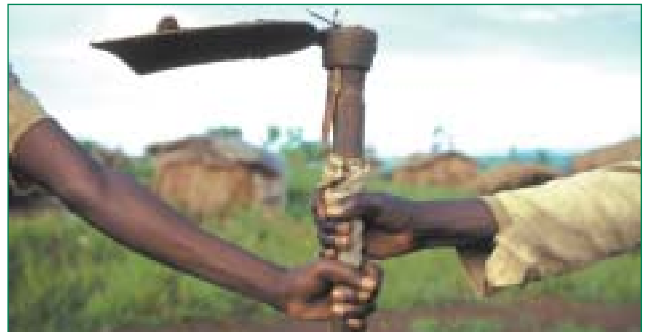
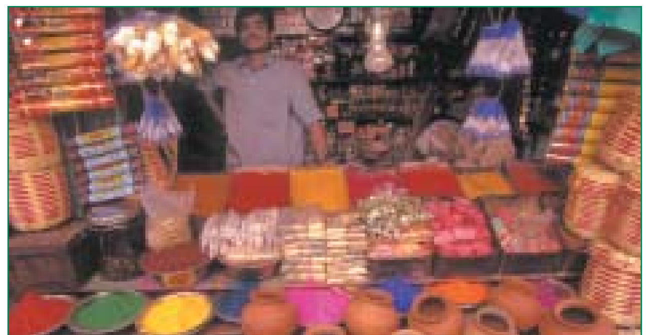
International Finance Facility

January 2003





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1 THE PROPOSAL

The **International Finance Facility (IFF)** will help meet the internationally agreed Millennium Development Goals.

The founding principle of the IFF is long-term, but conditional, funding guaranteed to the poorest countries by the richest countries.

On the basis of these long-term donor commitments, comprising a series of pledges for a flow of annual payments to the IFF, the facility would leverage in additional money from the international capital markets.

It would seek to raise the amount of development aid from just over $50 billion a year today to $100 billion per year in the years to 2015.

The facility would be in existence for around fifteen years, with the period for repaying its borrowing lasting around thirty years.

1.1 This document sets out a proposal for a new International Finance Facility (IFF).

1.2 The Facility is inspired by the world's shared commitment to tackling illiteracy, disease, poverty and underdevelopment in the poorest countries.

1.3 It is designed to provide additional financing to help meet the internationally agreed Millennium Development Goals – so that by 2015 every child is in education, infant mortality is reduced by two thirds and poverty is halved.

1.4 The founding principle is long-term, but conditional, funding guaranteed to the poorest countries by the richest countries.

1.5 The Facility would be built from long-term donor commitments, some of which have already been made by the richest countries. On the basis of these long-term donor commitments, the Facility would leverage in additional money from the international capital markets.

1.6 The Facility would provide a temporary framework to raise additional funds for development for the years leading up to 2015.

1.7 The Facility would be in existence for around 15 years, with the period for repaying its borrowing lasting around 30 years.

1.8 In this way the Facility would seek to bridge the development financing gap between the resources that have already been pledged and what is needed.

1.9 It would seek to raise the amount of development aid from just over $50 billion a year today to $100 billion per year in the years to 2015.

1.10 These are the sums of development assistance needed to meet the Millennium Development Goals agreed by both the international community and individual countries.

1.11 It has been estimated that:

- to achieve primary schooling for all, perhaps $10 billion more each year needs to be spent on education;
- to reduce infant and maternal mortality, around $12 billion extra health expenditure is required each year; and
- anti-poverty programmes needed to halve world poverty would require investment of up to $20 billion a year.

1.12 The new Facility, providing an additional $50 billion a year, could thus help in partnership with additional resources mobilised by developing country governments to:

- ensure that every child has primary schooling;
- radically reduce avoidable deaths from infant and maternal mortality, and tackle HIV/AIDS; and
- halve world poverty.

1.13 To achieve this the Facility would need to ensure not only additional money, but value for money.

1.14 While no country genuinely pursuing stability and reform should be denied the possibility of help to finance education, health and anti-poverty policies, each country drawing on the Facility will have to show the commitment to reform necessary to ensure that money will achieve the results intended.

