Innovative Financing Options and the Fight against Global Poverty: What's New and What Next?

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Can innovative approaches to mobilizing and utilizing financial resources make a difference in the fight against global poverty? Potentially yes, this chapter argues; however, there is no silver bullet in the offing. New approaches can be useful additions to the current array of instruments and activities for helping developing countries, but will not be so broadly applicable and effective that the present mainstays will replaced or needed less. The innovations that have the biggest payoffs will draw especially on private sector channels, either exclusively or, more likely, in partnership with public sector and multilateral channels. The background for this issue is discussed first, then an overview of the options is provided; various ways of thinking about them are outlined, and, finally, three specific options are examined.

Can innovative approaches to mobilizing and utilizing financial resources make a difference in the fight against global poverty? Potentially yes, this chapter argues. But with a caveat. To get from "potentially" to "certainly" will require much more practical experience with, and careful assessment of, the best of the emerging proposals, few of which have been adequately tested in action thus far.

Further, many proposals, including some that are presently much touted, may not survive this implementation test. Only a few may, in the end, merit full scaling up. Also, though a few may make noticeable contributions, none is likely to totally revolutionize the long, hard work of development; there is no silver bullet in the offing. New approaches can be useful additions to the current array of instruments and activities for helping developing countries, but will not be so broadly applicable and effective that the present mainstays will replaced or needed less.

And finally, the innovations that have the biggest payoffs will draw especially on private sector channels, either exclusively or, more likely, in partnership with public sector and multilateral channels. The background for this issue is discussed first below; then an

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Why This Issue and Why Now

Interest in finding new and better ways to facilitate development—and proposals for how to do so—are not new. Nor are the main reasons for constantly seeking improved solutions; basically, anything that can result in more progress and leverage the limited available resources more effectively is beneficial both for the countries concerned and for the international community of institutions seeking to help them.

Lately, discussion of this subject, and of particular options that appear especially promising, has become much more prominent. There are several reasons for this, and they are important here because they go to the heart of questions that are fundamental for any investigation of possible new approaches to anything. Those questions are: What are the overall objectives being sought? What would the new options be aimed at achieving? Why are the existing options not sufficient? And what would a change from old to new options be expected to produce in benefits (after also taking into account the costs of the change)?

One reason for the heightened search now for new options is that the current situation is widely felt to be inadequate. The prevailing levels of financial flows for development, domestically within developing countries and externally from donors and other partners, and the current mechanisms and practices for mobilizing and utilizing those flows are seen to be insufficient to meet the needs of developing countries to reduce poverty and achieve higher levels of development at the pace that they and the international community would like. Business as usual—it has often been said, whether at Monterrey, Group of Eight (G-8) meetings, or countless other "summits"—will not be enough to tackle critical problems fast enough.

There is some truth to these concerns. Calculations of aid flows in relation to the spending levels required to attain substantial progress invariably show large shortfalls. Among the many areas that feel the pinch, key health threats such as HIV/AIDs and malaria are outrunning efforts to contain them.

A closely related further consideration is that "official development assistance"—the public sector part of total flows—is not only too limited to meet the need but has also recently been cause for some concern because these flows may drift downward rather than move upward in the years ahead. Exceptions like Sweden, which has just transitioned to a commitment to increase its aid substantially so as to reach 1 percent of its gross domestic product, are more positive. However, close watchers of U.S., European, and other flows from countries belonging to the Organization for Economic Cooperation and Development, and the intricate politics behind them, including the shifting views of voters, are less optimistic. Some note that recent proposals such as France's ideas on global taxation of air travel and Gordon Brown's International Finance Facility may have emerged at least in part from concern that conventional aid flows would come under downward pressure as voters and their representatives rethought their priorities. U.S. flows, though up notably under the current administration, seem always to be at risk of falling.

An additional consideration is related to the private sector part of total flows. Private flows, which are primarily for investment and other commercial purposes though with a

smaller but influential addition of philanthropic funds as well, greatly dwarf public aid, as is often noted. Private flows help promote development in multiple ways, principally through the impact that investment has on economic activity, employment, incomes, and opportunities for entrepreneurs. Yet their impact is also limited by the fact that the bulk of them go to just the most attractive countries and sectors. They typically have not done much for crucial areas for development that do not provide attractive financial returns, such as education and health.

The obvious question that many have thus asked, especially recently and in light of the growing awareness that public flows are likely to remain highly constrained for the foreseeable future, is whether private flows can somehow evolve in directions that can be of more help to development. This might be either through simply expanding current flows, or through enticing providers of funds to reach places and activities that have benefited little in the past. These thoughts have led, in turn, to sharpened curiosity about what sorts of tools might do just that, and thus whether innovative financing instruments might be needed and might actually help.

