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EXECUTIVE SUMMARY

In January 2003 HM Treasury and the Department for International Development (DFID) launched a proposal for an International Finance Facility (IFF). The IFF is designed to “frontload” aid to help meet the Millennium Development Goals.

Estimates suggest that development assistance must be doubled and focused on the poorest countries if the Millennium Development Goals are to be met – an increase of at least \$50 billion a year. At the UN’s International Conference on Financing in Monterrey in 2002, donors pledged to provide an additional \$16 billion a year from 2006. But this means a significant resource gap must be bridged if the Millennium Development Goals are to be reached.

The Millennium Development Goals represent different indicators of the same basic poverty. Investments in different sectors must take place simultaneously to ensure sustainable progress. Education, health, access to water, roads and other infrastructure for growth must be tackled at the same time to ensure a lasting exit from poverty. Funding for debt relief should reinforce, not replace, funding to build a skilled work force and the infrastructure and capacity to trade. The IFF, as a stable financing vehicle, could provide the critical mass of additional and predictable funding needed to make lasting progress in all these areas.

Donors are committed to reaching the target of 0.7% ODA/GNI, but a number have fiscal constraints that will not allow them to increase aid levels in the short to medium term. The IFF should be seen as a complement to donors’ long-term commitment to 0.7% ODA/GNI: it would meet the immediate need for resources to meet the MDGs as donors move towards the 0.7% ODA/GNI target.

The IFF:

- is a financing mechanism which would provide up to an additional \$50 billion a year in development assistance between now and 2015.
- would leverage in additional money from the international capital markets by issuing bonds, based on legally-binding long-term donor commitments.
- would be responsible for repaying bondholders using future donor payment streams.
- would disburse resources through existing multilateral and bilateral mechanisms.

The IFF has the following advantages:

- It provides the additional resources necessary to help achieve the MDGs, making funds available for education, health, economic development, debt relief and building trade capacity.
- It locks in the political commitment of donors to Monterrey pledges.
- It provides the predictability and critical mass of aid needed for simultaneous and sustainable investment in developing systems across sectors, tackling the causes rather than the symptoms of poverty.
- It could achieve a step-change in aid effectiveness through donor agreement to high-level aid principles such as untying aid.

Since the proposal for the IFF was launched, it has received broad interest and support from emerging markets, developing countries, international institutions, faith communities, NGOs and business. The World Bank and the IMF are examining the proposal and will produce an interim report at the Spring Meetings in April, and a final report at the Annual Meetings in September. On April 8th, over 50 countries will discuss the IFF proposal at a Ministerial Forum jointly hosted by France and the UK in Paris, part of a process of consultation with emerging markets and developing countries. The proposal has also received support from a wide range of faith communities and NGOs, most recently at a conference at HM Treasury “Making Globalisation Work for All”.¹

The UK continues to consult with governments, international institutions, faith communities, NGOs and business in both developed and developing countries.

This document is designed to facilitate the ongoing process of consultation by setting out:

- ☞ Why we need an IFF: the Millennium Development Goals
- ☞ The Finance Challenge
- ☞ The IFF proposal
- ☞ How the IFF would work
- ☞ The IFF campaign
- ☞ Frequently-asked questions

¹ http://www.hm-treasury.gov.uk/documents/international_issues/global_new_deal/int_gnd_globindex.cfm

MILLENNIUM DEVELOPMENT GOALS

1.1 The International Finance Facility (IFF) is inspired by the international community's commitment, made in 2000 by all the members of the United Nations, to meet the Millennium Development Goals by 2015. The Goals are summarised in the box below.

The Millennium Development Goals

- ☞ Reduce extreme poverty and hunger by halving the proportion of people whose income is less than \$1 a day and the proportion of people who suffer from hunger
- ☞ Achieve universal primary education
- ☞ Promote gender equality and empower women by eliminating gender inequality in primary and secondary education (by 2005)
- ☞ Reduce under-5 child mortality by two-thirds
- ☞ Improve maternal health by reducing maternal mortality by three-quarters
- ☞ Combat HIV/AIDS, malaria and other diseases
- ☞ Ensure environmental sustainability, including by reducing by half the number of people without access to clean drinking water
- ☞ Develop a global partnership for development

More information about the Goals can be found on the United Nation's website¹.