1.15 It will do this by also providing, for the first time, a predictable and stable flow of a critical mass of aid, allowing developing countries to plan long-term investment effectively and efficiently, and linking up aid across health, education and anti-poverty programmes.

1.16 The Facility would thus build on existing agreements between developed and developing countries, with each country:

- pursuing anti-corruption, pro-stability policies and agreeing the necessary transparency in economic and corporate policies to achieve this;
- committing to the Doha development agenda - a sequenced opening up of markets to global trade;
- improving the environment to encourage increased investment and private sector-led growth; and
- as part of country-owned poverty reduction strategies, agreeing clear and costed plans for building education, health and economic capacity, seeing development aid not as compensation for past failures but as investment for future success.

1.17 So under our proposal the developed world would make a commitment to providing long-term, untied, and effective aid to the countries that need it most. The agreed target of 0.7 per cent of Gross National Income (GNI) in aid, to which developed countries have signed up, would be reached more quickly.

1.18 Section 2 of this prospectus addresses the need for an International Finance Facility. It sets out the Millennium Development Goals that we have to meet, and how far we are from meeting them. Sections 3 and 4 then set out what we have to do to meet these goals and the conditions that must be in place for the successful launch and development of an International Finance Facility. Finally, Section 5 sets out the details of the Facility itself.

2 WHY WE NEED AN INTERNATIONAL FINANCE FACILITY

2.1 In 2000, in a set of historic agreements, all the countries in the United Nations (UN), with the support of the International Monetary Fund (IMF), the World Bank, the OECD, the G7, and the G20, signed up to a set of Millennium Development Goals.

2.2 Meeting these historic goals will help to:

- eradicate extreme poverty and hunger by halving, between 1990 and 2015, the proportion of people whose income is less than one dollar a day and the proportion of people who suffer from hunger;
- achieve universal primary education by ensuring that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling;
- reduce by two thirds, between 1990 and 2015, the under-five mortality rate and reduce by three quarters the maternal mortality rate, as we combat HIV/AIDS, malaria, TB and other diseases; and
- ensure a sustainable environment - halving by 2015 the proportion of people without sustainable access to safe drinking water and sanitation, and tackling the problems of 100 million slum dwellers.

2.3 And it was agreed in 2000 that if we are to will these historic and shared ends we must also will the means.

2.4 But, having decided in 2000 to achieve these ambitious Millennium Development Goals, we are already, even in 2003, at risk of not fully meeting many of these targets.

2.5 On present trends, we are on track to halve the proportion of people living in extreme poverty by 2015. But one quarter of the world's population live in countries that are not on track to meet the goal of primary education for all by 2015. And the best estimate is that by 2015, on current trends, 100 million children (80 million in Africa alone) will still be denied schooling.

2.6 On current forecasts, 81 countries will not meet our goal of reducing infant mortality by two-thirds. And 47 out of 48 Sub-Saharan countries will fail to meet our goals of reducing maternal mortality.

2.7 Despite good progress in East and South Asia, elsewhere we are not on track to meet our target of halving poverty by 2015. Indeed, in Sub-Saharan Africa, Latin America and the Caribbean, the Middle East and North Africa, and the transition economies of Europe and Central Asia, the absolute number of people living on less than $1 a day increased by around 100 million people between 1990 and 1999. Sub-Saharan Africa remains the greatest concern and is facing new and terrible burdens, though some reforming countries in Africa are making progress towards these goals.

2.8 The facts are that today over 115 million children do not go to school, that 7 million die each year from avoidable diseases, and that over 1 billion people live on less than one dollar a day.

3 ACHIEVING THE MILLENNIUM DEVELOPMENT GOALS

3.1 Achieving our shared global objectives requires much more than just a financial mechanism. It requires an enhanced understanding between developed and developing countries.

3.2 To achieve the Millennium Development Goals we need something as bold as a twenty-first century equivalent of the Marshall Plan: a new compact or deal not just for aid but for development between the richest and the poorest countries.

3.3 The Marshall Plan was founded on an unprecedented transfer of 1 per cent of national income from the United States to rebuild Europe after the Second World War, financing reform and economic reconstruction. In the same way, today's development compact should be that, in return for reform in developing countries' economies, finance for development is on offer.