Adding to all these factors has been another: the growing dissatisfaction with the lack of more and better results from efforts to support development. Participants around the world in the aid and development business—from citizens to the many organizations involved—are concerned about "development effectiveness." The unfortunate confluence of new generations of players coming to the scene and larger geopolitical sea changes, together with excessive promises for how much could be accomplished by when, and too few successes and too many conspicuous and spectacular failures, has soured many on everything connected with things as they are. Hopes for better progress—and strong passion behind it—have inevitably reinforced interest in seeking new ways of doing things, including in how the funding for development is done.

Moreover, the changing landscape of the global and local challenges that need attention, and the participants' appreciation and priorities among them, have also fueled the search for innovative financing. Global public goods (such as the discovery of new vaccines for major diseases) and public "bads" (the unfolding of the HIV/AIDS pandemic) require different kinds of responses from the older, more traditional struggles to build schools or improve water systems.

Inevitably, given the diversity of these and yet further factors, the question of what the objective is in considering possible new approaches has no simple answer, as the next section further illustrates. Clearly, though, the guiding principle for deciding which options deserve the most attention is which would produce the most net benefits after taking into account the associated costs, including any transition costs. This, however, is no easy task, as will be apparent below.

What Are the Options: A Brief Introductory Tour

The options for new approaches that come up most often for discussion are currently both numerous (one can readily list at least twenty-five) and diverse (ranging from purely public sector to purely private sector initiatives, with a raft of mixed schemes in between). Box 7-1 lists several of them.

Box 7-1. A Plethora of Ideas and Proposals

Global taxes (e.g., for air tickets)	Global Development Bonds
International Finance Facility	Long-term sustainable investing (generation)
Advance Purchase Commitments	Private equity investing with enhancements
Targeted Exclusions from Patent Rights	Angel/patient equity investing (SMEs or GBOs)
Tax Relief for Donating Key Medicines	Tripartite venture capital firms (Rotberg)
Market Interventions for Key Medicines	Microfinance (and tiers of support to it)
Debt Buydowns (e.g., as in the polio campaign)	Microenterprise development
Results-based sequences of loans/grants	Blended value investing (e.g., Domini)
Local currency lending	Social investment partnerships (from GEXSI)
Guarantees from bilaterals or IFIs	Enhanced management of voluntary giving
Infrastructure Guarantee Facility	Electronic-billing-based fundraising
Risk insurance for natural disasters	Remittances (and derivatives from them)
Other risk insurance (e.g., crop prices)	"Use your balance sheet more" (for IFIs)
Debt relief (HIPCs; G-8 2005; and beyond)	"Use your endowment more" (for philanthropy)

Note: SME = small and medium-size enterprises; GBOs = grassroots business organizations; IFIs = international financial institutions; HIPCs = highly indebted poor countries; G-8 = Group of Eight.

Among the purely public sector options, one category encompasses new forms of taxation, the most prominent example being the French proposal, mentioned above, for taxing air travel (or more precisely, the fuel for air travel) in some internationally fair way. Another category, of which Gordon Brown's International Finance Facility (IFF) is the best known, involves borrowing against future aid flows so that resources that can do the most good today rather than tomorrow can in fact be used today. Using securitization and the bond markets, the IFF concept would be most helpful for activities—such as controlling a serious disease—where more action in the near term is vital rather than spreading out a program evenly over all years indefinitely.

A third category concentrates solely on certain health issues, and unlike the previous two, which are entirely public sector actions, links public and private actions together. This category could in principle be readily extended to other areas, even outside the health sector (for instance, to environmental protection), but has not been thus far, mostly because the donors and other partners backing the proposals have a strong focus in their own strategic priorities on health, and within health on the major diseases with high morbidity and mortality implications that are the target of the current proposals.

Among the specific ideas on health options is a reduced version of the IFF aimed at encouraging investment in vaccine development and immunization. This "IFFIm" is slated to be in full flight soon. Another idea is the Advance Purchase Commitment, which would be aimed at strengthening incentives for private sector–led research and development to generate effective vaccines against malaria, and possibly other diseases as well. Still another, referred to here as Targeted Exclusions from Patent Rights, would seek to enable developing countries to get more affordable access to selected medicines, without hurting the producers (because those countries would not purchase them otherwise, given their high cost under

patent). And another, Tax Relief for Donating Key Medicines, would focus on possible changes in U.S. tax rules that would make it more attractive to U.S. producers to donate more to developing countries (there apparently are ways of doing this that would not cost the United States much in terms of lost revenue). Finally, Market Interventions for Key Medicines would team up the funds of interested parties and the power of the marketplace to assure sufficient demand for especially important medicines to elicit and sustain adequate supply.

A fourth category, which could be either a totally public sector play or a combined public and private undertaking, builds upon two ideas, one from polio eradication efforts and the other from the growing chorus of voices insisting on getting results from aid—that is, performance-based support. In the polio case, the idea of Debt Buydowns linked loans by the World Bank with upfront commitments by donors to pay off the loans, thus enabling the recipient country to have the funds it needed, from the start, to tackle polio, but without a long-term buildup in its debt burden. A more recent variation, called results-based sequencing of support, would use the same joining of immediate and upfront commitment of future support, and add to that the requirement that the future support would be released only if and when specific targets, chosen by the recipient country itself, are achieved.

