

Governing Body

335th Session, Geneva, 14–28 March 2019

GB.335/POL/4

Policy Development Section
Development Cooperation Segment

POL

Date: 22 February 2019

Original: English

FOURTH ITEM ON THE AGENDA

Overview of relevant and existing forms of innovative finance mechanisms, related opportunities and risks, and potential for ILO engagement

Purpose of the document

This document is submitted in follow-up to the resolution concerning effective ILO development cooperation in support of the Sustainable Development Goals (SDGs) adopted by the International Labour Conference in 2018. In particular, it calls for the ILO to deepen, expand and diversify partnerships, including with other UN entities, international financial institutions (IFIs) and the private sector, and promote engagement with innovative finance modalities and multi-stakeholder networks and alliances, such as those tackling forced labour, child labour and modern forms of slavery. The Office should identify the opportunities and risks associated with forms of innovative finance mechanisms that are new to the ILO and report on them to the Governing Body for discussion and decision. Specifically the Governing Body, in November 2018, requested a discussion of forms of innovative finance mechanisms. This paper is provided in response to that request and suggests a way forward in 2019 to inform the ILO Development Strategy for 2020–25 (see draft decision in paragraph 32).

Relevant strategic objective: All.

Main relevant outcome/cross-cutting policy driver: All.

Policy implications: Yes.

Legal implications: None.

Financial implications: None.

Follow-up action required: Yes.

Author unit: Partnerships and Field Support Department (PARDEV).

Related documents: GB.334/INS/3/1; GB.335/INS/9; GB.335/INS/10.

1. Introduction: The scale of need

1. Achieving the Sustainable Development Goals (SDGs) by 2030 represents a major challenge. The required policy changes are of major importance, while the financing needs are huge, and far outstrip anything that could be provided through Official Development Assistance (ODA). The ILC 2018 report on effective development cooperation ¹ confirms that ODA now represents only 6.4 per cent of the total estimated funding gap, which is set at around US\$1.5 trillion. It is universally acknowledged that efforts are needed to harness a major volume of additional resources, inter alia, through international trade, foreign direct investment, private finance flows, and domestic sources of funding to support the achievement of the SDGs.
2. The reform of the UN development system aims to maximize the implementation of the SDGs, and a key objective of the new generation of United Nations Development Assistance Frameworks (UNDAFs) is to catalyse resources for those Goals, in particular along the lines set out in the Addis Ababa Action Agenda of 2015, with its emphasis on financing for development. This agenda calls for UN agencies to go beyond traditional ways of channelling funds, and to facilitate the reorientation of the overall flow of resources for development in line with national SDG targets. This includes domestic and international finance from both public and private sector sources.
3. Even within the context of the SDGs, the progress needed on the Decent Work Agenda remains daunting. Acknowledging the scale of this need, the resolution concerning effective ILO development cooperation in support of the SDGs, adopted by the International Labour Conference in 2018, called on the Office to:

... deepen, expand and diversify partnerships, including with other UN entities, IFIs and the private sector, and promote engagement with innovative finance modalities and multi-stakeholder networks and alliances, such as those tackling forced labour, child labour and modern forms of slavery. The Office should identify the opportunities and risks associated with forms of innovative finance mechanisms that are new to the ILO and report on them to the Governing Body for discussion and decision; ...
4. In November 2018 the Governing Body endorsed its call for a discussion of forms of innovative finance mechanisms. This paper is provided in response to that request.

2. Principles and definitions

5. A range of innovative finance mechanisms are available in the financial world: innovative finance for development refers to the recent application of financial market mechanisms to sustainable development outcomes, and the ways in which resources for development outcomes are both mobilized and allocated.

¹ ILO: *Towards 2030: Effective development cooperation in support of the Sustainable Development Goals*, Report IV, 107th Session of the International Labour Conference, 2018.