3.4 The first building block of such a compact is a new rules-based system for global economic growth and stability under which all countries can prosper. This should be founded on codes and standards to which all countries, developed and developing, can sign up and against which they can be monitored. The adoption of clear and transparent procedures and institutions in economic decisions would improve stability, deter corruption, and engender investor confidence. Along with the rule of law, they are essential preconditions for sustained development. These standards will also help countries that are in the process of liberalising capital markets, by helping to avoid destabilising and speculative inflows. This approach is a better guarantee of both an investment-friendly environment and long-term stability.

3.5 For developing countries, economic stability is a fundamental prerequisite for successful poverty reduction strategies. In adopting codes and standards, it will be important for them to sequence these reforms carefully, and we will continue to work with them to agree clear routes to achieve international standards.

3.6 The second building block is moving forward the great progress made at Doha by the swift adoption of an improved trade regime. This is essential for developing countries to participate on fair terms in the world economy.

3.7 Full trade liberalisation globally and trade-related reforms could lift at least three hundred million people out of poverty by 2015. Trade subsidies in the developed world total $350 billion each year – seven times greater than the aid provided to developing countries. Taking forward the Doha agenda requires reforms by all the richest countries. We call on the European Union, for example, to take action to tackle Europe's agricultural protectionism, which not only costs European consumers billions of euros but also entrenches poverty in the developing world.

3.8 Radical trade reform could be worth $150 billion a year to developing countries. But equally, developing countries should continue to do more. In the last forty years those developing countries that have been more open, and traded more in the world economy, have seen faster growth rates than those that have remained closed.

3.9 The UK Government is committed to a trading system where all countries participate on equal terms. We strongly support the new trade round launched at Doha. We are committed to Doha's core development agenda - a package of measures that will lead to major gains for developing countries and the poorest people in these countries.

3.10 The third building block is creating open markets and investment opportunities in developing countries so they can become engines of growth for the world economy, creating more favourable business environments in which private sector investment can be more productive. Country-owned poverty reduction strategies should create the right domestic conditions for business investment including improved infrastructure, the creation of an educated and healthy workforce, and sound legal processes that deter corruption and protect investment.

3.11 Business should also adopt best practice and high corporate standards so that they can engage as reliable and consistent partners in the development process. This requires good corporate standards backed up by the creation in developing countries of an enhanced dialogue between public and private sectors.

3.12 Putting in place these building blocks for stability, investment and trade, as some developing countries are in the process of doing, will demand radical changes by developing countries and developed countries. But while these are the long-term basis for global prosperity, much of the world's population cannot benefit from them without a fourth building block: a substantial transfer of additional resources from the richest to the poorest countries in the form of investment for development.

4 A NEW APPROACH TO AID

4.1 We cannot achieve the 2015 development goals if we revert to the old approach of providing aid as short-term compensation for the effects of poor policies, misdirected expenditure and corrupt behaviour.

4.2 Instead of a compensation for failure, aid must be an investment for success based on clear, country-owned poverty reduction strategies, building on the foundations of stability, trade and investment.

4.3 Aid must be used as it is in the more successful cases to finance the real priorities for poor people and the key investments that will put countries on a sustainable and lasting path to growth, prosperity and participation in the world economy.

4.4 Experience shows that aid works best when it supports strategies designed by developing country governments working with civil society. These strategies are a transparent framework for setting both priorities and the policies to support them: policies that foster stability and growth, create the conditions for investment and trade, and ensure that resources are directed efficiently to fighting poverty. They also provide the yardstick against which hard results can be measured. And African countries, for example, are demonstrating their shared commitment through the New Partnership for Africa's Development (NEPAD) to pursuing such reforms.

