

Chapter IV

Using innovative financing for health and climate change mitigation and adaptation

Summary

- ◆ Most resources raised through existing mechanisms of innovative development financing are channelled through global vertical funds, primarily financing health- and climate-related international and global public goods.
- ◆ Global funds, helped by a clear link between funding and visible outcomes, have been very successful in mobilizing resources for health. However, only one quarter (about \$5.5 billion) of the resources mobilized between 2002 and 2010 came through innovative funding mechanisms.
- ◆ In the area of climate change, there has been a great proliferation of funds and a less visible link between funding and outcomes, limiting the contribution of innovative mechanisms of financing to about \$3 billion between 2002 and 2011, although such financing is expected to increase considerably in the coming years.
- ◆ The proliferation of global funds has contributed to the fragmentation of the international aid architecture; and the link to targeted outcomes poses challenges in respect of aligning the additional funding with national policies and priorities. Such problems could be magnified should innovative financing increase substantially, particularly through purpose-specific instruments.
- ◆ To address these problems, consideration should be given to: (a) consolidating global funds in health and in environmental protection, so as to reduce fragmentation and transaction costs; (b) improvements in the governance structures of global funds so as to ensure adequate representation of the interests and priorities of recipient countries; and (c) compliance with agreed aid effectiveness principles, ensuring ownership through alignment with national development strategies and priorities.
- ◆ Large-scale innovative finance mechanisms represent a potentially more viable route to filling the large financing gaps for development and global public goods, if the political obstacles can be overcome.

Introduction

Innovative development finance (IDF) has to date been focused on specific uses, most notably in the health sector and, more recently, in confronting climate change. The present chapter examines the uses and disbursement dimension of the existing IDF mechanisms, with a view to assessing their effectiveness and the allocation of funds. It adopts a sectoral perspective, focusing primarily on health (as the sector in which innovative development finance is most developed) and climate change mitigation and adaptation (as the sector in

Innovative development finance is most developed in the area of health and has the greatest potential in climate change mitigation and adaptation

which it has the greatest potential in the near future). Based on the lessons drawn from these experiences, this chapter also seeks to assess the implications for global governance of scaling up IDF mechanisms or implementing larger-scale IDF mechanisms, such as international taxation, tax cooperation and allocations of special drawing rights (SDRs) by the International Monetary Fund (IMF).

Uses of innovative development finance for development and global public goods

Each of the innovative finance mechanisms that have been successfully implemented so far (reviewed in chap. III) has been driven by a very clear-cut earmarking of funds for a specific purpose. For funders, this serves the dual purpose of facilitating fundraising, particularly where the results are highly visible and politically popular, and ensuring that funds are allocated at the recipient level in accordance with donor priorities (Adugna, 2009). This has been the key to securing agreement with regard to such mechanisms and their ability to attract funds. From the recipient's perspective, however, earmarking reduces policy space and thus risks undermining some aspects of aid effectiveness, particularly national ownership and alignment with national development strategies.

The emphasis of actual and potential innovative finance mechanisms on climate change and health reflects in part an increasing focus on the delivery of global public goods (Kaul, Grunberg and Stern, 1999; United Nations Development Programme, 2003). The massive financing needed for climate change mitigation and adaptation looms large in current debates on development finance, while increasing cross-border health risks associated with globalization, and the fight against the HIV/AIDS pandemic in particular, have increased the attention given to global public goods in the health arena (Smith and others, 2003).

The development and global public goods agendas are clearly complementary. Development is an essential requirement for many global public goods in both the health and environmental spheres, while global public goods, such as limiting climate change and controlling the HIV pandemic, have very considerable developmental benefits. However, there is, as noted in chapter I, an important conceptual and practical distinction to be made between development finance and finance for global public goods. Traditionally, one important underlying rationale for official development assistance (ODA) has been a distributional principle, namely, that it is morally incumbent on the better off to support those who face multiple serious deprivations. The rationale for financing the delivery of global public goods, on the other hand, is based primarily on considerations of allocative efficiency, and includes a substantial element of self-interest: enabling resource-constrained countries to make their necessary contributions to the production of a global public good benefits the donor as well as (and potentially as much as) the recipient.

In consequence, while many forms of external finance have dual development and global public good objectives, levels of financing in these two categories need to be assessed separately (Dervis and Milsom, 2011). Development finance from Development Assistance Committee (DAC) donors should continue to be judged against the United Nations ODA target, whereas financing for global public goods should be based on relevant agreements, such as the 2009 Copenhagen Accord commitments on climate financing,¹ where such agreements exist (United Nations Development Programme, 2012).

Innovative finance mechanisms focus on the production of global public goods

The development and global public goods agendas are complementary...

...but need to be assessed against separate criteria

¹ See FCCC/CP/2009/11/Add.1, decision 2/CP.15.

Like ODA, innovative finance for development should also be assessed against aid effectiveness principles as agreed in the Paris Declaration on Aid Effectiveness and in the outcomes of other international forums (see chap. I), whose focus was not only on improving the stability and predictability of financial resources, but also on decreasing fragmentation and conditionality in the use of funds and facilitating local ownership and alignment with national development strategies. While financing for global public goods should also seek to be so aligned, in this case there may be a rationale for earmarking funds for a particular purpose on the basis of its cross-border externalities. The challenge is to reconcile global priority-setting with national priorities and effectiveness of spending at the national level, and to ensure that national systems are strengthened rather than weakened.

Differentiating between these two agendas is also important in the context of analysing the allocation of innovative finance. While aid allocations, motivated by equity considerations, are largely based on needs, financing for global public goods is driven mainly by efficiency considerations, with the primary concern being the potential impact on production of the global public good concerned. In some areas, such as communicable disease control, needs and potential impact may be closely related; in others, such as carbon emissions reduction, the relationship is likely to be much weaker.

The distinction between funding for development and funding for global public goods thus plays a key role in appraisal of the experience of innovative mechanisms for health and climate financing to date, in terms of both allocation and assessment against aid effectiveness criteria.

Innovative finance in health

Financing needs for health

Universal access to health care is a key goal of the global community, and in the last decade, health—and, more particularly, the health-care sector—has been increasingly prioritized both by national Governments and by donors. However, it is unlikely that the health-related Millennium Development Goals will be reached, let alone that broader global health needs will be fulfilled. Life expectancy remains very low and child mortality rates remain extremely high in many low-income countries, especially in sub-Saharan Africa.

While many of the factors underlying ill health in the developing world—undernutrition, lack of access to safe water and sanitation, poor living and working conditions, and low education levels—are rooted in poverty, health improvements also require access to effective health services able to meet a population's needs. Yet, access to health services and their quality remain poor in many developing countries, owing largely to an insufficiency of financial and human resources for national health systems.

Currently, annual government health expenditure in low-income countries averages \$12 per capita. Private expenditure accounts for an additional \$13 per capita, but most of this comes from out-of-pocket spending at the point of service delivery or for self-medication in the absence of affordable access to adequate health services. External assistance, which funds both private and public expenditure, amounts to \$6 per capita on average, almost one quarter of total spending (Taskforce on Innovative International Financing for Health Systems, 2009).

The health sector has been increasingly prioritized by national Governments and donors

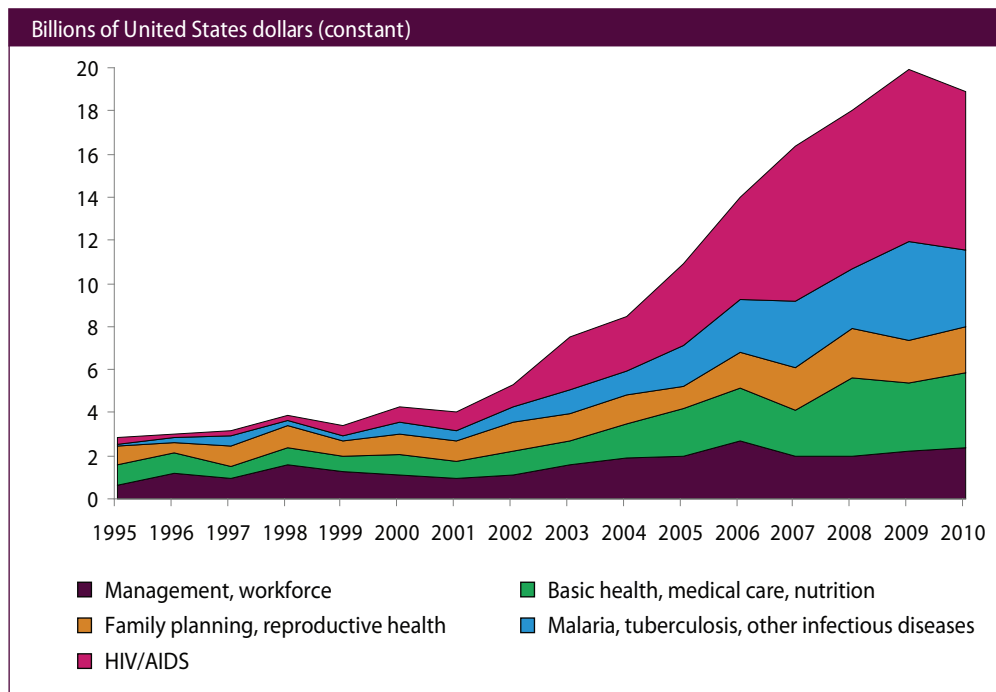
A considerable gap remains in financing global health needs

Funding needs are greatest for stable and sustainable resources for health system support

While it is difficult to quantify precisely the financing needed to address the remaining gaps in global health, it is clearly considerable. In a study carried out for the Taskforce on Innovative International Financing for Health Systems, the World Health Organization (WHO) found that merely achieving the health-related Millennium Development Goals—a much more limited objective than fulfilling global health needs—would require an additional \$29 per person per year of health sector spending in low-income countries by 2015, or more than a doubling of total current health spending (ibid.).

