climate change.** Development finance can be more effective when development interventions enable climate benefits to accrue alongside other economic benefits. Many climate change mitigation actions have strong local co-benefits in terms

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<sup>20</sup> Building Resilience: Integrating Climate and Disaster Risk into Development, World Bank, 2013

<sup>21</sup> Foresight: Reducing Risks of Future Disasters – Priorities for Decision Makers. Final Project Report. The Government Office for Science, London. (In all cases, a cost-benefit analysis of risk management is greatly influenced by value judgments on the discount rate, the time horizon over which benefits and costs are accrued, and the inclusion of exclusion of non-monetary outcomes, such as loss of human life), Government of the UK, 2012

<sup>22</sup> Reviewing the Economic Efficiency of Disaster Risk Management. Review commissioned by the Foresight Project: Reducing Risks of Future Disasters. UK Government Office for Science, Mechler, R., 2012

of improved local health, productivity, energy security, and reduced economic waste. Opportunities exist to harness these benefits in countries of various income levels, but tend to be more prevalent when incomes are lower, institutions and markets are weaker, and there is a legacy of distortive policies.<sup>23</sup> This presents opportunities to capture development and climate benefits through measures that integrate policy and institutional reforms in development finance support or prioritize funding for projects with development and climate co-benefits.

61. Sometimes actions to capture local co-benefits fail to deliver global “dividends”, including when the benefits of sustainable investments may not be sufficient to justify increased short-term costs when compared to traditional, non-sustainable projects. For example, in some cases, energy investment plans do not emphasize renewable energy and policymakers do not have the option of improving energy access in the country to capture the global climate benefit. In these situations finance may have a role to play, for example in the form of results-based incentive payments (e.g., purchase of carbon credits or allowances, grants, targeted concessional loans or guarantee products) to encourage low-carbon development choices or to shift the risk-reward profile of a financing structure.

62. When countries have more developed private sectors and markets, additional incentives and concessional finance can be designed to attract private financing into the overall project finance. Policy conditionalities, such as carbon pricing and energy subsidy reforms, are very important to ensure sustainable outcomes and guide resource allocation.

63. **Role of the MDBs and IMF:** To deliver development goals that are sustainable will require systematically integrating climate change, disaster risk and natural resource management considerations into macroeconomic policy frameworks, strategies, plans and operations and building development solutions that support a low carbon growth path. As trusted intermediaries for development finance, MDBs can:

- Work with governments to create enabling policy frameworks that allow development finance to capture climate benefits and minimize climate threats while delivering development outcomes;
- Be instrumental in allocating funds to maximize development and climate gains and employing financial structures that attract private financial participation in mitigation and adaptation projects;
- Further their strong track record in catalyzing private sector support for climate action<sup>24</sup> through support to critical first-mover projects that give markets confidence for replication. When concessional donor finance is combined with MDB funds, the leverage effect can be significant;
- Support innovation by developing new instruments for development and climate-smart investments as well as sharing and disseminating good practices; and
- Develop common metrics and analytical tools to help measure performance.

64. Still, the smart deployment of currently available development finance is a necessary but insufficient step. Additional resources are needed to address the urgent needs of those that are highly vulnerable to climate change in the near term. Delays carry higher costs and risk irreversible impacts.

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<sup>23</sup> For example, where common development barriers have yet to be addressed, such as high pre-existing inefficiencies (e.g. legacy of inefficient carbon-intensive infrastructure), policy distortions (e.g. energy price subsidies) or poor governance and high income disparities.

<sup>24</sup> *The Scope for MDB Leverage and Innovation in Climate Finance:* A Background paper for Mobilizing Climate Finance prepared at the request of G20 Finance Ministers. Multilateral Development Banks, 2011



### III. Financing Solutions to Help Achieve the SDGs

65. The SDGs are ambitious, and substantial additional financing will be needed to achieve them. The SDGs are inter-related, not independent. They cannot be funded as individual goals; what is “spent” on each goal will affect and be affected by the funding needs for other goals. Rather, the national development needs and plans of each country will determine the baseline cost of achieving the SDGs.<sup>25</sup> In any case, continued innovation in ways to find and use additional, efficient and effective financing solutions will be important. MDBs have a strong track record of catalyzing public and private finance through a number of innovative solutions, many of which they helped to develop.