1.2 Some significant progress is being made. We are on track to eradicate extreme poverty by 2015 in some regions. But unless additional resources are made available and used effectively, nearly all the Goals will be missed.

1.3 In the past decade, primary enrolments have increased at twice the rate of the 1980s. But at the current rate of progress more than 70 countries will fail to achieve universal primary education by 2015, and sub-Saharan Africa will not achieve this goal until well beyond 2100.

1.4 Life expectancy in developing countries has increased in the last 40 years by 20 years. But each year two million die unnecessarily from tuberculosis, one million die from malaria, 40 million are suffering from HIV/AIDS, and, on current forecasts, sub-Saharan Africa will achieve the target for reducing child mortality not by 2015 but by 2165.

1.5 There is, in fact, evidence that the plight of some countries has been deteriorating. 54 countries are poorer now than in 1990. In 21 countries a larger proportion of people are going hungry. In 14 countries child mortality has risen. In 12 countries primary school enrolment rates have fallen².

1.6 There is a moral and economic imperative to meet the Goals that almost every country in the world committed to in 2000. Increasing the effectiveness of existing resources will be a vital part of meeting this challenge, but without additional resources the goals will not be met.

¹ www.developmentgoals.org

² UN Development Programme (2003) *Human Development Report 2003 – Millennium Development Goals: A compact among nations to end human poverty*

2

THE FINANCE CHALLENGE

2.1 Estimates suggest that development assistance must be doubled and focused on the poorest countries if the Millennium Development Goals are to be met – an increase of at least \$50 billion a year¹.

2.2 Of that total, at least \$10 billion a year is estimated to be needed to achieve education for all, and a further \$10 billion to combat HIV/AIDS, malaria and tuberculosis.² Up to an additional \$25 billion a year is needed to combat maternal and child mortality.³

2.3 Costing each of the Millennium Development Goals separately can be misleading however. They are all reflections of the same basic poverty and cannot be tackled in isolation from each other – progress is needed against each at the same time. For instance, failing to invest in water and sanitation will undermine spending on rural clinics and doctors. And insufficient investment in women’s education will limit progress in reducing child mortality as, in almost all countries, child-death rates are inversely related to the level of maternal education.⁴ If the Goals are to be achieved therefore, additional resources must be predictable and of a critical mass that allows developing countries to invest in these areas simultaneously. The results will be mutually reinforcing, making aid, and our efforts to reduce poverty, more effective.

2.4 In order to take advantage of freer and fairer trade, developing countries need not just roads and electricity, but also a skilled and healthy workforce. Aid can play a key role in helping countries respond to trade opportunities. It is needed to ensure a domestic environment in which people and firms can produce goods and services efficiently and get them to international markets.

2.5 Additional resources are also needed for debt relief in order to help developing countries become sustainable – and remain sustainable. Unless there is an increase in the overall volume of resources available from donors to poor countries, extra debt relief would simply reallocate resources from one form of financing to another or from non-Heavily-Indebted Poor Countries (HIPC) to HIPC. And having reached debt sustainability, developing countries should be helped to stay sustainable through a more widespread system of grant financing.

Aid works: tackling curable disease

Measles affects 30 to 40 million children a year. About 770,000 children die of the disease – others are left blind, deaf or brain damaged. Yet the cost per child of vaccination (including injection equipment) is \$0.26.

\$25 per child will cover the total cost of immunisation against six major diseases - diphtheria, pertussis, tetanus, polio, measles and TB. For \$250 million, an extra 10 million children a year in low-income countries could be reached.

Development Initiatives

¹ Report of the High-Level Panel on Financing for Development (2002)

² Report of the High-Level Panel on Financing for Development (2002)

³ World Bank (2003) *Supporting sound policies with adequate financing*

⁴ Watkins (2000) *The Oxfam Education Report*

Aid absorption and effectiveness

2.6 There is good evidence that developing countries can absorb increased levels of aid, and use it effectively to reduce poverty. The World Bank has estimated that countries in Asia and Sub-Saharan Africa could effectively manage at least a 60-100% increase in aid flows in the short term.⁵ It would require an additional \$23 billion a year simply to restore aid to the same level in per capita terms that it reached in 1990.

