Global Outlook on Financing for Sustainable Development 2019

TIME TO FACE THE CHALLENGE

OECD

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TIME TO FACE THE CHALLENGE

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BETTER POLICIES FOR BETTER LIVES

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Foreword: Investing in a better sustainable development market

In 2015, the international policy community made a marked shift away from framing the world as donors versus recipients, to embrace a shared development agenda. With conflict- and climate-driven crises reminding us of our interconnectedness, this repositioning was well overdue. It's time for the funding design for our global agenda to match this shift. Financing for sustainable development is not a cost; it is an investment. Rather than a static web of providers and receivers, today's ecosystem of financing for sustainable development (FSD) should be seen as a dynamic market, with providers competing to respond to global demands. Healthy competition will help to drive innovation, better tailor financing to the needs of developing countries, and promote higher social and economic returns.

The *Global Outlook on Financing for Sustainable Development* takes a fresh look at the inter-linkages between sustainable development finance and policy, revealing that many paradoxes and inconsistencies exist. The sustainable development finance market is still in its infancy. This must be fixed through ambitious policy reforms (both in donor and recipient countries. In order to produce optimal financing mixes for developing countries, this market needs a triple shift: more transparency; new international standards and greater policy coherence. Ultimately, this will close emerging policy gaps like debt sustainability. A better FSD market will also reduce asymmetries of information with sustainable development impact metrics for investors. And, the "customers" of sustainable development finance will be empowered to make optimal choices. A properly functioning market calls for a more strategic interplay of beneficiaries, intermediaries and suppliers, so that each dollar spent is maximised and impactful.

The role of official development assistance (ODA) does not shrink in this market: if anything, it is more relevant to ensure that no country and no one is left behind. OECD countries' ODA is driven by a unique mandate, and, some argue, a moral imperative, to support development in countries most in need – including least developed countries, small island developing states, and fragile states. ODA is the principal investor in long-term resilience and stability. The *Global Outlook* acknowledges the role of ODA working in unison with private sector investors, the tax revenue system, migrants, philanthropists and others outside of traditional development circles, to support development goals.

A better FSD market will not only mobilise new finance flows – some of which are catalysed by ODA – it also demands better orchestration of all resources. We need to improve the quality of public and private investment while we grow the market. Private sector actors, for example, are called on not just to help underwrite the SDGs but "to engage as partners in the development process, to invest in areas critical to sustainable development, and to shift to more sustainable consumption and production patterns" (United Nations, 2015). Our goal must go beyond turning billions into trillions. The

larger objective is to turn all existing finance into more impactful investments for the billions of people that still live in extreme poverty today.

Within the OECD, this cross-sectoral approach required close collaboration of four directorates to produce this report – the Development Co-operation Directorate, the Development Centre, the Centre for Tax Policy and Administration, and the Directorate for Financial and Enterprise Affairs. Further contributions were provided from the Office of the Secretary General, the Public Governance Directorate, among other Directorates and divisions. The *Global Outlook* will exist at the OECD not only as a report, but a platform to build momentum and resources for a better informed FSD market amongst OECD actors and with the UN, partner countries, and private investors.

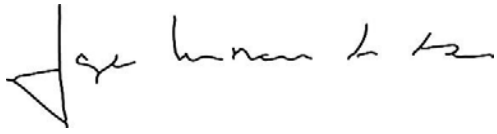

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Table of contents

Foreword: Investing in a better sustainable development market ... 3

Acknowledgements ... 13

Editorial ... 15

Abbreviations and acronyms ... 17

Executive summary ... 23

Infographic: Financing the Sustainable Development Goals ... 25

Overview: Time to face the challenge ... 27

In brief ... 28
The international community needs to accelerate the reform of the global system of financing for sustainable development ... 29
Towards a more efficient global system of financing for sustainable development ... 40
Notes ... 56
References ... 57

Chapter 1. Financing for sustainable development in a fast-changing environment ... 59

Financing for sustainable development capacities under stress ... 61
Financing for sustainable development needs are increasing ... 68
A call to transform the sustainable development finance system ... 76
Notes ... 80
References ... 81

Chapter 2. The expansion of the financing for sustainable development system: More actors and resources ... 85

In brief ... 86
Domestic sources of financing and internal drivers ... 87
External actors and financing flows ... 98
Moving towards financing for *sustainable* development ... 131
Notes ... 132
References ... 134

Chapter 3. Increasing complexity in the financing for sustainable development system - instruments, income and interlinkages ... 145

In brief ... 146
Increasing variation in instruments complicate the choice of the financing mix ... 147
Income levels influence sustainable development financing patterns ... 164
Interlinkages among sustainable development finance resources complicate the financing choice 173
Conclusion: New opportunities and risks require new approaches to measurement, policy and implementation ... 181

Notes ... 182
References ... 184
Annex 3.A. ... 192

Chapter 4. Better measures of financing for sustainable development ... 195

In brief ... 196
Financing for sustainable development measurement: All resources linked to sustainable development must be measured ... 198
Mapping Sustainable Development Goal financing: Better data are needed to assess SDG financing needs and gaps ... 205
Alignment and impact: Efforts to deliver impact-driven data aligned towards sustainable development rely on a new culture of evaluation ... 216
Looking forward: Towards a new financing for sustainable development compass ... 224
Conclusion and recommendations ... 228
Notes ... 229
References ... 231
Annex 4.A. ... 235

Chapter 5. Better policies to finance sustainable development ... 237

In brief ... 238
Better policies are needed to move from mobilising to maximising financing for sustainable development ... 242
Better policies to increase the efficiency of the sustainable development market ... 257
Forward look: Policies must target both inclusive and sustainable development ... 272
Conclusion and recommendations ... 274
Notes ... 275
References ... 278

Chapter 6. Implementation: Co-ordinating actors, tailoring solutions ... 285

In brief ... 286
Integrated national financing frameworks are key to achieving the Sustainable Development Goals ... 287
Financing for sustainable development solutions need to be tailored across different levels of governance ... 301
Funding gaps remain across sectors and policy goals ... 306
Conclusion and recommendations ... 316
Notes ... 317
References ... 319

Glossary ... 329

Tables

Table 0.1. Macroeconomic determinants of financing for sustainable development: A bleak outlook 30
Table 0.2. Individual trends in sources of sustainable development finance: A mixed picture ... 31
Table 1.1. Stressors in the system affect financing for sustainable development ... 61
Table 5.1. Sample of ESG and sustainability metrics offered by major data providers ... 267

Annex Table 4.A.1. SDG financing indicators ... 235

Figures

Figure 0.1. On average, tax revenues are the largest financial resource for all developing countries regardless of income category ... 32
Figure 0.2. External financing to developing countries (2000-16) ... 33
Figure 0.3. Private investment inflows as a share of GDP in developing countries are declining ... 34
Figure 0.4. Transforming the vicious circle into a virtuous circle ... 35
Figure 0.5. The spaghetti bowl of sustainable development finance instruments ... 37
Figure 0.6. Financing resources available to developing countries, 2012-16 ... 39
Figure 0.7. Addressing financing for sustainable development measurement challenges: A three-pronged approach ... 42
Figure 0.8. Tracking the contribution of various financial flows to the SDG targets and indicators demands new metrics ... 44
Figure 0.9. Three opportunities to maximise the impact of finance on sustainable development ... 46
Figure 0.10. The cascade approach to articulating various sources of finance for sustainable development ... 46
Figure 0.11. Providing assistance and guidance to financing for sustainable development actors: Policy levers ... 48
Figure 0.12. Leakages in remittance transfers ... 50
Figure 0.13. Operationalising the World Bank Group's cascade approach ... 52
Figure 0.14. Monitoring the sectors at risk: ODA and OOF flows to developing countries 2012-16 ... 54
Figure 1.1. Economic growth has remained sluggish since the financial crisis ... 62
Figure 1.2. Commodity prices have dropped ... 63
Figure 1.3. Effect of copper prices on investment ... 64
Figure 1.4. Debt levels have been rising in both developed and developing countries ... 65
Figure 1.5. The world's poverty headcount has been declining ... 70
Figure 1.6. Inequality between countries has decreased ... 71
Figure 1.7. Inequality within countries is increasing in many regions ... 72
Figure 1.8. Transforming the vicious circle into a virtuous circle ... 76
Figure 2.1. Mix of financial resources in developing countries ... 88
Figure 2.2. Tax-to-GDP ratios by country classification ... 90
Figure 2.3. Domestic private investment against per capita GDP ... 94
Figure 2.4. Domestic credit to private sector as a share of GDP ... 95
Figure 2.5. Cross-border finance to developing countries, 2000-16 ... 98
Figure 2.6. Destinations of external financing in 2016 ... 100
Figure 2.7. China's growing importance as a source of investment in developing countries ... 103
Figure 2.8. Private investment inflows as a share of GDP in developing countries are declining ... 105
Figure 2.9. Inward M&A: middle-income and least developed countries ... 106
Figure 2.10. Remittance inflows as a share of GDP ... 110
Figure 2.11. Remittance costs across regions exceed the 3% SDG target ... 111
Figure 2.12. Philanthropic giving by sector, 2013-15 ... 115
Figure 2.13. Bilateral concessional finance to select country groups over time ... 120
Figure 2.14. Concessional and non-concessional financing per capita (selected groups) ... 121
Figure 2.15. The proliferation of multilateral providers ... 124
Figure 2.16. Different roles in decentralised development co-operation ... 129
Figure 2.17. Sectoral allocations of decentralised development co-operation in 2015 ... 130
Figure 3.1. Portfolio of official providers ... 148
Figure 3.2. The portfolio breakdown of bilateral sustainable development finance providers ... 150
Figure 3.3. The pay-out from mezzanine finance ... 151
Figure 3.4. Factors influencing the selection of instruments of bilateral providers ... 163

Figure 3.5. Domestic vs external resources in the financing mix ... 165
Figure 3.6. The availability of financing resources at different income levels ... 166
Figure 3.7. Share of tradable debt securities in overall external debt ... 167
Figure 3.8. Use of instruments in project finance transactions ... 168
Figure 3.9. The share of emigrants in terms of percentage of population rises with GDP per capita, 2010 ... 169
Figure 3.10. Poverty headcount ratio (2011 PPP) is still high in middle-income countries ... 171
Figure 3.11. Interlinkages among financing sustainable development resources ... 174
Figure 4.1. Tracking the contribution of various financial flows to the SDG targets and indicators demands new metrics ... 197
Figure 4.2. The way forward ... 198
Figure 4.3. Measuring development finance in a fast-changing world ... 200
Figure 4.4. Types of data shared publicly by foundations ... 205
Figure 4.5. Public/private SDG financing gaps ... 210
Figure 4.6. SDG-related sectoral financing gaps ... 212
Figure 4.7. Financial indicators of SDG Indicators Framework ... 213
Figure 4.8. Public and private financing needs by sector ... 214
Figure 4.9. SDG hits per business case study ... 215
Figure 4.10. Public and private investment needs by income level ... 216
Figure 4.11. SDG indicators by goal and tier ... 218
Figure 4.12. Foundations' use of performance evaluation mechanisms ... 220
Figure 5.1. Better aligning the trillions to support sustainable development gains ... 239
Figure 5.2. Three opportunities to maximise the impact of financing on sustainable development ... 243
Figure 5.3. OECD members' role in the cascade approach ... 246
Figure 5.4. A holistic approach to strengthen revenue systems ... 254
Figure 5.5. Ripple effects of support to the ICT sector across SDGs ... 256
Figure 5.6. The role of policy in the financing for sustainable development market ... 258
Figure 5.7. Total public and publicly guaranteed debt by creditor in low-income developing countries, % GDP ... 259
Figure 5.8. External debt stock growth by origin of flows, Cabo Verde, Index, 2000=1 ... 261
Figure 5.9. Cumulative number of policy interventions targeting sustainability per year ... 263
Figure 5.10. Analysis of policy coherence by DAC member governments ... 268
Figure 5.11. Time-bound plan for policy coherence ... 268
Figure 5.12 Top institutional challenges of policy coherence ... 269
Figure 5.13. Main objectives of the PCSD Partnership ... 270
Figure 5.14. Leakages in remittance transfer due to intermediary actors ... 273
Figure 6.1. World Bank Group diagnostic and strategy process ... 288
Figure 6.2. Number of government agencies delivering DAC members' official development assistance ... 289
Figure 6.3. The Financing for Stability framework emphasises risk management ... 290
Figure 6.4. Investing in the building blocks of ICT markets ... 292
Figure 6.5. How international co-operation can support integrated financing of the 2030 Agenda: GIZ and the Mexican government ... 296
Figure 6.6. DAC members' priority development partnerships ... 297
Figure 6.7. Diagnostic tools need to be integrated into a coherent whole ... 299
Figure 6.8. Monitoring the sectors at risk: Official development assistance and other official flows to developing countries 2012-16 ... 307
Figure 6.9. Identifying transition gaps: Official development assistance and other official flows to social sectors 2012-16 ... 308
Figure 6.10. Towards a typology of financing sources for gender equality ... 310

Figure 6.11. The proportion of official development assistance that aims to achieve gender equality 312
Figure 6.12. Key features of national development banks ... 314

Annex Figure 3.A.1. Instruments used by bilateral development finance institutions ... 192
Annex Figure 3.A.2. Planned and current use of sustainable development finance instruments by DAC members ... 193

