Innovative Financing Mechanisms & Solutions

Stuart Davies & Jose Palacin*


KEY MESSAGES

- Innovative finance includes mechanisms and solutions which increase the volume, efficiency and effectiveness of financial flows.
- Innovative finance has taken many forms and continues to evolve by innovation as well as to adapt to development needs.
- With traditional ODA – development finance falling far short of what is needed globally to finance the SDGs, particularly post-COVID-19, new financing mechanisms and solutions are essential if we are to succeed.
- Building better, better builds on the policy responses available to governments for better outcomes through financing and innovation.
- Building on the corporate finance landscape can be achieved through corporate bonds, socially responsible investment, and corporate finance.
- Identifying, developing new and strengthening existing linkages between IFIs outcomes can better guide and shape outcomes and will be required to ensure the effective use of various sources of finance.

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Unite the Nations Economist Network

Brief history of Innovative Finance

Creation of the MDGs

Geneva & New York Declaration: First global intergovernmental dialogue on innovative means for financing development

International conference on F4D, Monterrey

Millennium Summit: Declaration on Innovative Sources of F4D


Doha Declaration on Innovative F4D

General Assembly resolution devoted to innovative sources of financing for development

I-8 Group created

Busan Declaration to further develop innovative finance mechanisms to mobilise private finance for shared development goals; Rio Declaration to scale up innovative financing

Source: Dalberg
Brief history of Innovative Finance (Cont.)

UN General Assembly to develop post-2015 goals

2013

Sendai Framework for Disaster Risk Reduction; Addis Ababa Action Agenda of the Third International Conference on Financing for Development; Transforming our world: the 2030 Agenda for Sustainable Development; Paris Agreement on Climate Change.

2015

Group of Friends of SDG Financing formed to replace the Leading Group

2016

High-Level Event on Financing for Development in the Era of COVID-19 and Beyond convened by Canada, Jamaica and the UN.

2020

Discussions to consider the need for a Fourth International Conference on Financing for Development at FfD Follow-up forum.

2022
Definition, Scope and challenges

• Innovative financing is designed to compliment traditional international resource flows (inc. aid, FDI, and remittances) and mobilize additional resources for development through private investors.

• It has a dual role of:
  • Enabling a broad range of approaches to mobilize resources
  • Increase the effectiveness and efficiency of financial flows that address sustainable development.

• There is no single agreed definition of innovative financing but some overlap.
  • ‘non-traditional applications of solidarity, PPPs, and catalytic mechanisms that (i) support fund-raising by tapping new sources and engaging investors beyond the financial dimension of transactions, as partners and stakeholders in development; or (ii) deliver financial solutions to development problems on the ground’ [World Bank]
  • ‘mechanisms of raising funds or stimulating actions in support of international development that go beyond traditional spending approaches by either the official or private sectors, such as: 1) new approaches for pooling private and public revenue streams to scale up or develop activities for the benefit of partner countries; 2) new revenue streams (e.g. a new tax, charge, fee, bond raising, sale proceed or voluntary contribution scheme) earmarked to developmental activities on a multi-year basis; [or] 3) new incentives (financial guarantees, corporate social responsibility or other rewards or recognition) to address market failures or scale up ongoing developmental activities’ [OECD]
  • ‘An innovative development financing mechanism is a mechanism for raising funds for development. The mechanisms are complementary to Official Development Assistance. They are also predictable and stable. They are closely linked to the idea of global public goods and aimed at correcting the negative effects of globalization’ [Leading Group on Innovative Financing]

• Consequently:
  • There is substantial scope for misinterpretation of what the practicalities of innovative financing might involve.
  • Lack of standards, data, liquidity, and performance metrics makes it difficult for investors to assess innovative financing opportunities.
  • Creating new innovative financing mechanisms - especially mechanisms without evidence-based track records - can be costly.
  • Innovative financing mechanisms for development, particularly those still in the nascent stage, may fail to offer risk-return profiles that fit investor requirements.

Source: K4D
When the goals were adopted in 2015, UNCTAD estimated that $2.5 trillion was required to achieve them in developing countries.

The gap now stands at about $4 trillion per year [56% increase] after the outbreak of COVID-19. [Sept 22]

- Positively, at $4tn this is less than 1% of global finance [$486.6tn, Jan 23].

Past trends strongly indicate that new innovative financing will bridge some of this gap in future years.

PwC estimated that Global investable assets for the asset management industry will increase to more than $100trn by 2020 from $37.3trn in 2004.

Innovative financing can also have substantial leveraging potential.

- The World Bank estimate that the $7.7bn in guarantees issued to support investments in developing countries between 2000 and 2008, levered addition investment financing of US$20bn (2.6x).
# Mechanisms and solutions for New Financing, Enhancing the Efficiency, and Improving the Effectiveness of Development Finance

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| Generally, refers to instruments to raise funds from the Capital Market. | - Bonds  
- Loans  
- MSME Finance  
- Impact Investment Fund  
- VC & Private Equity Funds |  | Mechanisms designed to reduce (perceived) risk. | Payments linked to agreed outcomes. | Mechanisms or models that leverage technology. | Compulsory Contributions to a country’s fiscal revenue. | Voluntary contribution to a social or environmental outcome. | Mechanisms the reduce or extend a country’s debt when certain outcomes are met. |

**Source:** UNDP
Promoting New Financing - Labelled Bonds: A Growing Market

Labelled sovereign bonds market size, $bn and number of countries, end 2022

Source: Climate Bonds Initiative
Labelled Bonds: The good and the not so good

Benefits

• «Greenium» is elusive but broader investor base
• Signalling effect
• Halo effect
• Debt structure
• Market development
• Performance incentives in sustainability-linked bonds

Limitations

• It is debt!
• Coordination is costly (but also useful)
• Additional issuance costs
• Not a «reputation eraser»
• Exchange rate risks
Promoting Effective Financing: Principles of Responsible Banking

- Designed to be integrated into banks’ strategies and portfolio of activities, the PoRB brings purpose, vision and ambition on sustainable finance.