While these figures have to be interpreted with caution, there is arguably a considerable funding gap relative to needs. Some 40 per cent of the \$251 billion of total additional spending necessary between 2009 and 2015 would finance capital investments; 60 per cent would pay for additional recurrent costs, the latter primarily for expansion of the health workforce and increased pharmaceutical expenses. The fact that spending requirements are greatest for supporting health systems, and substantially less for combating specific diseases, partly reflects the sharp increase in external assistance for disease-specific programmes over the last decade (figure IV.1).

Figure IV.1
Total ODA to health, from all donors reporting to OECD, 1995-2010



Source: OECD StatExtracts (<http://stats.oecd.org/Index.aspx?datasetcode=CRS1>).

The predominance of recurrent costs in health system financing means that additional funding must be stable, predictable and sustainable. The higher level of recurrent spending necessary to achieve the health-related Millennium Development Goals would also have to be maintained beyond 2015 merely in order to sustain the health benefits achieved. Ideally, these resources would come from domestic sources; however, economic and fiscal constraints limit the potential of many low-income countries to generate or reallocate resources on this scale, so that for the foreseeable future, external finance will continue to play an important role.

The role of innovative finance in the health sector

Most innovative financing mechanisms covered in this publication have targeted interventions in the health sector. As shown in chapter I and figure I.3, virtually all innovative development finance for health—from innovative sources and from innovative intermediate financing mechanisms—has been disbursed through three global initiatives: the Global Fund to Fight AIDS, Tuberculosis and Malaria, the GAVI Alliance and UNITAID (table IV.1). These initiatives have been key drivers of the surge in development assistance for health and because of their innovative governance structures and allocation mechanisms and their vertical (disease-specific) orientation, they have dramatically changed the architecture of development cooperation in health in the last decade.

Innovative finance in health is disbursed through global health initiatives

Table IV.1
Major global health Initiatives

<i>Initiatives</i>	<i>Focus of operations and modalities</i>	<i>Sources of funding</i>	<i>Disbursement</i>
Global Fund to Fight AIDS, Tuberculosis and Malaria	Provides grants for HIV/AIDS, tuberculosis, malaria programmes, and the health system strengthening linked to these diseases Submission of funding proposals by Country Coordinating Mechanisms; selection by expert panel; implementation at the country level by governments, non-governmental organizations and international organizations	US\$19 billion in contributions between 2002 and 2010: 94 per cent from traditional bilateral funds, 3.5 per cent from the Gates Foundation and 1.9 per cent from innovative sources (UNITAID, Product Red, Debt2Health)	Disbursements of US\$14.4 billion for grants in 150 countries between 2002 and 2011 ^a
GAVI Alliance	Grants for programmes to improve immunization and access to vaccines in countries with gross national income below \$1,520 Implementation by national authorities in cooperation with United Nations organizations	US\$5.2 billion in contributions between 2000 and 2010: 39 per cent from bilateral ODA, 23 per cent from the Gates Foundation and 36 per cent from IFFIm	Disbursements of US\$3.5 billion between 2000 and 2011 ^a
UNITAID	Global drug purchasing facility using its market power to lower prices of effective HIV/AIDS, malaria and tuberculosis treatments	US\$1.3 billion in contributions between 2006 and 2010: 75 per cent from innovative sources (68 per cent from the Solidarity Levy on Airline Tickets; and 7 per cent from Norway's CO ₂ levy), 23 per cent from bilateral contributions; and 3 per cent from the Gates Foundation	Disbursements of US\$955 million between 2006 and 2010

Sources: Global Fund to Fight AIDS, Tuberculosis and Malaria (2011a); GAVI Alliance (2011a and 2011b); and World Health Organization (2010).

a Data from Global Fund to Fight AIDS, Tuberculosis and Malaria (<http://portfolio.theglobalfund.org/en/DataDownloads/Index>); and GAVI Alliance (<http://www.gavialliance.org/results/disbursements/>). See also table IV.2.

The Global Fund, created in 2001 as an initiative of the United Nations and the Group of Eight (G8) to finance programmes targeting the three priority diseases, is by far the largest of the three funds, having received more than \$19 billion in contributions from donors between 2002 and 2010. Funding for the Global Fund comes overwhelmingly from traditional bilateral ODA, while most of the remaining financing (3.5 per cent) has been provided by the Bill and Melinda Gates Foundation. Up to 2010, three IDF mechanisms—UNITAID, Product Red and Debt2Health—together accounted for 1.9 per cent of its total funding (Global Fund to Fight AIDS, Tuberculosis and Malaria, 2011a).

The GAVI Alliance, launched at the World Economic Forum in 2000, aims to provide predictable and sustainable resources to countries for adoption of new vaccines and increased coverage of existing ones, while also seeking to lower vaccine prices for low-income countries by aggregating demand and procurement and promoting competition among suppliers. GAVI received \$5.2 billion from its funders between 2000 and 2010, 36 per cent of which came from an innovative source, the International Finance Facility for Immunisation (IFFIm).²

UNITAID, launched in 2006 as a drug purchasing facility, seeks to supply affordable medicines for HIV/AIDS, malaria and tuberculosis to low-income countries by using its purchasing power to lower market prices of drugs of proved quality, and to create sufficient effective demand for niche products with large public-health benefits. Uniquely, the majority of UNITAID funding—\$1.3 billion in total between 2006 and 2010—comes from innovative sources, primarily the Solidarity Levy on Airline Tickets, an integral part of its operating model, which, in 2010, accounted for 63 per cent of UNITAID funding (World Health Organization, 2010). Norway's contribution to UNITAID is funded by a tax on its carbon dioxide (CO₂) emissions; and the remaining funding comes from bilateral contributions (23 per cent) and the Gates Foundation (3 per cent).

Overall, IDF mechanisms raised \$5.5 billion for health initiatives between 2002 and 2010 (United Nations, General Assembly, 2011). However, as discussed in chapter III, most of the IDF mechanisms have limited additionality to the ODA provided by DAC members. IFFIm brings forward future ODA disbursements; Debt2Health swaps are funded with bilateral ODA; and contributions to UNITAID are channelled through ODA budgets. In all, only \$0.2 billion of the \$5.5 billion raised to date through IDF mechanisms in the health sector is additional to ODA in the narrow sense of representing funds not classified as or sourced from ODA (*ibid.*). The Global Fund and the GAVI Alliance in particular have thus been effective primarily in channelling ODA and private charitable contributions into the health sector (either directly or through innovative mechanisms) rather than in generating new and additional resources for development finance.

Innovative finance mechanisms raised \$5.5 billion for health between 2002 and 2010

Governance of innovative disbursement mechanisms

Global health partnerships rely heavily on traditional sources of finance...

The global health programmes, albeit largely funded, directly or indirectly, from traditional public and private sources, have nevertheless been innovative in their governance structures and allocation strategies. This institutional innovation was born from a sense of urgency generated by the HIV/AIDS crisis and skepticism about the potential of traditional aid modalities to deal with this and other large-scale health crises (Hardon and Blume, 2005). The new global partnerships were to be evidence-based and guided by independent scientific review, and to be focused on quantifiable results, while the delivering institutions

² Since its inception in 2006, IFFIm has become an increasingly important funding source, accounting for 64 per cent of its total funding during this period.

themselves were to remain lean and transparent and to include the private sector and civil society in their governing structures (Isenman and Shakow, 2010).

The three initiatives were thus set up as public-private partnerships, with the private sector, civil society and philanthropic donors, as well as Governments represented at the board level. They do not implement programmes on the ground but rather finance programmes and projects of developing-country Governments, multilateral organizations and non-government organizations.

A key common feature of the global health funds is their focus on specific diseases or interventions which has been critical to their success in fundraising. As discussed in chapter V, the vertical approach is far from new in development assistance for health. Tackling infectious diseases and pandemics has long been a priority in international development, and donors have tended to view vertical approaches as the most direct means of targeting them. However, there has been a debate regarding the appropriateness of the vertical approach and its relationship with health system development, which dates back to the 1960s and beyond.

There are three particular reasons for the vertical approach adopted by the global funds. First, it reflects a strong political consensus on the need to address specific health issues on a global level—a consensus much stronger than that on health in a broader sense. This is most obvious in the case of the HIV/AIDS pandemic, which is seen as a global health emergency with potential repercussions not only in the most strongly affected countries, but in donor countries as well (Ooms and others, 2011). Second, disease-specific interventions hold the promise of quick, demonstrable and readily quantifiable results which can be directly linked to funding. This is a particular concern not only for philanthropic donors, which value clear success indicators, but also for official donors seeking to demonstrate the impact of ODA. Third, all three mechanisms are strongly oriented towards global public goods (which provide benefits to all countries) or international public goods (which provide benefits to a large subset of countries).

Innovative development finance for health has focused on two types of global public goods. The first type, associated with the Global Fund, encompasses dimensions of health that themselves have global or international public-good attributes—primarily the control of communicable diseases of global scope, notably HIV/AIDS and tuberculosis³ (particularly multidrug resistant tuberculosis). In addition to its considerable importance within each country, reducing the prevalence of these diseases brings substantial benefit to other countries (including donors), by reducing the risk of their spread across borders. Their effective control is thus a global public good which can be produced only by the collective efforts of all countries.

The second type consists of global or international public goods that require only one producer, while providing generalized health benefits, notably the technologies embodied in vaccines and pharmaceuticals for the prevention or treatment of diseases of global (or wide international) scope. Allowing low-income countries to access these goods has been the primary focus not only of the GAVI Alliance and UNITAID, but also of advance market commitments and the Affordable Medicines Facility-malaria.

At the national level, however, progress in health outcomes—in terms of both global public goods of the first category and national health priorities—can be sustained only if strong health systems are in place to provide reliable access to high-quality health

...but are innovative in their governance structures and allocation strategies

Global health funds adopt a vertical approach focusing on specific interventions that address global public goods

³ GAVI Alliance support for polio myelitis vaccination, as part of global eradication efforts, also falls within this category. Since the scope of malaria is not global, its control can be considered only an international—but not a global—public good.

services. Such systems can also substantially reduce the cost of delivering the interventions supported by global funds and other donors. From an aid effectiveness point of view, the key challenge for vertical programmes is thus to strengthen existing health systems, or at least to avoid damaging them, through their more narrowly focused interventions (Unger, de Paepe and Green, 2003).