Boxes

Box 0.1. What is a holistic approach to financing for sustainable development? ... 29
Box 0.2. From mobilising new resources (billions to trillions) to maximising the impact of available resources (shifting the trillions) ... 36
Box 0.3. Towards a market of financing for sustainable development? ... 41
Box 1.1. The Chilean counter-cyclical response to the end of the commodities super-cycle ... 64
Box 1.2. In My View: Should public money finance private sector development? By Arancha Gonzalez, Executive Director, International Trade Centre (ITC) ... 77
Box 2.1. Fiscal policies can help mitigate inequality ... 89
Box 2.2. In My View: Tax reform and quality spending are crucial for a more sustainable and inclusive economy, by Sri Mulyani Indrawati, Finance Minister, Indonesia ... 91
Box 2.3. In My View: Getting private resources on board for sustainable development, by Royston Braganza, CEO, Grameen Capital India ... 97
Box 2.4. Trade has been a key driver of development but is slowing ... 101
Box 2.5. China becomes the top source of investment in developing countries for the first time ... 103
Box 2.6. In My View: Adapt finance and the financial system to "save the world" by Bertrand Badré, former Managing Director of the World Bank and CEO and founder of Blue like an Orange Sustainable Capital ... 108
Box 2.7. Motivations of remitters ... 109
Box 2.8. In My View: How to mobilise remittances for development financing, by Dilip Ratha, Head of Global Knowledge Partnership on Migration and Development ... 112
Box 2.9. In My View: Unlocking financial innovation to accelerate pro-poor innovation, by Mark Suzman, Chief Strategy Officer & President, Bill & Melinda Gates Foundation ... 116
Box 2.10. In My View: Increasing the pie, by Charlotte Petri Gornitzka, DAC Chair ... 123
Box 2.11. Multilateral providers of financing for sustainable development ... 125
Box 3.1. Guarantees can leverage private resources: the Bosnia and Herzegovina example ... 152
Box 3.2. Taxation as an instrument of financing for sustainable development ... 152
Box 3.3. In My View: Official development assistance remains essential to make innovative financing work, by Jérôme Olympie, Ministry of Foreign Affairs and International Development, France ... 153
Box 3.4. The humanitarian impact bond - Innovative bonds can raise financing for humanitarian purposes ... 156
Box 3.5. Philanthropic foundations can act as innovation catalysts ... 157
Box 3.6. Mobilisation through blended finance - Elazig Integrated Health Campus project ... 159
Box 3.7. Social impact investment helps to provide quality education in Côte d'Ivoire ... 160
Box 3.8. Triangular co-operation brings together diverse resources in support of sustainable development ... 161
Box 3.9. Migration hump ... 168
Box 3.10. In My View: Transitioning to middle-income status: Implications for financing development, by Annalisa Prizzon, Senior Research Fellow, ODI ... 170
Box 3.11. Holistic approach in action - The OECD DAC work on transition finance ... 173

Box 3.12. In My View: The impact of remittances on international debt financing, by Dilip Ratha, Head, Global Knowledge Partnership on Migration and Development 178
Box 3.13. Development finance in support of domestic resource mobilisation 180
Box 3.14. Removing ODA tax exemptions can amplify the catalytic effect of development finance 180
Box 4.1. How is TOSSD contributing to the measurement of financing for sustainable development? 201
Box 4.2. The challenges of measuring philanthropy for development 204
Box 4.3. PARIS21 Initiative: Prospects for a global fund on data for development 206
Box 4.4. The challenges of defining and measuring illicit financial flows 208
Box 4.5. In My View: Financing and partnerships to fill the Sustainable Development Goal financing gaps, by Chantal-Line Carpentier, Chief New York Office, UNCTAD 211
Box 4.6. Using the SDGs as a common framework to strengthen results-based management 218
Box 4.7. In My View: The challenges of measuring the impact of investments, by Eric Berseth, Executive Director, and Vincent Mudry, Head of Operations, Philanthropy Advisors 221
Box 4.8. In My View: The importance of integrating SDGs in corporate sustainability reporting, by Pietro Bertazzi, Head of Sustainable Development, Global Reporting Initiative (GRI) 223
Box 4.9. In My View: International spillover effects of SDG financing, by Guido Schmidt-Traub, Executive Director, Sustainable Development Solutions Network 224
Box 4.10. Measuring Sustainable Development Goal implementation in France: The challenge of breaking down the SDG silos 227
Box 5.1. Phasing out fossil fuel subsidies to maximise financing for sustainable development 240
Box 5.2. In My View: Global solidarity to finance the Sustainable Development Goals, by Jeffrey D. Sachs, Director, UN Sustainable Development Solutions Network 241
Box 5.3. In My View: Implementing the cascade approach and creating markets strategies, by Stephanie von Friedeburg, IFC Chief Operating Officer 247
Box 5.4. Next generation partnerships create shared value for the Sustainable Development Goals . 250
Box 5.5. In My View: Is "maximising finance for development" selling out to the private sector? by Caroline Heider, Director General, Evaluation, IEG, World Bank Group 253
Box 5.6. Tax Inspectors Without Borders 255
Box 5.7. Better collecting and spending of domestic resources 256
Box 5.8. One Belt, One Road initiative provides new sources of debt financing for infrastructure needs 260
Box 5.9. Strengthening principles to promote debt sustainability 262
Box 5.10. In My View: Toward a next generation framework of corporate sustainability metrics* by Daniel C. Esty, Yale University 266
Box 5.11. Institutional mechanisms to strengthen policy coherence 270
Box 5.12. Transparency of policy for official development assistance-funded goods and services ... 271
Box 5.13. A new framework for inclusive growth 272
Box 6.1. In My View: How can private sector operations help in fragile contexts? By Ben Miller, Associate Director, CDA Collaborative Learning 291
Box 6.2. In My View: Lessons learned from UNDP Development Finance Assessments, by Margaret Thomas, Chief, Development Impact Group, UNDP 294
Box 6.3. Inclusive dialogue is a key mechanism for effective private sector engagement 298
Box 6.4. Better tools can increase tax revenue mobilisation 300
Box 6.5. In My View: The local challenges of financing sustainable development by Anuradha Thakur, Ministry of Finance, India 302
Box 6.6. R20 Regions of climate action 304
Box 6.7. Compact with Africa 305
Box 6.8. Innovative partnerships can drive gender equality 311
Box 6.9. Innovative partnerships can accelerate the climate transition 313

Box 6.10. National development banks can be key innovators and intermediaries in green infrastructure finance 314

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Editorial

By Angel Gurría, Secretary-General of the OECD

The current financing for sustainable development agenda urgently needs to be re-focussed. It must be examined through a broader lens, one where economic co-operation and development are viewed together as strategic partners in overcoming today's most pressing global challenges. We know that failure to achieve the United Nations Sustainable Development Goals (SDGs) will result in unprecedented global impacts – increased natural disasters, epidemics, and large-scale forced migrations that respect no borders.

The *OECD Global Outlook on Financing for Sustainable Development* presents a path forward for OECD countries to provide better support in advancing the Sustainable Development Goals. Even more importantly, the *Outlook* demonstrates that OECD countries have a powerful capacity to achieve both inclusive growth at home, and support development gains in countries most in need. This is not a zero-sum game: some of the same policy tools used to achieve inclusive growth in OECD-countries can be harnessed to increase SDG financing.

The *Outlook* makes a powerful argument for development to be considered within domestic policy contexts, bringing Ministers of Finance, Revenue, Trade, Investment and others, to join the fight. It is clear that financing for sustainable development today requires eliminating silos and strengthening policy dialogues. Taking just one example from the *Outlook*, while substantial amounts of cross-border financing (USD 1.7 trillion) and tax revenues (USD 4.3 trillion) accrued to developing countries in 2016, little is known about the development impact of the vast bulk of this financing, and what partners can do to maximise it.

The *Outlook* also echoes the optimism of the 2030 Agenda for Sustainable Development, which has shifted the ambitions of Financing for Sustainable Development well beyond aid, to include private investment, remittances, taxation and philanthropy. In this respect, we need to redouble our efforts to build synergies across the spectrum of public and private actors in developing and developed economies and to channel these resources to where they are needed most. It is also critical that the international community harness this optimism, drive, and commitment. The indispensable and promised surge in resources to support the SDGs has not materialised and in some cases has even dropped. Collectively, we stand at a crossroads and the time to act is now.

The OECD focuses on building strong, inclusive economies, setting common standards, expanding trade and investment, and contributing to development in OECD and non-OECD countries alike. We have also long documented the costs of artificial divisions. In a divided world, we all lose, and those most in need are left behind. In 2015, we witnessed the potential of multilateralism as global leaders stepped forward to agree to the 2030 Agenda – the UN Sustainable Development Goals, the Paris

Climate Change Agreement, the Addis Ababa Action Agenda and AEOI as well as BEPs regarding the international tax agenda. We must now re-join forces and work better together – across new platforms and in new ways – to deliver the 2030 Agenda and better policies for better lives.

Abbreviations and acronyms

AAAA	Addis Ababa Action Agenda
ADB	Asian Development Bank
ADP	Accelerated Data Programme
AEOI	Automatic exchange of information
AFD	French Development Agency (Agence Française de Développement)
AfDB	African Development Bank
AIDS	Acquired immunodeficiency syndrome
AIIB	Asian Infrastructure Investment Bank
AIMM	Anticipated Impact Measurement and Monitoring
AMC	Asset Management Company (IFC)
AMC	Advance market commitment
BAPS	Busan Action Plan for Statistics
BEPS	Base erosion and profit shifting
BIS	Bank of International Settlements
BMZ	German Federal Ministry for Economic Cooperation and Development
BRI	Belt and Road Initiative (also One Belt, One Road)
BRICS	Brazil, Russian Federation, India, China and South Africa
CDC	Commonwealth Development Corporation
CEO	Chief executive officer
CFA	Chartered financial analyst
CPF	Country partnership framework
CPSD	Country private sector diagnostics
CRS	Creditor Reporting System
CSO	Civil society organisation
CSR	Corporate social responsibility
DAC	Development Assistance Committee (OECD)
DCD	Development Co-operation Directorate (OECD)
DDC	Decentralised development co-operation

DEV	Development Centre (OECD)
DFA	Development finance assessment
DOTS	Development Outcome Tracking System
DRM	Domestic revenue mobilisation
DSF	Debt Sustainability Framework
EBRD	European Bank for Reconstruction and Development
ECF	Extended Credit Facility
ECOSOC	United Nations Economic and Social Council
EDFI	European Development Finance Institutions
EIF	Enhanced Integrated Framework
EITI	Extractive Industries Transparency Initiative
ESG	Environment, social and governance
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign direct investment
FMDV	Global Fund for Cities Development (Fonds Mondial pour le Développement des Villes)
FSD	Financing for sustainable development
GDP	Gross domestic product
GEF	Global Environment Facility
GIIN	Global Impact Investing Network
GIZ	German Federal Ministry for International Cooperation
GNI	Gross national income
GPEDC	Global Partnership for Effective Development Co-operation
GRI	Global Reporting Initiative
GVC	Global value chain
HIPC	Heavily indebted poor country
HIPSO	Harmonized Indicators for Private Sector Operations
HIV	Human immunodeficiency virus
IADB	Inter-American Development Bank
IATI	International Aid Transparency Initiative
IBRD	International Bank for Reconstruction and Development
ICRC	International Committee of the Red Cross
ICT	Information and communication technology

IDA	International Development Association
IDB	Islamic Development Bank
DR	Indonesian Rupiah
IDDRI	Institute for Sustainable Development and International Relations (Institut du Développement Durable et des Relations Internationales)
IEG	Independent Evaluation Group
IEP	Institute for Economics & Peace
IFC	International Finance Corporation
IFF	Illicit financial flow
IHSN	International Household Survey Network
IIGCC	Institutional Investors Group on Climate Change
ILO	International Labour Organization
IMF	International Monetary Fund
INFF	Integrated national financing framework
ICT	Information Communication Technologies
IsDB	Islamic Development Bank
ITC	International Trade Centre
JICA	Japan International Cooperation Agency
KIC	Knowledge and innovation community
LDC	Least developed country and territory
LIC	Low-income country
LIC DSF	Debt Sustainability Framework for Low-Income Countries
LIDC	Low-income developing countries
LMIC	Lower middle-income country
LRG	Local and regional governments
M&A	Mergers and acquisitions
MAC	Mutual Administrative Assistance in Tax Matters
MDCR	Multi-dimensional country review (OECD)
MDB	Multilateral development bank
MCM	Ministerial Council Meeting (OECD)
MDCR	Multi-dimensional country review
MDG	Millennium Development Goal
MENA	Middle East and North Africa
MFD	Maximising finance for development

MIFA	Microfinance Initiative for Asia
MNE	Multinational Enterprise
MRI	Mission-related investment
M&E	Monitoring and evaluation
NAP	National action plan
NDB	New Development Bank
NDC	Nationally determined contributions
NEDA	National Economic and Development Authority (Philippines)
netFWD	Network of Foundations Working for Development (OECD)
NGO	Non-governmental organisation
NSDS	National sustainable development strategies
NSS	National statistical systems
ODA	Official development assistance
ODF	Official development finance
OECD	Organisation for Economic Co-operation and Development
OOF	Other official flows
PCSD	Policy coherence for sustainable development
PEFA	Public expenditure and financial accountability
PPP	Purchasing power parity
PRI	Principles for Responsible Investment
RBC	Responsible business conduct
RIA	Rapid integrated assessment
R&D	Research and development
SCF	Standby Credit Facility
SDG	Sustainable Development Goal
SIDS	Small island developing states
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
SPFM	Subnational Pooled Financing Mechanism
TADAT	Tax Administration Diagnostic Assessment Tool
TiVA	Trade in value added
TOSSD	Total official support for sustainable development
UMIC	Upper middle-income country
UN	United Nations

UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Conference on Trade and Development
UN DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNFCCC	United Nations Framework Convention on Climate Change
UN-IAEG	United Nations Inter-agency and Expert Group
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
USAID	United States Agency for International Development
USD	United States Dollar
VAT	Value-added tax
VFM	Value for money
VNR	Voluntary national review
WASH	Water, sanitation and hygiene
WBCSD	World Business Council for Sustainable Development
WBG	World Bank Group
WFP	World Food Programme
WHO	World Health Organization
WTO	World Trade Organization

Executive summary

The Sustainable Development Goals and 2030 Agenda have redefined global ambitions: creating a better world for all is a collective responsibility. As time passes, this agenda becomes ever more urgent – challenges such as extreme poverty and climate change can only be solved by a global, collective response.