- The 6 principles are:
  1. **Alignment**: of business strategies to be consistent with individuals’ needs & society’s goals, as expressed in the SDGs, Paris Climate Agreement and relevant national and regional frameworks.
  2. **Impact & Target Setting**: continuously increase positive impacts, while reducing the negative impacts on, and managing the risks to, people and environment resulting from activities, products and services.
  3. **Clients & customers**: work with clients and customers to encourage sustainable practices.
  4. **Stakeholders**: consult, engage, and partner with relevant stakeholders to achieve society’s goals.
  5. **Governance & Culture**: embody effective governance and a culture of responsible banking.
  6. **Transparency & Accountability**: Review and report positive and negative impacts on society’s goals.

Source: UNEP FI
IF Roles for selected Development Actors

**Government**
- Taxes & Subsidies, licensing and fees
- Regulations & Standards
- Market monitoring
- Information pooling & disseminating
- Insurance & Guarantees
- Convening power & network development
- Pooling risk via investment partnerships (PPP)
- Infrastructure investments (digital/Fintech)

**Central Banks**
- Differentiated rediscount rates & capital reserve requirements
- Convening power & moral suasion to promote sustainability criteria
- Disclosure rules to highlight and mitigate sustainability risks

**Donors**
- Development capital platforms
- Technical Assistance
- Convening power & network development
- Support new mechanism & solution development
- Financial standards, regulation & monitoring

**Multilaterals**
- Loans, Grants, Insurance & Guarantees
- Technical Assistance & Monitoring
- Convening power & network development

**CSO & other**
- Funds development
- Lobbying and Advocacy

**Private Sector – Financial and other**
- Funds development
- Corporate Social Responsibility
- ESG and principles of Responsible Banking
Innovative Financing Opportunities: Jamaica Case Study

Financing sustainable development in Jamaica is constrained.

- **Net ODA as a percentage of gross capital formation**: Jamaica’s upper middle-income status means access to concessional financing is restricted.

- **Fiscal space for additional debt**: GOJ’s commitment to reducing its Debt/GDP to below 60% by 2028 means that both fiscal space will be squeezed and a limited appetite for additional debt.

**Opportunities for Innovative Financing**

- Development of Impact bonds
- Partnership with Caribbean Philanthropic Alliance to access in excess of US$1.5trn
- Leveraging diaspora funding by channeling better Jamaica’s strong remittance flows

**Challenges**

- Ready-investible pipeline for investors and it for purpose financing instruments tailored to Jamaican context.
  - Project development capacity failures
  - Private finance failures

Source: UNDP
Concluding points

• Innovative financing includes mechanisms and solutions that increase the flow of finance; improve the efficiency of financing flows; and enhance the effectiveness of financing flows.
• Innovative financing can and has taken many forms and continues to evolve to suit the context and application.
• Traditional sources of financing will fall far short of what is require to finance the SDGs, and more so following COVID-19.
• Building forward better will require the full use of policy levers available to governments to mobilize finance.
• New partnerships between governments, central banks, private finance, academia and development actors will be needed to sustain action.
• Identifying, developing new and strengthening existing linkages between SDG outcomes to better target finance to multiple outcomes is needed to be most impactful.
Final Thought…

• **Context:** How best to arrange innovative financing that supports sustainable economic transformation in vulnerable resource constrained countries?

• **Theory of change…**
  - A more diversified economy enables higher per capita incomes; lower volatility; poverty reduction and better long-term growth prospects.
  - Economic diversification occurs as we develop more progressively sophisticated baskets of goods and services over time.
    - It involves greater economic complexity/structural transformation.
  - For greater economic complexity we need to reallocate factors of production from low to high productivity activities and sectors.
  - And to do this, countries need to increase their productive capacities.
    - Productive capacities are multi-dimensional covering human; natural; energy; transport; ICT; private sector; and structural change.
  - The extent to which countries can enhance the mix of productive capacities will depend on accessible resources, structural vulnerabilities and stage of development.
    - Access to finance, expertise, technologies and trade networks are especially important to those resource constrained.
  - **[Proposition]** Countries at lower stages of development maybe more likely to pursue diversification strategies that are less sustainable than countries at high stages of development.
  - They may develop a mix of productive capacities that promote less sustainable economic complexity; diversification; and economic transformation and lead to higher future levels of environmental degradation; wider inequalities and greater socio-economic volatility.

• We are trying to better understand the linkages leading to sustainable economic transformation, as well as identify what suite of innovative financing is required to bridge the sustainable economic transformation financing gap.
  - That is:
    - To build the right mix of productive capacities that promote sustainable economic complexity, and
    - Enable countries to diversify and develop a more progressively sophisticated and wider basket of goods that support the environment, reduce inequalities for sustainable development.

**Source:** Financing for Sustainable Development Report 2023;
D Tennant, Davies, S, Tennant, S and Whitely P: Promoting Sustainability Through Economic Diversification, Complexity and Productive Capacity Enhancements: University of the West Indies: March 2023
Thank you