Allocation of resources raised by innovative finance for health

The Global Fund allocates resources based on national proposals

The global health initiatives vary greatly in their approaches to balancing inter-country equity and efficiency considerations in their resource allocation. The Global Fund has the strongest bias towards efficiency, operating as a challenge fund rewarding the best project proposals within the context of a process of competitive tendering for a fixed amount of resources on a global level (Isenman, Wathne and Baudienille, 2010). Proposals are submitted to the Global Fund through the Country Coordinating Mechanism, a country-level partnership in which key stakeholders are represented, and assessed and selected for funding by a technical expert panel. Once approved, the funds are disbursed to the principal recipients (usually ministries of finance or health, international agencies or non-governmental organizations), which are nominated and overseen by the Mechanism, and implement the projects. There is also a results-based element in funding: an evaluation after two years determines whether targets have been met and whether funding should be continued for a second phase. While both low- and middle-income countries are eligible for funding, proposals in middle-income countries must address specific populations with severe disease burdens in their proposals and a higher level of co-financing is required in their case.

This allocation model is in line with two core principles of the Global Fund: ownership of programmes and a focus on performance. Disbursements are always tied to country-based funding proposals so as to ensure national ownership, and the selection of proposals is conducted at the global rather than at the national level on the basis of their quality.

By comparison, GAVI Alliance and UNITAID allocation strategies place a stronger emphasis on equity. GAVI provides funding only to countries with a gross national income (GNI) per capita below a certain threshold which is annually adjusted (in 2012, the threshold is \$1,520), while the current strategy of UNITAID includes a commitment to spend at least 85 per cent of its resources in least developed countries.

GAVI announces funding windows in vaccine support based on country needs

The GAVI Alliance announces funding windows in new and underused vaccine support, immunization services support and health system strengthening support. Countries can access these funds by submitting funding proposals through an Inter-Agency Coordinating Committee comprising representatives from government, civil society, WHO and the United Nations Children's Fund (UNICEF) provided that they fulfil the eligibility criteria (including multi-year immunization plans, costing and financing analysis, and coverage rates for specific existing vaccines in cases where funding is sought for introducing new vaccines). In contrast to the Global Fund, GAVI provides a de facto indicative allocation of funds for countries based on the number of children in age cohorts in eligible countries (Isenman, Wathne and Baudienille, 2010).

Resource allocations for diseases and interventions are determined by the global health partnerships' respective mandates. More than half of the Global Fund's grants are dedicated to HIV/AIDS programmes, while malaria accounts for slightly less than one third and tuberculosis for the remainder. Funding for health systems is linked

to disease-specific grants (Global Fund to Fight AIDS, Tuberculosis and Malaria, 2011a). UNITAID drug purchasing programmes show a similar pattern, with HIV/AIDS accounting for more than half of its total spending, and malaria and tuberculosis for 22 per cent and 16 per cent, respectively (World Health Organization, 2010). The largest share of GAVI resources—almost 70 per cent—is allocated to the introduction of new and underused vaccines in eligible countries, the remainder being dedicated to supporting immunization services and health system strengthening (GAVI Alliance, 2011a).

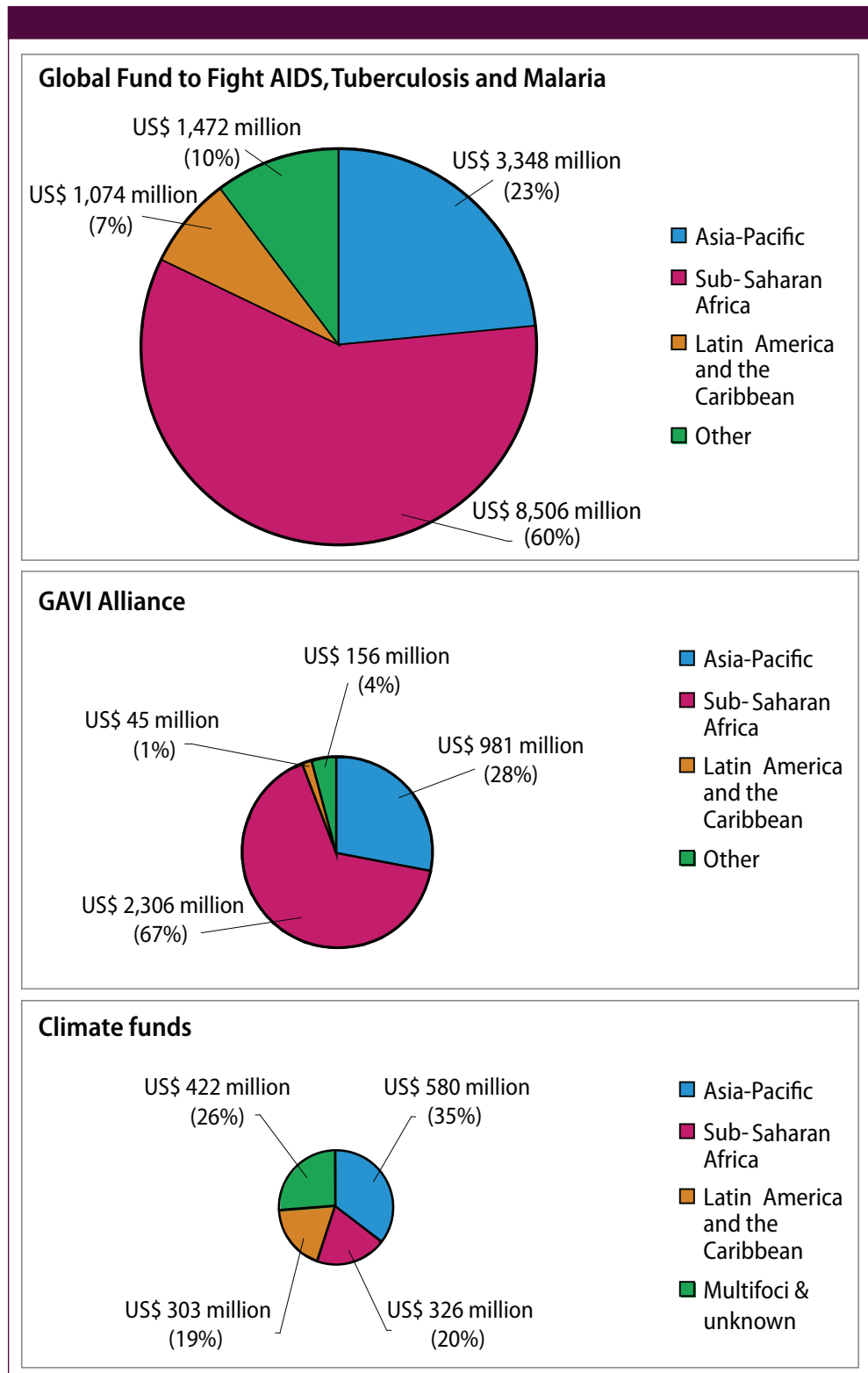
Table IV.2

Cumulative disbursements of the Global Fund to Fight AIDS, Tuberculosis and Malaria and of the GAVI Alliance to selected regions and the top five country recipients in each region, by amount and share of global total, 2000–2011

Region		Global Fund (cumulative disbursements, 2000-2011)			GAVI Alliance (cumulative disbursements, 2000-2011)	
		Amount (millions of US dollars)	Share of global total (percentage)		Amount (millions of US dollars)	Share of global total (percentage)
East Asia and the Pacific		2063.0	14.3		255.4	7.3
<i>of which:</i>	China	601.1	4.2	Viet Nam	74.3	2.1
	Indonesia	384.6	2.7	Indonesia	49.4	1.4
	Thailand	292.5	2.0	China	38.7	1.1
	Cambodia	278.2	1.9	Cambodia	27.3	0.8
	Viet Nam	130.9	0.9	Myanmar	26.3	0.8
South Asia		1284.7	8.9		725.3	20.8
<i>of which:</i>	India	801.6	5.6	Pakistan	309.5	8.9
	Bangladesh	189.7	1.3	Bangladesh	186.6	5.3
	Pakistan	90.2	0.6	Afghanistan	97.7	2.8
	Nepal	70.8	0.5	India	59.0	1.7
	Iran (Islamic Republic of)	45.0	0.3	Nepal	48.6	1.4
Sub-Saharan Africa		8505.9	59.1		2306.4	66.1
<i>of which:</i>	Ethiopia	1142.1	7.9	Ethiopia	317.5	9.1
	United Republic of Tanzania	759.0	5.3	Democratic Republic of the Congo	247.6	7.1
	Nigeria	614.6	4.3	Kenya	214.0	6.1
	Rwanda	575.5	4.0	Uganda	133.6	3.8
	Malawi	477.4	3.3	Nigeria	118.1	3.4
Latin America and the Caribbean		1074.2	7.5		44.6	1.3
<i>of which:</i>	Haiti	208.3	1.4	Honduras	17.1	0.5
	Peru	116.3	0.8	Nicaragua	12.6	0.4
	Dominican Republic	99.5	0.7	Bolivia (Plurinational State of)	10.5	0.3
	Guatemala	84.8	0.6	Guyana	2.4	0.1
	Honduras	78.2	0.5	Haiti	1.8	0.1
Other regions		1471.9	10.2		156.1	4.5
Global total		14399.7	100.0		3487.8	100.0

Sources: Global Fund to Fight AIDS, Tuberculosis and Malaria (<http://portfolio.theglobalfund.org/en/DataDownloads/Index>); and GAVI Alliance (<http://www.gavialliance.org/results/disbursements/>).

Figure IV.2
Regional distribution of cumulative disbursements from health and climate funds since 2000



Sources: The Global Fund to Fight AIDS, Tuberculosis and Malaria (<http://portfolio.theglobalfund.org/en/DataDownloads/Index>); GAVI Alliance (<http://www.gavialliance.org/results/disbursements>); and Climate Funds Update (www.climatefundsupdate.org).
Note: Each pie chart is scaled in proportion to its total disbursements.