The Addis Ababa Action Agenda (AAAA) provides the framework to finance these collective ambitions. It calls on a diverse array of actors - governments, businesses, foundations and individuals - to mobilise more financial resources, in a more co-ordinated manner, and in the pursuit of economic growth that enhances human well-being and preserves the environment, particularly in developing countries.

Yet three years after the AAAA was signed in 2015, the promised surge in finance available for those countries to achieve the SDGs has not materialised. Government revenues – the main pillar of financing for development at USD 4.3 trillion - remain on average in low-income countries below the 15% of GDP threshold often considered necessary for effective state functioning.

Worryingly, the overall supply of external resources to developing countries has declined. Private investment in particular has shown a sharp decrease, with FDI dropping by 30% over 2016-17 to USD 750 billion, and project finance decreasing by an alarming 30% in the first trimester of 2018 alone. Other major financial flows are stable, but remain small in comparison: remittances by migrants reached a record high of USD 466 billion in 2017; official development assistance is steady despite fiscal pressures in provider countries at USD 146.6 billion in 2017; and philanthropy contributes an average of USD 7.9 billion a year over 2013-2015. As for innovative finance, this still accounts for a minor share of official providers' efforts although it is growing.

Declining financing for sustainable development is not only a risk for developing countries: it is a global threat, as failure to achieve sustainable and peaceful prosperity globally will have consequences for all.

Therefore, this first edition of the Global Outlook on Financing for Sustainable Development calls for urgent and bold action to implement the AAAA and fulfil the promise of Agenda 2030 at home and abroad. Seeking to mobilise a greater quantity of financial resources for developing countries will not be enough; the quality, or sustainable development footprint, of all finance must be enhanced.

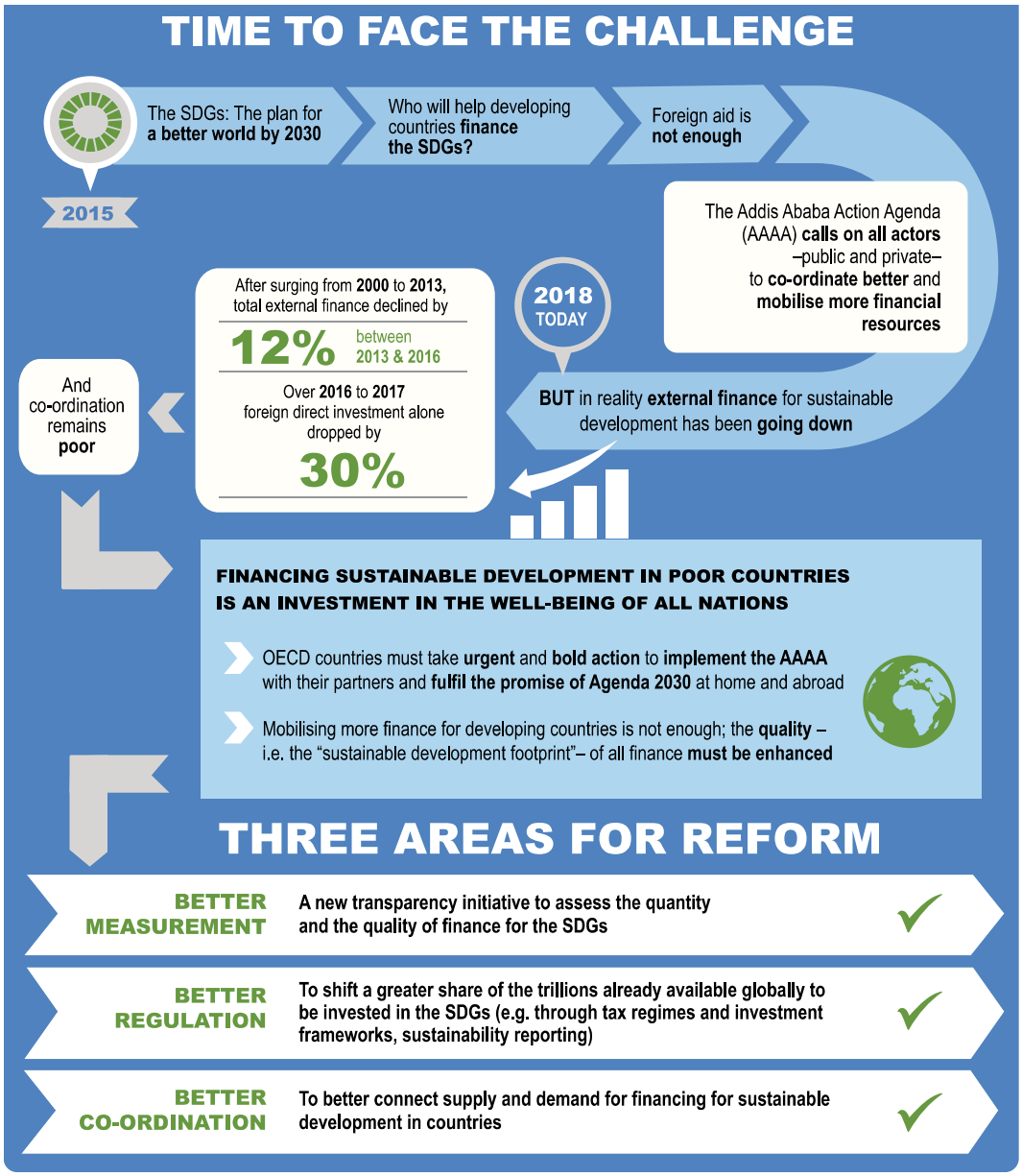
The Global Outlook identifies three areas for reform. First, on measurement: we need better indicators and tools to assess the volume of financial flows, but also their alignment with the SDGs. Measurement must expand beyond aid to all flows from all actors, and to tracking flows towards specific SDGs and development objectives. For example, a dollar invested in polluting activities cannot be counted the same way as a dollar invested in clean energy. A culture of evaluation and impact needs to be developed to understand the actual footprint of resources as well as the trade-offs and synergies. The report thus calls for a new transparency initiative as a first step to address these gaps.

Second, policy reforms are needed to shift the trillions, i.e. create incentives for a greater share of the total available finance to be invested in sustainable development. This includes supporting the capacity of developing countries to make the most of financing options; guiding providers of finance towards high standards, and preventing harmful practices such as tax evasion and avoidance; and encouraging greater policy coherence for sustainable development in the home countries of providers – for example, through tax regimes and investment frameworks, and efforts to reduce the cost of remittance transfers.

Third, we need to improve the co-ordination of various actors in their operations, so as to better connect supply and demand for financing for sustainable development. In particular, country development strategies need to be better linked with available financing. Several diagnostic tools and guidelines are already available to help design such strategies and identify matching resources, but co-ordination in countries remains low. The *Global Outlook* urges donors to provide more coherent support to countries as they develop the Integrated National Financing Frameworks called for in the AAAA.

The ambitious change agenda set out in this inaugural edition of the *Global Outlook* aims to support the UN-led efforts to implement Agenda 2030 and the AAAA. The report puts the onus on OECD providers of development co-operation to use all available levers to support the visions and choices of partner countries for their sustainable development. It recommends concrete actions, identifies areas for further policy dialogue, and points to knowledge gaps which the next editions will aim to fill.

Infographic: Financing the Sustainable Development Goals



Overview: Time to face the challenge

Financing the Sustainable Development Goals (SDGs) in developing countries is a major challenge. Three years after the Addis Ababa Action Agenda (AAAA) in 2015 called on all actors - public and private - to co-ordinate better and mobilise more financial resources, the outlook is not encouraging: external finance - which many developing countries continue to depend on heavily - has been going down, largely due to the drop in private flows, and co-ordination remains poor. The trend must be reversed: financing the sustainable development of poor countries is an investment in the well-being of all nations. OECD countries must face the challenge: urgent and bold action is needed to implement the AAAA with their partners and fulfil the promise of the 2030 Agenda for Sustainable Development at home and abroad. Mobilising more finance for developing countries is not enough; the quality – i.e. the "sustainable development footprint"– of all finance must be enhanced. This Overview chapter synthesises the report's diagnosis and its recommendations for reforms in three areas: (i) better measurement of the quantity and quality of finance for the SDGs; (ii) better incentives to direct the finance already available globally to the SDGs; and (iii) better co-ordination of actors to connect the supply and demand for financing for sustainable development in developing countries.

> *"Prosperity, like peace, is indivisible. We cannot afford to have it scattered here or there among the fortunate or to enjoy it at the expense of others. Poverty, wherever it exists, is menacing to us all and undermines the well-being of each of us. It can no more be localized than war, but spreads and saps the economic strength of all the more-favored areas of the earth. We know now that the thread of economic life in every nation is inseparably woven into a fabric of world economy. Let any thread become frayed and the entire fabric is weakened. No nation, however great and strong, can remain immune. (...)*
>
> *We know now that economic conflict must develop when nations endeavor separately to deal with economic ills which are international in scope. To deal with the problems of international exchange and of international investment is beyond the capacity of any one country, or of any two or three countries. These are multilateral problems, to be solved only by multilateral cooperation."*

Address by the Honourable Henry Morgenthau Jr., U.S. Secretary of the Treasury, at the Inaugural Plenary Session of the Bretton Woods International Monetary Conference, 1 July 1944.

In brief

By setting new ambitions for the world's nations, the 2030 Agenda and the Sustainable Development Goals (SDGs), adopted in 2015, kick-started a redefinition of international co-operation. Creating a better world for all requires breaking free of the limits of traditional North/South approaches. It demands a collective effort to share prosperity and help all actors play their part in facing up to fast-evolving global challenges. The 2015 Addis Ababa Action Agenda (AAAA), in line with the 2002 Monterrey Consensus, provided the framework to finance these ambitions. The AAAA called on a broad diversity of actors – from central governments to local, from private investors to philanthropies– to mobilise more domestic and external financial resources, more effectively and in a more co-ordinated manner, in pursuit of economic growth that enhances human well-being and preserves the environment.

Three years in to this commitment to the SDGs, this first edition of the *Global Outlook on Financing for Sustainable Development* sounds an alarm. The need for financing for sustainable development is increasing but the actual volume of external resources available to developing countries is declining, and is not yet compensated by a symmetric growth of domestic resources. The revenue of governments is the central pillar of the FSD system, and while tax revenue-to-GDP ratios are increasing, in many countries they remain stubbornly low. Moreover, the radical shift needed in the quality of public and private investment, especially in the poorest economies, has barely started. The urgent call to action issued from Addis Ababa has yet to be heard by all.

What would it take to heed that call and fix the financing for sustainable development (FSD) system? What is the role of each actor? Where to start in the face of such formidable complexity? The *Global Outlook* invites all actors to step back and take a fresh look at this system as a market – one where the demand for more and better investment in sustainable development (the SDG financing needs) must be met by a variety of current and potential suppliers. The *Global Outlook* primarily targets the responsibilities of OECD development co-operation policy makers, but has relevance

for the broader international community. The analysis reveals the symptoms of an imperfect, immature market that needs more transparency, better regulation and more efficient co-ordination.

The report, therefore, calls on policy makers in the FSD system to face the challenge and accelerate the maturation of this system. It proposes reform in three priority areas: better inform actors in the market by more accurately measuring FSD flows and their impact; improve policies and regulations in the system to create new incentives for directing a greater share of public and private investment towards sustainable development; and better implementation of the holistic approach put forward in the Monterrey and AAAA commitments (Box 0.1) through more tailored and co-ordinated operations.

This overview offers a list of recommendations, primarily for OECD policy makers, to be prioritised and translated into concrete actions.

Box 0.1. What is a holistic approach to financing for sustainable development?

The Monterrey Consensus on Financing for Development, in paragraph 8, defines the holistic approach to financing for development as the following:

In the increasingly globalising interdependent world economy, a holistic approach to the interconnected national, international and systemic challenges of financing for development – sustainable, gender-sensitive, people-centred development – in all parts of the globe is essential. Such an approach must open up opportunities for all and help to ensure that resources are created and used effectively and that strong, accountable institutions are established at all levels. To that end, collective and coherent action is needed in each interrelated area of our agenda, involving all stakeholders in active partnership (UN, 2003[1]).

Accordingly, the holistic, integrated approach has two main dimensions:

- Areas of the development agenda – economic, social and environmental – are interrelated;
- Actions are coherent, involving all stakeholders in active partnerships to make the most of their interactions, so that their collective impact on sustainable development is more than the sum of the parts.

The international community needs to accelerate the reform of the global system of financing for sustainable development

The evolution of the FSD system since Monterrey and Addis Ababa may leave policy makers feeling overwhelmed. First, by a sense of urgency as the ongoing decline in financial flows to developing countries suddenly casts serious doubt on the world's collective capacity to reach the SDGs – with high stakes for countries at all levels of development. Second, by the complexity of the system, with its growing diversity of actors and instruments, their intricate interactions, and the constantly changing

financing needs over time. This complexity makes it harder to fully grasp and effectively act to properly maximise these combined contributions to sustainable development. Third, by a sense of unfinished business as the holistic approach has yet to be fully implemented or its benefits reaped. Moreover, the innovation that is occurring is promising, but is not producing results to scale.

