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Gates Report

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Technical Note on the Report of Bill Gates to the G20 on Financing for Development

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Introduction

This technical note summarizes some of the key financing proposals likely to be contained in Bill Gates's forthcoming report to G20 leaders. It is intended to offer an opportunity for early comment and advice from ministers and officials, and to contribute to preparations for the Cannes summit. **It is not a draft of the report itself.** Beyond the financing issues discussed in this note, in his report Bill is likely to put special emphasis on innovation as a fundamental driving force for development and reflect on new ways to make the gains from innovation more rapidly and broadly available in poor countries. He will suggest to leaders ways the G20 can lead in this, encouraging and transferring innovations that spur and transform the lives of poor people. When he speaks to G20 leaders, he hopes to give practical examples of new partnerships for innovation and development which the G20 has unique potential to promote and scale up.

With respect to financing specifically, Bill will argue that we need to celebrate – and strengthen – poor countries' own growing capacity to mobilize and use their own resources. Aid can play a critical role in this, and reinforce governments' deployment of national resources to priority growth and poverty reduction objectives. Beyond aid, the key to growth is the dynamism of private capital and of the major emerging economies, as sources of finance and of innovation. The G20 should lead in innovating to crowd in these new resources: strengthening aid commitments; being much bolder in their use, alongside private effort, to incentivize private investment not just by reducing risk but by expanding new asset classes and innovative instruments; identifying new revenue streams that could finance health, development and climate adaptation in more predictable ways; and finding new ways to mobilize global savings for development.

Strengthening poor countries' own resources

Bill's report will stress that the long-term goal for development finance is to enable the poorest countries to reach the point where governments can take care of their obligations from domestic public resources, and economies are resilient enough to finance growth by generating strong domestic and international private investment.

The growth performance and relatively rapid post-crisis recovery of many poor countries, including those of Sub-Saharan Africa, is encouraging in this respect. If Sub-Saharan African countries can maintain current average growth rates, for example, their economies will double in size in real terms by early next decade, and GDP per capita will rise by more than 50%. Though the region will still be poor, and some countries will do much worse than this because of conflict or other factors, sustained growth can overall greatly strengthen their capacity to finance their priorities, and emulate the robust development path of successful emerging economies.

Bill will argue that the G20 can do a lot to support the mobilization of domestic resources. The G20 plays a critical role in maintaining an open trading system and guiding the world economy back to health, and that is a key requirement for poor countries' growth. Rapidly growing G20 countries can do more to share their experience of replacing past reliance on external aid with strong national tax and budget systems: South Africa's leadership in the CABRI initiative of African fiscal authorities is a good example. The G20 can also help poor countries improve the management of fiscal resources. G20 countries are the source of most of the external financial flows into (and out of) poor countries. Greater transparency around those flows would help revenue authorities do their job, and help citizen confidence about the use of national resources, especially in the extractive industries which are a critical revenue source for many poor countries. The Extractive Industries Transparency Initiative needs to be extended well beyond the current "compliant" countries – for example, only five African countries make that list – and more could be done to help the much larger group of countries working towards compliance. Transparency should not only be about recipient countries. G20 countries, as the source of most extractive industry investment, should require their companies to disclose details of oil and mining investments and payments to governments, as has recently been required in US legislation.

Bill's report will argue that greater effectiveness in allocating public resources to the right priorities, and spending them efficiently, is at least as important as mobilizing those resources. Here, he will point to distinct contributions that different governments can make. First, getting budget priorities right. African leaders have collectively set themselves important targets, for example, for investment in health (15% of national budgets) and agriculture (10%), both vital areas for poverty reductions and the MDGs. Most governments are as yet well short of these targets. It would be useful, perhaps through peer mechanisms like NEPAD and CAADP, to develop specific fiscal plans to move to these levels, and to track progress by individual countries. Clearly G20 aid donors and other partners can do much to reinforce such efforts to improve allocation of resources for greater poverty impact, especially by aligning their own aid and technical co-operation. Second, focusing on results and value for money. The trend among aid donors to focus on results and reward outcomes is useful and should be strengthened. But the report will argue that this should not be confined to aid programs, but more systematically implemented in governments' operations. In health, for example, the data show that it is often possible to improve results dramatically, in terms of reducing death and disability, by making the right choices within existing financial resources. G20 countries have rich experience of "what works" in development that is valuable to poor countries, but evaluations from individual countries need to be more widely shared in a form where other countries can learn practical lessons. Mexico, for example, has established a National Council for the Evaluation of Social Development Policy, called Coneval. Coneval measures progress on national development targets, conducts rigorous evaluations of key investments, and produces annual performance reviews for key government programs. Similar bodies are taking shape in Argentina and India. Bill will suggest that one way to do this could be a G20 partnership, also drawing on multilateral, private and NGO experience, to conduct comparative cost-benefit studies, share evaluation experience more systematically and identify readily transferable lessons about effectiveness and efficiency.