Geographically, about 60 per cent of Global Fund flows have gone to Africa, 23 per cent to Asia and 7 per cent to Latin America; GAVI allocations follow a very similar pattern (see table IV.2 and figure IV.2). The strong emphasis on Africa reflects its particularly high disease burden and the focus of the global partnerships on low-income countries and least developed countries. GAVI in particular has targeted the poorest and most fragile low-income countries, which have received relatively large disbursements per child (CEPA, 2010). UNITAID supports projects in 94 countries, covering most of sub-Saharan Africa and 26 Asian countries as a priority. However, the geographical allocation of funds cannot readily be estimated owing to the global nature of its approach and the nature of its relationship with implementing partners.

The absence of predefined and needs-based country allocations in the Global Fund contributes to a relatively weak, though positive, relationship between disease-specific needs and disbursements: countries with a higher incidence of HIV or tuberculosis have on average received only marginally more funding for programmes for these diseases in the last decade (see figure IV.3).⁴ While this may in part be due to income thresholds, it is also possible that lack of capacity to formulate effective programmes and/or obstacles to project implementation have limited access in some high-incidence countries.

Despite the greater emphasis of the GAVI Alliance on equity and its indicative country allocations, there is no discernible relationship between its disbursements and immunization needs (figure IV.4). This may reflect in part the eligibility requirements relating to coverage rates. By far, the largest component of GAVI Alliance activities entails support for the introduction of new and underused vaccines. However, access to this funding requires at least 70 per cent coverage of diphtheria, pertussis and tetanus (DPT3) immunization.⁵ While countries below this threshold can apply for immunization services support, less funding is available within this window; moreover, a strong performance-based component is included, with funding after the initial investment being based on the additional number of children receiving immunization. This has made it difficult for low-income countries with weak institutions, in particular, to access these resources (Chee and others, 2007).

There is no strong link between the disease-specific needs of countries and disbursements

Effectiveness of innovative finance for health

Examining the overall effectiveness of innovative development finance is a challenging task, as IDF funds are disbursed in combination with more conventional development finance from bilateral and private donors. In the present section, we focus on the principal channels through which IDF is disbursed, namely, the Global Fund and the GAVI Alliance.⁶

Both these institutions emphasize their commitment to the aid effectiveness agenda and to the Paris Declaration on Aid Effectiveness, the Accra Agenda for Action⁷ and the Busan Partnership for Effective Development Cooperation. In some areas—notably transparency, innovative and more inclusive governance structures, and emphasis on results—they are sometimes considered exemplary. However, tensions exist between the earmarking of funds for specific purposes and other aid effectiveness principles, particularly country ownership. The present section assesses the Global Fund and the GAVI

Both the Global Fund and the GAVI Alliance are committed to the aid effectiveness agenda

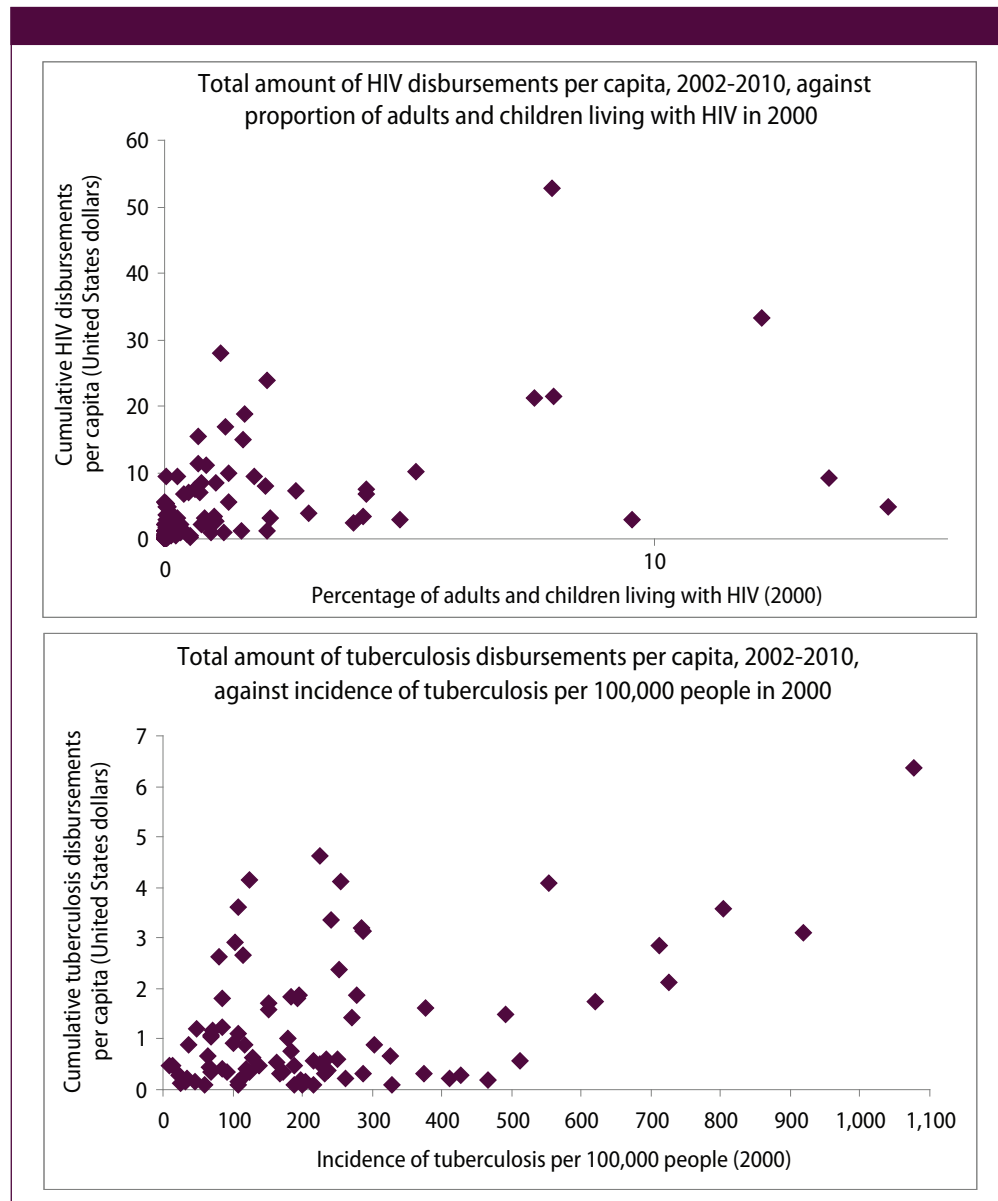
⁴ A similar analysis for malaria has not been possible owing to inadequate data.

⁵ Under GAVI phase 1, the minimum coverage rate required for DPT3 was 50 per cent.

⁶ UNITAID is considered only in selected parts of this section, as it disburses its funds to multilateral implementing partners. Direct assessment of effectiveness at the country level would thus be difficult.

⁷ Document A/63/539, annex.

Figure IV.3
Allocation of Global Fund resources (2000-2010) versus country needs



Sources: Global Fund to Fight AIDS, Tuberculosis and Malaria (<http://portfolio.theglobalfund.org/en/DataDownloads/Index>); and Health Nutrition and Population Statistics Database, World Bank (<http://databank.worldbank.org/ddp/home.do>).

Alliance from a global perspective, in terms of ability to meet stated goals, stability and predictability of disbursements, fragmentation and country ownership and alignment with national strategies. Chapter V considers the perspective of recipient countries.

Meeting stated goals

Vertical funds have achieved visible results in their priority areas

The major strength of vertical funds is generally perceived to be their ability to achieve rapid and visible results. Both the Global Fund and the GAVI Alliance report strong progress in their priority areas of intervention, quantified in millions of lives. The GAVI Alliance claims that its vaccination programmes have prevented more than 5 million

Overall, the health partnerships are able to make longer-term commitments for support, on average, than bilateral donors, and have thus contributed to increased predictability of aid for health in recent years (Dodd and Lane, 2010; see also Organization for Economic Cooperation and Development, 2011b). However, the Global Fund's overwhelming reliance on bilateral contributions leaves it highly vulnerable to funding cuts. In November 2011, it was forced to cancel its eleventh funding window, reflecting budgetary pressures in main donor countries. As a result, it will fund only projects already approved and not issue new grants until the end of 2013. Similarly, the independent evaluation of the International Finance Facility for Immunisation noted concerns about the financial sustainability of the GAVI Alliance in the context of its dependency on IFFIm (Pearson and others, 2011).

Fragmentation

In recent decades, the number of donors and aid projects in all areas of development cooperation has risen sharply, while the average project size is on the decline. More than 30 countries now have to deal with over 40 active bilateral and multilateral donors, while not a single country had to deal with this degree of fragmentation just two decades ago (International Development Association, 2007). This state of affairs undermines policy coherence, raises transaction costs and imposes substantial administrative burdens on countries with limited capacity and human resources.

The pooling of donor funds and a move from bilateral to multilateral aid delivery clearly have the potential to reduce fragmentation. However, and particularly in the case of HIV/AIDS, the global health partnerships have not replaced bilateral donors but, rather, have added actors to an already complex aid architecture. A study in seven recipient countries found that the Global Fund Country Coordination Mechanisms were increasingly integrated with other country coordination structures, but that in some of those countries, multiple coordination bodies with overlapping membership and mandates continued to coexist (Spicer and others, 2010).

In response to such criticisms, the Global Fund and the GAVI Alliance have scaled up their health system support and increased their coordination efforts at the country level. In 2009, together with WHO and the World Bank, they created the Health Systems Funding Platform, which aims to coordinate funding for health system strengthening and to disburse funds on the basis of a single national health plan, fiduciary arrangement and monitoring and evaluation framework. While it was originally intended that there should also be substantial new resources to fund joint health system strengthening programmes, these have failed to materialize; and engagement by other donors has been limited. As a result, the emphasis has shifted towards coordinating the health system strengthening programmes of the participating organizations (Hill and others, 2011).