Definitions

6. The Leading Group on Innovative Financing for Development² describes it as “comprising mechanisms for raising funds for development that are complementary to ODA, predictable and stable, and closely linked to the idea of global public goods”. There are several other definitions, most of which refer to innovative finance for development as a complement to traditional ODA, and involving both the public and the private sector, international cooperation, and cross-border resource flows to developing countries as guiding principles.³
7. Among the different definitions, the following common purposes are found:
 - (1) Mobilize additional resources that would not otherwise be available for development – it does not displace or replace existing resources.
 - (2) Make resources available more effectively and efficiently by redistributing or reducing risk and linking future financial returns to the objective achievement of agreed results.

Innovative finance mechanisms

8. Innovative finance includes a broad range of initiatives and mechanisms.⁴ In the context of this paper and taking into account the larger UN initiatives in this field, the following four suggested categories of innovative finance mechanisms may offer the greatest relevance and potential for ILO development cooperation programmes:⁵

² An informal network that currently brings together 55 countries, alongside international organizations, non-governmental organizations (NGOs) and foundations dedicated to the eradication of poverty and the preservation of global public goods. See: Innovative Financing for Development, <http://www.leadinggroup.org/rubrique327.html>.

³ See, for example: OECD (2014), *Development Co-operation Report 2014: Mobilising Resources for Sustainable Development*, Chapter 15, p. 179; and the Department of Economic and Social Affairs (2012), *World Economic and Social Survey 2012: In search of new development finance*.

⁴ A more detailed analysis of the concepts and practices involved may be found in *Innovative Finance: Putting your money to (decent) work*, available on the ILO social finance website at <http://www.ilo.org/socialfinance>. This draft paper is for consultation and specific to the fields covered by the ILO’s Social Finance Programme.

⁵ See reference document: “Overview of relevant and existing forms of innovative finance mechanisms, related opportunities and risks, and potential for ILO engagement” (GB.335/POL/4/REF).

Selected innovative finance mechanisms

	1	2	3	4
	Financial Products	Risk Mitigation Mechanisms	Results-Based Financing	Technology-Enabled Solutions
Description	Products meant to mobilise and raise funds from capital markets	Mechanisms aimed at reducing (perceived) risks	Payments are linked to certain outcomes being met	Financing mechanisms that leverage technology
Instruments	<ul style="list-style-type: none"> -Bonds & Notes -Loans -Microfinance & SME finance -Impact Investing Funds -Venture Capital & Private Equity Funds 	<ul style="list-style-type: none"> -Subsidies -Guarantees -Insurance and Options 	<ul style="list-style-type: none"> -Development/Social Impact Bonds -Outcome-Based Funds -Advance Market Commitments 	<ul style="list-style-type: none"> -Blockchain -Digital Technology -Crowdfunding

9. To understand the potential of a particular innovative finance initiative, it is, for example, important to analyse its potential to reach scale in order to have a true development impact. It should be effective and ensure better use of funds in achieving intended outcomes, and should be efficient in terms of improving the timeliness of financing and tying funding to outcomes. Additional criteria to consider include the sustainability of the initiative, the predictability of the inflow of funds, and the initiative's marketability in order to attract private sector participation.

Trends and examples

10. The above categorization is not exhaustive, and many other options may be available. However, the use of these and similar forms of innovative finance by development actors has grown considerably over the past two decades, although estimates of the amount of resources mobilized using these mechanisms vary widely. According to the 2018 Annual Impact Investor Survey by the Global Impact Investing Network, impact investors – including development financial institutions and charitable foundations pursuing both financial and social returns – collectively manage almost US\$230 billion in assets.⁶
11. Innovative finance stakeholders vary widely, but the most obvious involve collaboration between the private and the public sector. The private sector can provide financing to the public sector, for example by investing in bonds such as that issued by the City of Cape

⁶ Global Impact Investing Network (2018), *Annual Impact Investor Survey 2018*.

Town to finance green projects in the city, or the Inter-American Development Bank Education, Youth and Employment (EYE) bond. Conversely, the public sector can make investments in the private sector through guarantees and pay-for-performance mechanisms, illustrated by the German Federal Ministry for Economic Cooperation and Development (BMZ) and the Netherlands Development Finance Company investment in the Regional MSME Investment Fund for sub-Saharan Africa, an impact investment fund supporting micro, small and medium enterprises in Africa. Similar initiatives have been launched by many other governments and their development finance institutions, involving a wide range of different arrangements.