66. Such financing solutions enhance impact in different ways. “**Additional**” finance provides more money for development, generating a distinctly new flow of funds. “**Efficient**” financial mechanisms add value by reducing risks and improving financial characteristics of a program rather than raising new funds. “**Effective**” mechanisms are designed to increase purchasing power of available funds by incorporating incentive structures that enhance accountability and ownership. Many initiatives combine these attributes.

67. MDB financing solutions can be grouped into four broad categories. Each comprises specific approaches and tools that can be customized to the circumstances of a goal or program. There is no one-size-fits-all solution:

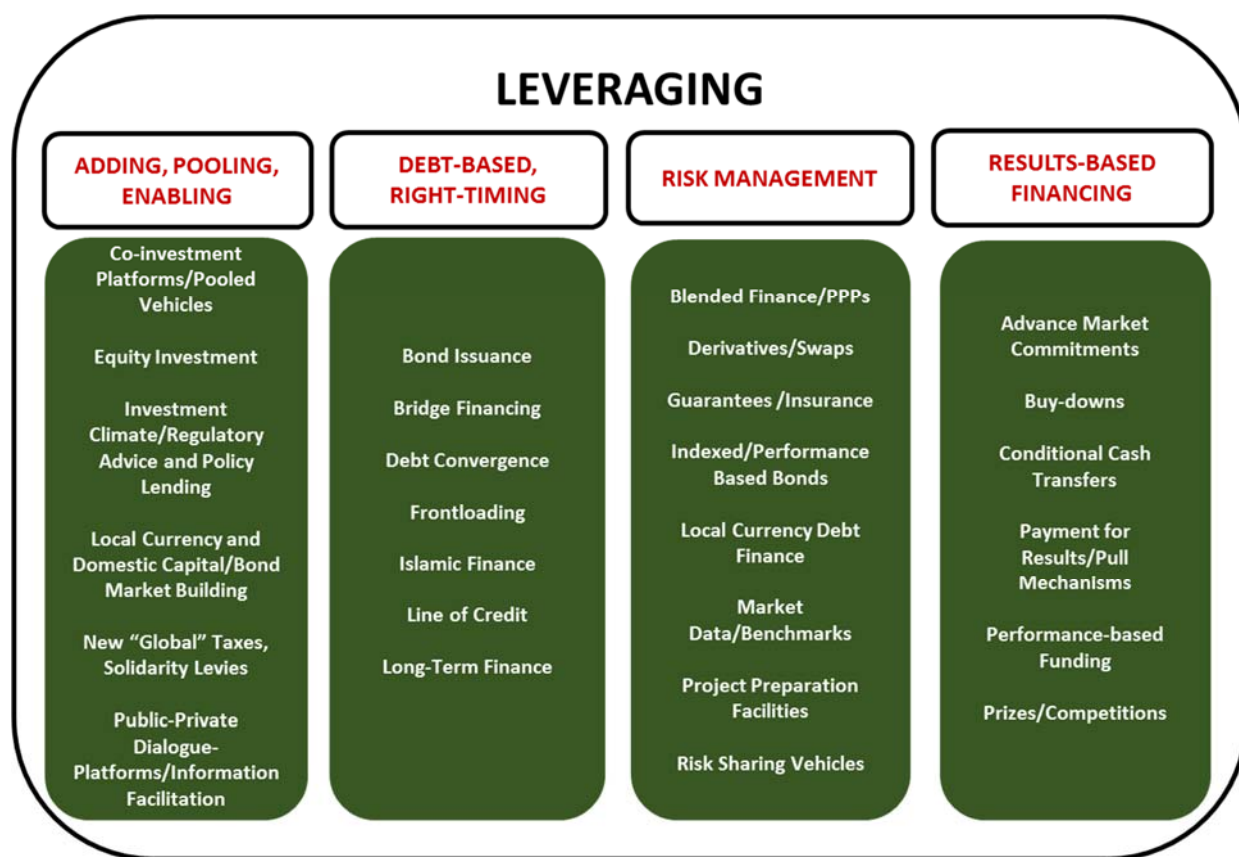
- 1) **Adding, Pooling, Enabling:** This category of solutions covers new flows, such as taxes or fees, as well as policy-driven “flows” that are not traditional finance instruments/investments but do generate economic or financial value. Equity investment is also fundamental, creating new businesses, generating new flows, jobs, and growth. Policy guidance and lending strengthen the domestic policy, legal, tax, regulatory and institutional environment for many purposes: to increase a country’s available resources and creditworthiness; enhance development impact (more results for the money), and encourage and attract private investment.
- 2) **Debt-based/right-timing instruments:** These help transform cash flows to provide a steady, predictable stream for development programs based on their liquidity needs and time horizons. Issuers and financial intermediaries, including the MDBs, have developed a range of new instruments targeted to specific markets and financing purposes, ranging from green bonds and vaccine bonds to the fast-growing Islamic Finance market. Different instruments have been designed to provide long-term flows, predictability, flexibility, or short-term bridging, to meet specific development finance needs.
- 3) **Financial risk management mechanisms:** These are initiatives which leverage public funds to create investment incentives for the private sector, through mechanisms that correct market failures, reduce sovereign risk and/or macroeconomic and climate driven vulnerabilities. Various forms of risk management approaches, including guarantees, derivatives, blended finance, pooled vehicles, project preparations facilities, and others, provide insurance protection for risk sharing or risk transfer.

