Centre for Aid & Public Expenditure | Development Progress

Financing the future

How international public finance should fund a global social compact to eradicate poverty

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Executive summary
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odi.org/financing-future

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A window of opportunity

This year the world will agree new Sustainable Development Goals (SDGs) to shape global development policy until 2030. Achieving these goals would have transformative effects, eradicating the scourge of global poverty and expanding opportunities for many millions worldwide. Success will require political leadership backed by financial commitments.

This report has a simple message: the proposed SDGs are achievable, but adopting a business-as-usual approach will leave us far short of the target. Projections based on current patterns of development point to a world in 2030 where:

- low-income fragile states have been left even further behind
- some 550 million people are still living on less than $1.25 a day, most of them in sub-Saharan Africa
- around four million children will die needlessly before the age of five
- universal health and education are still distant prospects in many countries, with some in sub-Saharan Africa still 20 years away from achieving universal primary education.

These outcomes are avoidable. When governments come together at the Financing for Development (FFD) conference in Addis Ababa in July 2015, they will have the opportunity to transform international development cooperation and put the world on a path towards the SDGs.

Governments meeting in Addis Ababa must navigate their way between two fallacies. The first is that money doesn't matter. Good domestic governance and supportive international policy are high on the FFD agenda, and rightly so, but without a renewed effort to mobilise finance the Addis Ababa summit will fail. And while private finance is a big part of the story, eradicating poverty by 2030 will be impossible without adequate public finance. At present, however, the tax capacity of the world's poorest countries falls far short of the scale of public investment required – in this report we estimate there will be a $84 billion annual financing gap for social services and social protection alone. Contributing governments might not like this message, but if they are serious about the SDGs, they must match new development ambitions with new development finance.

The second fallacy is that development outcomes will automatically follow financial inputs. The experience of the Millennium Development Goals (MDGs) era has laid bare the failings of that approach to development. The delivery of international public finance (IPF) must be adaptive and politically smart. In particular, IPF providers must find ways to support the development of state capacity in low-income fragile states.

This report sets out the case for a strengthened commitment for IPF to support a new social compact, focused on the poorest countries. We make a range of recommendations, some of which could be adopted in July's financing for development agreement, which would contribute to making development cooperation fit for purpose in the SDG era.

Classroom, Ghana (Photo: Ben Grey)

A global social compact

The Financing for Development conference should lay the groundwork for the establishment of a minimum standard of living for all, calibrated to national contexts. This basic social compact must include minimum income provisions, alongside universal health care and universal access to good quality education. These are three critical elements in the fight to tackle chronic poverty, stop impoverishment, and accelerate the escape from poverty. Poverty eradication means providing everybody with access to essential basic services.

Social sector investments should not be seen as an alternative to a growth agenda, but an integral part of it. Investments in people complement investments in infrastructure. The pendulum of development fashion has swung back towards economic growth – and that is probably a good thing. But the pendulum should not be allowed to swing too far. Even in growth success stories the benefits often trickle down to the poor far too slowly. Eradicating extreme poverty by 2030 will require mechanisms to reduce inequality and share the fruits of economic growth.

A new global social compact needs to include all the basic elements necessary for a decent standard of living. In this report we focus on just three core foundations: social protection, universal health coverage (UHC) and universal primary and secondary education.

A new global social compact needs to include all the basic elements necessary for a decent standard of living.

Safe shelter, Juba, South Sudan (Photo: Oxfam)

1. Social protection

Well-designed, properly financed and effectively targeted social protection programmes bring the poorest people closer to a decent standard of living and can encourage productive investments that lead people out of poverty. The FFD conference presents an unprecedented opportunity for the international community to support the introduction and extension of nationally owned social protection programmes to include social transfers that are designed to lift people out of extreme poverty. We estimate an indicative budget for such programmes, based on a cash transfer scheme calibrated to the gap between the $1.25 purchasing power parity extreme poverty line and the average income of the poor in each country, making allowances for leakage and administrative costs. This exercise suggests a budget of $42 billion per annum, from all public sources, would be consistent with raising incomes above the extreme poverty line in all low-income countries. Current international aid efforts in this area are under-financed, short term and fragmented. Against this backdrop, it is time to reconsider the case for a multilateral financing mechanism.