MAKING AID MORE EFFECTIVE

4.5 Within the framework of poverty reduction strategies, we must strengthen the measures that ensure the effectiveness of current and increased aid flows:

- increased international scrutiny of aid quality. As part of this approach, the UK proposes improved external scrutiny of the quality of bilateral and multilateral programmes;
- streamlined conditionality that should be transparently agreed and based on country-owned poverty reduction strategies. This will allow governments to be more accountable to their citizens and donors;
- increased efforts to fight corruption and improve public financial management. Corruption diverts resources away from activities that are vital for poverty reduction, deters private investors and may even erode public support for development assistance;
- in return, donors must also act to improve aid effectiveness by pooling aid, providing predictable, long-term funding in support of developing countries' poverty reduction strategies. This will achieve economies of scale and avoid wasteful duplication, bureaucracy and ineffectiveness;

- improved targeting of aid towards low-income countries with sound policies and large numbers of poor people. Too much aid is still going to countries that use it badly or that have relatively high-income levels. In 1998, aid per poor person was $950 in the Middle East and North Africa, compared with only $9 per capita for low-income countries as a whole. The European Commission spent only 38 per cent of its Official Development Assistance in low-income countries in 2000. The UK is committed to ensuring that 90 per cent of its bilateral aid resources will be spent in low-income countries by 2006; and
- untying of aid: OECD countries should work towards untying all aid, including food aid and technical cooperation, as the UK has done. Untying aid can increase the value for money achieved from aid by up to 20 per cent.

4.6 Overall, better use and focusing of aid by bilateral donors and international institutions could make aid 50 per cent more effective in reducing poverty.

AID ABSORPTION

4.7 This new approach will deliver a step change in aid effectiveness. It will also allow an increase in aid from $50 to $100 billion a year to be used effectively to help meet the Millennium Development Goals (MDGs) by 2015.

4.8 We know that many countries have used aid well, including those, such as South Korea and Malaysia, that have graduated from being poor to becoming industrialised countries.

4.9 And we also know that aid plays a catalytic role for private investment, with every $1 of aid leading to $2 of private investment. Well-designed and well-allocated aid can 'crowd in' private investment, both domestic and foreign.

4.10 Uganda has reduced extreme poverty by 20 per cent since 1992, down from 55 per cent of the population, and has doubled the enrolment of primary school children in the space of three years — with aid contributing over 50 per cent of the budget.

4.11 In Vietnam, economic growth supported by aid has contributed to a halving of poverty in the past 15 years, and a two-thirds reduction in child mortality.

4.12 There is good evidence that poor countries can readily absorb higher levels of aid. The World Bank has estimated that two thirds of the countries that are unlikely, on current trends, to achieve the MDGs already have in place appropriate policy and institutional environments, and on-going reforms, to allow an additional $40 billion a year to be absorbed. Countries with good policies have a higher capacity to use aid effectively than those with weaker policies. Early evidence shows that countries implementing poverty reduction strategies have increased poverty reduction spending by 20 per cent.

4.13 In Mozambique, for instance, net resource flows more than doubled between 1996 and 1999, from $0.7 billion to $1.8 billion, and have continued to increase since, increasing aid as a proportion of Gross Domestic Product (GDP) from 20 per cent to 50 per cent. Growth rose from 4.3 per cent in 1995 to a peak of 12.6 per cent in 1998.

4.14 The OECD estimates that India currently only receives $1 of aid per person, corresponding to 0.3 per cent of GDP. Scaling up India's education system by one third would bring about universal primary education at a cost of 1 per cent GDP. Doubling aid could meet a third of this cost, and be readily absorbed into current systems.

4.15 Aid is also critical for countries emerging from conflict. World Bank research suggests that those countries can absorb high flows effectively. With many African countries emerging from conflict, it is critical that substantial resources are made available and sustained over the long term to avoid a return to instability and conflict.

4.16 Increased and more predictable aid will allow countries to plan long-term investment. It will also allow a critical mass of aid to be linked up across health, education and anti-poverty programmes.

4.17 For example, increased investments in education are needed now in order to reduce poverty in the future, and without investment in tackling HIV/AIDS now, efforts to train teachers will be undermined. Similarly, complementary investments in water supply are crucial so that children are not required to spend hours away from school collecting water for their families, and investment in rural roads is critical to allow the poorest communities to access health facilities more easily.

4.18 So with these conditions outlined above in place, we need to find a new mechanism to ensure that developing countries receive the finance necessary for them to meet the 2015 Millennium Development Goals.