Headwinds building in the global macroeconomic environment jeopardise financing for sustainable development in the short and medium term

The availability of financing for sustainable development depends on a number of factors, among them economic growth, debt levels, trade and investment trends, and migration flows. Stresses on some of these factors in recent years have created a net, downward pressure on development finance resources. Table 0.1 summarises the effects of some of these changes.

Table 0.1. Macroeconomic determinants of financing for sustainable development: A bleak outlook

	2018 state of play
Growth	pre-2008 levels not recovered
Commodity prices	super-cycle ended in 2011
Debt levels	at historic peak both in developed and developing countries
Migration	increase of flows and in-donor refugee costs vs. increase in remittances
Technology	mix of opportunities and threats

Growth: Since the 2008-09 crisis, GDP growth in OECD countries has remained flat and forecasts have only recently improved. Despite an initial rebound, GDP growth in emerging and developing economies also slowed, to 6-7% in the People's Republic of China ("China") and around 3-4% in sub-Saharan Africa – far from double-digit growth rates some of those countries experienced in previous decades. Global GDP growth stood at 3.8% in 2017, down from 5.6 % prior to the crisis (IMF, 2018[2]). The difference (1.8% average point) falls in the range of the estimated investment gap of an incremental 1.5-2.5% of world GDP that, according to some estimates, is required to finance the SDGs (Schmidt-Traub, 2015[3]). Slower growth negatively affects the capacity of developing countries both to mobilise domestic resources for development and to attract external financial flows.

Commodity prices: In 2017, 64% of developing countries derived 60% or more of their exports from commodities (UNCTAD, 2017[4]). The end of the commodity super-cycle in 2011 and the subsequent drop in commodity prices have severely constrained growth and domestic resource mobilisation capacity of developing countries. Conversely, commodity net-importing countries benefited.

Debt levels: Sustainable debt, which is essential to financing development, reached a historic peak of USD 164 trillion in 2016, i.e. 225% of world GDP (Gaspar and Jaramillo, 2018[5]). Debt levels could constrain the capacity of both beneficiaries (through reduced absorption capacity) and providers (through reduced budgetary flexibility) to marshal FSD resources. Fiscal balances have deteriorated in 70% of low-income countries, and the number of developing countries at high risk or in debt distress has nearly doubled, to 24 from 13, in the past five years (IMF, 2018[6]).

Migration: As of 2017, an estimated 258 million people live in a country other than their country of birth, 49% more than in 2000. The increased migration flows to OECD countries since 2010, spurred by conflicts and economic hardship, have been accompanied by steadily

increasing remittance volumes. These reached USD 466 billion in 2017, about three times the value of official development assistance (ODA).

Technology: The overall effect of technological change on trade and FSD is still to be determined. What, for instance, will be the balance between jobs lost to automation and new jobs created? Is it within reach for all developing countries to leapfrogging into a service economy? How fast will new instruments and more tools, such as mobile payment of utility bills or taxes, improve domestic resource mobilisation?

The growing gap in financing for sustainable development is a global threat

Remittances flows are steadily growing while other essential sources of financing for sustainable development are declining

In terms of individual flows of finance to developing countries, the drops in domestic private investment and foreign direct investment (FDI) are major causes for concern. Remittances have remained on an upward trend but mostly support household consumption and thus will not compensate for an eventual loss of jobs and government revenue. ODA also remains steady but is falling short of international commitments (Table 0.2).

Table 0.2. Individual trends in sources of sustainable development finance: A mixed picture

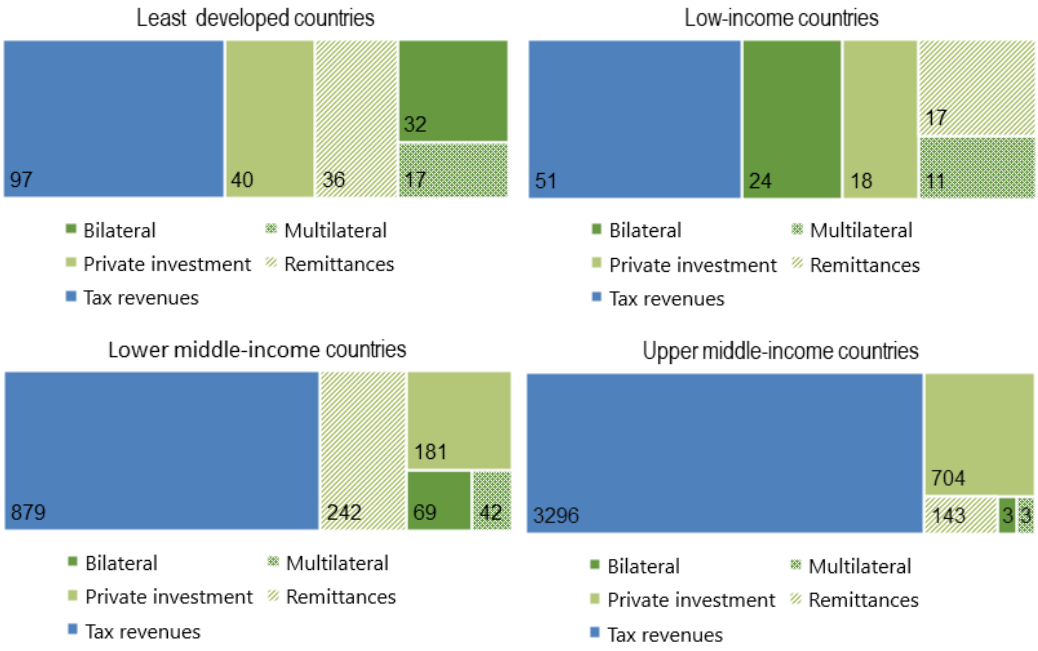
Worrying trends	Encouraging trends
Domestic resource mobilisation – (public) Tax revenue to GDP ratio (at 14% in least developed countries/low-income countries) still below the 15% recommended threshold; (private) domestic private investment in decline.	**Philanthropy** – USD 8 billion a year on average (2013-15)
Private sector – M&A flows to developing countries started to decline in 2012, followed by a 11% drop in FDI in 2016 and in project finance in 2018 (-30% in the first semester). By contrast, amounts mobilised by ODA, while still limited, have rapidly increased.	**Remittances** – Record high USD 466 billion in 2017
Official assistance	
Development Assistance Committee (DAC) bilateral assistance – USD 167 billion in 2017. USD 146.6 billion was concessional, or 0.31% of GDP (short of the 0.7% objective) and slightly dropping 0.6% compared to 2016 (+1.1% excluding drop of in-country refugee costs). Non DAC – USD 6.9 billion in 2015.	

The **revenue of governments** is the central pillar of the FSD system (Figure 0.1). In 2016, tax revenues in developing countries amounted to USD 4.3 trillion, more than double cross-border flows in the same year. Yet more revenue is needed. The tax revenue-to-GDP ratios in low-income countries (LICs) and least developed countries (LDCs) average 14% and remain below the 15% threshold that is increasingly recommended as a minimum benchmark for effective state functioning. Tax revenues represented 42.7% of the overall finance mix in LDCs, compared to 78.2% in upper middle-income countries (UMICs).

Domestic private investment is the main source of capital formation in most countries, but by some measures it has been declining. For example, the volume of mergers and acquisitions (M&As), a key measure of vibrancy in an economy, dropped by 60% in developing economies (excluding China) between 2010 and 2017, from USD 237 billion to USD 95 billion.

Figure 0.1. On average, tax revenues are the largest financial resource for all developing countries regardless of income category

USD billion, 2016



Note: The estimates have been calculated for the list of developing countries eligible for ODA but exclude a number of countries and territories because of lack of data on tax revenue. Those excluded are the following low-income countries (LICs): Democratic People's Republic of Korea; Somalia, which is also a least developed country ([LDC]); and South Sudan (also an LDC).
Among lower middle-income countries and territories (LMICs), the following are excluded: Bhutan (LDC), Kosovo, Mongolia, Myanmar (LDC), Sri Lanka, Syrian Arab Republic, Vanuatu (LDC), West Bank and Gaza Strip. The third group to be excluded are upper middle-income countries (UMICs): Cuba, Fiji, Former Yugoslav Republic of Macedonia, Libya, Montenegro, Nauru and Venezuela.
Source: IMF (2017[7]), "World revenue longitudinal data", https://data.world/imf/world-revenue-longitudinal-dat; and OECD (n.d.[8]), "Global revenue statistics" (database), https://stats.oecd.org/index.aspx?DataSetCode=REV; OECD (2018[9]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1; World Bank (2018[10]), "Migration and remittances data", http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data; IMF (2018[2]), "Balance of payments statistics 2017", http://www.imf.org/external/datamapper/datasets/BOP for private investment data.

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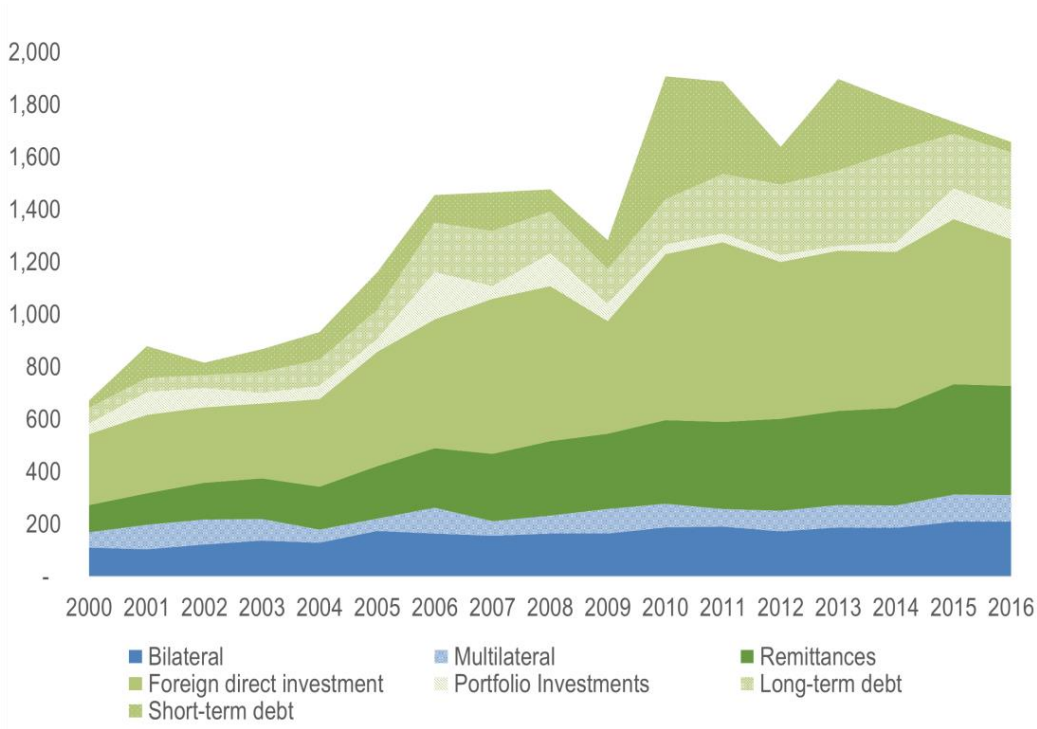
International actors, both public and private, contribute substantive amounts of cross-border finance to developing countries. The volume of external finance available to developing countries has substantially increased to USD 1.7 trillion in 2016 from USD 675 billion in 2000. But recent trends are sobering, with total external finance declining by 12% between 2013 and 2016 (Figure 0.2).

Figure 0.2. External financing to developing countries (2000-16)

2016 USD billions, constant prices



Source: Author's calculations based on OECD (2018[11]), "Creditor Reporting System" (database), *https://stats.oecd.org/Index.aspx?DataSetCode=crs1* for official bilateral and multilateral flows; World Bank (2018[10]), "Migration and remittances data" http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances; IMF (2018[2]), "Balance of Payments database", http://www.imf.org/external/datamapper/datasets/BOP for FDI, portfolio investments, and long-term and short-term debt.

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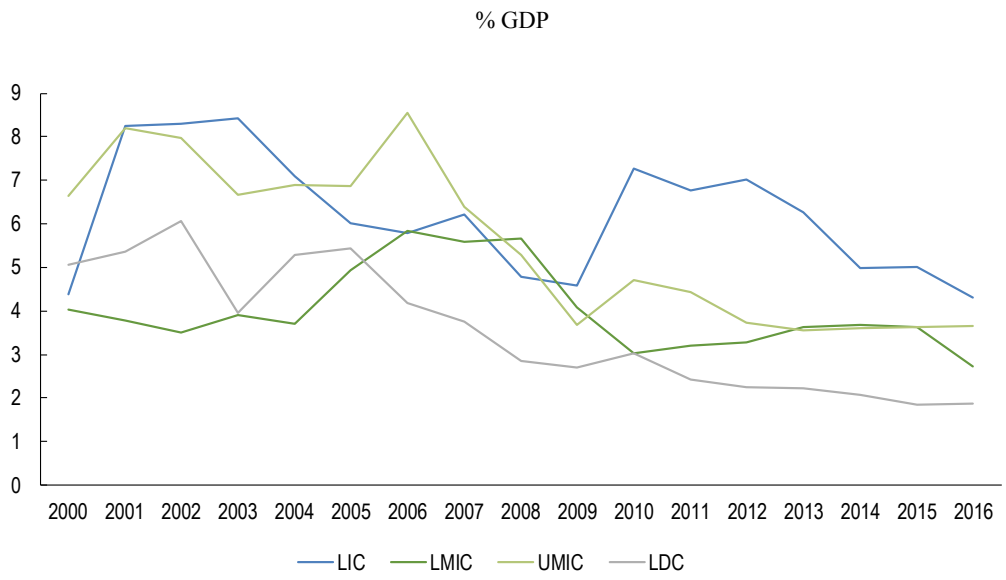
The **private sector** provides the bulk of cross-border finance, but is in decline (Figure 0.3). Commercial investors are the single largest provider, with around USD 750 billion in **foreign direct investment** (FDI) and **portfolio investment**. A 30% drop in FDI to developing countries over 2016-17 is cause for alarm, not only because it implies a substantive decline in financing but also because it means fewer opportunities for developing countries to access international markets and technical know-how. **Trade** stalled in the aftermath of the 2008-09 crisis and bounced back in 2017 on the back of better growth forecasts (4.7% growth in world merchandise trade volume compared to 1.8% growth in 2016). Trade remains subject to protectionist tensions and possible related setbacks, with growth forecast to slow to 3.9% in 2018 and 3.7% in 2019, subject to the issues of trade tensions and a loss of momentum (World Trade Organization, 2018[12]).