Recommendation: the creation of a new global social protection facility, the 'Bolsa Familia Global'

There is a need for a multilateral mechanism to provide predictable long-term funding for nationally owned social protection programmes in countries that lack the domestic resources to fund these themselves. This mechanism – in effect, a 'Bolsa Familia Global' – would provide transitional matched funding for governments seeking to scale up social protection geared explicitly towards transfers and social guarantees for the poorest. It would mediate between donors operating on a short-term budgetary horizon and governments making long-term social protection commitments, under an inclusive governance structure that operates impartially, with transparent allocation rules (including on graduation from its funding).

2. Universal health coverage

Everybody should have the best possible chance of enjoying good health for its own sake, but ill-health is also a major source of poverty and vulnerability. Millions of the world's poorest households are effectively priced out of health provision, unable to afford the cost of treatment and basic medicines. Universal health coverage (UHC) should be seen as a vital element of any strategy for achieving the SDGs. On the basis of updated costings from the High Level Task Force on Innovative International Financing for Health Systems, we calculate that UHC in low- income countries would require around $74 billion per annum for a basic health package, from all public sources. Health systems are the responsibility of domestic governments, but there is a strong case for strengthening the international public finance architecture to better support their endeavours.

Recommendation: The Global Fund to Fight AIDS, Tuberculosis and Malaria should become a Global Fund for Health

The Global Fund should become a vehicle for the acceleration of progress towards UHC and the provision of long-term financial support for country-led, problem-driven approaches to systems strengthening and service delivery. One important weakness of existing funds has been a lack of country ownership, coupled with a neglect of local capacity building. That is why an explicit focus is needed on support for countries to expand and improve their own health systems.

3. Universal primary and secondary education

As with health, education matters in its own right – and it is a catalyst for progress in other areas. Improved access to good quality education is associated with higher incomes, improved health indicators and strengthened participation in decision-making. There is good evidence that education can contribute to national economic growth. Using the latest country-by-country estimates from the 2015 Education for All report, we estimate that extending universal primary and lower secondary education to all in low-income countries would cost $32 billion per annum. In producing these estimates, special attention has been directed to countries affected by conflict and humanitarian emergencies. These countries account for around half of the children currently out of school – and receive little support from current aid delivery mechanisms. Improved donor coordination is critical.

Recommendation: the creation of a Humanitarian Fund for Education in Emergencies (HFEE)

Modelled on the best practices of the pooled funds in health, the HFEE would bring together all actors to provide early action and lasting support for children caught up in conflict and other emergencies. The facility could operate by tendering for the delivery of cost-effective education provision, drawing where possible on the knowledge, skills and competencies of local organisations, rather than high-cost western NGOs and international agencies.

International Public Finance

This report uses the term international public finance (IPF) to broaden the focus beyond the official development assistance (ODA) provided by members of the OECD Development Assistance Committee (DAC). It also focuses on the concessional elements of IPF, such as grants, as appropriate for the financing of a basic social compact. In 2013, ODA from all donors that report to the DAC amounted to $150 billion. Emerging donors that do not report to the DAC, such as China and Brazil, are estimated to account for 10-15% of global ODA-like flows, contributing somewhere in the region of $20-25 billion per annum of concessional development finance, and their importance is growing.

The financing gap

Estimates the total cost of delivering three key elements of a basic social compact. These are not estimates of the quantity of international assistance needed: the best sources of finance are domestic. While there are many innovative private solutions to health and education challenges across the developing world, extending access to the extreme poor will require public finance, and where domestic resources are insufficient, delivering the social compact will require concessional IPF.

The financing gap has been estimated by comparing the total estimated costs for the three key interventions, of around $148 billion per annum, against potential domestic resources and existing ODA allocations. For this report we developed a model based on the assumption that developing countries collect revenues in line with their estimated tax capacity and allocate half of their total resources to the social sectors. This avoids rewarding low tax effort with higher IPF flows. On this basis, the total financing gap is around $84 billion per annum, $73 billion of which is in low-income countries.