Even in this attenuated form, the Platform has some potential to increase aid effectiveness and to reduce transaction costs associated with fragmentation. As it becomes operational in more countries, however, it will have to address a number of challenges. The Global Fund and the GAVI Alliance maintain separate procedures and timelines for receiving and approving grant applications, which renders joint applications less attractive for countries (Evidence to Policy Initiative, 2011). There is also a significant degree of uncertainty centred around the amount of funding that will be available for health system strengthening, given the current fiscal environment and the preference of certain constituencies on the boards of both institutions for focusing on their core mandates.

Health system support has been scaled up and is becoming better coordinated in order to reduce fragmentation

Local ownership and alignment

Country ownership of national development strategies and donor alignment with such strategies are at the core of the aid effectiveness agenda. These goals are best realized through general budget support and sector-wide approaches. In development assistance for health, however, sector-wide approaches have so far played a relatively minor role—accounting for less than 8 per cent of total aid for health between 2002 and 2006 (Piva and Dodd, 2009).

The ability of the global health partnerships to act in conformity with those goals is constrained by their disease- and intervention-specific mandates, reflecting global health priorities, which may limit the scope for alignment with national health priorities. Measured in disability-adjusted life years (DALYs)⁸, HIV/AIDS, tuberculosis and malaria account for 5.2 per cent, 2.7 per cent and 4 per cent, respectively, of the total disease burden in low-income countries (World Health Organization, 2008). In comparison, diarrhoea, and maternal and perinatal conditions, account for 7.2 per cent and 14.8 per cent, respectively, of the disease burden. While non-communicable diseases account for almost one third of the disease burden, they are largely ignored by donors and draw less than 3 per cent of overall aid to health (Nugent and Feigl, 2010).

Some degree of ownership is ensured within the constraints of the vertical approach by funding proposals from countries and implementation by nationally nominated principal recipients (Radelet and Levine, 2008). Nonetheless, this strengthens the case for further extending health system support so as to allow recipient countries greater flexibility in allocating health spending in line with national priorities; and to ensure that disease-specific interventions are set up in such a way as to strengthen national systems instead of undermining them, for example, by drawing health workers out of the general public-health system into vertical programmes. To address these concerns, the GAVI Alliance and the Global Fund could usefully fund investments in the educational infrastructure and the training of new health professionals, instead of focusing only on in-service training on disease interventions of existing staff (Vujcic and others, 2012).

Conclusion

Innovative disbursement mechanisms in the health sector target specific diseases and interventions, generally with global public-good characteristics. The earmarking of funds for a highly visible purpose with global appeal and the potential to demonstrate measurable results has arguably been integral to those mechanisms' success in channelling substantial resources into their priority subsectors and enabling large-scale measurable progress in specific areas of health.

While it can represent a departure from national priorities, provision of additional resources for particular diseases or interventions may be justifiable to the extent that it corrects underfunding of global public goods. However, it is important that, in delivering such funds, a further increase in the fragmentation of the aid architecture and disbursement mechanisms—and thus in the transaction costs of aid delivery—be avoided. This can best be achieved by consolidating bilateral and multilateral disbursement mechanisms.

Disease-specific mandates constrain global health partnerships in respect of aligning their funding with country priorities

The earmarking of funds for a visible purpose was integral to channelling resources into priority areas

⁸ Disability-adjusted life years take into account both premature death and disability caused by disease.

It is also important to ensure that the ability of health systems to deliver on local needs as well as global priorities is enhanced rather than impaired. This implies a need for integration of financing for disease-specific programmes into health systems, and greater funding for health systems (including budgetary support) in addition to disease-specific funding. While the Global Fund and the GAVI Alliance have themselves taken some important steps in this direction, notably through the establishment of the Health Systems Strengthening Platform, their specific mandates set a limit to these efforts.

Climate change

While the funding mechanisms that have thus far been established under the rubric of innovative development finance have focused mainly on health, there is a growing emphasis on climate change. As in the case of health, where innovative mechanisms have mainly funded particular health-related interventions with strong global public-good attributes, such as communicable disease control, climate-related innovative development finance has similarly concentrated on the global public good of mitigation rather than adaptation.

The unprecedented global improvements in average living standards over the last two centuries have come at the cost of serious degradation of the natural environment. The most serious environmental threat is climate change, brought about by global emissions of carbon dioxide and other greenhouse gases. In addition to considerable expenditure for adaptation, climate change necessitates a fundamental shift in development strategies towards a much less carbon-intensive model, and a major reduction in reliance on fossil fuels.

While climate change arises overwhelmingly from historical emissions in developed countries, it impacts disproportionately the well-being and livelihoods of people in developing countries. This makes a compelling case for the assumption by richer countries of the costs of mitigation and adaptation.

Financing needs for climate change mitigation and adaptation

Financing needs arising from climate change in developing countries are large

Estimates of the financing needs arising from climate change in developing countries are seriously complicated by methodological issues and the inherent uncertainties surrounding climate change impacts and associated mitigation and adaptation needs, and vary widely according to geographical and sectoral coverage, timescale and assumed objectives (Buchner and others, 2011). However, it is generally recognized that the costs are considerable.⁹

The World Bank (2010c), for example, reports estimates of additional annual investment needs in developing countries by 2030 at \$140 billion–\$175 billion for mitigation (plus additional upfront investments of \$265 billion–\$565 billion) and \$30 billion–\$100 billion for adaptation. Other studies produce broader estimates of the financing needed to achieve sustainable development objectives. *World Economic and Social Survey 2011* (United Nations, 2011a), for example, estimates incremental green investment needs

⁹ Reports estimating climate financing needs include those of Stern (2007); United Nations Framework Convention on Climate Change (2007); United Nations Development Programme (2007); International Energy Agency (2008); McKinsey & Company (2009); United Nations Conference on Trade and Development (2010); World Bank (2010c); United Nations Environment Programme (2011); and United Nations (2009b; 2011a).

for achieving sustainable development objectives in a context of climate change and global carbon constraints at about 3 per cent of world gross product (WGP).¹⁰ Assuming that some 60 per cent of such investment will occur in developing countries, this implies a little over \$1 trillion per year in additional investment, which will require domestic and external financing from the public and private sectors.

At the 2009 United Nations Climate Change Conference in Copenhagen, developed countries pledged \$100 billion annually to developing countries by 2020 to finance climate change adaptation and mitigation,¹¹ this compared with total aid from DAC countries for climate change-related programmes of \$42 billion between 2000 and 2009 (Organization for Economic Cooperation and Development, 2011c). While DAC commitments increased to almost \$23 billion (15 per cent of total ODA) in 2010, one third for adaptation and two thirds for mitigation (Organization for Economic Cooperation and Development, 2011d), this amount remains short of the commitment, and well below the level of international assistance required.

Developed countries have pledged \$100 billion annually to developing countries by 2020 for climate change adaptation and mitigation

The role of innovative finance in climate change funding

Despite the considerable potential of the innovative financing proposals discussed in chapter II—notably, international carbon taxes, emissions trading, financial and currency transaction taxes, and allocations of special drawing rights (SDRs)—innovative development finance has thus far made a limited contribution, estimated at something over \$1 billion to climate change financing.¹²

So far, innovative development finance has made only a limited contribution

As discussed in chapter II, the one tax mechanism developed to date is a 2 per cent levy on transactions of the Clean Development Mechanism (CDM), a global emissions trading scheme established by the 1997 Kyoto Protocol¹³ to the United Nations Framework Convention on Climate Change¹⁴ as a means of transferring finance and technology to developing countries for exploitation of low-carbon development opportunities (see Article 12 of the Protocol). To date, the proceeds amount to \$168 million, providing two thirds of the cumulative cash receipts of the Adaptation Fund¹⁵ (the remainder coming from voluntary government contributions). So far, utilization of these resources has been minimal: of about \$258 million available, just over \$30 million had been disbursed for projects in 12 countries by 2011, and almost half of this covered fund administration costs (Nakhooda and others, 2011).

Separately from the Clean Development Mechanism, Germany allocates part of the proceeds from the sale of tradable emission certificates under the European Union Emission Trading Scheme (EU ETS) to fund its own International Climate Initiative and thereby support international projects for climate change mitigation and adaptation and climate-related biodiversity. To date, the International Climate Initiative has received

¹⁰ These estimates are broadly in line with those of the United Nations Environment Programme (2011), but do suggest that the investments needed to induce a green energy transformation would be higher.

¹¹ See FCCC/CP/2009/11/Add.1, decision 2/CP.15, para. 8.

¹² The present discussion focuses on mechanisms designed primarily to channel resources to climate-related programmes rather than risk-mitigation mechanisms such as the Caribbean Catastrophe Risk Insurance Facility. Mechanisms in the latter category are discussed in chapter III.

¹³ United Nations, *Treaty Series*, vol. 2303, No. 30822.

¹⁴ *Ibid.*, vol. 1771, No.30822.

¹⁵ See FCCC/KP/CMP/2007/9/Add.1a, decision 1/CMP.3.

pledges of \$841 million and \$582 million of financial support has been approved. However, it is unclear how much has been disbursed as of early 2012 (Climate Funds Update, n.d.).

Debt-for-nature swaps constitute the longest-standing innovative financing mechanism for environmental projects (see chap. III). Since their emergence in the 1980s, it has been estimated that some \$1.1 billion–\$1.5 billion worth of debt has been swapped for environmental causes (Sheikh, 2010; Buckley, ed., 2011). However, it is difficult to determine how much of this has been for climate change mitigation and adaptation.

Despite the limited contribution of innovative mechanisms to climate finance to date, the urgency and global nature of the climate change threat make this the area most likely to generate a scaling up of existing flows in the near future, and the issue most likely to stimulate progress on larger-scale mechanisms.

Substantial progress may already be anticipated in the coming years. From 2012, the Government of Germany will allocate 100 per cent of the proceeds derived from auctioning EU ETS permits to a Special Energy and Climate Fund, established in 2010 to finance national and international climate-related expenditures. This is expected to generate \$780 million in 2012, and some \$3.2 billion annually in 2013–2015, approximately 15 per cent of which (about \$500 million per year) is to be directed to international climate financing from 2013. Activities to be supported include forest protection and biodiversity and enhancement of existing climate-related activities (including the International Climate Initiative), as well as a new German climate technology initiative (German Watch, 2011).