A fifth category comprises various options for modernizing the existing instruments for bilateral or multilateral lending so as to be more responsive to recipient country requirements. For example, lending in local currencies rather than in dollars would reduce the difficulties that some countries experience in managing their currency exchange risks. Or greater flexibility in how guarantees are provided—and on what terms—is a high priority for some countries. Also, there is a strong view in some quarters that some of the multilaterals should "use their balance sheet" more aggressively in the sense of deploying their assets more actively to support their mission, rather than being overly conservative in how much lending and grant making they do.

Other categories cover: further debt relief beyond the Highly Indebted Poor Countries (HIPC) initiative, and/or full implementation of the G-8 Gleneagles commitments; provision of risk insurance for natural disasters and other problems (e.g., collapses in crop prices); and more strategic management of voluntary giving (the tsunami response highlighted the need for this). Also, remittances—payments from migrants back to their home countries—have recently been more clearly appreciated for the hugely important source of financial flows into developing countries that they truly are. Total remittances worldwide now exceed $126 billion per year and for some countries are one of their largest sources of foreign exchange, or *the* largest.

Beyond all these options, there are a host of others that sit more squarely—or entirely—in the private sector alone. The vast and multifaceted engine of private sector investing, both through markets and through direct private arrangements, has a towering presence in the development process as noted above, and questions about how to draw on and harness that dynamism are highly prominent now. One proposal, called Global Development Bonds, is described in a later section.

Other options within the private sector span the spectrum from microsize firms to the slightly larger enterprises at the small and medium-size level, and on into larger ventures. At the micro end, microcredit is now a burgeoning business and crowded field, with many new actors and initiatives.

Microcredit's close cousin, microenterprise development, combines the finance of microcredit with the hands-on technical assistance and training of business development programs. Firms that grow beyond that, and cross into the small end of small and medium-size enterprise, enter a danger zone where the relatively larger infusion of capital they need to thrive is either extremely difficult for them to obtain or comes at a cost so high to them that they are at risk of being crushed by daunting repayment obligations. Both these areas—microenterprise development and the next step up from them—have needs that no one has figured out yet how to meet on a large scale, fully and sustainably.

For still larger firms, and for other forms of larger investments (e.g., project finance for infrastructure improvements), the key challenge is to reduce the risks to investors as much as possible in each specific country situation, because only then will they provide more support in that setting, with more potential benefits for development.

That risk reduction needs to begin with ensuring that the country's "investment climate"—that is, the full gamut or policies and practices that determine its macroeconomic and microeconomic policies, legal and judicial systems, and so on—is as solid as possible, given that investor confidence is everything. Helping countries strengthen their investment climate is a core part of the mandate of the international financial institutions such as the World Bank.

In addition, risk reduction also requires the reduction of high information costs. An investor in New York who is not confident of knowing all the ins and outs of a prospective investment halfway around the world in Indonesia has to assign a much higher risk rating to that undertaking than she would otherwise or than the investment itself, fairly and fully assessed, might warrant. Often that higher rating can be fatal to whether a worthwhile investment goes ahead or not. Markets find ways of lowering information costs where there are good returns to be had, but history is replete with cases where bold steps by early movers were needed to get progress started. Who would need to do what in this case—to jump-start the squeezing down of information costs—and what sorts of enticements would be needed to accelerate that process point toward other potential options for innovative financing. The Global Development Bonds concept outlined below could be developed further in that direction.

What to Make of It All

Making sense of this heterogeneous multitude of proposals—to understand them better and how they relate to one another—is no simple matter. A logical place to begin is with the options' objectives—that is, what they are aiming to achieve. This is a natural extension of the broader question, noted above, of why search at all for new approaches.

For virtually all the options here, the underlying objective has two elements: a specific problem to be fixed, such as a disease or the effects of natural disasters for uninsured parties; and a financing "opportunity," such as debt to be repaid (in the case of the polio debt buydowns) or the terms of lending (in the case of the local currency lending option). In some options, the originating problem to be fixed is more salient, as in the case of market interventions for key medicines. In others, the financing opportunity seems to have had more weight, as in the case of debt relief.

Either way, problems and opportunities should drive decisions about which options to pursue, rather than vice versa—that is, rather than starting with interesting "solutions" and then looking for problems to apply them to. Leading from problems to solutions seems, in fact, to be what the options so far have done, although not entirely. One exception may be electronic-billing-based fundraising, which is a proposal to enable householders in developed countries, on a voluntary basis, to have their monthly electricity, water, or other utility payments automatically rounded up and the "remainder change" then sent to programs in developing countries. Whatever appeal this idea may have—and preliminary estimates suggest it could raise a few billions of dollars a year if done on a global scale—it is unlikely to gain much traction without a compelling link to a tangible problem to be solved, such as malaria control.