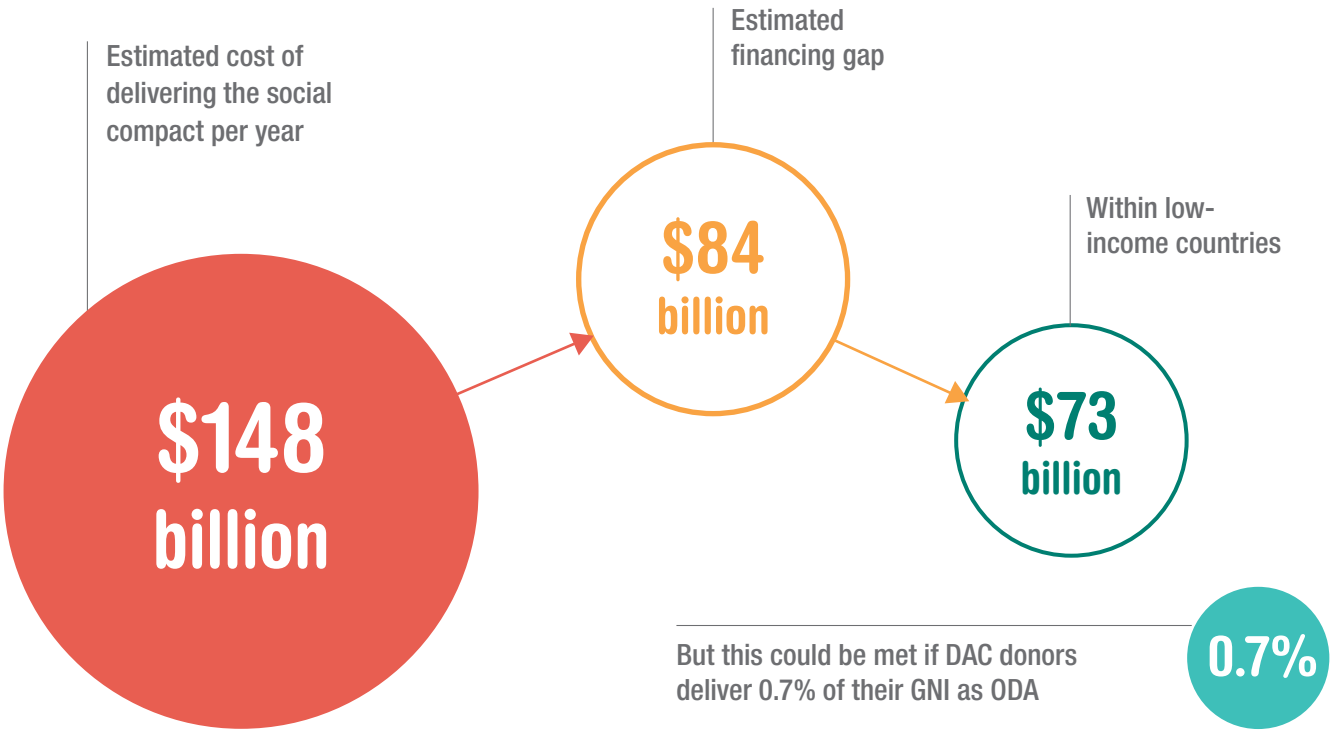
The Addis Ababa summit should aim to set out concrete commitments to close this gap. Aid donors should start by fulfilling past promises. If rich countries are serious about the SDGs, they have to get serious about delivering 0.7% of their gross national income (GNI) as ODA. Spending an additional $84 billion annually on the social sectors would be possible if DAC donors delivered on their 0.7% promise and emerging providers scaled up their development assistance programmes.

Recommendation: IPF providers make long-term commitments that are commensurate with financing the basic social compact

IPF providers should commit to supporting governments that are themselves committed to introducing a national basic social compact, by ensuring that they have sufficient funding to do so. This means that donors cannot turn their backs on past commitments. The estimated financing gap in the social sectors alone is $84 billion per annum. Developing countries cannot be expected to embrace ambitious new SDGs without commensurate international support.

Recommendation: non-DAC IPF providers improve the reporting of their activities and consider setting their own financing targets for the SDGs

Emerging providers, such as China and Brazil, have rapidly increased their development assistance in recent years. A greater commitment from such providers to focus on SDG priority sectors and to improve the transparency and communication of their IPF would be a welcome step forward. The first stage would be to build on what emerging providers are currently willing to report, and to set targets on that basis. Wider reforms to the aid architecture may be needed as a pre-condition of such a move.