Migrants from developing countries are an important provider of FSD and the least volatile. They sent home a record USD 466 billion of remittances in 2017. In some countries, they make up as much as 30% or more of GDP, as in Tajikistan, Kyrgyzstan and Tonga.

Philanthropic foundations are emerging as increasingly important providers. They provide smaller volumes of financing than many other actors, USD 24 billion for the period 2013-15 (an average of USD 8 billion per year) but philanthropies are key players in the health sector and sometimes pioneer innovative financing solutions.

Public sector or official providers, with combined resources amounting to USD 311 billion in 2016, play a special role in targeting poverty reduction and the most vulnerable countries. Since 2000, financing provided at below market rates or concessional terms grew fastest for the group of low-income countries and fragile and conflict-affected countries and territories. Among official providers, emerging economies such as China play an increasing role.

Figure 0.3. Private investment inflows as a share of GDP in developing countries are declining



Source: Authors' calculations based on IMF (2017[13]), "Balance of Payments" (database), http://www.imf.org/external/datamapper/datasets/BOP; IMF (2018[14]), "World Economic Outlook" (database), https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx.

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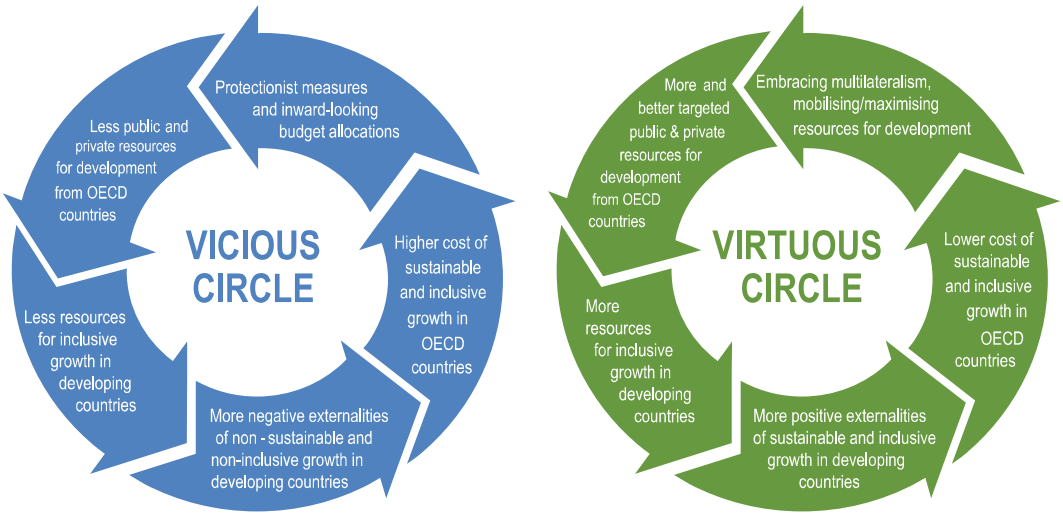
All nations need sustainable development globally to achieve more inclusive growth at home

At the same time that resources for the sustainable development of developing countries are diminishing, rapid global population growth, environmental degradation, and persistent levels of fragility and conflict are putting upward pressure on financing needs. The resulting scissor effect dramatically compromises the global ambitions of the 2030 Agenda. Stress on financing capacities could result in a vicious circle that effectively slows progress towards the SDGs through increased negative externalities of non-inclusive or non-sustainable growth, the temptations of protectionism and isolationism, and ultimately fewer resources for financing for sustainable development.

Countries at all levels of development would bear the cost of this vicious circle. Achieving the SDGs may be primarily a domestic agenda, but the world is interconnected and interdependent. Individual results, and the cost of achieving them, depend on collective results. For example, collective failure to reduce negative externalities in global migration, health or climate issues would not only slow human progress in developing countries. It also would affect richer economies and disproportionally harm the well-being of their more modest citizens. The stark takeaway of this scenario is that OECD countries will not be able to achieve more inclusive growth at home without more sustainable development globally. However, increased global connectedness also means that a virtuous circle of development is possible (Figure 0.4). Resources spent on achieving the SDGs in developing countries are an investment in OECD members' own sustainable and inclusive growth and their capacity to achieve the SDGs at home.

Figure 0.4. Transforming the vicious circle into a virtuous circle



Source: Authors

The development crisis looming in consequence of such a scissor effect – that is, less FSD at a time of mounting FSD needs – calls for macroeconomic policies to reverse the downward global trends in growth, trade and investment in order to mobilise more resources than are currently available. Yet short-term or medium-term relief of these stressors is uncertain at best and focusing solely on mobilising additional domestic and foreign and public and private resources is unlikely to be sufficient.

Defaulting on the promises of 2015, however, is unacceptable. This is why the FSD system urgently needs to be reformed to enhance the sustainable development footprint of each actor and each dollar spent. The international community is aware, as demonstrated by the recent shift in priorities for the FSD agenda from mobilising, or growing resources, to maximising them, or making the most of existing and future additional resources through the AAAA's holistic approach (Box 0.2).This requires a better understanding of interactions among the various actors and instruments that could lead to increased co-ordination and coherence. The growing complexity of the FSD system greatly complicates the task of policy makers.

Box 0.2. From mobilising new resources (billions to trillions) to maximising the impact of available resources (shifting the trillions)

The language and practice of major institutional sustainable development finance actors have evolved. In the 2015 report (African Development Bank et al.[15]), the Development Committee, *From Billions to Trillions: Transforming Development Finance*, multilateral financial institutions committed "to promote and catalyse private investment, addressing risk and uncertainty, helping to mobilize and scale up resources and co-investment from traditional, institutional and other public and private investors".

A 2017 report for the Development Committee moved to the concept of what it calls maximising finance for development, echoing the shift set out in *Forward Look – A Vision for the World Bank Group for 2030*" (World Bank, 2018[10]). This latter report introduced what is being called the cascade approach and argued for focusing on the quality, and ultimately impact, of development finance rather than only its quantity (i.e. amounts). It further proposed making better use of the interactions of the various actors and sources of finance for sustainable development. One example of this would be to create incentives for the channelling of migrants' remittances towards productive investment rather than final consumption, thereby opening opportunities for new economic linkages between firms locally and broadening the tax base in the receiving countries. Actions on different levels from finance providers to regulators would be required.

Going from billions to trillions can appear daunting – to the extent that it may discourage further budgetary efforts in difficult macroeconomic contexts. But shifting the trillions acknowledges that most of said trillions in potential sustainable development finance are already there, in the global economy, but need to be better targeted to sustainable and inclusive growth. For example, governments spend USD 500 billion in fossil fuel subsidies that, rather than supporting the SDGs, encourages damage from the use of oil, gas and coal at an estimated cost of nearly USD 5.3 trillion. Shifting this half-trillion to more sustainable uses would have tremendous, positive knock-on effects on sustainable development.

The financing for sustainable development system has grown more complex, leaving the international community unsure how to undertake its reform

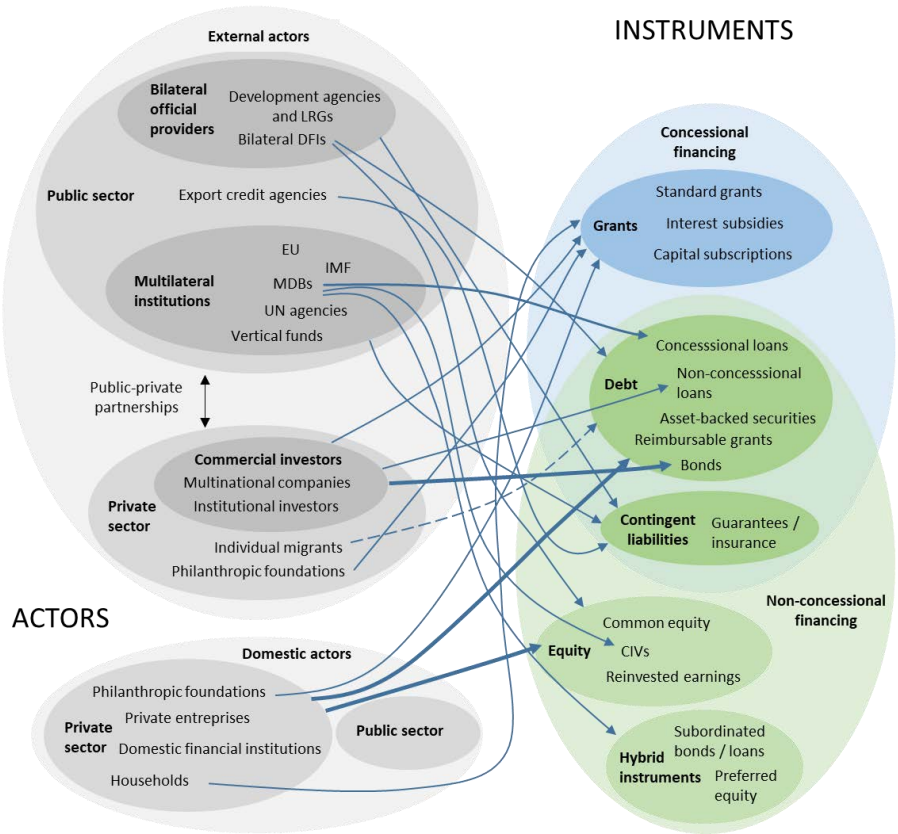
Once concentrated on *international aid*, the international co-operation agenda has moved to *development finance* and now towards *financing for sustainable development*. With this shift has come a great expansion of the number and diversity of *financial actors* who are called upon by the international community in Monterrey and Addis Ababa to play a part. These include taxpayers, private investors, diaspora communities, donors and philanthropic actors, among others, all of whom bring their own rationales, roles, resources, instruments, incentives and intermediary objectives and whose distinct contributions to sustainable development derive from their respective and diverse comparative advantages. Their contributions are all very different in nature and have different effects. Sustainable development, though, is not about simply adding all these up. For example, it is one thing to enlist private firms and emigrant remitters onto the roster of FSD suppliers. It is another to understand how much of their investment and spending actually affects sustainable development positively. What is more, the growing diversity of *instruments* – concessional, non-concessional and mixed – makes it harder for developing countries to craft the optimal FSD mix that matches their needs. Finally, as countries develop, their FSD

needs change over time, as does their capacity to access certain resources such as ODA. This complexity in turn complicates the work of policy makers to chart and agree on a reform path for the FSD system.

New financial instruments and their interactions add to the complexity, but have yet to mobilise significant new resources

The multiplication of actors and openness to innovation have led to the use of more diverse instruments in the FSD market (Figure 0.5). The expansion has contributed to opportunities for more choices and better tailoring of solutions to developing countries' needs. At the same time, this profusion of choices, when combined with some asymmetry of information, risks adding another layer of complexity to the system. In consequence, further efforts to map and classify instruments are needed. Countries' needs (demand side) rather than the preference of providers (supply side) should drive the choice of instruments. Responses to the Global Outlook Survey on Financing for Sustainable Development demonstrate that this is not yet the case, however (Chapter 3).

Figure 0.5. The spaghetti bowl of sustainable development finance instruments



Source: Authors

As the number of actors increases, so does the number of possible combinations of resources. Ideally, a well-functioning system would help to leverage actors' respective comparative advantages and maximise their collective contribution to sustainable development, thus transforming what has been termed the landscape of largely uncoordinated actors into a more harmonious financing system. This would allow developing country governments to build their own optimal financing mix in support of their efforts to implement the SDGs. In reality, however, the FSD system is a very complex place to navigate, and finding the optimal financing mix is challenging.

The multitude of financing approaches available is a complicating factor. There are more than 1 000 FSD instruments to choose from. Official FSD providers increasingly show interest in new instruments such as mezzanine finance, often with the intention to mobilise private sector investors. Between 2000 and 2016, bilateral providers set up 167 facilities with a combined size of approximately USD 31 billion to engage in blended finance transactions that are designed to involve the private investors in development finance operations.

Innovation is taking place at a fast pace, with a plethora of new instruments, but it has yet to achieve its full potential. The actual volumes raised through innovative approaches, while on the rise, are still very small, both in absolute and relative terms. Besides, if not properly introduced, innovation could add yet another layer of complexity to financing decisions even if it enables FSD actors to choose among a wider range of available approaches. Bringing innovation to scale to harness its potential for sustainable development calls for a learning process with investment in capacities.

Finally, the different resources interact with each other, creating potential synergies as well as trade-offs that add more complexity. A lack of understanding of these interlinkages can result in inefficient policies. For example, with regard to trade-offs, developing countries frequently use tax incentives to attract foreign investment without paying enough attention to whether these policies will indeed help to trigger significant investment flows and compensate for domestic resource losses. Over 80% of low-income and lower middle-income countries offer tax holidays and tax exemptions on investment. But tax incentives often are not among the most important factors in investment and location decisions. More research on interactions can inform policy choice for developing country governments and for official providers who can provide targeted support for policy areas with the greatest catalytic effect.