Strengthening aid commitments

Bill's report will argue strongly that economic difficulties and fiscal consolidation should not lead G20 and other donors to retreat from aid commitments vital to poor people's lives. Rich countries' fiscal books cannot be "balanced off the backs of the poor". Donor countries' aid as a share of public spending is far too small to produce major budget savings, accounting for no more than 1-2% of budgets. However, the impact of cuts on poor countries and their people is much more severe, both in the short term (e.g., drug and food availability) and on longer term investment projects uncompleted or unfunded.

Bill will strongly welcome the decision by some rich G20 countries, such as the UK and Australia, to continue to expand aid budgets to meet their commitments. He will urge all "traditional" aid donors to keep the commitments they have made by 2015. To illustrate the potential impact on financing for development: if all countries that have made specific aid-to-GDP commitments were to meet them, and the rest of the OECD/DAC group were able to attain the current European average of 0.44% GDP, development assistance would roughly double, to around $250 billion p.a.. This will not be achievable in the current environment. A more realistic target, where specific commitments are met by those who have made them and all other donors at least maintain aid at current GDP shares, would yield an additional $80 billion over 2010 levels.

The report will welcome the expansion of aid programs by G20 countries such as Korea, China, India, Turkey, South Africa and Brazil, and point out that a commitment by these countries to at least maintain their current efforts, in terms of budget or GDP shares, would provide over time a sizable "aid dividend" from their rapid economic growth. Though these countries understandably see their aid programs as being a different model from traditional donors', it is still important that they provide full data and continue to improve the transparency of their assistance, as others are rightly being urged to do. In his full report, Bill will focus on the great potential of the emerging countries to use the sharing of their own recent successful experience for development, well beyond the limited frame of their role as aid donors.

<u>Potential new revenue streams for development and climate adaptation</u>

Bill's report will talk about the potential for new revenue measures, some of which have been under active discussion in the G20. A Financial Transactions Tax has been supported by some governments of the G20 and a wide range of civil society groups, but opposed or greeted skeptically by others. The report will acknowledge the controversy around the proposal, but is unlikely to go into the detailed analytical merits, for example with respect to different approaches to optimal taxation of the financial sector, but will make the case for a substantial allocation to development. It will note that FTTs of various kinds India and the UK, and therefore seem to be feasible even without universal adoption. If G20 members or some other set of countries (e.g., within the EU), can agree on the outlines of an FTT, Bill's report is likely to argue, it could generate substantial resources. For example, some modeling suggests that even a small tax of 10 bp on equities and 2 bp on bonds would yield about $48 billion on a G20-wide basis, or $9 billion if confined to larger European economies. Some FTT proposals offer substantially larger estimates, in the $100-250 billion range, especially if derivatives are included. If a substantial part of the revenues could be allocated to development, this would be a useful addition to resources – and would be additional help to some donor countries to meet their aid commitments in the current environment. Of course, to the extent that some countries applying the tax would use part of the proceeds to fund aid commitments they have already made, the revenue would be part of the aggregate aid increases already discussed, rather than incremental to them.