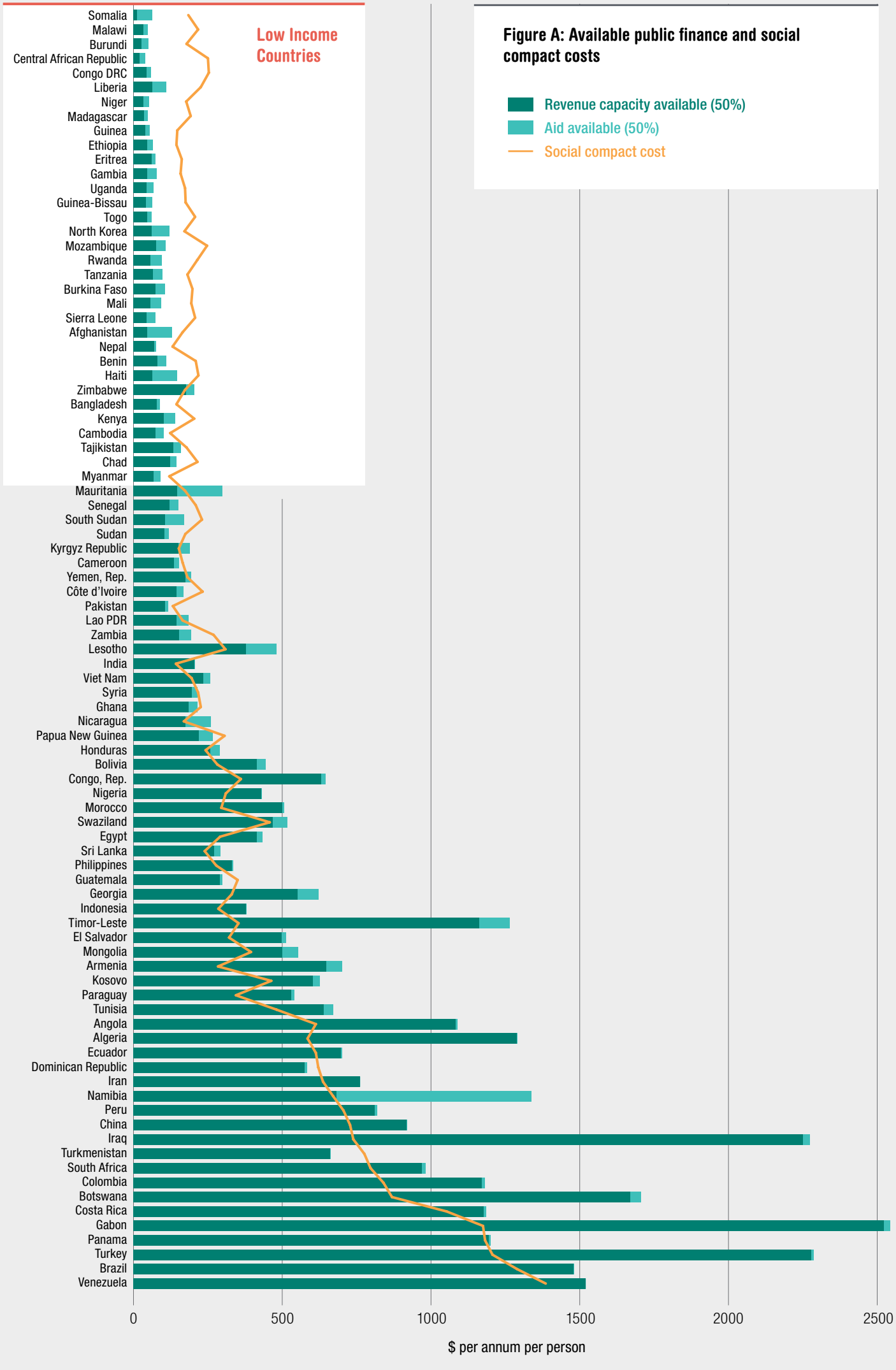


Figure A: Available public finance and social compact costs
Revenue capacity available (50%)
Aid available (50%)
Social compact cost
Low Income Countries
Somalia
Malawi
Burundi
Central African Republic
Congo DRC
Liberia
Niger
Madagascar
Guinea
Ethiopia
Eritrea
Gambia
Uganda
Guinea-Bissau
Togo
North Korea
Mozambique
Rwanda
Tanzania
Burkina Faso
Mali
Sierra Leone
Afghanistan
Nepal
Benin
Haiti
Zimbabwe
Bangladesh
Kenya
Cambodia
Tajikistan
Chad
Myanmar
Mauritania
Senegal
South Sudan
Sudan
Kyrgyz Republic
Cameroon
Yemen, Rep.
Côte d'Ivoire
Pakistan
Lao PDR
Zambia
Lesotho
India
Viet Nam
Syria
Ghana
Nicaragua
Papua New Guinea
Honduras
Bolivia
Congo, Rep.
Nigeria
Morocco
Swaziland
Egypt
Sri Lanka
Philippines
Guatemala
Georgia
Indonesia
Timor-Leste
El Salvador
Mongolia
Armenia
Kosovo
Paraguay
Tunisia
Angola
Algeria
Ecuador
Dominican Republic
Iran
Namibia
Peru
China
Iraq
Turkmenistan
South Africa
Colombia
Botswana
Costa Rica
Gabon
Panama
Turkey
Brazil
Venezuela
0
500
1000
1500
2000
2500
$ per annum per person