5 THE INTERNATIONAL FINANCE FACILITY

Our proposal is an **International Finance Facility** to bridge the gap between the resources that have already been pledged and what is needed to meet the Millennium Development Goals by 2015.

The Facility would be built on long-term donor commitments, comprising a series of pledges for a flow of annual payments to the IFF.

On the basis of these commitments, the Facility would leverage up immediate resources for aid by issuing bonds in the international capital markets.

Aid flows would provide predictability by funding 4 – 5 year disbursement programmes to poor countries through existing bilateral and multilateral mechanisms.

There would be necessary safeguards for donors comprising:

- one or two high-level financing conditions as a basis for the pledges by donors to the Facility; and
- more detailed conditionality, based on clear development criteria, that governs the disbursement programmes funded by the IFF.

The IFF would provide, for the first time, a predictable and stable flow of aid to help finance investment to meet the MDGs.

CREATING THE FACILITY

5.1 In recent years, we have seen great progress in the financing of international development.

5.2 In 2000 the world community agreed the Millennium Development Goals.

5.3 Agreements on debt relief have released $62 billion for 26 countries with burdens of unpayable debt and potentially $100 billion for 38 eligible countries.

5.4 In 2002, at Monterrey and then at Johannesburg the international community signed up not only to a coherent and principled approach to development, but also to the first increase in official development aid for twenty years – an increase in aid of $12 billion a year by 2006. And in Canada in July 2002, a New Partnership for Africa was initiated.

5.5 But as we have seen, the scale of the challenge we face requires us to go much further if the 2015 development goals are to be met.

5.6 The UK's proposal is for an International Finance Facility to bring forward the additional $50 billion per year needed to meet the development goals by 2015: to bridge the gap between the resources that have already been pledged and what is needed.

5.7 The founding principle is long term, but conditional, funding guaranteed to the poorest countries by the richest countries.

5.8 The Facility would be built on long-term donor commitments to provide regular annual payments to the Facility. On the basis of these, it would leverage up immediate resources by issuing bonds in the international capital markets, thus frontloading aid in the period of urgent need.

5.9 Leveraging funds in this way has long been a part of the financing of development through the World Bank and other development banks. But the IFF is structured to meet the limited and specific task of raising the critical mass of financing needed to meet the development goals in 2015.

HOW WOULD IT WORK?

5.10 Donors would make a series of long-term pledges (each of them lasting 15 years) for a flow of annual payments to the IFF. Each pledge would be a binding commitment, subject to high-level financing conditionality. On the back of these pledges the IFF would issue bonds in its own name. It would thus turn the long-term income stream from donors into capital available for more immediate disbursement. The capital raised would be disbursed to the poorest countries with each donor using its chosen mechanism.

5.11 The IFF would be a temporary finance facility, not a development bank or aid agency. The disbursement of funds would be in 4 - 5 year programmes, providing the predictability essential for effective aid, through existing bilateral and multilateral mechanisms, again in line with donor wishes.

5.12 The Facility would be replenished at regular intervals (for example every 3 years). At each replenishment, donors would make a fresh series of annual long-term funding pledges (each lasting 15 years) to the IFF as the basis for further borrowing.

5.13 We envisage that the Facility would be in existence, raising and disbursing funds, for around 15 years. The repayment phase would continue for around a further 15 years after which the Facility would be wound up.

5.14 There would be necessary safeguards for donors to ensure that finance raised by the IFF is used for its intended purpose by countries committed to meeting the development goals.

5.15 Donors' pledges to the IFF would be conditional upon the recipient countries meeting one or two common, clearly defined high-level financing conditions to be agreed. These could be, for example, not having prolonged arrears to the International Monetary Fund (IMF) or UN sanctions. Donor payments to the IFF in respect of a particular country would be suspended if that country breached these high-level financing conditions.

5.16 The 4 - 5 year disbursement programmes to poor countries through existing bilateral and multilateral mechanisms would be subject to more detailed conditionality, based on clear development criteria. This would aim to make the most effective use of aid to achieve the Millennium Development Goals, ensuring that payments were made only to countries implementing agreed poverty reduction strategies.