The demand of developing countries for financing for sustainable development evolves over time, but supply cannot always respond

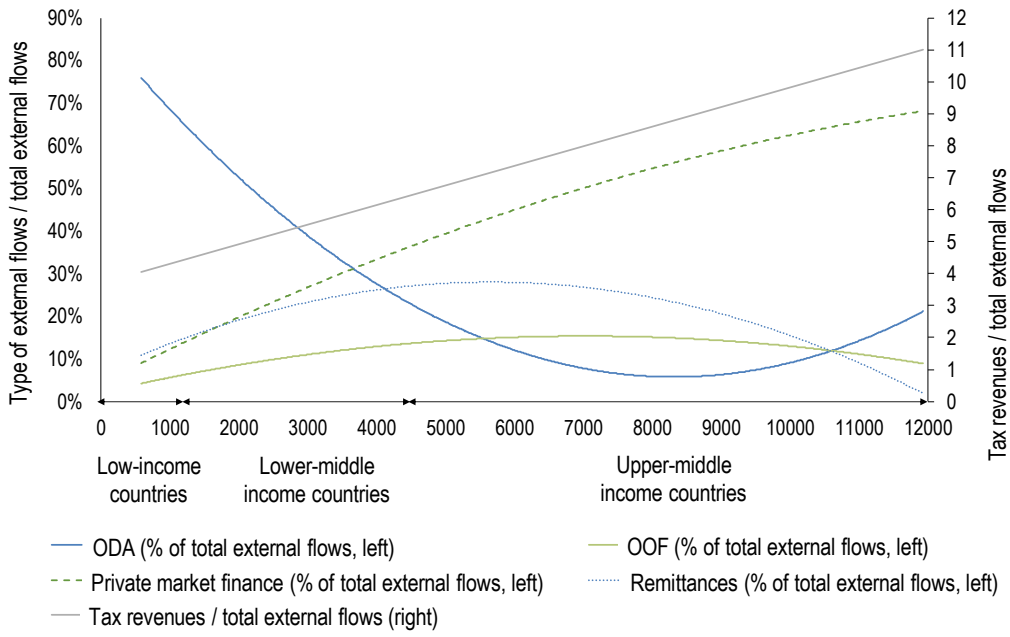
As countries transition from one category of income-per-capita to the next, their needs (demand) and the mix of resources available to public and private actors (supply) change. For example, countries exiting the OECD Development Assistance Committee (DAC) list of recipients cease to be eligible for ODA yet may still be unable to use alternative, costlier sources to finance some of their pressing development needs. Complementarities of resources at different stages of transition are yet to be fully explored and understood.

The development community needs to more systematically review and adjust FSD mixes to different transition contexts. For example, while tax revenues are slightly less than half the volume of total financing for low-income countries, they make up more than 70% for lower middle-income countries and around 90% for upper middle-

income countries. Among cross-border resources, the financing mix changes as well. While private flows represent around 30% of cross-border resources in LICs, they represent almost 70% for the wealthiest UMICs. (Figure 0.6). Developing country governments have to manage the transition process with timely and well-coordinated policies to promote domestic resource mobilisation and attract foreign investment. For official FSD providers, who can support developing country governments in targeting an optimal financing mix, this means that the phasing out of development finance has to be carefully managed in co-ordination with the increase in other sources.

Figure 0.6. Financing resources available to developing countries, 2012-16

2015 prices



Note: The resources include concessional flows (ODA), non-concessional flows (OOF), private flows (foreign direct investments, private securities, and claims from banks and other sources such as bonds, equity, etc.), and remittances.

Sources: OECD calculations based on OECD (2018[9]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for official bilateral and multilateral flows; World Bank (2018[10]), "Migration and remittances data" http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances data; IMF (2018[2]), "Balance of payments statistics" http://www.imf.org/external/datamapper/datasets/BOP for private market finance (FDI, portfolio investments and long-term and short-term debt).

StatLink https://doi.org/10.1787/888933852996

Towards a more efficient global system of financing for sustainable development

The stress on sources of FSD for developing countries will not be easily lifted or reversed. To achieve the SDGs, a systemic change is needed. The Monterrey Consensus and the Addis Ababa Action Agenda have shown the way by calling for a holistic approach (Box 0.1) that promotes efforts to not simply *increase* but to *maximise* financing, i.e. to enhance the development impact of existing and future additional resources by using them more effectively and making the most of their interactions.

Now, three years into the 2030 Agenda for Sustainable Development and the AAAA, it is time to ask how successfully this new approach has been implemented. Have silos among actors or AAAA action areas been broken? Has the promise of this holistic approach been fully harnessed in terms of new scaling-up opportunities and interactions and dynamic effects? Have risks associated with the emergence of new actors and the use of new instruments and modalities been fully measured and addressed?

The answer of this *Global Outlook* is a qualified "no". In the absence of a clear mapping of the different actors' respective roles, resources, types of instruments, etc., the FSD system has in fact become harder to navigate, especially for developing countries. Its amorphous character also presents a risk of dilution of responsibilities in designing and implementing the necessary reforms.

One way of better grasping the complexity is to step back, and take a fresh look at the system as a market – one where the demand for more and better investment in sustainable development must be met by a variety of current and potential suppliers (Box 0.3). This analogy, for all its faults and merits, reveals an imperfect, immature market that needs more transparency, better regulation and more efficient co-ordination.

This report is meant to send a wake-up call to actors in the FSD market. It urges policy makers to accelerate its reform and highlights three priority areas:

- *Better measurement of FSD flows and their impact to reduce information gaps for actors in the market*. Traditionally, the international community including the OECD has focused on measuring the flows. Little is known about the needs, the gaps, and the impact or development footprint of those flows. One dollar spent on polluting activities is still counted the same way as one dollar spent on clean energies. A culture of evaluation and impact needs to be developed and put in place.
- *New policies to regulate the market* and direct a greater share of public and private investment towards sustainable development. This means maximising the opportunities – i.e. using a holistic approach to shift the trillions to the SDGs – and minimising the risks by regulating the FSD system to increase its transparency and efficiency.
- *Better implementation of the holistic approach called for in Monterrey and Addis Ababa to achieve better co-ordination amongst actors in the market*, especially at country level where the global goals are to be achieved. Country development strategies need to be better linked with available domestic and external financing. This requires better co-ordination at all levels, from global to local, while simultaneously taking into account sector-specific and policy-specific needs (e.g. climate and gender).

Box 0.3. Towards a market of financing for sustainable development?

A market is a system where parties engage in an exchange in more or less spontaneous or structured ways. It is driven by the basic forces of supply and demand that it matches up more or less efficiently.

The financing for sustainable development (FSD) system, on many counts, increasingly shows the characteristics of a market. On the demand side are the SDG financing needs – a demand for financing sustainable development projects that is put at several trillions of dollars in investment in developing countries alone. This demand is spread across the world since the SDGs are universal.

On the supply side are global savings that could be channelled through public or private investment towards sustainable development projects. Supply can take many forms due to the variety of intermediaries: taxpayers' money is channelled through ODA, for instance; shareholders' money is channelled through sustainable business investments; pensioners' and investors' money is channelled through financial institutions; and so on.

The market analogy might surprise those who see generosity as the essence of development co-operation. Looking at FSD through this perspective, though, does not undermine or devalue generosity. On the contrary, the analogy helps reappraise the role of development co-operation in light of market failures and the need to supply financing for sustainable development on more concessional terms in sectors or countries where the price established by the market is too high for the demander – e.g. in fragile contexts.

Global savings largely exceed the estimated SDG financing needs. The demand for FSD, however, is competing with demand for other types of financing that might have a higher short-term return (e.g. pecuniary) but a lower, unassessed or adverse long-term impact on sustainable development. For example, investment in fossil fuel represents more than twice the value of total climate investment. The case for FSD still needs to be made. In addition, the relative share of FSD in total finance needs to increase. But to do so, it is necessary to distinguish the share of finance that effectively promotes more sustainable development from the share that does not or that aggravates economic, social and environmental outcomes. Hence the need for better measurement of impact.

As a result, a global SDG financing gap remains or, in market terms, some of the demand for FSD is unsatisfied. The SDG financing challenge then turns on mobilising more resources (increasing supply) and, more importantly, remedying market failures by redirecting resources towards the unsatisfied demand. This might require a better structuring of the FSD market, first through increasing transparency and efficiency to avoid, for instance, asymmetry of information and second, by creating policy incentives to guide savings towards FSD gaps.

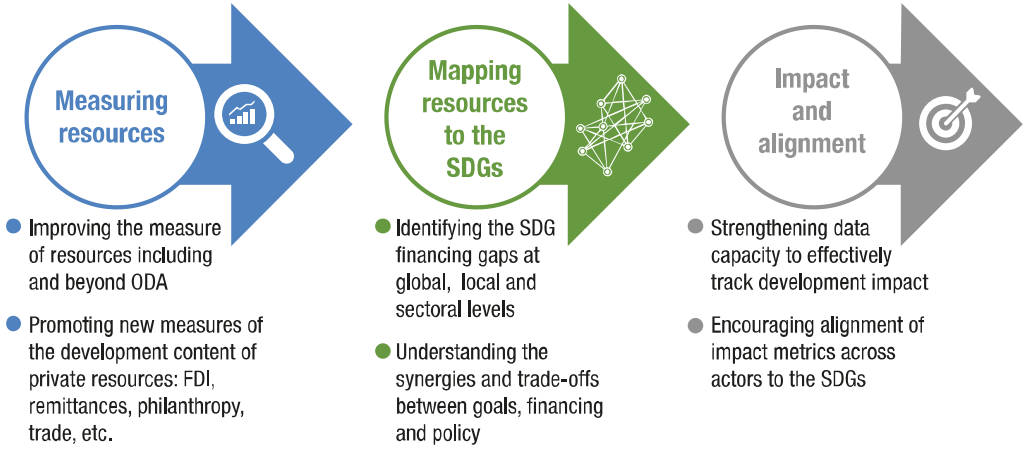
Better measurement of flows, alignment with the SDGs and impact is the first step towards reforming the sustainable development finance system

Measurement is the first step to setting goals and targets and, ultimately, to defining strategies and policies that maximise development impact and accelerate progress towards the SDGs. Accurate and timely data are essential to ensuring transparency and accountability of all actors in the provision of financing towards collective ambitions including poverty eradication and peaceful societies.

So far, measurement efforts have focused on monitoring ODA flows and the target of 0.7% of the gross national income (GNI) of donors. By including new actors in the picture, the AAAA has greatly expanded the need for measurement and, by extension, the challenges that accompany measurement – notably that not every dollar invested has the same sustainable development impact. There is still little measuring of sustainable development impact, however, especially as concerns several major actors including institutional investors who are managing trillions in potential financing.

To achieve the ambitions of the AAAA, the measurement of financing for sustainable development must overcome three challenges (Figure 0.7). The first is measuring the flows to determine the pace of FSD. The second is mapping the resources for the SDGs to see if the direction of FSD is right. The third challenge is measuring impact. This report concludes that some progress has been done on the first while little progress has been made on the second and even less on the third.

Figure 0.7. Addressing financing for sustainable development measurement challenges: A three-pronged approach



Source: Author

Measuring all resources in support of sustainable development requires new mechanisms and measures

What volume of resources actually flows to developing countries once all the actors and sources identified in the AAAA are taken into account? The development community's capacity to answer this basic question remains very limited. The AAAA may have set a destination and even a direction, but FSD actors have been navigating without a compass.

Several new data sources are being monitored to fill the gaps. However, measures of trade, investment, philanthropic giving, remittances and domestic resources in developing countries by and large fall short of the dashboard that is needed – one that features quality, internationally comparable and publicly available data. Governments can encourage more comprehensive reporting by a broader array of actors.

Assessing synergies and trade-offs adds to the complexity of measuring finance for sustainable development

In addition to needing better capacity to measure total flows, the international community needs a clear view of where these flows are going. Very few SDG tracking mechanisms exist, which leaves open a raft of fundamental questions. How much financing actually targets the SDGs and how can it be mapped? What are the SDG financing needs and gaps? How can the trade-offs and synergies among SDGs be measured? How can the transboundary impacts of one country's sustainable development on another country's sustainable development be monitored? How can the dynamic effects of resources be understood, particularly as developing countries' financing portfolios shift?

The task is even more complex than for the Millennium Development Goals (MDGs) due to the multiple synergies and trade-offs between and among the SDGs. Since 2016, 86% of OECD countries (31 out of 36) have carried out the United Nations SDG voluntary national review process but only two have developed metrics to track financing that tackles global challenges and/or promotes global public goods.