A greater focus on poverty

Donors must also strengthen the poverty focus of their IPF programmes. Current development assistance flows are heavily skewed against those countries in the greatest need of support. If the group of low-income countries is ranked by income and divided in two, the richer half currently receives twice as much country-programmable ODA per person, on average, than the poorer half. If allocations are evaluated relative to the number of people living in extreme poverty in each country, the picture looks even worse: on that basis, the average low-income country receives about a third as much as lower-middle-income countries.

The majority of low-income countries are also afflicted by conflict and classified as fragile states, a group particularly neglected by the current pattern of interntaional assistance.

Recommendation: 50% of concessional international public finance goes to least-developed countries

If IPF were to be allocated to support the introduction of a basic social compact in those countries that cannot afford it themselves, it would need to be much more pro-poor. The estimated financing gap implies that more than 80% of existing ODA would need to go to the least-developed countries (LDCs) to cover the costs of a basic social compact. In reality, countries also have other development priorities, the costs of which may be distributed in different ways. What is clear is that current aid allocations are far from being pro-poor. We endorse the target that has been proposed by civil society organisations and the OECD that 50% of all concessional IPF should be spent in LDCs. We recognise

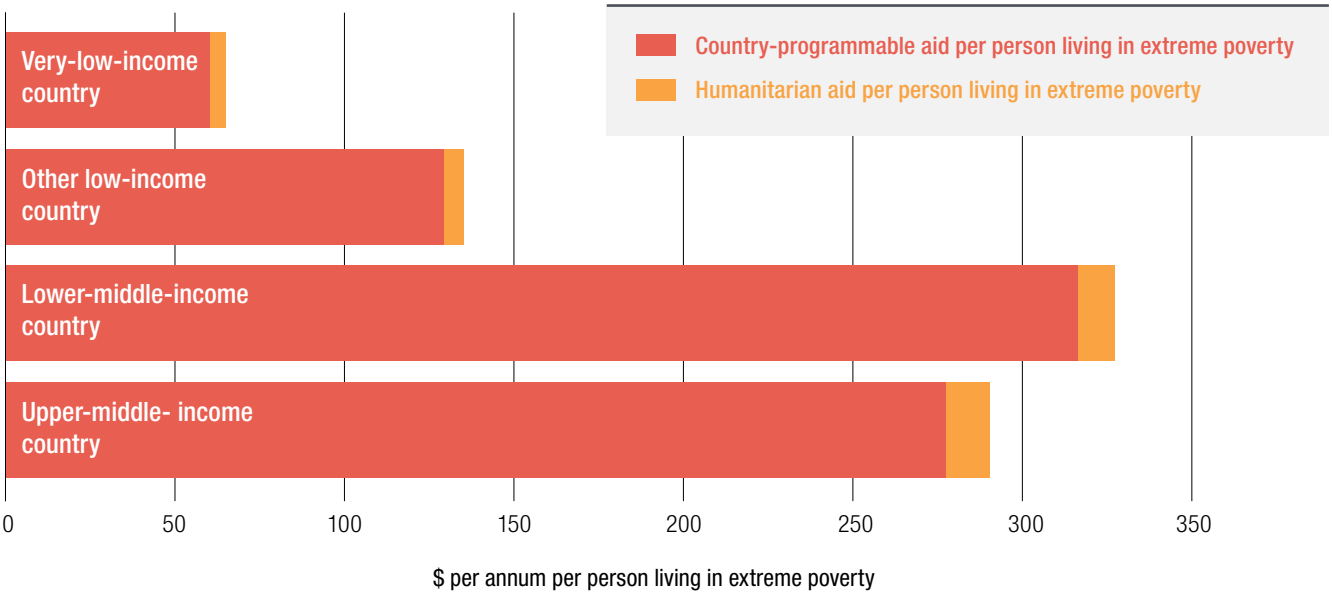
Famine in Somalia 2011 (Photo: Africa Renewal)

that this does not go far enough, and that it is not a substitute for increasing total IPF volumes, but it would be a commitment worth securing nonetheless.