5.17 The financial risk of a breach of a fundamental financing condition by a specific recipient country and an ensuing suspension of donor payments would lie with the IFF. But the risk to the IFF as a whole would be small provided:

- there were sufficient cash balances in the Facility to be likely to cover the shortfall arising if some recipient countries did not meet the high-level financing conditions;
- the IFF had commitments from a relatively large number of donors balanced across a range of recipient countries; and
- there were limits to the proportion of funding to any one country.

5.18 This would naturally promote a degree of coordination between donors and an effective distribution of resources.

5.19 On this basis, the IFF would be able to leverage a substantial proportion (perhaps up to 80 per cent) of the net present value of the long-term payment stream pledged by donors. Because of the distribution of risk, indications are that the IFF would be able to borrow on very favourable terms reflecting the underlying credit quality of the donor commitments.

5.20 The poverty of many of the countries struggling to meet the development goals and the need to avoid imposing an unsustainable burden of debt means that the bulk of the IFF's funds would be disbursed as grants with perhaps an element of highly concessional loans.

5.21 The IFF could also be used to help fund further debt relief for existing debts, which for some poor and indebted countries is a valuable instrument to help achieve the Millennium Development Goals.

5.22 Discussions with the financial community indicate that the concept is based on sound precedents and that there should be no market barriers to creation of the IFF. The global market for bonds similar to those the IFF would issue is very deep. For example, the international market for AAA bonds issued by supranational institutions and agencies was worth in excess of $360 billion in 2002. There should not therefore be any material impact on the cost of borrowing.

5.23 The IFF is a means to an end – meeting the development goals by 2015. There have been other proposals for new and innovative ways to raise funds to meet these goals, including a Tobin tax, arms tax and an issue of IMF special drawing rights (SDRs). These and other proposals need to be looked at on their merits.

5.24 The IFF concept however offers a number of advantages:

- it is focussed on the financing necessary to help achieve the internationally agreed Millennium Development Goals;
- it is founded on developed countries' long-term commitments to those countries that are striving towards achieving the goals;
- it bridges the gap by leveraging these long-term commitments, enabling the 0.7 per cent target to be met sooner and allowing a substantial increase in aid when it will have the most impact on achieving the targets by 2015;
- it will also allow a critical mass of aid to be linked up as a co-ordinated programme of sustained investment across health, education and other anti-poverty programmes;
- by crystallising long-term commitments from donors it can provide a predictable and stable flow of aid over the medium term to countries that remain committed to achieving the goals, thereby helping provide a catalyst for increased private investment;
- its structure encourages donor pooling and co-ordination, improving the effectiveness of aid. By bringing together donor flows and diversifying risk it is able to secure value for money; and
- it is based on a tried and tested principle for raising development finance.

A CONCERTED RESPONSE TO THE CHALLENGE

5.25 The increased additional funding that the new International Finance Facility could provide offers a means so that no country genuinely committed to poverty reduction and to meeting the Millennium Development Goals need be denied the chance of achieving its goals through lack of resources.

5.26 All will have a part to play in a new compact and each will have responsibilities.

5.27 The developed world must make a commitment to provide long-term, untied, and effective aid to the countries that need it most. Developing countries must demonstrate a commitment to poverty reduction strategies: they must address political and economic stability and create an enabling environment for human, physical and social investment.

5.28 We must also be clear that the private sector has an important role in poverty reduction: without successful engagement of business, domestic and foreign, as reliable and long-term partners in the development process, we cannot hope to secure the economic growth required to lift millions out of extreme poverty.

5.29 And education, health and anti-poverty programmes can only be successfully delivered if we engage civil society. Developing and developed country governments must work in partnership with civil society to keep the Millennium Development Goals at the forefront of international priorities. We must bring together governments and international statesmen and women, the churches and faith communities, Non-Governmental Organisations, business leaders and international organisations into one forum, to drive the process forward.

5.30 For its part, the UK stands ready to provide the long-term commitment that is necessary, but we cannot make progress alone. We seek to build support from within the entire international community, engaging confidence and support from developing country governments themselves and from their citizens. Acting together with clear purpose and urgent resolve the world can by 2015 achieve the Millennium Development Goals and tackle the evil of global poverty.