From 2013 onward, the European Union as a whole has agreed to auction emissions allowances (in some sectors up to 100 per cent), which is expected to generate revenues in the range of \$20 billion–\$35 billion per annum. While member States have been reluctant to make a collective decision to earmark these resources for climate financing, many individual countries have indicated their intention to allocate at least 50 per cent for this purpose (I-8 Group/Leading Innovative Financing for Equity (L.I.F.E.), 2009). However, it remains unclear what proportion of these resources, if any, will be used to finance climate change action in developing countries. Since Germany has been the most willing EU country to devote the proceeds of emission allowance sales to international climate-related activities, average allocations of post-2013 revenues are unlikely to exceed Germany's commitment of 15 per cent. This would imply IDF from EU ETS trading in the order of \$1 billion to \$5 billion per annum.

The Reducing Emissions from Deforestation and Forest Degradation plus Conservation (REDD+) initiative is another potentially important IDF mechanism for climate change mitigation in developing countries. While the Programme currently acts as a coordinating mechanism for conventional bilateral and multilateral funding, it is proposed that REDD+ should evolve into an innovative carbon trading-based mechanism that would issue tradable carbon credits to countries with tropical forests for saving and planting trees, which could then be sold to other countries to offset their own carbon emissions. A number of pilot projects testing REDD+ principles and procedures have been launched, and some \$450 million of financing has been approved between 2008 and 2011, with disbursements of \$250 million (Nakhoda, Caravani and Schalatek, 2011).

REDD+ is considered a key component of the post-2012 international climate change regime; and with deforestation accounting for an estimated 17 per cent of greenhouse gas emissions (Intergovernmental Panel on Climate Change, 2008), its financial potential is considerable. It has been estimated that markets for emission reduction credits from REDD+ could generate some \$30 billion per annum for developing nations,

The urgency and global nature of the climate change threat make it the area most likely to generate a scaling up of innovative finance

REDD+ could evolve into an innovative mechanism by issuing carbon credits to countries for preserving tropical forests

stimulating an exponential increase in demand for carbon sequestration services, particularly from South-East Asia (Nakhooda, Caravani and Schalatek, 2011). Potential receipts for Indonesia alone could amount to \$2 billion per year (Figueroa, 2008).

However, despite support from a number of countries, notably Norway, and from the United Nations and other multilateral organizations, no international agreement has yet been reached on the implementation of such a carbon offset approach. At the seventeenth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, held in Durban from 28 November to 11 December 2011, significant progress was made towards agreement on important preconditions for the design and operation of a REDD+ emissions trading scheme, including reference levels for forest-related carbon emissions, environmental safeguards, and monitoring, reporting and verification. However, the absence of agreement on identifying sustainable means of financing represents a major obstacle to the establishment of a REDD+ market mechanism in the near future. Other problems include the lack of reliable information on the highly variable opportunity costs of forest protection in different local contexts and the carbon content of forests (Nakhooda, Caravani and Schalatek, 2011). The voluntary nature of REDD+ may also limit its scope and undermine effective project delivery; and trade-offs may arise between the necessity of preventing deforestation, and the need to tailor REDD+ activities to local circumstances, including potential adverse effects on forest-dependent communities and indigenous peoples.

In scaling up existing IDF mechanisms and implementing new ones, it is important to ensure that resources are not diverted away from development assistance. Among the existing mechanisms, however, only the levy on CDM transactions devised to finance the Adaptation Fund is truly additional to traditional ODA: proceeds from the sale of ETS emission certificates, support to climate-related risk insurance mechanisms and debt-for-nature swaps are all included in ODA.

Allocation of innovative climate finance

In the climate change sector, innovative financing is disbursed mainly through multilateral, bilateral and national special-purpose funds which earmark resources for particular adaptation and/or mitigation activities. The distinction between adaptation and mitigation is critical: while support to adaptation benefits primarily the recipient country (although it may arguably be considered compensation justified by the historical responsibility of developed-country emissions for climate change), financing of mitigation in developing countries is more appropriately viewed as supporting production of a global public good of universal benefit (climate stability). Thus, while there is a strong case to be made for a needs-based allocation and national administration of funds for adaptation, the key considerations in mitigation are potential for and cost of mitigation.

The Adaptation Fund, which is funded principally through innovative finance, allocates resources according to need. The Fund takes into consideration the level of vulnerability and urgency, while seeking to ensure equitable access to funds (for example, by capping overall resource allocations to each country). Unusually, its board, comprising 16 members representing the parties to the Kyoto Protocol to the United Nations Framework Convention on Climate Change, includes a majority of developing countries, in line with the compensatory nature of adaptation flows.

Innovative financing is disbursed largely by special-purpose funds for specific adaptation or mitigation activities

In principle, Adaptation Fund projects are implemented by national implementation entities, thus providing national Governments with direct access to funds (Dervis and Milsom, 2011). In practice, however, national implementation has so far been the exception (United Nations, General Assembly, 2011). Moreover, the Adaptation Fund's allocation criteria have not always been clear, and low-income and resource-scarce countries often lack the human and technical capacity to tap these funds effectively.

Despite a commitment to balanced allocation, resources for adaptation trail behind resources for mitigation

This low level of funding reflects a more general lack of resources for adaptation, which dramatically trail behind resources for mitigation, despite the commitment to balanced allocation set out in the Copenhagen Accord (Nakhouda and others, 2011). Despite a commitment to splitting resources equally between sustainable energy on the one hand and adaptation and biodiversity on the other, Germany's International Climate Initiative (funded from auctions of certified emissions reductions (CERs)) in practice devotes a larger share of funds towards the former. This results from its selection of projects on the basis of their mitigation potential; innovative nature; and their complementarities with partner countries' national strategies, Germany's climate policy and the conservation of other global environmental goods.

The Green Climate Fund is envisaged as the main multilateral financing mechanism for disbursement of climate finance

The Green Climate Fund, agreed in Cancun in 2010,¹⁶ could dwarf all the existing funding channels in the coming years. It is envisaged as the main multilateral financing mechanism for disbursement of the additional resources pledged in Copenhagen. It may also be a channel for innovative finance flows: for example, the European Union is currently exploring options for the pricing of carbon emissions from the shipping and aviation industries in order to finance the Fund.¹⁷

Because of its potential importance, the Green Climate Fund's governance structures and its allocation and disbursement principles were strongly contested. While developing countries insisted on financing from new, additional and predictable sources, and (as in the case of the Adaptation Fund) on direct access to these funds, developed countries argued for the Fund's primary role to be as a catalyst of private investments, and for basing disbursements on measurable results (Schalatek, Nakhouda and Bird, 2012). At the seventeenth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, held in Durban in November–December 2011, it was decided that developed and developing countries should have equal representation on its Board, and that allocation would broadly follow the model of the Adaptation Fund, allowing developing countries direct access to funding (Nakhouda and Schalatek, 2012).¹⁸

Since it is envisaged that the Green Climate Fund will channel tens of billions of United States dollars annually, an appropriate balance between equity and efficiency is critical. Allocation mechanisms could usefully draw on the experience of the funds set up under the Global Environment Facility (GEF), including the Least Developed Countries Fund and the Special Climate Change Fund. The Facility determines country envelopes based on a formula that includes per capita income (so as to ensure that poor countries receive sufficient resources), past institutional performance as measured by the World Bank Country Policy and Institutional Assessment (CPIA) and past performance on GEF projects, and a measure of the likely environmental benefit of the investment (Global Environment Facility, 2010).

¹⁶ See FCCC/CP/2010/7/Add.1, decision 1/CP.16, para.102.

¹⁷ <http://www.euractiv.com/climate-environment/finance-ministers-eye-transport-levies-feed-climate-fund-news-510986>.

¹⁸ See FCCC/CP/2011/9/Add.1, decision 3/CP.17.

It is not clear that existing climate funds are allocating resources either in accordance with efficiency criteria or in function of needs. Asia and the Pacific has been the largest recipient of climate finance, receiving about one third of the funds, with the main country recipients being China, India and Indonesia. Sub-Saharan Africa and Latin America and the Caribbean each received one fifth of climate funds (see figure IV.2 and table IV.3). The geographical allocation of climate funds may in part reflect their focus on mitigation (adaptation accounting for only 25 per cent of the total) and the greater potential for mitigation in more industrialized regions; but even in respect of adaptation, the share of sub-Saharan Africa is relatively limited (35 per cent, as compared with 27 per cent for Asia and the Pacific and 20 per cent for Latin America). Similarly in forestry, where sub-Saharan Africa has considerable potential, its share of funding is relatively limited: only 15 per cent of REDD+ funding has gone to sub-Saharan Africa, representing approximately half the shares of Latin America (32 per cent) and Asia and the Pacific (29 per cent).

The geographical allocation of climate funds partly reflects the focus on mitigation

Table IV.3
Climate funds disbursements by region and the top five countries in each region, 2002–2011

Region	Cumulative climate funds disbursements	
	Amount (millions of US dollars)	Share of global total (percentage)
Asia and the Pacific	580.5	35.6
<i>of which:</i>		
China	187.3	11.5
India	143.6	8.8
Indonesia	86.6	5.3
Cambodia	33.5	2.1
Viet Nam	33.4	2.0
Sub-Saharan Africa	326.2	20.0
<i>of which:</i>		
South Africa	28.0	1.7
Ghana	20.0	1.2
United Republic of Tanzania	14.0	0.9
Ethiopia	12.0	0.7
Zambia	11.0	0.7
Latin America and the Caribbean	302.7	18.6
Other regions	422.4	25.9
Global total	1631.8	100

Sources: Region and global totals taken from Climate Funds Update website (www.climatefundsupdate.org); country data for East Asia and the Pacific and South Asia from Sobhan (2012); figures for sub-Saharan Africa from Noman (2012).