Bill will discuss a second revenue-raising proposal focused specifically on health. There is a compelling case for all governments to tax tobacco heavily to reduce consumption, improve health and generate revenue to meet health costs. WHO's target is excise tax increases to at least 70% of the pack price, to raise the price of tobacco relative to other goods. While some countries already tax tobacco heavily, the average excise tax in G20 countries is 48%, and poorer countries tend to be much lower. **The public health impact of raising these levels would be considerable, and the revenues substantial – about $170 billion p.a. if fully implemented by the G20 and the rest of the EU. Bill's report will suggest that a small part of such incremental excise taxes, on a sliding scale by GDP, could be a Solidarity Tobacco Contribution, to be allocated at the discretion of the taxing governments to a menu of agreed global health objectives – for example, WHO, the Global Fund, Unicef, GAVI, Unitaid, and others. Aside from a win-win of substantial revenue mobilization and health impact, this could improve the predictability of funding for important global public goods which G20 countries support. On the model considered in the report, a Solidarity Tobacco Contribution might total $9 billion per year.**

A third revenue proposal relates to climate change. It is increasingly clear that poor countries will have no choice but to make major shifts, over the coming of decades, in the design and scale of basic investments in food production, water management, coastal protection and other areas to adapt to changes in climate. In fact the distinction between economic development strategies and climate adaptation is already becoming meaningless, though the additional adaptation investment costs still have to be funded. The World Bank and IMF, in their work for G20 finance ministers, indicate that these additional costs are significant but not unthinkable – around $80-100 billion annually for all developing countries, and $17 billion each for the poorest regions, South Asia and Sub-Saharan Africa. Over time markets and governments should, and will, price carbon more explicitly, and carbon reduction price differentials between rich and poor countries offer opportunities to finance the adaptation needs of poor people on a significant scale through the market. The report will say that this market is, however, still relatively small and prone to uncertainties and distortions, and will take time to get right. Meantime, there is a lot of merit in the WB/IMF proposals to introduce consistent taxes on shipping and aviation fuels, even though these are politically hard to agree on, and technically complex to design equitably among countries. Despite these complexities, their analysis suggests that an efficient carbon-based bunker fuel tax, for example, could yield up to $30 billion annually by 2020, and a similarly based aviation fuel tax somewhat less. Most of this revenue could be retained by national authorities to offset tax reductions in other areas as part of a market-based climate approach – but a modest portion, devoted to adaptation finance for low income countries, could make a big contribution to protecting the livelihoods of very poor people.

Engaging the private sector in innovative ways

As may be expected, the report will argue strongly that private capital is the central driver for growth and poverty reduction. Much of what needs to be done is well known – a market-friendly investment climate, open trade and financial policies, reward for risk-taking and innovation. Private investment, especially from large emerging and oil-rich economies, is growing strongly, but could do more if better incentivized to serve poor countries and poor people. Public goods need private energies and investment, whether to turn publicly funded research into an adopted drought-resistant seed or a delivered affordable vaccine, attract funds into much needed investments, or stimulate credit and value chains to fuel small business growth and capital accumulation. Within this broad view, Bill is likely to focus on a few areas where there seems untapped potential both to increase investment and to channel it towards high development impact.

The report will explore how remittances can make a greater contribution to development. Remittances to developing countries now run at $350 billion a year and growing; for Sub-Saharan Africa, they total $22 billion in recorded flows, but under-estimation is especially high here. The G20, which includes major host and sending countries of migrants, has unrivalled experience on remittances. Three issues will be stressed. First, the G20 should continue to press down on transaction costs: average costs of sending money home have been brought down just below 9% on average, but there is clearly scope for further reduction. Governments in remitting and receiving countries can do more to publicize comparative costs (including online) and increase competition, partially using information already available through the clearing house at the World Bank. Second, more remittances might be channeled towards family savings in receiving countries by ensuring that "financial inclusion" reforms being worked on by the G20 directly encourage this and address regulatory and other obstacles. Third, the potential of diaspora bonds and remittances securitization is quite promising – the combination of home-country patriotism and safe investment is a powerful one – and the World Bank estimates that emigrants have savings of some $400 billion ($52 billion for Africa) that are currently mostly in cash or near-cash. The report will suggest that the G20 might focus on lessons from diaspora bonds and securitization experiences to reduce risk and regulatory obstacles. One idea may be for IFC and investment promotion agencies in migrants' host countries to increase confidence in these instruments by developing participation partnerships with issuing entities in poor countries.