12. Public and private actors often launch joint initiatives. An example is the Danish SDG Investment Fund recently established by five Danish pension funds together with the IFU, a Danish government-owned investment fund that offers advisory services and risk capital to companies wishing to do business in developing countries and emerging markets. The SDG Investment Fund contributes to the SDGs through commercial investments in the private sector in developing countries, aiming to create sustainable businesses and ensuring a solid return to its investors.⁷
13. Across the UN, efforts are under way to mobilize and channel innovative finance for the SDGs. Various initiatives to develop and implement innovative finance solutions for sustainable development have emerged, including the UN Environment Tropical Landscape Financing Facility,⁸ UNDP's SDG Impact Finance,⁹ UNICEF's Innovation Fund,¹⁰ and the development of a blockchain-based digital ID system to boost financial inclusion through a credit rating system in Sierra Leone by the United Nations Capital Development Fund and partners.¹¹
14. Some of these initiatives, though not for the moment involving the ILO, relate to decent work outcomes, as for example UNDP's Youth Employment Bond in Serbia or the joint World Bank/World Wildlife Fund support for green, small and growing businesses in South Africa. In January 2018 Humanity United launched "Working Capital", a US\$23 million venture fund to invest in ethical supply chain innovations, backed by the UK Department for International Development (DFID) and leading garment sector brands to promote more transparent supply chains and better working conditions.
15. It is important to note that at this stage it is still difficult to obtain comprehensive or systematic information on the impact of innovative finance or its performance as compared to traditional development assistance schemes. Several successes are reported but many initiatives are recent, and evaluations are lacking in both quantity and quality.

⁷ See: <https://www.ifu.dk/en/news/new-4bn-fund-contributes-to-un-sustainable-development-goals/>.

⁸ Supported by the Government of Indonesia and involving UNEP, the World Agroforestry Centre, ADM Capital, and BNP Paribas. See: <http://tiffindonesia.org>.

⁹ See: <http://undp.socialimpact.fund>.

¹⁰ The Fund has made 72 investments in 42 countries, with an eye to investing in 20 more start-ups in 2019. See: <https://unicefinnovationfund.org>.

¹¹ See: <https://www.microcapital.org/microcapital-brief-kiva-uncdf-undp-using-blockchain-to-build-digital-id-system-in-sierra-leone-to-boost-financial-inclusion/>.

16. The ILO has some experience of engaging in innovative financing modalities. A good example is the ILO's work through its Social Finance Programme¹² on the Africa Agriculture and Trade Investment Fund described in the box below. Feasibility studies are also in progress on exploring the opportunities for innovative finance within the context of ILO flagships. The further exploitation of the possibilities for innovative finance proposed in this paper would add to this growing body of knowledge.

Impact Investment Fund

Definition: A traditional investment fund is a vehicle that allows a number of separate and unrelated investors to make investments together. Impact investment funds bring together investors to allocate capital to development outcomes. They vary in terms of their strategy, thematic area (e.g. health, financial inclusion, etc.) and the instruments they use (e.g. private equity, debt, etc.). Some impact investment funds are "blended", meaning that they combine public and private funds and are designed to achieve a financial return alongside clear positive social and/or environmental impact.