Effectiveness of innovative climate finance

Assessing the effectiveness of innovative climate finance requires, as in the case of health, an examination of the global funds through which it largely flows. The following discussion is not limited to those funds currently receiving IDF flows since existing as well as new climate funds are likely to be a preferred channel for future IDF resources, including

those from new large-scale mechanisms. However, the scope for assessment of these funds is limited, as most are still in their infancy: 19 of the 23 funds monitored by the Climate Funds Update have become operational only within the past five years (Climate Funds Update, n.d.).¹⁹

Meeting stated goals

Climate funds counter the problem of international collective action which leads to underfunding for climate change mitigation

The close alignment of climate funds with the global public good of climate change mitigation is generally considered a key advantage, enabling them to counter the problem of international collective action which leads to underfunding. Their clear focus on achieving internationally agreed goals, such as climate change mitigation and adaptation and preserving biodiversity, is central to their potential to mobilize financial resources, particularly in the current climate of fiscal consolidation in the developed world. Along the same lines, their involvement in renewable energy technology transfer and adaptation facilitates the leveraging of private investment, which is essential to a green economy transition.

In some cases, results orientation is also a priority. The GEF Trust Fund, for example, has a stated goal of demonstrating three to four innovative low-carbon technologies in 10–15 developing countries. Similarly, the European Commission Global Energy Efficiency and Renewable Energy Fund has established specific goals, such as bringing one gigawatt of clean energy capacity to developing countries' markets. However, it is too early to assess their performance against these goals.

Stability and predictability

The ability of climate funds to deliver stable, sustainable and predictable resources will depend on their sources of finance, as different IDF mechanisms have different implications in this regard. The levy on Clean Development Mechanism transactions could, in principle, provide a relatively stable and automatic source of finance; but in practice, the trading of emission certificates as financial assets and speculative investments can generate high volatility in carbon prices. The stability of funds from emissions trading will also depend on the sustainability of the Mechanism itself. Notwithstanding the recent extension of the second commitment period of the Kyoto Protocol, this remains uncertain.

Proceeds from the auctioning of EU ETS emission permits also have the potential to provide substantial (and somewhat more predictable) funds if there is a genuine political commitment by European countries to auctioning a larger share of emission allowances (as opposed to the prevalent practice of granting them without charge) and to earmarking a significant portion of the proceeds for helping developing countries address climate change post-2013. REDD+ financing could also provide stable resources, particularly if it evolved into an emissions trading mechanism. However, its future design remains unclear, and such uncertainty could weaken the momentum of and support for this initiative. In contrast, debt-for-nature swaps entail one-off deals and therefore cannot be considered either stable or predictable sources of finance.

New large-scale mechanisms such as currency and financial transaction taxes could, by contrast, provide sizeable, stable and sustained financial resources for climate change, despite their pro-cyclical nature.

Currency and financial transaction taxes could provide sizeable and stable financial resources for climate change

¹⁹ The four exceptions include the initiatives set up under GEF; namely, the GEF Trust Fund (1994), the Special Climate Change Fund (2001), the Least Developed Countries Fund (2002) and the Strategic Priorities on Adaptation (2004).

As in the case of health, however, even if financing mechanisms offer stability and predictability in respect of raising funds globally, this will not necessarily translate into stability and predictability of disbursements at the country level, which is also dependent on disbursement mechanisms. In this regard, the current large discrepancies between the amounts pledged, deposited and approved and actual disbursements are a cause for concern.

The sustainability of climate finance flows also depends on the lifespan of climate funds, which is often very uncertain. The Adaptation Fund is to operate “indefinitely”—presumably as long as it commands political support—while the lifespan of the Amazon Fund and the Forest Carbon Partnership Facility are “undetermined”. The GEF Trust Fund will be operational until 2014; but having operated for almost two decades and been replenished five times, it seems likely to continue beyond this date. Similarly, the Congo Basin Forest Fund will operate until 2018, with the possibility of extension. World Bank initiatives—including the Clean Technology Fund, the Strategic Climate Fund, and the Forest Investment Program—may conclude their operations should a new United Nations Framework Convention on Climate Change financial architecture (such as the Green Climate Fund) come into force (Climate Funds Update, n.d.).

Climate change is likely to stay high in the international agenda for some time to come. The long-term sustainability of international assistance for climate change hinges largely on the political commitment of funders to supporting the global public good of climate change mitigation and the development priority of adaptation. Provision of additional climate finance could involve a shift away from the conventional notion of development assistance aimed at long-term national financial self-reliance, towards a new global public goods paradigm encompassing sustained finance over the long term. While this could ensure sustained funding, it would also imply a shift of focus in the use of funds from the interests of recipient countries towards those of the international community, including the donors themselves.

A new global public-goods paradigm could lead to sustained finance for climate change over the long term

Fragmentation

Despite the potential of innovative development finance to provide new and more stable climate finance, the plethora of funds emerging in recent years risks adding to the complexity of an already highly fragmented aid architecture, within which 31 DAC donors operate 1,571 environmental partnerships, alongside 30 or more non-DAC donors and dozens of small multilateral environmental agencies (Castro and Hammond, 2009). The proliferation of financing instruments and disbursement mechanisms risks giving rise to inefficiencies, coordination failures, duplication of efforts and higher transaction costs.

A plethora of funds adds to the complexity of an already highly fragmented aid architecture

Established in 2008 to support low-carbon and climate-resilient development in developing countries, the World Bank Climate Investment Funds (CIFs) in particular have been criticized for creating parallel structures for financing climate change mitigation and adaptation outside the multilateral framework under the United Nations Framework Convention on Climate Change for ongoing climate change negotiations (Climate Funds Update, n.d.), although similar criticisms could also be levelled at bilateral climate funds.

Many of the concerns associated with the significant transaction costs and administrative burdens imposed by the presence of multiple donors with different agendas, reporting requirements and delivery mechanisms, particularly in resource-scarce countries, could be addressed in part by a Green Climate Fund if that Fund were to act as the principal multilateral financing mechanism for supporting climate action in

developing countries by channelling a significant share of international climate finance. The World Bank, which is to act as the interim trustee of the Green Climate Fund for its first three years, foresees an important role for the existing Climate Investment Funds in providing concessional climate finance (over the next five years) until the Green Climate Fund becomes fully operational (World Bank Institute, 2012). Thereafter, the Climate Investment Funds may become integrated under the Green Climate Fund itself (Climate Funds Update, n.d.).

Local ownership and alignment

The disbursement of climate finance through sector-specific funds oriented towards global public good objectives raises the risk of distorting national priorities and undermining country ownership. Recognizing such concerns, the majority of climate funds are committed to ensuring that projects they fund are country-driven, and aligned with national development strategies, through inclusive consultation processes and governance structures and clear endorsement by recipient countries.

Increased provision of technical assistance, and direct access to resources (as in the case of the GEF Trust Fund), are also important to enhance countries' capacity to manage financial flows and resist intrusive conditionalities, and to enhance local ownership.

Governance implications of scaling up innovative development finance

Innovative finance would have to be scaled up considerably to fulfil resource needs

Innovative finance mechanisms have so far played a relatively minor role in quantitative terms, and have largely been based on ODA rather than on generating additional resources. They would thus need to be scaled up considerably and to change significantly in nature in order to fill the gap between feasible scenarios for ODA and resource needs, particularly for climate change mitigation and adaptation and green development paths. In principle, this could be achieved by scaling up existing mechanisms, or through the implementation of new large-scale IDF mechanisms (such as those discussed in chap. II) designed to generate a larger pool of funds which could be used more flexibly for a range of development and/or global public goods-related purposes. Either approach would raise potentially important issues of global governance.

Mobilizing private finance

Aid will have to leverage private finance to meet resource needs

It is neither realistic nor appropriate to assume that the additional resource requirements will be met entirely from external public sources: increasing the availability of domestic fiscal and private resources is also critical. The considerable volume of financing needed for climate change mitigation and adaptation, in particular, implies an important role for private as well as public finance. This suggests a hybrid approach entailing the use of aid to leverage private finance—an approach that has been adopted, inter alia, by the Global Environment Facility, Germany's International Climate Initiative, Japan's Fast Track Finance and the EU Global Energy Efficiency and Renewable Energy Fund, and is envisaged in the recently agreed structure for the Global Climate Fund.

Such efforts could usefully seek to leverage resources from new long-term institutional investors such as pension funds and sovereign wealth funds (SWFs). Sovereign wealth funds are of particular importance in light of their very considerable capital base (estimated at \$3.5 trillion in assets in developing countries), very long term liabilities, and already significant green investments. Their mandate to preserve and transfer wealth to future generations arguably makes green investment particularly appropriate, to the extent that the risks associated with climate change represent a potential liability to nation States (Bolton, Guesnerie and Samama, 2010). There is also a need to reform financial market regulation, corporate governance, and rules regarding fiduciary responsibility so as to ensure that private investors face appropriate incentives to scale up the provision of climate finance (United Nations, General Assembly, 2012).

Scaling up existing mechanisms

If innovative development finance is to generate the resources required for development and global public goods, it is essential that it should generate genuinely additional resources rather than attract limited ODA from other uses. A careful balance is also required between funding for targeted global initiatives and that for aid institutions with a wider developmental remit (Isenman and Shakow, 2010). The role of aid in encouraging and supplementing national resource mobilization to meet national development goals suggests the need for a further shift of ODA towards budget support, so as to reinforce both national ownership and the accountability of Governments to their national constituencies rather than to donors.

Nonetheless, depending on the institutional and governance environment of the recipient country, earmarking of funds for particular uses may be justified in supporting developing countries' contributions to the production of global public goods with important development dimensions. Trust funds or fiscal stabilization funds could provide a useful mechanism for facilitating the alignment of donor funding for such purposes with country priorities, ensuring long-term financing, and aligning traditional ODA with innovative forms of development financing (United Nations, 2010a).

The operations and modalities of IDF disbursement mechanisms should also be designed to ensure that their disbursements at the country level, as well as their funding at the global level, are stable, sustainable and predictable. They should have sufficient flexibility to ensure national ownership and coherence with national development strategies and priorities; and they should minimize administrative burdens imposed on recipient countries with serious financial and/or human resource constraints.