Recommendation: a commitment to leave no fragile state behind

Most predictions show that extreme poverty will be increasingly concentrated in fragile states. The international community must be involved, at scale, in every low-income fragile state, and take a long-term perspective. Support to fragile states must also reflect the New Deal's Peacebuilding and Statebuilding Goals (PSGs), in addition to investments in social protection and the social sectors. Effective IPF delivery in these contexts is extremely challenging, but if the international community is serious about the SDGs, there is no other option.

Figure B: Aid per person living in extreme poverty



A new effectiveness agenda

The MDGs spawned a new era of thinking about how aid should be delivered, with the concept of country ownership at its heart. The Paris Declaration on Aid Effectiveness in 2005 was a seminal moment, and has been followed by a range of other international agreements. These agreements, while important, need updating for the SDG era. Three key changes need to be made.

The first is the recognition that poverty is becoming increasingly concentrated in fragile and conflict-affected states, countries with low levels of state capacity, and that current practice is not well aligned with the long-run challenge of development in these countries. One constraint is the risk-aversion of donors. In the understandable concern to demonstrate value-for-money, many aid agencies have shied away from engagement in difficult environments. This is short-sighted and counter-productive. As in other areas of development, early investment in prevention can offer better value-for-money than delayed investments in a cure.

The second change is to learn the lessons of recent efforts to improve aid effectiveness. Despite best intentions, the aid effectiveness agenda has not always delivered for poor people. This reflects, in part, a lack of awareness of the political and organisational bottlenecks to progress. The new IPF effectiveness agenda must continue to recognise the importance of country ownership, but it also needs to reflect the reality that aid is more effective when donors are politically smart and take a problem-led, adaptive approach to development. IPF providers need to become more like development entrepreneurs, or venture capitalists, prepared to take risks and adapt to circumstances, and recognising that some failure goes with the territory.

The final change that is needed is the recognition that IPF is no longer the preserve of the DAC donors, and so neither is the aid effectiveness agenda. New providers are rapidly entering the marketplace, leading to a new 'age of choice'. While these providers account for only 10-15% of concessional IPF at present, their importance is growing fast. The new agreement needs to reflect their experiences and priorities, and the qualities of their support that are particularly valued by countries. Speed is one such key quality.

Recommendation: IPF providers must reinvigorate the aid effectiveness agenda and make IPF fit for purpose in the SDG era

A new framework should incorporate core elements of the Paris agenda, but add long-term commitment, risk-sharing, adaptive programming and speed. Ownership, alignment and harmonisation remain critical, all the more so in fragile states. But IPF providers also need to become more 'politically smart', more adaptive, and make longer term commitments. Risk-sharing is also particularly important in fragile states. The new framework would need to be designed and agreed in a way that reflects the views and priorities of non-DAC donors, through a multilateral mechanism that involves all relevant stakeholders.

A beneficiary of Bolsa Família, Maria Luzia and her children. (Photo: Ana Nascimento/ Ministério do Desenvolvimento Social e Combate à Fome)

A new multilateralism

A number of the themes we highlight in this report point in the same direction: towards a greater role for multilateral development agencies in the SDG era. Multilaterals can better absorb and share the risks inherent in working in fragile states, take a longer-term approach to development and, with the right governance structures, have the potential to be more accountable to the countries in which they operate. Multilaterals tend to make greater use of country systems, and score better on assessments of aid quality. They can provide more predictable finance, giving countries the confidence to make long-term fiscal commitments. They have the scale to take responsibility for whole regions or country categories and find it easier than bilaterals to shift their allocations to make them more pro-poor.

The picture is not wholly positive, however. Multilaterals can be inflexible and, although they are sometimes better able to act than bilateral donors, their procedures are sometimes poorly suited to the realities of fragile states with low levels of government capacity. Long-standing problems with governance and accountability are well known. The need for a new IPF effectiveness agenda applies as much to multilaterals as to everyone else.