Example: The **Africa Agriculture and Trade Investment Fund (AATIF)**, initiated by Kreditanstalt für Wiederaufbau (KfW) Development Bank, on behalf of the German Federal Ministry for Economic Cooperation and Development, is a public-private partnership (PPP) aimed at realizing the potential of Africa's agriculture for the benefit of the poor. While the Fund pursues a private-sector approach addressing the specific needs of the agricultural sector in a market-oriented manner, its social and environmental management system seeks to ensure positive development impacts. Since 2012 the ILO and UN Environment have provided technical advice, developing and testing assessment methodologies, building capacity and supporting the implementation of a monitoring framework. Research conducted shows that participating farmers have higher productivity and income than their peers who are not part of the scheme. There is a positive impact on food security in the region. Overall employment in the sector has increased, but this also involves a growth in casual labour contracts.¹³

3. Opportunities and risks

Opportunities: Financing decent work results and outcomes

17. Investors are increasingly adopting the SDGs as a framework to measure the positive development impact of their investments. According to the Global Impact Investing Network, over 50 per cent of investors surveyed already track performance against the SDGs, while 82 per cent tracked SDG 8 when monitoring investment performance, as they realize the interlinked nature of the SDGs and the multiplier effect that decent work offers as a pathway to progress across multiple goals.¹⁴ From an investor perspective, investing in decent work makes business sense because good working conditions and respect for fundamental principles and rights at work are positively correlated with productivity and financial performance. This is illustrated in the impact assessment studies concerning the Better Work programme.¹⁵
18. At the same time, investors refer to measuring social impact as one of the greatest challenges, with numerous different standards for measuring social and environmental impact. One is the

¹² For further details of the ILO's Social Finance Programme, see: <https://www.ilo.org/socialfinance>.

¹³ ILO (2015): *Building Capacity for Social Compliance of Investments in African Agriculture*.

¹⁴ Global Impact Investing Network (2017), *Annual Impact Investor Survey 2017*.

¹⁵ ILO and the International Finance Corporation (2016): *Progress and Potential: A focus on firm performance*, Better Work Programme.

Global Reporting Initiative, which promotes the use of sustainability reporting through a catalogue of generally accepted social, environmental and financial performance metrics.¹⁶

19. The increased interest by a range of actors in supporting decent work outcomes as part of a broader push towards the SDGs presents significant opportunities for the ILO to leverage innovative finance mechanisms for the Decent Work Agenda and to build the capacity to design, implement, and monitor initiatives that have a real and positive impact on development. A key area where ILO expertise would prove particularly invaluable would hence be in offering expert guidance on measuring the decent work impacts of investment. The ILO's body of international labour standards, its supervisory bodies, its privileged access to the actors of the world of work and its global expertise would offer an authoritative basis for developing the corresponding tools and for influencing the design and roll-out of different initiatives to the greatest effect, including through the involvement of social partners.

Risks related to engagement with innovative finance

20. The selection and involvement of the right partners – those who subscribe to and support the ILO's mission, share its values and aims, and respect fundamental principles and rights at work in their operations – is of the utmost importance. Innovative finance often involves private sector actors, and the appropriate due diligence mechanisms must be in place to inform and assess such partnerships, building on the existing PPP guidelines.
21. The partnerships and the mechanisms are meant to realize development outcomes. Given that many innovative finance mechanisms are also investment mechanisms, there is a risk that the intended results are not achieved. This means that investment capital may be lost and investors will not be fully repaid and, equally important, the partners involved may in such cases face a reputational risk, including the ILO.
22. Invocation of the values of the Decent Work Agenda by actors involved in innovative finance for development needs to be based on acknowledged definitions and principles, derived from ILO expertise and authority in defining decent work targets and appropriate measurement techniques. In particular, investments need to be steered towards nationally and globally agreed development needs, avoiding to the extent possible leaving anyone behind or increasing inequalities. Adequate monitoring and accurate measurement of results to ensure optimal and balanced impact at all levels is hence a key issue. The ILO has the expertise to help shape the indicators of success in terms of decent work. Many UN entities are already engaging in initiatives directly relevant to decent work. The ILO must endeavour to ensure that such initiatives embody ILO principles, based on the full participation of constituents and in accordance with the principle of national ownership and the needs of policy and budgetary coherence.

4. Potential ILO engagement

23. A sizable number of innovative finance initiatives now being developed touch on aspects of the Decent Work Agenda, often in the context of the social pillar of the Environmental, Social and Governance (ESG) framework used for socially responsible investment.¹⁷ Here too the

¹⁶ IRIS is managed by the Global Impact Investing Network. See: <https://iris.thegiin.org/>.