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<sup>25</sup> A series of country studies is underway to analyze how specific countries in diverse circumstances can use a combination of public, private, domestic, and international sources of financing to fund the implementation of the SDGs. *See* [worldbank.org/post2015](http://worldbank.org/post2015)

- 4) **Results-based financing:** Two benefits occur when funding is reserved until results are delivered. First, the risk of success/failure may be transferred in part or in full to the entities conducting the work. This promotes accountability, ownership, improved management, and effectiveness of service providers. Second, it may help crowd in additional funding toward the development objective. Results-based instruments include conditional cash transfers, pull mechanisms, performance-based funding, and impact investment.

68. The following table shows major instruments under each category. Specific initiatives may have attributes in more than one category. Equity investment, for example, can be seen as the foundation for bringing in additional funding; at the same time, providing equity can be similar to a guarantee as an effective form of risk mitigation, making an entity more resilient. A catalogue of financing solutions will be made available online (initially at [worldbank.org/post2015](http://worldbank.org/post2015)).



### Looking Ahead

69. With our shared and unique institutional mandates, each of the organizations that prepared this joint Discussion Note shares a common commitment to reducing poverty and inequality worldwide. The MDBs and the IMF reaffirm their commitment to ramp up efforts to further enhance coordination and complementarity among themselves, as well as with other development actors, in the implementation of the proposed SDGs in each of the developing countries they serve.

Globally, countries will lead, and—collectively—the MDBs and the IMF will remain central to the global development toolkit.

70. Employing our convening role and comparative advantages as multilateral financial institutions to help translate the proposed SDGs into realistic targets, policies and programs, we commit to:

- **Explore increasing available financial resources**, examining how to make best use of our specific financial models and circumstances to increase funds available to client countries.
- **Expand policy guidance and technical assistance** to increase the amounts, quality and efficiency of resource mobilization and public expenditure by national, subnational and municipal entities, deepening our respective capacities to serve and support clients.
- **Promote and catalyze private investment**, addressing risk and uncertainty, helping to mobilize and scale up resources and co-investment from traditional, institutional and other public and private investors, and exploring financial solutions that provide new flows, greater efficiency and more effective development impact.
- **Support international action on regional and global development issues**, based on our regional and global expertise in tackling regional and global development issues including, *inter alia*, climate change and cross-border health crises; for example designing and implementing climate actions that generate multiple local health, agricultural, employment and resilience benefits.
- **Further improve coordination and alignment**, continuing to strengthen working relationships with each other and with existing and new development partners.

71. **Next Steps:** This joint Discussion Note has been agreed through the respective MDBs and IMF management processes. Governance bodies, including to date the executive boards of the WBG, IMF and the Inter-American Development Bank, have reviewed it as relevant in accordance with their procedures. The suggestions, comments and inputs from the Development Committee as well as from these reviews will be taken on board. The Discussion Note is the basis for ongoing work and interaction among the MDBs, the IMF, shareholder countries, partners, and other international, regional, bilateral and national development institutions and development banks in the run-up to the Addis Conference. The Discussion Note, along with additional information and documents relevant to the MDB and IMF post-2015 Financing for Development work, will be available online ([worldbank.org/post2015](http://worldbank.org/post2015)).

### Questions for the Development Committee

1. How can the MDBs and the IMF further coordinate their individual and shared responsibilities and activities to support client countries implement the proposed SDGs?
2. Does the proposed approach, with its focus on catalyzing increased private and public resources to support country-driven policies and programs, reflect the ambition for the MDBs and the IMF to contribute to the transformation of development finance needed to achieve the SDGs?
3. How can MDB and IMF stakeholders contribute to the post-2015 agenda and to the collective work of the MDBs and IMF?