Some multilaterals, particularly global funds, can make use of innovative sources of finance to overcome the challenge of the short-term time horizons of much development spending. Vertical funds have their drawbacks, but they represent mechanisms for the mobilisation of a more predictable flow of resources, at scale, to tackle critical development challenges in the least- developed countries. Their advantages can include a greater emphasis on results, the inclusion of civil society and the private sector, transparency, innovation and adaptation, and proven effectiveness in helping countries to scale up. At the same time, vertical funds have faced challenges in terms of country ownership and local capacity building. At worst, they risk setting up parallel systems. This is why an explicit focus on strengthening country systems is needed. But a second generation of vertical funds, such as those we have proposed, has the potential to deliver a step-change in international support for a basic social compact.

Fragile states do not need a new fund, but more effective coordination between the funds that are already engaged.

Recommendation: the multilateral architecture for operating in fragile states is strengthened

Multilateralism is particularly important in fragile contexts. Fragile states do not need a new fund, but more effective coordination between the funds that are already engaged. The UN has international legitimacy and a mandate, while the Bretton Woods Institutions have financial resources and technical expertise. Coordination has improved, but more needs to be done. Even within the UN system, there is inadequate coordination between the UN Security Council and the UN Peacebuilding Commission. This needs to change. At country level, there also needs to be better coordination between actors working on different objectives, including political settlements, personal security, humanitarian action and development.

Figure A: Available public finance and social compact costs
Source: Authors' calculations based on World Bank (2014a), UNESCO (2015), Rottingen et al., (2014), Minh Le et al. (2012), and Fenochietto and Pessino (2013).

Figure B: Aid per person living in extreme poverty
Source: Authors' calculations based on OECD (2014d) and World Bank (2014e).

Read the full report at
odi.org/financing-future

Financing the future

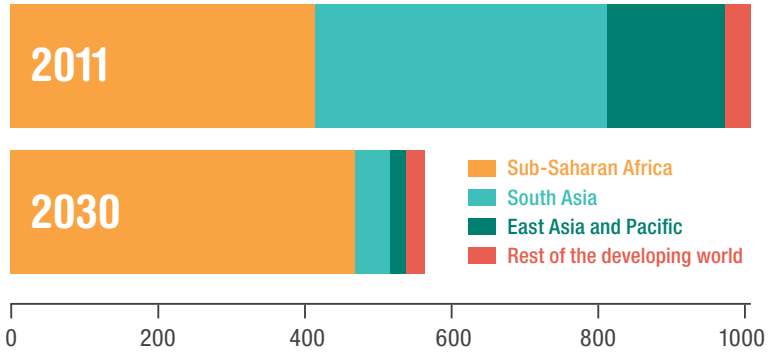
How international public finance should fund a global social compact to eradicate poverty

If we stick to business as usual, we'll fall far short of our development goals in 2030

500m
people will still be living on less than **$1.25** a day

Extreme poverty will be even more concentrated in sub-Saharan Africa

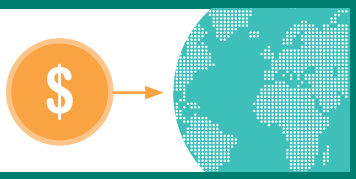
Number of people living in extreme poverty (millions):



4m
children will die needlessly before the age of five

Low-income fragile states will be left even further behind

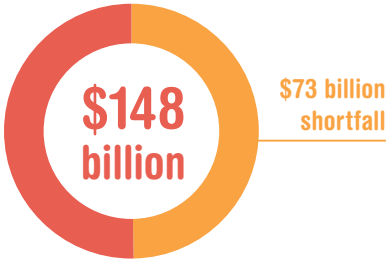
But we can avoid this. Aid won't solve the whole problem, but if we can mobilise the money and be smart about spending it, we can help to eradicate global poverty over the next 15 years.



We need a new global social compact

- Social protection for the poorest
- Free basic universal healthcare
- Free primary and secondary education for all

What will this cost low income countries per year?



Even if they raise taxes and use existing aid, there will still be a shortfall of $73 billion.

But if governments fulfil their existing aid pledges, we can meet these costs – and still have at least **$40 billion** to spare.

We can't afford not to. July's Financing for Development summit should:

1. Create or expand global funds for health, education in humanitarian crises, and social protection
2. Redirect 50% of foreign aid budgets towards the poorest countries where aid is most needed
3. Commit rich countries to giving 0.7% of their national income in aid
4. Bring emerging economies into the system as contributors
5. Develop smarter, more flexible and long-term ways to provide aid

Read the report at **odi.org**

#FtF2015

Sources available at **odi.org/financing-future**

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