2.7 We know that returns from aid can stay high as aid increases. Economic theory predicts that the marginal benefits of aid fall as the amount of aid increases, but studies indicate that diminishing returns are very dependent on how aid is managed and rarely set in before aid reaches 25-50% GDP. In many cases declining returns are caused by unpredictable aid flows causing macro-economic volatility.

2.8 In Mozambique, net resource flows more than doubled between 1996 and 2001, and aid as a proportion of GDP reached 40%. Growth has averaged between 7 and 8% over the last five years, and poverty has declined by 15% since 1996.⁶

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

2.10 And 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.

Aid works: development in Nepal

In Nepal, UK development assistance is helping to improve the lives of poor people despite the continuing civil conflict between the Maoists and the Government. In partnership with other bilateral and multilateral donors, the UK has contributed to the following achievements:

- ⌘ construction of 500 km of rural roads, opening up six districts to the road network
- ⌘ completion of more than 500 water supply and sanitation schemes
- ⌘ construction of more than 400 community bridges
- ⌘ land, shelter and access to safe drinking water for over 7,000 former bonded labourers and their families
- ⌘ adult literacy packages for more than 50,000 people in 20 districts
- ⌘ provision of essential medical supplies to health posts in 30 districts

DFID

⁵ World Bank (2003) *Supporting sound policies with adequate financing*

⁶ Ministry of Planning and Finance (2004) *Poverty and Well-Being in Mozambique: the second national assessment*

Aid works: the eradication of polio

With the help of aid, polio has been reduced to its lowest level in history. In DRC, despite ongoing conflict, over 11 million children were immunised in 2001 during national immunisation days. As a result, the number of confirmed cases was reduced from 603 to zero within 12 months.

In 2001 over 575 million children under 5 were vaccinated against polio in 94 countries as part of the global push to eradicate polio.

Development Initiatives

2.11 Of course, not all developing country governments will be able to plan for and use large new increases in aid immediately, and some will face capacity constraints in the public sector. That is why the IFF would phase in aid flows gradually, up to the \$50 billion a year, and why donors must help governments to improve their systems. In many cases institutional capacity responds quickly and effectively to increased flows of finance.

2.12 High levels of aid can be managed so as to avoid inflation, or “Dutch disease”. If aid is used productively to overcome domestic supply bottlenecks in the formal or informal sectors or to finance imported goods and services, in most cases inflationary effects will be very limited and outweighed by positive growth and poverty reducing effects.

2.13 And, while increased aid could increase aid dependency in the short to medium term, the experience of well-managed countries in receipt of large aid flows suggests that aid has helped them to grow fast enough to reduce aid dependence over time. The African continent as a whole should be able to sustain the higher spend per capita financed by the IFF within reasonable time frames. For example, if aid to sub-Saharan Africa were doubled from the current \$13bn to \$26bn by 2006 and GDP grows at 4%, then revenue growth could start to substitute for the higher aid flows and sustain the higher total spend per capita by about 2020.

Aid works: education and health in Ethiopia

Almost half of Ethiopia’s population of 66 million is estimated to live in absolute poverty. The country is heavily reliant on aid, which supports around 40% of public sector spending.

Sector programmes have supported dramatic improvements in indicators from a low base:

€# Enrolment in primary education increased by 14% p.a. during 1997/98 – 2000/01, and exceeded the target of 7 million students;

€# Between 1997/98 and 2001/02, immunisation coverage increased from 20% to 42%

Foster, M. (2003) *The Case for Increased Aid*

Aid works: eliminating river blindness in West Africa

River blindness (or onchocerciasis) causes blindness, disfigurement and unbearable itching. But, over 30 years, donor funding for the Onchocerciasis Control Program (OCP) resulted by 2002 in the elimination of the disease from 11 countries in West Africa, including Burkina Faso, Ghana, Mali, and Sierra Leone.

The result: 600,000 cases of river blindness prevented, 5 million productive years of labour added to the economy, 16 million children with lives free of the disease and 25 million hectares of land available for safe settlement.

Development Initiatives

Bridging the finance gap

2.14 At the UN's International Conference on Financing in Monterrey in 2002, donors pledged to provide an additional \$16 billion a year from 2006. But this means a significant resource gap must be bridged if the Millennium Development Goals are to be reached.