Other insights on the options can be gleaned from looking at them as a group from the perspective of the sources and destinations of the financial flows they would generate—that is, where the funds would come from and where they would go to. A table like the one shown in box 7-2 can help in this regard. A more detailed definition of sources and destinations as in box 7-3, with distinctions too among flows (1) within a developing country and (2) from outside, may be needed for some applications.

<table>
<tr><th colspan="8">Box 7-2. Organizing the Options by Where Funds Come From and Go To</th></tr>
<tr><th></th><th>Public Sector</th><th>Financial Sector</th><th>Corporate Sector</th><th>Small, Medium-Size, and Microenterprise</th><th>Civil Society</th><th>Donor Programs</th><th>Households</th></tr>
<tr><td>Public Sector</td><td>Developing countries' own development programs</td><td colspan="2">Government support to financial and corporate institutions during financial or economic crises</td><td>Government-supported local development banks</td><td>Government programs administered or monitored by civil society organizations</td><td>Fee-based services (e.g., technical assistance) provided by international agencies</td><td>Developing countries' own development programs</td></tr>
<tr><td>Financial Sector</td><td colspan="3">International banks take financial positions in developing country projects and firms. Ideas for facilitating more include: Global Development Bonds</td><td>Local bank lending for microcredit and SME development.</td><td>Philanthropic and/or corporate social responsibility initiatives</td><td rowspan="2">Joint ventures, e.g., with the International Finance Corporation.</td><td>Home loans</td></tr>
<tr><td>Corporate Sector</td><td rowspan="2">Tax payments and license fees</td><td>Commercial loans</td><td>Foreign Direct Investment (FDI)</td><td>Subcontracting</td><td></td><td>Wages paid to employees</td></tr>
<tr><td>Small, Medium-Size, and Microenterprises</td><td>Local bank lending for microcredit and SME development</td><td>Franchising</td><td>Start-up support—from families and sweat equity</td><td>SME firms support to local community organizations</td><td>NGO support to SMEs (e.g., Technoserve)</td><td></td></tr>
<tr><td>Civil Society</td><td>Debt Buydowns (e.g., Rotarians on polio)</td><td>Church groups form credit unions</td><td>Growers' collectives negotiate with corporates</td><td colspan="4">NGO programs</td></tr>
<tr><td>The "Official</td><td>Aid projects,</td><td>IFI assistance</td><td colspan="2">IFI programs with private sector</td><td>Donor</td><td>Donor</td><td>Relief</td></tr>
</table>

Donors"	as traditionally done for over 50 years	for strengthening a country's financial sector	partners (as in the IFC and its equivalents in other IFIs)	programs administered or monitored by civil society organizations	cofinancing and other partnerships	programs (e.g., after natural disasters)
Philanthropic Sector	Debt Buydowns (e.g., Gates on polio)	International Finance Facility		Foundations' programs		
Remittances	Community improvement programs	Transmittal fees	Cross-border enterprises and investing by diasporas	Community improvement programs		Migrant workers send money home

Note: SME = small and medium-size enterprises; FDI = foreign direct investment; NGO = nongovernmental organization; IFI = international financial institution; IFC = International Finance Corporation.

Box 7-3. The Sources and Destinations of Financing, in More Detail

Public sector: The various components of developing country governments (e.g., as sovereign, as national agencies such as a ministry of health, as subnational entities, or as public enterprises; and through both on-budget or off-budget flows). Public sector support from outside the country appears under "official donors" support below.

Financial sector: Banks and other financial institutions, pension and insurance entities, other institutional investors, and investment firms including private equity and venture capital groups. The resulting flows, both domestic and from global capital markets, encompass both debt and equity finance.

Corporate sector: Local firms and multinationals (e.g., *Fortune* 100 companies). Includes both their direct investment in plant and equipment, and their portfolio investment.

Small enterprises, medium-size enterprises, and microenterprises: Though some of these firms are big enough to get capital from the markets, many are so small that they have to rely only on start-up sweat-equity. Others, in between these extremes, are at risk of dying in the no-man's land of capital starvation.

Civil society: Nongovernmental organizations, faith-based organizations, labor groups, and the like. Both local and international.

"Official donors": The bilaterals (e.g., the Europeans, the United States, Japan, and others, through their aid programs and sometimes also through other channels too, such as their export-import banks, and foreign and military assistance). Also, the multilaterals (the international financial institutions, including the International Monetary Fund, the World Bank, the regional and subregional development banks), the UN agencies, and others, including the European Union.

Philanthropic sector: Private foundations, corporate foundations, and voluntary giving.

Remittances: Flows across borders (e.g., from migrants back to their home countries) and within countries (e.g., from city workers back to their rural origins).