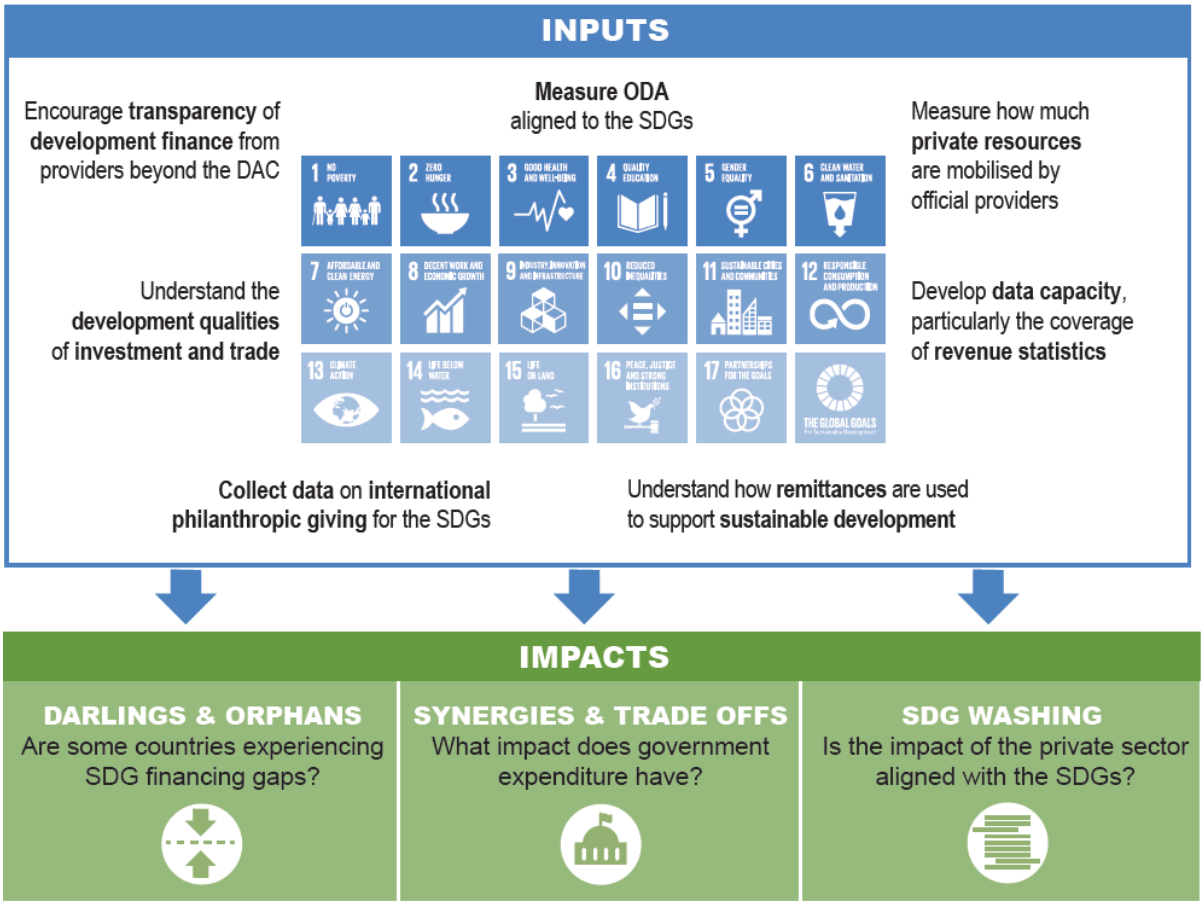
The total annual investment gap in key sustainable development sectors is estimated at USD 2.5 trillion (UNCTAD, 2014[16]). This figure is 17 times current ODA volumes (USD 146.6 billion in 2017) and more than 10 times the estimated MDG financing gap. While such estimates inevitably raise methodological issues, the order of magnitude suggests that ODA alone will not fill the SDG gap. Nonetheless, this investment gap estimate is small when compared to resources currently invested or held by companies, pension funds and other economic actors. The challenge, then, is how the efficient use of limited public resources can best be combined with the right incentives and/or regulations to direct private funds towards the SDGs.

Measuring the sustainable development footprint of financing is key to implementing the Addis Ababa Action Agenda

Not all forms of finance or trade have the same sustainable development footprint. Tracking their contribution, including to the SDG targets and indicators framework, demands new metrics (Figure 0.8). For example, monitoring the impact of foreign investment within global value chains means looking at transfers of all kinds beyond capital that can include technology, know-how and knowledge transfers and transfers from lead firms to production partners abroad. Such a broad lens is needed to fully assess the quality of investment. Similarly, many questions remain for aid providers regarding synergies and trade-offs between and among the goals including how to make official assistance 100% compatible with the Paris Agreement on Climate Change.

One major challenge is to properly account for FSD flows and their impact regardless of stated intentions. SDG washing, when there is misrepresentation of the contribution to sustainable development, is a risk and can become an obstacle to the alignment of actors' strategies to the SDGs. A stronger culture of evaluation and impact assessment should be developed to ensure that the trillions raised for the 2030 Agenda actually serve the right goals.

Figure 0.8. Tracking the contribution of various financial flows to the SDG targets and indicators demands new metrics



Source: Author

Actions to improve the measurement and monitoring of development finance

The multiplication of FSD actors and instruments is a source of both opportunities (more resources, more competition, better conditions and better-tailored solutions) and risks (immature market with weak regulation, asymmetry of information). A new mapping of FSD actors, instruments, interactions and innovations is needed to help understand the fast-changing FSD system, as outlined here:

Measuring all flows. A transparency initiative should be launched to remedy the blind spots of FSD and reduce the risks associated with the profusion of actors and instruments.

1. Promote a culture of evaluation and impact among institutions, civil society and the private sector through a better assessment of the contributions (improved standards and practices for data collection and measurement) and the development footprint (impact assessment) of each and every actor.
2. Invest in countries' capacity to produce high-quality, internationally comparable and publicly available data including revenue statistics and data on SDG spending in national budgets

3. Building on ongoing international efforts to measure total official support for sustainable development (TOSSD), develop a measure reflecting a country's overall contribution to sustainable development through official support (i.e. taxes) as well as through philanthropic giving, firms' behaviour, contribution to public goods, etc.
4. Continue efforts to map all FSD actors and instruments to reduce the asymmetry of information and improve countries' abilities to manage diverse sources.

Understanding the interactions better. The AAAA action areas remain in silos and the potential benefits of interactions among FSD actors have not been fully harnessed.

5. Set ambitious targets for innovative financing for development that comprise, for example, a larger role for development finance institutions, numerical targets for the use of blended finance, new bonds, etc.
6. Further explore the potential of interactions among FSD actors and sources and attempt to measure negative or positive dynamic/synergetic/catalytic effects.
7. Support these catalytic effects by further exploring policy links and impacts – for example, among investment, tax and development policies – so that policy makers at all levels fully internalise the development impact of their choices.

Assessing the actual impact of flows on sustainable development. Measuring the volume of flows is no longer enough. Efforts should be made to measure how much the various flows actually contribute to sustainable development and the 2030 Agenda. This means putting in place a culture of evaluation and impact.

8. Accelerate discussions about moving from measuring financing for development to financing for sustainable development (e.g. by excluding flows that are not fully SDG-compatible) as the TOSSD Task Force, for example, has started to do. Explore how this measurement could be applied to the private sector and how the trade-offs and spillovers among SDGs can be leveraged.
9. Develop evaluation and impact assessment tools (e.g. business self-assessment tools to benchmark performance against specific SDGs with competition, SDG results-frameworks for governments) to measure the quality and development footprint of various FSD actors and sources.
10. Improve measurement of the SDG financing gap on the basis of this evaluation.
11. To support the transparency initiative, prolong ongoing efforts to use new technologies (artificial intelligence, data mining, hackathons, etc.) to develop capacities to map flows to the SDGs and assess SDG financing needs and gaps.

Better policies are needed to increase the sustainable development footprint of finance and to manage the risks

A further shift is needed to strengthen policy design. In order to increase the efficiency of the FSD global system, policy interventions should contribute to increasing the development footprint of its actors by seizing new opportunities and better regulating the market by managing new risks. Figure 0.9 reveals three opportunities to maximise the impact of finance on sustainable development

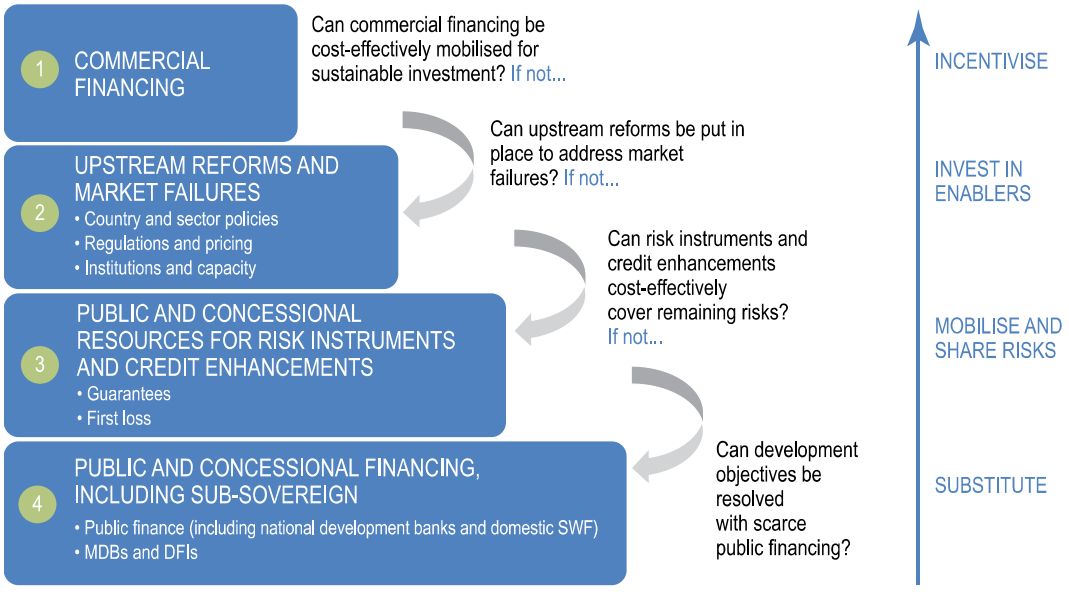
Figure 0.9. Three opportunities to maximise the impact of finance on sustainable development

Source: Author

Seizing opportunities to increase the sustainable development footprint of sustainable development finance actors

Public and private sources of financing need to be better articulated for sustainable development. The cascade approach is one way to do this (Figure 0.10). In the two extreme situations (scenarios 1 and 4), the private and/or public sectors entirely fill demand for FSD. In between, public resources are used to create markets and move to another equilibrium through capacity building (scenario 2) or risk sharing (scenario 3).

Figure 0.10. The cascade approach to articulating various sources of finance for sustainable development



Source: Based on (World Bank Group, 2018[17]), *Approach Paper 'Creating Markets for Sustainable Growth and Development" 2018*, https://ieg.worldbankgroup.org/sites/default/files/Data/reports/ap-creating-markets.pdf.

Increasing the development footprint of private investment requires new types of partnerships with the private sector. Questions about procurement and tied aid have long been central to the debate on the role of business in the FSD system. The international community should promote new forms of business and investment for shared value that boost productivity, inclusiveness and development and replicate or scale-up best practices.[1] The objective is to increase the development footprint of business or investment, as well as encourage initiatives along global value chains that could simultaneously involve donors, local governments, private business, investors and philanthropists, and civil society organisations.[2]

Making the most of FSD at all stages of development and reducing dependence on foreign aid demands stronger enablers in developing countries. Enablers can include capacity to trade and mobilise domestic resource effectively, a strong private sector, quality infrastructure and technologies, and competition and regulatory reforms. The objective is to support demand for FSD that in turn leverages sustainable and inclusive growth by creating additional FSD capacities. For example, the features of national policy frameworks for investment vary across countries. There remains significant scope for structural reforms to lift unnecessary barriers to private investment in support of the SDGs.

Managing risks: Protecting and guiding actors in the sustainable development finance market

Continuing the market analogy (Box 0.3), competition within the FSD system can have positive effects as it does in markets for goods and services. It can help to drive innovation, better tailor financing to the needs of beneficiary countries and promote higher development returns on financing. This FSD market, however, (Box 0.3) is not yet a mature one. It lacks transparency, policy guidance and coherence mechanisms to remedy asymmetries of information (e.g. which instruments can a country use or what is its optimal financing mix?) and to mend policy gaps (e.g. debt sustainability and development impact metrics for investors). To minimise the risk of setbacks such as high-risk debt level, policy levers should be used at the level of beneficiaries (the market's customers), intermediaries and suppliers to ensure the proper functioning of the market so that each dollar spent is maximised in support of sustainable development.

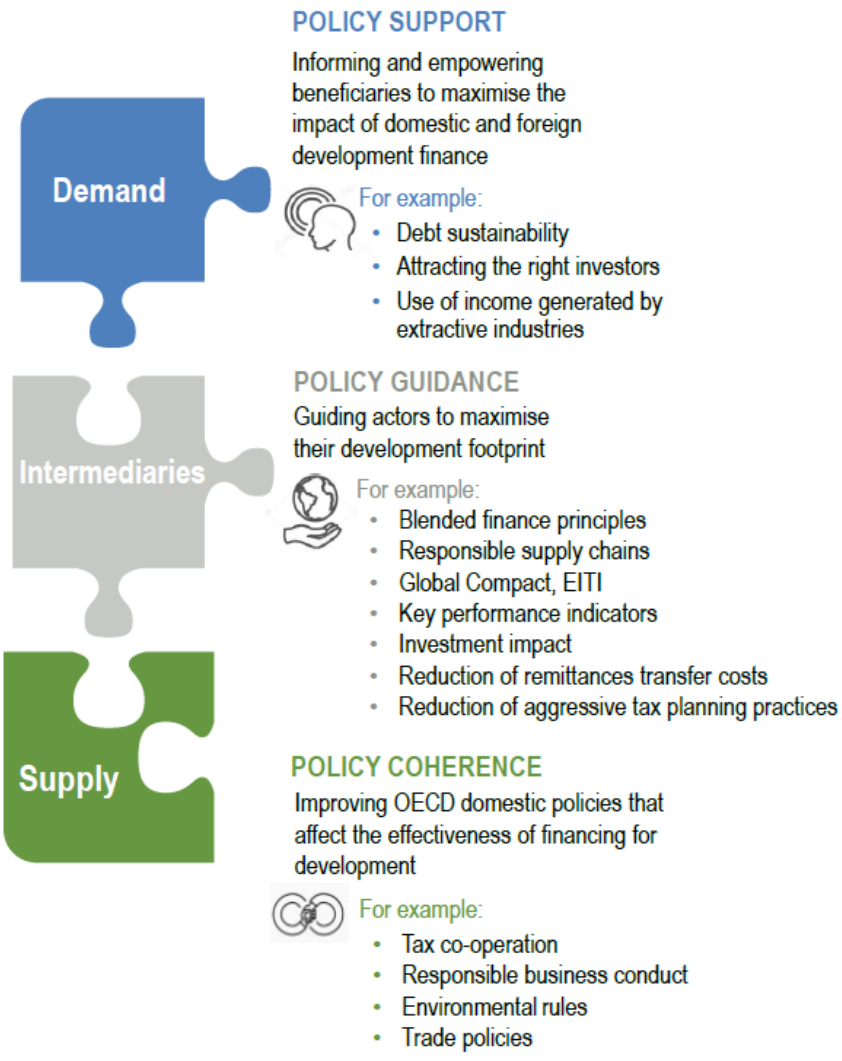
Improving the functioning of the FSD system requires better policies at three levels (Figure 0.11). First, on the demand side, policy support can help developing countries be in a position to make the most of available choices. Actors in developing countries create demand for a growing array of financing sources, but capacity constraints limit their ability to design the optimal mix and access the resources on the best terms possible. International co-operation can help alleviate some of these constraints. Safeguards are needed to heighten the transparency of the terms and transactions of a growing range of financing sources available to customer countries, in particular those with less regulatory capacity.