2.15 The UK is committed to meeting the 0.7% ODA/GNI target. On current plans the UK will see its ODA/GNI ratio rise to 0.4% in 2005-06, equivalent to £4.9 billion, and up from 0.26% in 1997-98 and 0.34% in 2003-04.

2.16 But although donors are committed to reaching the target of 0.7% ODA/GNI, a number of donor countries have fiscal constraints that will not allow them to increase aid levels in the short to medium term. If we are to meet the MDGs we cannot wait for all countries to achieve the 0.7% target – we need to urgently increase the amount of aid now. The IFF should be seen as a complement to donors' long-term commitment to 0.7% ODA/GNI: it would meet the immediate need for resources to meet the MDGs as donors move towards the 0.7% ODA/GNI target.

Aid works: Rwanda Revenue Authority

Rwanda is recovering from a devastating genocide and civil war in 1994 in which more than 10% of the population is believed to have died. Around half of the national budget is now financed through aid.

With donor support, the Rwanda Revenue Authority was established in 1998 to overcome existing administrative bureaucracies, an absence of professional staff and corruption. Faced with a very low tax base (due to a large subsistence agriculture sector), there has been considerable focus on improving tax administration.

Improvements in revenue performance have been remarkable. Domestic revenue increased by 42% between 1999 and 2002, increasing the share of revenue in GDP from 10% to 13%.

DFID

3

THE UK PROPOSAL FOR AN INTERNATIONAL FINANCE FACILITY

3.1 In January 2003 HM Treasury and the Department for International Development (DFID) launched a proposal for an International Finance Facility. The IFF is designed to “frontload” aid to help meet the internationally agreed Millennium Development Goals. It would double development aid by raising up to an additional \$50 billion a year for the world’s poorest countries in the years to 2015.

What is the IFF?

- ⌘ A temporary financing mechanism to provide up to an additional \$50 billion a year in development assistance between now and 2015.
- ⌘ It would work by ‘frontloading’ donor commitments. Resources promised in the long-term would be invested in tackling the causes rather than the symptoms of poverty today.
- ⌘ Based on legally-binding long-term donor commitments, the IFF would leverage in additional money from the international capital markets by issuing bonds. The IFF, funded by donor countries, would be responsible for repaying bondholders.
- ⌘ The IFF would be a financing mechanism, not a development bank or aid agency, and would disburse resources through existing multilateral and bilateral mechanisms.
- ⌘ Because the IFF would deliver a critical mass of predictable aid, principally in the form of grants and debt relief, it would mark a step-change in aid effectiveness, allowing developing countries to maximise the benefits of long-term investment.
- ⌘ Donors could agree to a set of high-level principles for aid disbursement, which would further improve aid effectiveness by, for instance, untying aid and targeting it at the poorest countries.

“Frontloading” development assistance

3.2 The IFF would ‘frontload’ commitments made at Monterrey by borrowing through bonds issued in the international capital markets, against long-term pledges of Monterrey commitments. This would produce up to an additional \$50 billion a year for disbursement to the poorest countries in the years to 2015. Bonds would be repaid in the years following 2015. Pre-Monterrey commitments would be unaffected.

3.3 There is a strong moral case for bringing forward these additional resources. Inaction condemns millions of children to on-going poverty and disease. In some African countries, teachers are dying from HIV/AIDS faster than they can be trained. But there is also a compelling economic case.

3.4 Borrowing to invest is a well-established domestic and development principle. All donor countries borrow to invest in future prosperity, while the World Bank is a long-standing borrower in the capital markets.

3.5 The IFF's borrowing must pass two economic tests. Firstly, it must meet the sustainable investment principles of the donor country, whereby the rate of return on the investment must be greater than the donor country's target rate of return and greater than the cost of the borrowing needed to bring forward the investment resources. Secondly, because the resources would be invested in recipient countries, the rate of return must also be greater than the recipient countries' own target rate of return for public investment.¹

3.6 The IFF would pass both these tests. The cost of borrowing would be similar to that of multilateral borrowers such as the World Bank. The target rate of return for public investment in developing countries varies between countries but tends to be around 8%. Project and programme investments in the poorest countries deliver much higher returns than both these tests. Evaluations of World Bank projects show average annual rates of return of 23%².

3.7 Investing in poverty reduction through the IFF would not remove the need for continued, substantial development assistance in the medium to long-term, and this is why the UK is committed to the 0.7% ODA/GNI target.