One insight that emerges from reflecting on the possibilities from this viewpoint is that policymakers seeking the best and most efficient strategies for promoting development are probably not spending enough time thinking about this matrix and where their optimal choices are. The tendency—in government, business, civil society, philanthropies, and donors—to focus mostly on one's own backyard, and not internalize creatively the many

ways of working with others and through their backyards, is always difficult to overcome. Put another way, most thinking today, in the daily work of translating objectives to action, is confined too much to the diagonal entries in box 2 (e.g., from public sector to itself, from financial sector to itself). Too little exploration is done, in the heat of the battle to get things working, of the off-diagonal cells, where one partner links up with another.

Related to this point is another: many of the most interesting options involve combinations of multiple actors, particularly public-private partnerships of diverse kinds. An example—"results-based sequences of loans and grants"—is discussed below.

Ultimately, the best way from the perspective of choosing among options, as noted above, is to ask how they compare in the benefits they would yield in relation to the costs of adopting them. The public as well as the private benefits and costs of the options would need to be carefully considered in that analysis, along with what would happen if no action is taken. The feasibility—institutionally and politically—of the options would also need to be assessed, as would also the time they would take to be effective and the supporting actions, if any, that would be required.

The importance of this benefit/cost perspective is illustrated by a comparison of two options currently attracting attention: the Advance Purchase Commitment and the Targeted Exclusions from Patent Rights for Key Medicines. They have very different footprints in their benefits and costs.

In an Advance Purchase Commitment, a group of funders (public, private, or a mix) would commit to provide financing—say, $3 billion—that would only be called upon if and when some crucial agreed result is achieved—say, the successful development of an effective vaccine against malaria. The funders' binding commitment would be aimed at incentivizing more effort to develop the desired product—in this case, by the institutions that have the capability to do so, which are by and large the pharmaceutical companies (which otherwise have higher-reward, lower-risk options in research for products that sell well in developed countries). This idea is currently in fashion—but it is costly. The $3+ billion price tag may cause sticker shock among the possible funders, and it is not clear that public sources could summon sufficient political will to play their necessary role .

In the Targeted Exclusions from Patent Rights for Key Medicines option, pharmaceutical companies would give up patent protection for selected vital drugs that have no market in the poorest countries. Certain heart medicines, for example, are badly needed everywhere but do not reach very-low-income countries because of their high cost. Under the Targeted Exclusions idea, the patent holder would allow countries with a per capita income below, say, $1,000 a year to produce the drug locally without paying patent royalties. Cheaper generics would then be available in those countries. Proponents argue that this would not hurt the pharmaceutical companies, because they could never sell these particular medicines in such poor countries. They also say that the usual fears about reverse flows of pills produced cheaply in developing countries that would be shipped back to rich country markets would be unfounded in this case, because consumers in the developed world would never accept generics from the least developed world for such a sensitive health need.

This intervention costs little or nothing, unlike the $3+ billion for an Advance Purchase Commitment for a vaccine. But the concept's feasibility, political and otherwise, seems doubtful. Concerns that this initiative would weaken efforts worldwide to strengthen intellectual property rights would spark sharp opposition from those who have large stakes

in that agenda. Indeed, precisely for that reason, the Targeted Exclusions from Patent Rights idea has gone nowhere since it first was suggested a few years ago.

Different problems may require different solutions, obviously. What is appropriate to stimulate development of a vaccine for malaria may be very different from what is right for an existing heart medicine. Some problems too are clearly more significant than others; malaria is a major killer worldwide, whereas heart disease, though a major concern, affects far fewer people.

Other basic questions need to be pursued as well. In particular, are there *gaps* that should be explored? That is, are there options that have not yet been identified that should be looked for because it seems natural that they should, given what can be learned from arrays like box 2? Similarly, are there additional lessons from looking at the whole array together that have not been obvious so far, or at least have not been recognized and acted upon fully to date, because many of the options were developed in isolation from one another?

Although these and other questions deserve further investigation, there is another more important point. Thinking about how the options stack up against one another may in the end be less helpful than identifying those that should be further examined and assessed and then ensuring that they get this attention. In other words, conducting a beauty contest among them is less important than certifying which can fly and which cannot. There is a reason why this observation is especially pertinent in this case. Many different options are needed in practice, because different specific situations with different requirements will be best served by different financing strategies, and because no single option will be so effective that there will not be a need for many.

The options that, from that standpoint, should be examined and assessed in more detail are those that (1) appear to have potential, but have not been already studied (2) sufficiently or (3) completely and correctly. By these criteria, many options are not a priority now for further examination—short of just plain trying them out and assessing what happens. The IFF and global taxation of air travel, for instance, have been much written about already, and the fact that they have not found sufficient backing thus far to be close to broad adoption may be signal enough that the political obstacles may be daunting, and that would moot any other unanswered questions about them.

Winnowing down, in this way, the full list of options to just those that most deserve attention now, this analysis found several of particular interest. The remainder of the chapter discusses three of them, leaving others for future work.