Diaspora communities are not the only private individuals interested in providing patient capital for development. Studies, including assessments by major banks, suggest a capital pool in the hundreds of billions of dollars of investors willing to trade off some financial return for social impact. These include philanthropists, individual savers, family or private wealth funds of high net worth individuals, and others. The challenge for this sector, however, is in turning good intentions and interesting experiments into large-scale investment flows to build social capital. The G20 could assess current experience among them – for example microfinance funds, the UK social finance bond and proposed social finance bank, the strong demand for IFFIm bonds to support GAVI by Japanese social investors-- to identify possible guarantees, tax incentives or regulatory streamlining which might unlock these funds at scale.

A third point in this part of the report is to encourage funding instruments which "pull" private sector actors into worthwhile development activities. The Advance Market Commitment for pneumococcal vaccine is an important learning model. Bill's report will welcome the G20 initiative, sponsored initially by Canada and now joined by a number of other countries, to bring that experience to agriculture. Pilots of customized pull mechanisms in key areas such as increasing crop yields, reducing post-harvest losses, enhancing livestock and improving nutrition would be funded under this approach.

A special opportunity: infrastructure development and sovereign wealth funds

A significant part of market-driven international investment is not in fact private, but ultimately government owned, and presents a special opportunity for development.

The report will point to the extraordinary success of emerging and oil-exporting countries in accumulating savings and the rise of sovereign wealth funds. Non-G7 surpluses are now approaching $6 billion, while SWF assets exceed $4 trillion and continue to grow rapidly, led by China, Abu Dhabi and a few others. Bill will argue that there is an opportunity to scale up their investment in poor countries' infrastructure in a big way, beyond the helpful but limited initiatives so far, and provide a core of financing which will also bring in greater private sector investment. An infrastructure fund financed by just one percent of SWF assets would start at $40 billion, and could reach $80-100 billion or more with projected SWF growth over this decade. Given the scale of poor country infrastructure needs (for example $80 billion p.a. for Sub-Saharan Africa, as estimated by the African Development Bank), there is a compelling reason to find smart ways to tap this pool of global savings for development, and especially for infrastructure as the backbone of growth and poverty reduction.

The report will welcome the fact that this is being considered seriously, including by the African Development Bank, NEPAD and the G20's own Development Working Group. Such an infrastructure fund should offer high credit quality and a market-related return, but provide financing on concessional terms for poor countries, consistent with their poverty and debt-servicing capacity. Interest rates for poor countries would need to be lower, and maturities longer, than the terms SWF investors could offer. This means that there is a substantial "subsidy wedge" to be financed between the investment return of the SWF and the loan terms faced by the borrower.

The report will suggest that non-concessional development finance institutions such as IBRD, IFC and the African Development Bank would play an important role in the provision both of some financial guarantees and project quality assessment. Nevertheless it will be necessary to "push the envelope" in order to get the cost of funds down, probably to a target level much closer to IDA credit terms than to the risk-free return rate which might be an appropriate benchmark comparator for the SWF investors. This could involve four considerations, each with its own sensitivities for governments.

First, to make sense, MDB guarantees should be more highly leveraged than past policy and practice. This will likely involve the addition of IDA and the African Development Fund as guarantors, with perhaps 4:1 leverage rather than the comparatively conservative 1:1 of the ordinary capital windows.

Second, aid, from both traditional donors and emerging countries, will need to provide a source of financing for the remaining subsidy element. The leverage and development impact of such payments could by very high, but clearly there may be sensitivities around the appearance of transfers to SWF owners.

Third, the MDB concessional windows – especially IDA and to some degree the Asian Development Fund – could be a future source for financing the subsidy, rather than direct payments from aid donors. The scope for this should increase, as some rapidly growing countries graduate from the concessional entities and create financing headroom. The core traditional donors to these entities, as well as the shareholders of the MDBs generally, would need to see this as a high-priority use of concessional funds.

Forth, the infrastructure facility would need to have clear governance arrangements reflecting the respective financial contributions of its investors and donors, distinct from the regular governance structure of the MDBs which might still provide project preparation and management services alongside their balance sheet involvements.