3.8 The IFF only brings forward the Monterrey Commitments, which are just some 0.05% of GNI. So aid flows beyond 2015 could be considerably higher than current levels of aid, even allowing for IFF bond repayments. Firstly, GNI growth will mean larger flows if the ODA/GNI ratio remains constant. Secondly, we expect that the ODA/GNI ratio will get closer to the 0.7% target by 2015.

A step-change in aid effectiveness

3.9 The IFF could not only double aid flows to the poorest countries, but also secure a step-change in aid effectiveness. By locking in commitments from a wide range of donors, it would provide recipient countries with predictable, stable and coordinated aid flows. And it would ensure that these aid flows are used effectively through donor agreement to high-level principles, that might include the following:

Resources to be invested in poverty reduction

Finance from the IFF should ensure that aid is used to finance the key investments that will help put countries on a sustainable and lasting path to poverty reduction, prosperity and participation in the world economy.

Resources to be untied to contracts using suppliers from the donor country

About 21% of all aid is still tied – only 4 out of the 22 DAC members in 2001 had untied all of their aid. Untying aid can increase the value for money achieved from aid by up to 20% and it can boost skilled labour markets with direct and positive spill over for the private sector.

Resources to be provided in predictable multi-year programmes lasting at least three years

If governments are to make long-term commitments to invest in systems and infrastructure, and tackle the causes rather than the symptoms of poverty, then aid commitments must last into the medium term. Unpredictable aid flows make macro-economic management very difficult and add considerable uncertainty to already shock-prone economies.

¹ In many donor countries and recipient countries the Social Time Preference Rate (STPR) is used as the target rate of return for public investments. In the United Kingdom the STPR is 3.5%.

² Foster, M. (2003) *The Case for Increased Aid*

Resources to be disbursed mainly in grant form

The poverty of many of the countries struggling to meet the development goals and the need to avoid an unsustainable burden of debt means that the bulk of the IFF's funds should be disbursed as grants.

Resources to be disbursed to a wide range of recipients

This would ensure that a range of countries benefit and also that the IFF receives the highest possible credit ratings for its bonds.

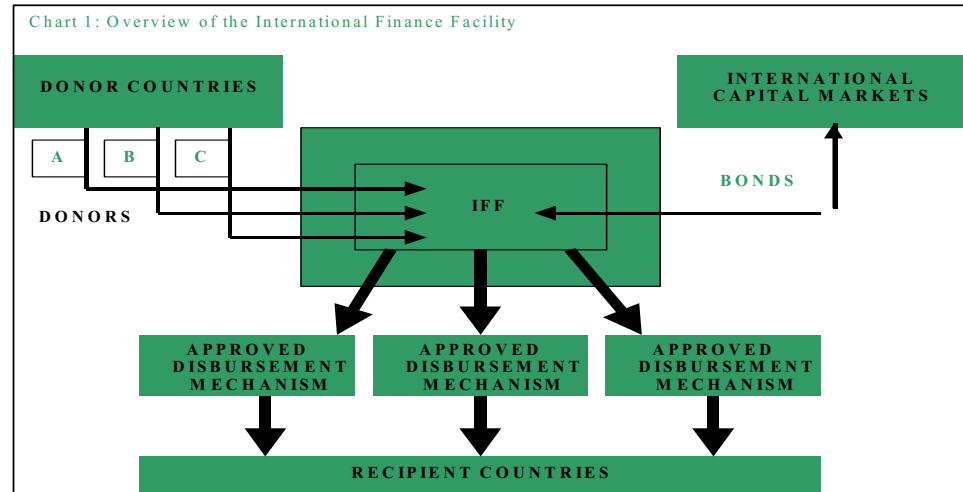
Resources to be targeted at low income countries

Too much aid is still going to countries that have relatively high income levels. For example, in 2001, aid per poor person was \$675 in the Middle East and North Africa, compared with only \$13 per poor person in South Asia.