Results-Based Sequencing of Loans and Grants

As noted above, the "results-based sequencing of loans and grants" option is essentially an extended and broadened form of the "debt buydowns" employed successfully in the polio eradication campaign. In that case, a coalition with prominent grant funding from the Rotarians and the Bill and Melinda Gates Foundation helped countries pay off (hence "buy down") debt from loans from the World Bank that were needed by those countries to mount intensive efforts to wipe out polio.

The extended or broadened form combines the original concept with results-based (i.e., output-based) conditioning of support on performance. Here is how it works. A developing country's government and an external funder together work out a program of support, under

which the government undertakes to reach certain goals by specified dates (e.g., improve antimalaria programs and achieve a particular reduction in malaria deaths). The external funder agrees to support the work through either a loan (e.g., from the World Bank) or a grant (e.g., from a bilateral donor or a philanthropic institution). So far, this is nothing new, but here comes the difference.

A third party—most likely another grant financer but conceivably a lender—is part of the deal from the outset, committing to provide additional support when and only when the specified targets have been attained. The additional funding can be thought of as supporting the next phase of the work or ensuring the sustainability of the program or, as was the case in the polio eradication campaign, providing funds to pay off a part or all of the initial loan, if there was one.

All three parties gain from this scheme. The country gets the money up front that is needed to do the work, and then has the assurance of more to follow if the work is properly completed. Its government gets other benefits as well, including possibly the prospect of paying off some debt, always a popular move with voters. The initial external funder has greater prospects of seeing their support result in the desired outcomes. And the third-party financer can tell its overseers that its money will be released only when the results it is intended to support have already been achieved. Also, if it puts the money aside at the start of the whole endeavor, the value of that capital grows over time up to the point (e.g., five years later) when it is drawn down.

There can also be benefits in the form of increased harmonization among donors, to the degree that the linking together of aid flows in results-based sequences results in closer partnership, with the country, in coordinating what programs are supported and how. But this harmonization aspect is also one of the challenges that must be solved to make this sequencing option successful and suitable for scaling up, because donors have thus far found that aligning themselves together in their development work is far from an easy undertaking.

A second challenge is getting grant financiers on board with sufficient funds to achieve significant impact. Despite the early examples set by the Rotarians and the Gates Foundation, the foundation world has been slow to follow. Bilateral donors, especially in Europe, have not yet shown much interest, but should, because they would gain a lot in terms of the objectives they are seeking in their assistance programs. Today, their traditional flows are having mixed results, with less leveraged effectiveness than could be achieved through results-based sequencing of aid. With so many donors now calling so strongly for more of a focus on results, there has never been a better time to pursue this option.

Global Development Bonds

Private financial flows to developing countries have exceeded public flows since the end of the 1980s, although debt and equity figures have been volatile, trending downward at times since the late 1990s, and focused on selected regions. But private foreign investment in developing countries could be much larger still, were it not for various impediments, especially the risks involved.

Mitigation of investment risks of various kinds is now regular practice in developed countries, using many standard tools involving guarantees, insurance, securitization, tranching, overcollateralization, and so on. But risk mitigation instruments for investments in

developing countries, despite various offerings from international institutions, local entities, and the markets, have remained extremely limited. As a result, developing countries, projects, and companies perceived to be high risk are largely unable to reach the higher credit ratings where more investors could participate and where investment terms would be significantly more favorable for them.

Lessening that constraint is the idea behind a concept being called "Global Development Bonds" (GDBs), which would seek to achieve greater risk mitigation for developing country investments through thoughtful application, with adaptation where needed, of some of the same financial engineering techniques that have proven effective in the developed world.

Those thinking seriously about GDBs include people with considerable financial markets experience in the private sector and others versed in the development and political aspects of the issues. Term sheets and organizational structures have been prepared, laying out how the concept would work. The result, GDB proponents feel, could provide a boost to development in the same way as the municipal bond market provides for states and localities in the United States—though on a smaller scale.

As a "private-to-private" option, meaning that funds flow from the private sector (probably, mainly from developed countries) and go to private sector projects and firms in developing countries, GDBs would be free of some of the limitations that hamper the traditional aid programs from the public sector and the official international development institutions. They would, in essence, do what the World Bank does—packaging low-credit-rating investments (developing country projects) in ways that result in a higher-rated aggregate (the World Bank is rated AAA) that can borrow on favorable terms and pass on the savings to poorer clients. But unlike the World Bank, GDBs would operate entirely through private markets. Both channels—private-to-private and public and official initiatives—have strengths and weaknesses, so there are advantages to a strategy that draws on both and sees them as complementing each other.

The backstopping enhancements that make GDBs viable need to be significant enough to make a difference. Though creative financial engineering in the private sector can cover part of that distance, some backing through public action may also be required as the necessary legal and financial authorities are being established to launch GDBs. Varying degrees of public backing could be considered. In the U.S. context, the least demanding might be to enable the federal government's Overseas Private Investment Corporation to strengthen its support. Other larger steps could include granting of authority to invest, to a small and hard-limited extent, in a joint private/public entity that would help reguarantee GDBs; and/or the authorization of slightly more expanded support through special-purpose vehicles or government-sponsored entities.