¹⁷ In October 2018 the Investing in a Just Transition initiative, led by the London School of Economics and Political Science and Harvard's Initiative for Responsible Investment, working in partnership with the International Trade Union Confederation, released an investor guide that provides a framework for just transition and connecting climate action with inclusive growth and sustainable

ILO's role as an authority on decent work issues and measurement of impact would be invaluable. In this context it will be necessary to further explore what the specific contribution of the ILO could be, and how to structure the ILO engagement most effectively.

24. The objective of ILO engagement with innovative finance mechanisms is therefore to determine how they can be harnessed to support decent work outcomes at global and country level, with the full involvement of ILO constituents. For the ILO, the opportunity to promote decent work outcomes through such mechanisms could allow it to influence and steer far greater resources towards decent work outcomes, and involve new stakeholders to scale up successful intervention models. In this way it would contribute to the design of sound interventions with financing mechanisms that make a positive impact on decent work while providing a return on investment, facilitating potential sustainability and upscaling.
25. Furthermore, monitoring, evaluation and reporting systems need to be developed to supplement the lack of data and evaluations of the impact innovative financing mechanisms have on decent work outcomes. Since financial payments are often linked to the achievement of results, indicators need to be concrete, measurable and sufficiently linked to the desired outcome.
26. There are several roles that the ILO could play:
 - (1) *Influencer*: The ILO could seek to influence and steer such initiatives, working with UN partners, development finance institutions, and bilateral development partners, as well as with private sector initiatives and entities, in full consultation with ILO constituents.
 - (2) *Adviser*: The ILO could also provide guidance to constituents on how they might develop their own views and expertise in this field, with a view to influencing how innovative finance mechanisms are developed and implemented in their countries. This would also involve bringing together ILO constituents, public and private institutions, and other innovative finance stakeholders to discuss and develop innovative ways to realize decent work outcomes.
 - (3) *Disseminator of standards and knowledge*: The ILO could make information on a range of decent work issues available as a public good in the form of toolkits and indicators as a basis, for example, for impact investment funds to assess and track progress on decent work.
27. In all these roles training and capacity development for constituents and staff would be essential to ensure the effective involvement of constituents and their institutions in processes related to investment pre-screening, the exercise of due diligence, and sustainability management. There is a major and cross-cutting role to be played here by the International Training Centre of the ILO.¹⁸

5. The way forward

28. The ILO has a significant opportunity to advance the cause of ensuring that decent work objectives are pursued with adequate financing for the scale of the task, in full awareness of the risks involved, while at the same time developing its own knowledge base to

development. This framework should enable investors as fiduciaries to take action and incorporate the full range of ESG dimensions in their investment strategies.

¹⁸ For more on these issues, see the "ILO-wide strategy for institutional capacity development" (GB.335/INS/9).

systematically inform its strategy, with particular reference to the reforming UN and the SDGs. Seizing these opportunities requires that risks are mitigated effectively.

29. The ILO has taken some initial steps in engaging in innovative finance. Its emerging capacity in this area needs to be further strengthened to understand, assess, and engage in innovative finance mechanisms. This paper offers a basis for the development of such expertise, as called for in the ILC resolution.

30. Concretely, it is proposed that the Office:

- continue to build its knowledge of innovative finance mechanisms and to develop its capacity in this field accordingly, including by further identifying and assessing those that are relevant to decent work outcomes;
- develop the capacity of constituents to further build their awareness of innovative finance and of its potential to scale up decent work outcomes, as a basis for their potential engagement in such initiatives.

31. These steps will provide a basis to gain an understanding of and identify the longer-term role the ILO might play in relation to new and relevant innovative finance for decent work and will accordingly inform the ILO's Development Cooperation Strategy for 2020–25, which will be presented to the Governing Body in March 2020.

Draft decision

32. *The Governing Body requested the Office to take into account its guidance on the ILO's engagement in innovative finance mechanisms and implement the proposed way forward.*