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The International Financing Facility: Issues and Options

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Chancellor Gordon Brown has proposed not just that international aid efforts should rise to the challenge of meeting the UN's Millennium Development Goals, but also that funding to poor countries be doubled right away, with an extra US$50 billion a year mobilised from now until 2015. The proceeds would save mothers and infants from preventable death and put children through school by the million. And it need not cost taxpayers a penny, beyond the additional amounts that their governments have already committed for the future.

This scheme – dubbed the International Financing Facility (IFF) – uses bond markets to bring forward cash for development faster than aid budget increases can realistically materialise. Rich country pledges for future years are securitised by a new entity that issues long-term bonds with this solid backing. The proceeds of these bond sales are then handed out as grants to existing development agencies, exclusively for antipoverty programmes in low-income countries. Several years later, rising aid budgets will be used to pay bondholders.

How the IFF works: 10 points

1. Donors make legally binding multiyear pledges to IFF.
2. Each pledge is contingent on high-level conditionality.
3. IFF issues AAA-rated bonds more than 100% backed by pledges.
4. IFF uses bond proceeds to fund grants to official aid agencies.
5. Aid agencies are responsible for disbursements to beneficiaries.
6. Donor payments also fund bond interest and IFF administration
7. Pledges (contingent, arms-length) may qualify as off-budget.
8. The scheme is expected to last 30 years.
9. For the first 12–15, aid grants greatly exceed donor payments.
10. Thereafter, aid grants cease as bonds are retired.

Here are the main concerns so far expressed about the scheme:

• *We should not finance development aid through borrowing*. This is a myopic perspective, as governments routinely borrow, or give loan guarantees, for all kinds of public-interest investments, some with much lower expected returns than this one. Many countries also borrow to finance other government spending, and in doing so they are already partly funding their aid budgets with debt.

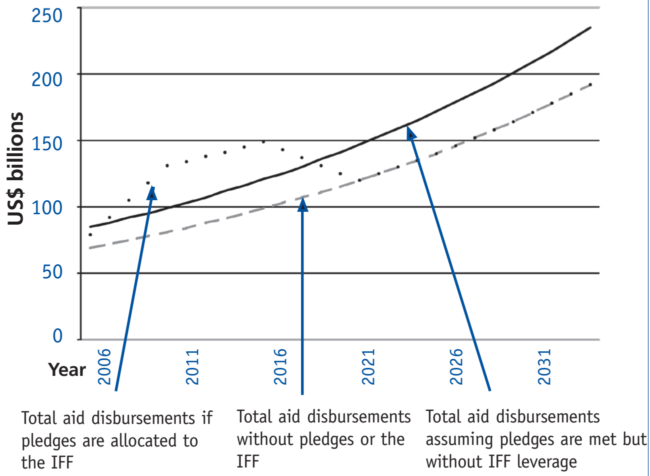
• *There is no way that poor countries can absorb extra money on that scale*. There is ample evidence that aid to poor countries that pursue minimally sensible policies, or emerge from conflict and other shocks, reduces poverty and improves lives. Development needs and capacities have been well documented recently, on the kind of scale that the IFF seeks to achieve. Of legitimate concern is the possibility that ramping up aid very fast to a few heavily aid-dependent countries could create damaging inflationary pressures there.

• *We need to make aid agencies more effective and accountable*. Absolutely. There are already enough reasonably well managed and transparent channels in place to carry IFF aid to where it is needed, but they all need further improvement. The IFF scheme, by design, does not address the underlying effectiveness of the aid system, which is why its governance set-up, as discussed below, needs to attract greater international scrutiny.

• *It is a dodge used by less generous countries to shirk their responsibility*. Some suspect a sleight-of-hand to distract attention from the less generous aid shares characteristic of the G7. This does not have to be an either/or proposition: the IFF is a potential lock-in mechanism for aid increases that have yet to materialise, making it easier for laggard countries to meet their underlying commitments. Nonetheless, as the two early IFF champions, the UK and France, are still barely halfway to the UN aid target of 0.7% of national income, and only one of them (France) has named a specific date for

Aid disbursements with and without the IFF

This shows what happens between 2006 and 2031 if existing pledges are delivered, or not delivered, or delivered and allocated to the IFF.



Source: Development Initiatives, The International Finance Facility Briefing Note (Sept 2003)

Note: Assumes 4% underlying growth rate of Overseas Development Assistance

reaching it, the Chancellor's position here is not as strong as it might be.

• *When IFF bonds are paid back, aid budgets will need to be cut.* This is quite possible: we cannot guarantee that aid will continue to rise inexorably, and the bonds will have to be paid back, starting soon after 2015. Even so, the front-loaded human and economic benefits should make the whole operation worthwhile, assuming the initial aid boost is used effectively.

• *The same thing could be achieved more cheaply by asking existing institutions to borrow from markets along these lines.* This is also entirely possible, and indeed the World Bank and IMF have already been asked to compare all possible ways of 'accelerating' aid such as the IFF. Their initial report on this is due out in April 2004. One should opt for the best available IFF-like alternative, considering all the financial and the governance implications: but that is not a reason to withhold support for the entire idea as it now stands.

How will the IFF actually allocate its funding across development agencies and countries?

The governance of the IFF itself, and the basis on which some development programmes are chosen, is perhaps the biggest unresolved issue, when other qualms have been set aside.

At stake is who controls a major new international aid node – a huge 'synthetic aid agency' – which could perhaps become as large as all the 80+ members of the present official aid system put together.

The published proposals suggest that legal responsibility for its awards will lie with a modestly sized governing board, mostly representing pledging countries, plus a minority of recipients. Broader involvement of developing countries or of civil society is not yet foreseen.

At the same time, it is proposed that each donor country will largely determine for which programmes the IFF will disburse funds backed by that country's pledge. This 'multiple unilateralism' would be subject to high-level policy restrictions, such as the IFF supporting only programmes to reduce poverty in low-income countries. Presumably such criteria will be fully transparent and leave only limited discretion to the IFF Board in their application.

There is therefore a fundamental ambiguity here surrounding how IFF policies are to be made. If the IFF is to be essentially a passive pass-through device for the aid choices of its sponsoring members, it delivers little that could not be achieved at their national level, and may be scored formally as an integral part of public expenditure (see box).

If, on the other hand, its board is truly empowered to redistribute aid across agencies and recipient countries to any extent, then its decision-making criteria, voting control and representation become very important at the global level. At the extreme, the IFF could even be structured so as to introduce a major positive element of choice and competition in favour of developing countries, though this does not look likely today. At the very least, developing countries should be empowered to monitor the IFF's adherence to the high-level aid principles, and hold it accountable.

Indeed, the IFF could easily reinforce existing imbalances in world governance and burden-sharing, both in the North-South dimension and as between the G7 and other donors, rather than act as a powerful counterweight to them. Some of the reluctance of potential sponsors to this day, and most of the lack of enthusiasm from civil society, probably relate to this ambiguity.

Conclusion

Despite these challenges, accelerating substantial amounts of aid in this way is vital in order to achieve the MDGs. For the initiative to be a success, not only do its sponsors have to obtain financial backing for it: they must also now address where the IFF will take its policy steer from, and how.

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