The specific risks that would be covered could also be variously defined. Risks connected with currency fluctuations, possible political changes in countries, policy reversals, regulatory shifts, and/or social pressures pose differing challenges, for which existing risk mitigation mechanisms offer extensive experience. GDBs would not cover another category of risks—commercial risks—which capture the underlying uncertainties about the business venture itself.

The developers of the GDB idea reasonably observe that even a modest start could significantly increase financial flows to developing country investments. Compared with the roughly $70 billion in official aid to developing countries annually, 270 times that amount—more than $19 trillion—is invested in U.S. securities markets. If only a few tenths of a

percent of that private capital shifted to investments in developing countries, the increase in flows into those countries could dwarf the flows from aid. Risk mitigation that enabled the large institutional investors to join in would also have a potentially large impact. U.S. pension funds alone total $7.8 trillion in 2004; U.S. life insurance company assets are $4.2 trillion.

The developers are aware that their explorations will be regarded in some quarters as politically impossible. But at a time when other approaches to fighting global poverty—such as the current U.S. administration's Millennium Challenge Corporation—are finding their way, GDBs offer an option that has the political attraction of being squarely a private sector–led initiative and requiring no budget allocations, an important consideration at a time when the budgetary climate has rarely been worse.

As the developers also note, every other change in the past—including the special provisions for municipal bonds—was once viewed as utterly unimaginable. Naysayers are inevitable—but they are not always right.

Much more needs to be investigated before it will be clear whether GDBs are a promising option or not, and if so, what their particulars should be. Specialists are now developing term sheets and flowcharts, and testing the political waters. Time will tell where this leads.

Investing in Grassroots Business Organizations

At the opposite extreme from the huge macro-level high visibility of GDBs is the "bottom-of-the-pyramid" world of microfinance, microenterprise development, and social entrepreneurship. Much has been written about this vibrant universe of small-can-make-big ideas which are private-sector-based in the most elemental sense of building up from nothing.

Microfinance per se—that is, providing cash without also providing business advice, training, technical assistance, and the like—has become a crowded field. Further testing and drawing of lessons from various approaches would clearly be useful, not least because faster expansion will create more opportunities sooner for the bottom rungs on the economic ladder. More evidence will also help on the differing challenges across regions, countries, industries and sectors, and cultural groups. Also on firm size: There is a world of difference between the tiniest of the "micro" category, and the larger heft of the next category up (called, confusingly, "small"), and the still bigger wingspan of "medium," which is still well below that of "large" enterprises. Special problems of firms caught in "dead spots" in this size spectrum—having grown out of a backyard venture but not yet become big enough to have access to the larger capital they need to grow further—are being better documented now.

Related to this debate, a tidbit from the history of providing enterprise credit is revealing. For decades of the twentieth century, efforts to provide finance to emerging firms failed one after another. Then, just in the past few years, a flowering of new attempts has had impressively successful results. Why the difference? The earlier efforts were mostly dominated by the public sector: government-run development finance institutions. Ineffective management, poor loan recovery rates, and high costs killed them. The new breed is entirely private sector led—both from above (the Citigroup example mentioned

above) and from the country level (Unibanco), and they have found robust ways to keep costs down and repayments up.

Microenterprise development—which provides business advice and more, in addition to finance—remains less charted terrain. Though many entrants are exploring the possibilities on a limited scale, it is not yet clear that they can be scaled up sustainably to levels that would make an appreciable dent in poverty. The costs and complexities of providing business advice, technical assistance, and training are much more daunting than simply providing money. But that hands-on support may be more important. Many firms, once they get above the very small, need major management strengthening as much as or more than money. (For example, a firm with an accounting problem cannot go on having the founder's untrained brother be the bookkeeper.) Cracking this problem—of how to support microenterprise development on a larger-scale basis—may be one of the preeminent challenges where private sector know-how and creativity are most needed.

One effort that is taking a promising stab at that is the Strengthening Grassroots Businesses Initiative (SGBI) spearheaded by Harold Rosen of the World Bank Group's International Finance Corporation. In their lexicon, grassroots business organizations are socially driven ventures, whether for-profit or not-for-profit, that reach out to those at the "base of the pyramid" as partners, suppliers, consumers, and/or beneficiaries. These businesses provide income, employment, and training for disadvantaged people, bridging the gap to the global marketplace.

SGBI aims to have a catalytic impact in this emerging sector, building partnerships with like-minded groups and leveraging its own resources, networks, and position within an international institution. It provides a package of funding and technical assistance to grassroots businesses, helping them expand their impact and creating opportunities for replication and scaling up. Complementing and building on this on-the-ground work, SGBI also supports intermediaries and associations serving multiple grassroots businesses, and it facilitates the sharing of experience and lessons learned with clients and partners.