4

HOW IT WOULD WORK

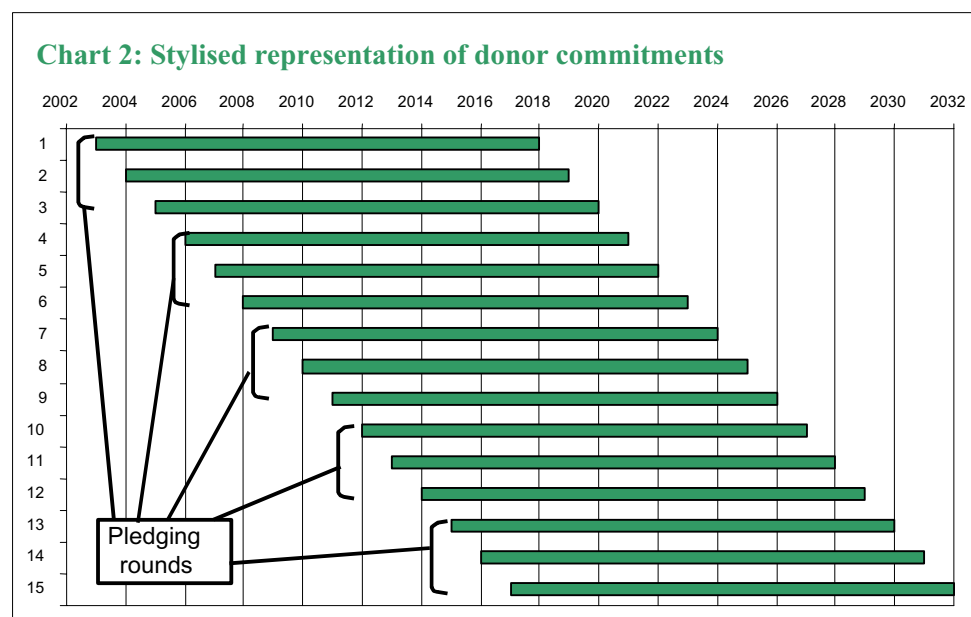
4.1 The Facility is a financing mechanism, not a development bank or disbursement agency. Chart 1 is an overview of the Facility’s structure.



Donor commitments

4.2 IFF income would consist of annual payments from donors. At regular intervals, perhaps every three years, donors would pledge 15-year streams of annual payments to the IFF. These regular ‘pledging rounds’ would build up a pattern of overlapping streams of payments to the IFF. Chart 2 shows what this could look like.

4.3 These donor pledges would be legally binding, subject to a high-level financing condition. Failure by a donor at any time to make any of the payments in a ‘stream’ to which it was committed would be viewed by financial markets as a sovereign default.



4.4 Donors would be ‘severally’ (i.e. individually), not jointly, liable for making their payments to the IFF. They would not have any responsibility for making good payments on which another donor had defaulted.

The high-level financing condition

4.5 Donor pledges would be subject to recipient countries meeting a fundamental condition of good governance, breach of which would make it impossible for the donor to continue to make the committed annual payments to the IFF in respect of that recipient. The condition must be clearly defined and capable of independent determination for the purpose of risk analysis by the international capital markets. It is distinct from the conditions likely to be imposed by disbursement mechanisms used by the IFF.

4.6 The original proposal for the IFF suggested that the financing condition might include the recipient country not falling into prolonged arrears to the IMF, or becoming subject of UN sanctions.

4.7 Subsequent analysis by international capital market experts suggests that avoidance of prolonged IMF arrears could be a suitable financing condition.

Financing costs

4.8 It is important that the IFF minimises the financing costs of leveraging in funds from the international capital markets. This means securing the highest possible rating for the IFF bonds.

4.9 Since the original proposal was launched, discussions with the financial community indicate that, subject to the underlying credit quality of the donor commitments, the Facility could obtain the highest AAA credit rating. This would mean that the Facility could borrow cost-effectively and on similar terms to other multilateral agencies such as the World Bank, and bilateral donors.

4.10 For example, at an interest rate of 5% the IFF would disburse \$500 billion of aid over a 15-year period, with donors making \$720 billion of payments to the IFF over a 30-year period.

Disbursement

4.11 The Facility would seek to disburse its funds through existing effective bilateral and multilateral mechanisms. Funds would be allocated according to a set of high-level principles to be agreed by donors, that would help to ensure the effectiveness of aid financed through the IFF. One of these principles might be to target funds to low-income countries, for instance, the poorest countries in receipt of IDA concessional loans. The allocation to countries and disbursement mechanisms would take account of donors' preferences. Information on the spread of countries receiving IFF funds would be freely available.