The achievement of these objectives could be facilitated by preventing the proliferation of disbursement channels which has been observed in the climate sector in recent years, and through efforts to pool resources from multiple sources in a small number of institutions, so as to address both the fragmentation problem and overdependency of disbursement channels on particular funding mechanisms (like that of GAVI on IFFIm).

Even if the number of disbursement channels were reduced, effective coordination mechanisms would remain essential. In the area of health, the most appropriate framework in this regard is the World Health Organization, given its constitutional mandate "to act as the directing and co-ordinating authority on international health work" (article 2 (a) of the WHO Constitution, signed on 22 July 1946). The United Nations Framework Convention on Climate Change (which was opened for signature in 1992 at

Innovative development finance must generate genuinely additional resources

Disbursements need to be stable, predictable and sustainable, and effectively coordinated and to ensure national ownership

the United Nations Conference on Environment and Development and has been ratified by 192 countries) is the central global coordination mechanism for climate change. The functions of such coordination mechanisms should include ensuring both that the balance of funding availability for different purposes broadly reflects the pattern of needs so as to prevent the skewing of priorities, and that their administrative and monitoring requirements are consistent so as to minimize the imposition of administrative burdens on recipients.

Support to global public goods must simultaneously strengthen national systems

While support to global public goods is needed, it is essential that such support be accompanied by complementary support to the national systems on which they depend (for example, health system support needs to accompany support to vertical programmes) so as to ensure that such systems are strengthened rather than weakened. The Health Systems Strengthening Platform, as originally conceived, provides a useful model in this regard. Sustained political commitment to disbursement mechanisms is also essential, and may be more readily attainable for fewer, larger and broader mechanisms than for the various climate funds whose lifespan is currently uncertain.

Finally, it is important that the governance frameworks of global funds should be firmly established on the basis of democratic principles of representation, accountability and transparency. Many of the existing global climate and health funds, when compared with some other international agencies, are commendable for the transparency and inclusivity of their governance. However, and particularly in the case of use-specific funds, the mechanisms through which they are created and coordinated should be guided by similar principles.

International taxes

The implementation of international taxes will likely raise intense political resistance

Implementation of a tax (for example, on financial or currency transactions or carbon emissions) in a coordinated fashion across countries, and determination of the use of the proceeds at the global level, would raise a number of potentially problematic issues. Not least among these is the issue of tax sovereignty—the unique right of the nation State to levy taxes on its citizens—which is likely to be the basis for intense political resistance on the part of some Governments.

This also raises the issue of the choice among “feasible globalizations”. Rodrik (2002) argues that the nation State system, democratic politics and full economic integration are mutually incompatible, and that at most two of these three pillars can co-exist. The post-1945 system of global governance was based on the principle of subordinating international economic integration to the demands of national economic management and democratic national politics. Even if some limits on integration were preserved, the issue of international taxation versus the democratic nation State as the dominant political unit would still remain a source of tension.

Global or globally coordinated taxes would also raise the question which body should receive and allocate the resources generated. While a comparative assessment is beyond the scope of this chapter, each multilateral institution clearly has its own weaknesses in terms of coverage, representation and operational capacity (Buirra, ed., 2005). The experience of health—and more particularly climate—finance suggests, however, that the establishment of new disbursement mechanisms should be avoided, and existing mechanisms consolidated as far as possible, so as to minimize the costs associated with fragmentation. It is also important that the governance of such mechanisms should be representative, accountable and transparent.

One advantage of a global or globally coordinated tax would be its potential to reduce the financial dependency of international institutions, which risks skewing their decision-making towards the interests of their funders, even where this is not institutionalized in their formal governance structures. However, such a prospect could represent a further hurdle to implementation, as it may be expected to strengthen resistance among those countries whose influence in global governance would be diminished as a result. Their opposition might be rationalized by portraying global taxation proposals as an attempt by international institutions to establish their autonomy and reduce accountability through the generation of revenues not directly controlled by member States.

A global tax would reduce the financial dependence of international institutions on their funders

Tax cooperation

Another prominent tax-related proposal—although it does not strictly fall within the purview of innovative development finance—is international tax cooperation, which could help to bring significant volumes of untaxed financial assets into national tax jurisdictions. By strengthening national resource bases, and thereby diminishing the reliance of international institutions on the goodwill of donors, this could help to increase the financial sustainability, national ownership and coherence of development strategies.

Tax cooperation could bring significant volumes of untaxed financial assets into national tax jurisdictions

Increased tax cooperation would require the strengthening of international tax structures, which currently allow citizens and firms to avoid and/or evade taxes or otherwise defraud national tax systems. Cooperative arrangements among sovereign jurisdictions could offer the possibility of increasing public revenues substantially in both developing and developed countries (FitzGerald, 2012).

A decade ago, the High-level Panel on Financing for Development (also known as the Zedillo Commission) proposed the creation of an international tax organization to compile and share tax information, monitor tax developments, restrain tax competition among countries to attract investment, and arbitrate country tax disputes (United Nations, General Assembly, 2001). Such an institution could be built on existing frameworks, and could be relatively limited in scale, as it would not collect taxes, but rather regulate the flows between tax jurisdictions. Any redistribution towards poorer or smaller countries that might be considered desirable would be carried out through existing institutions.

While the proposal for an international tax organization was not endorsed in the Monterrey Consensus of the International Conference on Financing for Development,²⁰ subsequent developments—including the global financial crisis, non-governmental organization campaigns focusing on “tax justice”, and improved institutional capacities of tax authorities in developing countries—suggest a renewed interest in the establishment of an agency to carry out the Zedillo Commission’s aim of establishing “a mechanism for multilateral sharing of tax information, like that already in place within the Organization for Economic Cooperation and Development (OECD), so as to curb the scope for evasion of taxes on investment income earned abroad” (United Nations, General Assembly, 2001, p. 7). Such an international tax cooperation agency could build on the work of existing OECD and United Nations bodies, with technical support from IMF (FitzGerald, 2012).

²⁰ Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2012 (United Nations publication, Sales No. E.02.II.A.7), chap I, resolution 1, annex.

Special drawing rights

An SDR allocation requires an 85 per cent majority in IMF

Allocations of special drawing rights could help developing countries add to their official foreign reserves, thereby reducing their need for balance-of-payments surpluses or borrowing to build those reserves, and thus freeing resources for more development-oriented purposes. However, an SDR allocation requires the support of an 85 per cent majority in the IMF, which, given the Fund's "economically weighted" voting system, allows the United States of America (or any three other G7 countries) to veto such a proposal. Historically, this has proved a major obstacle, and only three allocations have taken place (in 1970–1972, 1979–1981 and 2009). The scale of the challenge is demonstrated by the 2009 special allocation (which provided additional SDRs to countries that were not IMF members when earlier allocations had been made): while this had been agreed in 1997, it was ratified only in 2009, in the wake of the global financial crisis.

Allocations proportional to quotas constrain potential developmental benefits

The developmental benefits of SDR allocations are seriously constrained by the fact that SDRs can only be allocated in proportion to quotas, so that 58 per cent accrues to developed countries (after full implementation of the 2010 quota reform). By comparison, only 3.2 per cent accrues to low-income countries, and 2.3 per cent to least developed countries (International Monetary Fund, n.d.). However, breaking the link to quotas would require an amendment to the Fund's Articles of Agreement, which would again require an 85 per cent majority voting power (and the support of three fifths of the membership).

It has also been proposed that the share of reserve-rich countries in SDR allocations could be used to finance development and/or global public goods, for example, through the creation of "trust funds", which could provide the capital for a "Green Fund" or a development fund with other objectives (see chap. II). Developed (and potentially other reserve-rich) countries would place their unused SDRs in the trust fund as equity, and the return on investments by the trust fund could be used to service the interest payments on the drawdown of their stock of SDRs (Erten and Ocampo, 2012).

Alternatively, IMF could cooperate with the multilateral development banks in allowing some of the resources generated by an SDR allocation to be invested (by IMF itself or by countries with excess holdings) in bonds issued by multilateral development banks (ibid.). While such bonds would be offered at market interest rates, in principle they could be used for concessional lending if combined with grant funding financed, for example, by revenues from an international tax or from ODA.

Another proposal is for IMF members to lend some of their SDRs to IMF to supplement the usual quota-based resources for regular IMF conditional lending programmes, for example, by treating some unused SDRs as deposits in (or lending to) IMF (United Nations, 2009a; Ocampo, 2011). However, such an approach would be impeded by the division of IMF accounts between "general resources" and the SDR Department. Overcoming this problem would again require an amendment to the Fund's Articles of Agreement.

Conclusion

The major disbursement mechanisms through which innovative development finance for health passes (notably the GAVI Alliance and the Global Fund) have been highly successful in attracting funding, and have used such funding to achieve significant results in their

respective fields. While the financial contribution of innovative financing mechanisms remains modest in the area of health, and more so in that of climate change, innovative financing has the potential to be scaled up substantially in the latter in the coming years. However, the potential of innovative financing to close the considerable gaps between ODA and financing needs in both these areas is limited, as almost all existing innovative financing is either derived from or passed through ODA budgets, thereby seriously limiting additionality. The focus of innovative development finance on global public goods may therefore also signify a shift of development financing from national needs towards global priorities, potentially at the expense of national ownership and alignment with national development strategies.

While it is relatively early to make an assessment, there are signs that certain forms of IDF are somewhat more stable and more predictable than conventional ODA, although issues such as the sustainability of the International Finance Facility for Immunization (the largest source of IDF for health) and the very low level of disbursements from the Adaptation Fund are of concern in this regard. Particularly in the area of climate change, the proliferation of funding mechanisms raises concerns in respect of the further fragmentation of a highly diffuse aid architecture.

Meeting developing countries' financing needs with regard to achieving agreed global goals, notably the Millennium Development Goals and climate change mitigation and adaptation, would thus imply both a major increase in the volume of IDF and a shift in its focus so as to ensure greater additionality. Scaling up existing mechanisms would also risk further compounding the fragmentation of the aid architecture. In principle, larger-scale IDF mechanisms such as those discussed in chapter II, represent a potentially more viable route if the political obstacles can be overcome.