With each qualifying business, SGBI follows a three-step approach. First, a pragmatic diagnosis of the business's operations identifies obstacles to growth and opportunities for improvements, taking into account its priority needs and possibilities to bring in partners to assist in capacity building and funding. Second, an action plan is agreed on with the business's leadership team, detailing operating, financial, and social performance targets and key milestones needed to reach those targets. And third, a combination of technical assistance and/or patient capital (e.g., long-term, low-interest loans) is implemented, with funding provided as and when milestones in the action plan are met. The technical assistance is delivered through local providers as much as possible, with backstopping from resident International Finance Corporation staff.

An example is Honey Care in Kenya, an enterprise established expressly to increase the incomes of rural farmers. To date, Honey Care has doubled the income of more than 2,500 small-scale farmers through its "Money for Honey" program, which trains them in commercial beekeeping and then buys their honey at a guaranteed price. Honey Care then packages and sells the honey, which is of very high quality. SGBI is working to provide technical assistance and patient capital to Honey Care to further scale up its Kenyan operations and replicate its model in neighboring Tanzania (and potentially elsewhere).

SGBI's work with intermediaries and associations includes both financial and nonfinancial support as well—for example, by helping microfinance institutions broaden

their reach and promoting the establishment or expansion of marketing centers for grassroots business' products. As SGBI strengthens these one-tier-up intermediaries and associations, it will be able to expand its own reach—which is part of its business model too—moving, in effect, from a retail to a wholesale scale.

Conclusions

If the growing list of ideas and proposals for innovative approaches to financing is analyzed using frameworks like box 7-2 and concepts such as cost/benefit assessment incorporating political and other feasibility considerations, will we learn more than we know now? Will the current options become easier to understand and prioritize in terms of which deserve more research and/or immediate action, and which appear less promising? Will new options come to light, and be easier to spot and develop early on? Though this chapter merely scratches the surface of these questions, initial indications are encouraging.

The three examples described above—results-based sequencing of loans and grants, global development bonds, and investing in grassroots business organizations—demonstrate some of the vast variety of proposals that are emerging. They also reflect several more general points noted at the outset. All have potential, but verifying that potential would require testing them in practice and assessing their feasibility and impacts carefully. Furthermore, even if successful, none would obviate the need for other efforts as well, including existing initiatives and instruments and continued search for better ones. There is no silver bullet in this batch; each would help on some problems but would not solve all.

Another hypothesis suggested by the range of current options is that there has been an imbalance of attention thus far, with much focus on the public sector together with "official donors" and too little on options rooted in private sector activity. Yet the prospects for significant impact in accelerating development and reducing poverty may well be the reverse. The public–and–"official donor" sector options may have more limited impact than has been generally supposed, either because they will involve much smaller capital flows or will have difficulty getting widely adopted and implemented. The experience with the IFF, now funded by far fewer donor countries than had been hoped for originally, is an example. Conversely, the private sector options, with huge financial and organizational resources behind them, may have greater possible impact than they have been given credit for in the past.

Another related—but separate—hypothesis is that the conventional reasons sometimes given for dismissing private sector options may not be as compelling as was sometimes believed previously. The notion that market players—from the biggest institutional investors and venture capitalists down to the tiniest mutual fund accounts—have no interest in contributing to helping global development has been overturned by growing evidence that many want, at least with a small portion of their assets, to "not only continue doing well financially but also doing some good developmentally." And a small portion of a very, very large capital pool is still something more than small change.

Also, the notion that markets cannot or should not get enhancements backed by public sector commitments has begun to be questioned. Unlike some theorists opining from a distance, people who really know the markets from practical experience are pointing out that if the usual objections sometimes made to promising new ideas were followed to their limit,

a major part of public policy accumulated over literally hundreds of years of public choices by voters and leaders would be ignored entirely.

A further general point underscored here is that the quest for innovative financing options needs to be properly and compellingly rooted in the overall objective of reducing poverty. This may seem rather obvious. But there is always the risk that fascination with instruments will weaken focus on the ultimate objectives that the instruments are intended to serve. The current "gold rush" for new financing ideas should not detract from appreciation of the need, in each developing country situation, to start first with a careful analysis of what the particular problems are in that society's fight to reduce poverty, and then proceed to reasoned development of the appropriate solutions for each context.

No less important, practitioners and policymakers must remember that a new instrument, even if successful, may not necessarily have a large impact. Take, again, the microfinance example. Some players engaged in new approaches to expanding microfinance options believe that successful scaling up could provide a significant boost to development. Others feel that success, though an enormous help to some, would still have only a modest impact. Similar uncertainties surround expectations of what many other new interventions would yield. Efforts are planned now to reexamine the available evidence on these considerations, and to develop better estimates that, however rough, could at least be of some use in deliberating which options should be explored.

References

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