4.12 The detailed mechanics of how disbursement decisions are made would depend on the Facility's governance structure. Both this structure, and the high-level principles, would be for agreement by donors at the establishment of the IFF. Although the IFF is principally a financing mechanism with contributions solely from donors, it would also be important for recipient countries to have a significant role within the Facility. The UK is currently consulting on how this can best be achieved.

5

THE IFF CAMPAIGN

5.1 Since the proposal for the IFF was launched, it has received broad interest and support from emerging markets, developing countries, international institutions, faith communities, NGOs and business.

5.2 The proposal has been widely discussed within the G8 group of leading industrialised nations, the European Union, the United Nations, the G20 group of leading and emerging economies, the Commonwealth, at international meetings of the IMF and World Bank, with emerging market and developing countries, and with international organisations such as the UNDP, the UN Economic Commission for Africa, the WHO and NEPAD.

5.3 In September 2003, at the Annual Meetings of the International Monetary Fund (IMF) and the World Bank in Dubai, the international community mandated the IMF and World Bank to carry out an in-depth study of the Facility, alongside other financing proposals. The IMF and World Bank will produce an interim report at the Spring Meetings in April 2004, and a final report at the Annual Meetings in September 2004.

Dubai Annual Meetings' mandate for work on the IFF

'In order to help achieve the Millennium Development Goals, the Committee calls upon the IMF to cooperate with the World Bank in work on aid effectiveness, absorptive capacity, and results-based measurement mechanisms, and in examining the merits of various policy options and financing mechanisms, such as an international financing facility, to mobilize the substantial additional resources that are needed over the medium term. Developing and emerging market countries should also be closely involved.' - Extract from the IMFC communiqué, 21 September 2003

5.4 The Dubai Meetings also agreed that emerging market and developing countries should be closely consulted. The French Government, a supporter of the Facility, will host a Ministerial Forum for over fifty emerging market, developing and donor countries on 8th April, part of the consultation process. It will discuss the case for ODA, aid effectiveness, the case for innovative financing mechanisms and prospects for new systemic approaches.

Support from HIPC countries

'Ministers ... reiterated their support for the proposed new International Financing Facility designed to double ODA to \$100 billion' – Extract from the Commonwealth HIPC Ministerial Statement 2-4 March 2004

5.5 The Facility has received support from a wide range of faith communities and NGOs. On 16th February 2004, HM Treasury hosted a conference “Making Globalisation Work for All”. At the conference, a coalition of NGOs, faith leaders and figures from the business world reached a consensus requiring urgent action in trade reform and increasing aid to meet the MDGs.

5.6 The Global Alliance for Vaccines and Immunization (GAVI) has approached the UK to explore whether the IFF’s frontloading principles can be applied to GAVI so as to increase the resources available to meet the international community’s child mortality targets. The World Health Organisation estimates that the lives of three million children a year can be saved if universal access can be provided to all vaccines which are currently or soon to be available. GAVI is collaborating with the French and UK governments to take this initiative forward.

International Support for the IFF

- # "Proposals such as the International Financial Facility (IFF), which could ensure the substantial increasing of stable and predictable aid flows deserve particular attention from the donor countries." - Holy See statement to UN General Assembly, 16 October 2003
- # “..bold proposal... one of the most important new ideas to come in a long while” – Mark Malloch Brown, Administrator, UNDP, January 2003

5.7 The UK continues to consult with governments, international institutions, faith communities, NGOs and business in both developed and developing countries.

6

FREQUENTLY ASKED QUESTIONS

Is it wrong to borrow for development?

No. The World Bank, for example, is a long-standing borrower in the capital markets, and all countries borrow to invest in their long-term prosperity. There is clear economic justification for borrowing for investment in poverty reduction. The rates of return from such investment are greater than the target rates of return of both donor and recipient countries, and the cost of borrowing. For example, evaluations of World Bank projects show average annual rates of return of 23%.¹

There is also a moral imperative to act now to meet the MDGs, or we stand to lose another generation to poverty. At the current rate of progress sub-Saharan Africa will not meet the goal for reducing child mortality by two thirds until 2165. Without the additional resources that the IFF could provide, we will fail to meet the MDGs.

Is it an alternative to the 0.7% ODA/GNI commitment?

No, the IFF should be seen as complementary to the target of 0.7% ODA/GNI. In the long-term the Government is committed to reaching this target. But due to the fiscal pressures faced by key donors, the international community will not be able to meet the 0.7% target in the short term. If the two or three biggest donors do not get to 0.7% ODA/GNI immediately then even if every other major donor country reached 0.7% we would still not raise the \$50 billion needed to meet the MDGs.

What happens to aid budgets after 2015?

Donor contributions to the IFF would consist of the additional commitments made at Monterrey, leaving pre-Monterrey budgets unaffected. Aid flows beyond 2015 could be considerably higher than the current levels of aid, even allowing for IFF bond repayments. Firstly, higher GNI will mean larger flows if the ODA/GNI ratio remains constant. Secondly, we expect that the ODA/GNI ratio will get closer to the 0.7% target by 2015. Political debate about how far aid budgets are committed and increased by 2015 will be essential but that debate would start from a higher base, as the IFF would have doubled the amount of aid received by recipient countries. The IFF would also provide donors with more time to reach 0.7% at a time of fiscal pressure.

Will it increase developing country debt?

No - the IFF would disburse funds by way of grants or debt relief and so could reduce developing country debt. First, it could provide the additional resources needed for debt relief, without simply reallocating resources from one form of financing to another or from non-Heavily-Indebted Poor Countries (HIPC) to HIPC. Second, it is designed to provide grants to the poorest countries, ensuring debt sustainability. Its borrowing would not be financed by recipient countries but by the facility itself, using donor payment streams.

Would the IFF be a new agency?

No – the IFF would be a temporary financing mechanism specifically designed to raise and allocate the money needed to make progress on meeting the MDGs by 2015. It would seek to use existing effective bilateral and multilateral disbursement mechanisms.

¹ Foster, M. (2003) The Case for Increased Aid

What would the borrowing costs be?

Following consultation with the financial community, the UK anticipates that the interest rate on IFF bonds would be similar to that of other multi-lateral agencies such as the World Bank. It would therefore be significantly lower than the anticipated rate of return from investment.

Who supports the IFF proposal?

Since it was launched a year ago the IFF has received broad interest and support from emerging markets, developing countries, international institutions, faith communities, NGOs and business.

What about proposals such as Special Drawing Rights and the Tobin Tax?

The UK is continuing to explore the full range of options for raising finance for development. The question is whether there is political will to go ahead with alternative proposals, and whether the universal agreement needed to introduce a Tobin tax or an issuance of IMF SDRs could be achieved. The IFF, however, could go ahead and raise the additional finance needed, even without the participation of every country.

How long would the IFF be in existence for?

The IFF is a temporary facility designed to raise the money needed to make progress on meeting the MDGs by 2015. The Facility itself would be in existence, raising and disbursing funds, for around 15 years. The repayment period would continue for around a further 15 years after which the Facility would be wound up.

Would IFF borrowing have an adverse effect on the cost of borrowing?

No – because the international market for bonds similar to those the IFF would issue is very deep. In 2002 funding programmes in AAA bonds issued by US agencies (Fannie Mae, Federal Home Loan Bank, and Freddie Mac), along with KfW, the European Investment Bank, IBRD, the regional development banks and Cades totalled around \$1,060 billion, of which \$360 billion was in international capital markets.

Which countries would benefit from the IFF?

Funds would be allocated according to a set of high-level principles to be agreed by donors. One of these principles might be to target funds to low-income countries, for instance, concessional loans. The allocation to countries and disbursement mechanisms would take account of donors' preferences. Information on the spread of countries receiving IFF funds would be freely available.



FURTHER INFORMATION

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GLOSSARY

CAFOD	Catholic Agency For Overseas Development
DFID	Department for International Development
GDP	Gross Domestic Product
GNI	Gross National Income
HIPC	Heavily-Indebted Poor Country
IBRD	International Bank for Reconstruction and Development, World Bank
IDA	International Development Association, World Bank
IMF	International Monetary Fund
IMFC	International Monetary Fund Committee
MDGs	Millennium Development Goals
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
STPR	Social Time Preference Rate
UNECA	United Nations Economic Commission for Africa
UNDP	United Nations Development Programme
WHO	World Health Organisation