One example of this need for policy support is the need to help countries protect themselves from unsustainable debt. Debt is essential to financing the SDGs, if managed in a sustainable manner. Mechanisms to avoid debt crisis exist, but they are not binding on all actors. In the past five years, the number of developing countries in debt crisis or are at high risk of one has doubled. The IMF (2018[6]) reports that 40% of low-income countries are at high risk of debt distress in 2018 due in part to opaque terms and conditions of such financing and the deterioration of the terms of trade that affect some countries' capacity to repay debts. On the demand side, it is necessary to determine the elements and mechanisms that should be put in

place to avoid excessive or unsustainable debt levels; to help to reduce moral hazard and asymmetries of information; and to help to restructure debt, including commercial debt, in an effective manner.[3]

Another area where policy support continues to be needed is the building of a sound and predictable regulatory environment to attract private investment and enhance its contribution to development, for example through health, safety, labour and environmental regulation. Further work is also needed on the relationship between tax and environment. As developing countries seek to curb wasteful tax incentives, development co-operation may have a role to play in ensuring that tax revenues are a result of investment rather than forgone through policies meant to attract it. A number of initiatives, including at the OECD, also aim to improve governance and management of resources, for example through increased transparency in extractive industries and combating corruption and bribery.

Figure 0.11. Providing assistance and guidance to financing for sustainable development actors: Policy levers



Source: Author

The second level where better policies can improve the functioning of the FSD system is through new *policy guidance for FSD providers*. This can help to enhance providers' contribution to the SDGs. While voluntary frameworks in support of the goals abound, a more effective regulatory environment is needed to guide all actors towards high-quality standards of human rights, labour, environment and anti-corruption. The OECD has a role to play, with approximately 450 substantive legal instruments developed since its inception.

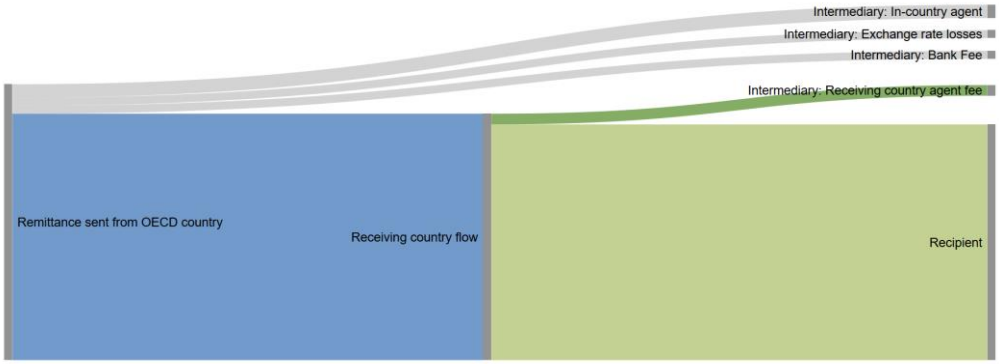
FSD intermediaries can be considered the third level for policy guidance. Intermediaries could divert resources away from beneficiaries and development objectives, depending on the nature of their practices and the potential for capturing rents. More needs to be done, including in new areas of the Addis Agenda such as remittances or investment.[4] Such approaches could aim to ensure that blended finance or impact investment truly promote sustainable development[5] and help to encourage more long-term financing, in line with the High-Level Principles of Long-Term Investment Financing by Institutional Investors developed by the Group of Twenty (G20) and the OECD.

Indeed, tax regimes have a key role to play in guiding the behaviour of FSD providers. New tools on international tax collaboration can reduce the incidence of capital leaving developing countries through both tax avoidance and evasion. Support needs to be increased to enable developing countries to fully benefit from these tools.[6]

Similarly, and in order to harness the potential of private sector resources, national, regional and global voluntary and regulatory frameworks must seek to promote responsible business conduct. Among the relevant frameworks are the United Nations Principles for Responsible Investment (PRI); Global Compact; and the OECD Guidelines for Multinational Enterprises and Due Diligence Guidance for Responsible Business Conduct (RBC). Such frameworks must also seek to promote effective co-operation with other private sector actors, as do the OECD Guidelines for Effective Philanthropic Engagement. Governments also have an important role to play in promoting responsible business conduct and in promoting and facilitating investments with the qualities that align with the SDGs (e.g. the OECD Policy Framework for Investment). Support needs to be increased to promote international value chains that strengthen the contribution of business to sustainable development (e.g. aid for trade, investment climate or business environment).

The third policy area for improving the FSD system is through *greater policy coherence for the Sustainable Development Goals* in the providers' home countries. A number of policies in FSD-sourcing countries could be reviewed in the light of the AAAA. However, only 50% of countries responding to the Global Outlook Survey on Financing for Sustainable Development, conducted in connection with this report, report that they carry out analysis of policy coherence between domestic policies and development objectives using evidence of impact on developing countries (see Chapter 5 (OECD, 2018[18])). One example of incoherence is the cost imposed on the transfer of remittances to developing countries at the level of countries of origin, transit and destination (Figure 0.12). Transfer costs remain between 14-20% in all developing country regions, stifling one of the most resilient source of external finance for developing countries.[7] Not only could leakages and costs of transfers be reduced, but these resources could be better leveraged using ODA or other FSD sources, such as through diaspora bonds and the use of remittances for financial inclusion or for other SDGs such as food security.

Figure 0.12. Leakages in remittance transfers



Source: Authors

There are many more policy coherence issues pertaining to FSD to resolve. Are tax exemptions of ODA in developing countries, for instance, coherent with domestic resource mobilisation efforts? How can OECD countries promote reporting by their companies on RBC developing country operations? How can OECD countries promote a tax regime or investment framework that encourages companies or investment funds to put more finance to work for the SDGs? Finally, how should tax compliance be ensured in such a way that will avoid diversion of resources from sustainable projects?

Actions to improve policies in the market for sustainable development finance

While efforts to mobilise additional resources for development and move from billions to trillions should be sustained, they should be supplemented by efforts to shift the trillions by redirecting existing and future flows toward the SDGs. To that end, the FSD market must be better regulated so that both providers and recipients of resources get the highest return.

Guide actors on the FSD market to ensure compatibility and maximum impact of financing for sustainable development flows on the SDGs

1. Protect customers in the FSD market, in particular against the risk of high debt, as called for in the recent Group of Seven (G7) meeting in Charlevoix in Canada. Protections could take the form of strengthening the work of the Paris Club as the prime international forum for restructuring official bilateral debt, for example, and including emerging creditors.
2. Broaden the coverage and step up the implementation of existing policies and instruments, either voluntary or regulatory that are aimed at increasing the quality of investment and responsible supply chains.
3. Research and develop further how an SDG perspective could be better integrated in business operations, the financial sector, and development finance, for example through an SDG index.
4. Put long-term saving and financing to work for the SDGs through a guide for pension funds, a new rating system for investment or company performance, etc.

5. Develop new tools to facilitate the attainment of targets assigned to innovative financial instruments, such as the blended finance toolkit developed on the basis of the OECD DAC Blended Finance Principles and the evaluation of their use, e.g. monitoring and evaluation of blended finance project and impact/diaspora/green/etc. bonds; improve the coherence of policies in donor countries through the Policy Coherence for Sustainable Development (PCSD) partnership and track policy incoherence, for instance in ODA tax exemptions and the cost of remittances along major corridors, to comply with the objectives of the G20 Remittance Agenda.

Invest in domestic enablers of sustainable development

1. Sustain support to trade (aid for trade) and private sector development including business environment and investment climate to facilitate the mobilisation of private resources.
2. Support the curbing of wasteful tax incentives, the identification of barriers to investment and the tools to support investment so that tax revenues are increasingly a result of investment, rather than forgone to attract it.
3. Step up technical assistance and capacity-building programmes pertaining to domestic resource mobilisation in line with the Addis Tax Initiative to reach the committed financing target of USD 447 million in the next four years.
4. Prevent tax avoidance and evasion, utilising new tools on international tax that can reduce capital leaving developing countries and increasing support to enable developing countries to fully benefit from these new tools, including building the evidence base and political will to implement them.

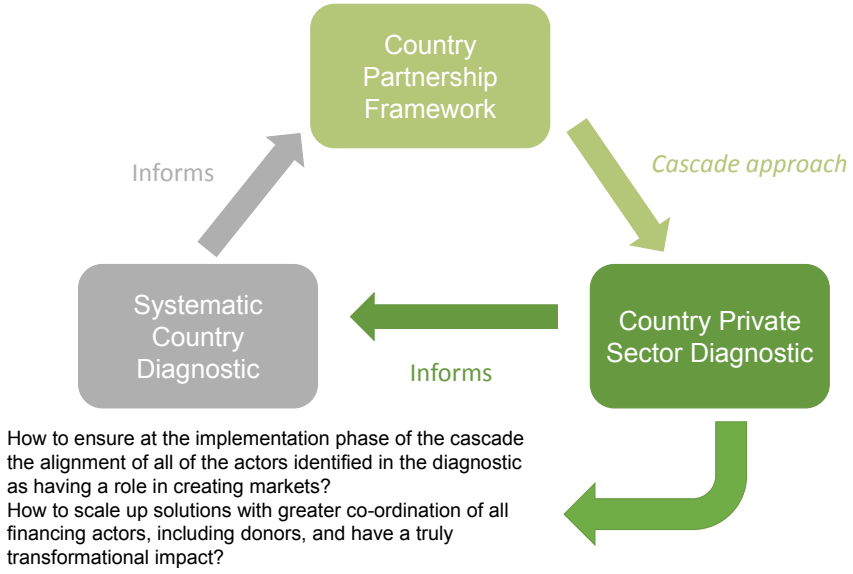
Better implementation of the Addis Ababa Action Agenda requires more integrated development strategies and operations

It is at the operational level that the demand for financing for sustainable development must meet supply. Actors In the market are yet to fully embrace the challenge or reap the fruits of greater interactions and co-ordination.

Improving co-ordination can help align country development and financing strategies

Financing the SDGs at national level should begin with a robust and predictable macroeconomic policy and regulatory environment that creates the conditions for implementing the national sustainable development strategy. Such a strategy needs to be embedded in financing plans. A number of country diagnostic tools are available to inform such strategies and plans. Some examples are the UNDP development finance assessments (DFAs); the World Bank Group's country private sector diagnostics (CPSDs) that apply the cascade approach to creating markets; and the broader OECD multi-dimensional country reviews (MDCRs). These tools, along with the integrated national financing frameworks (INFFs), can help to connect external financing with national development priorities. Figure 0.13 describes the cascade approach of the World Bank Group.

Figure 0.13. Operationalising the World Bank Group's cascade approach



Source: Author based on World Bank Group (2018[19]) *World Bank Group Directive: Country Engagement,* https://policies.worldbank.org/sites/ppf3/PPFDocuments/1cb5ccd7e58e479096378f9d5f23b57d.pdf; World Bank-IMF (2018[20]), *Forward Look - A Vision for the World Bank Group in 2030: Implementation Update,* http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23775499/DC2018_0005ForwardLookupdate_329.pdf.

Specific situations might require different types of diagnostics and a more diversified FSD toolbox. This is the case in fragile contexts, where private sector involvement may require tailoring innovative finance mechanisms and where the role of government systems may be reduced.[8] Small island developing states[9] and countries going through specific phases of transition from the one income per capita category to the next[10] may also need specific types of diagnostics.

Despite the multiplication of such instruments, however, the co-ordination of actors at national level remains problematic. The Addis Ababa Action Agenda aimed to eliminate silos, but they have largely remained – in part because actors have too few incentives to co-ordinate and the results of diagnostic work such as the CPSD are not always used to better match financing with policy. Domestic resource mobilisation is also often neglected.

Holistic financing for sustainable development strategies need to be implemented at all levels of governance

Although SDGs are primarily implemented at national level, some sustainable development challenges and resources are best managed across borders or at the level of cities or provinces. Diagnostics, partnerships and actions at global, regional and sub-national levels thus need to complement country-led development by building on existing frameworks and institutions as far as possible.

At the *global* level, the UN-led process, including the Inter-agency Task Force on Financing for Development (IATF), leads the AAAA and the holistic approach to financing for sustainable development. This process should be fortified by the G20,

building on the recommendations of its Eminent Persons Group on Global Financial Governance[11], the G7, OECD and other platforms with the objective of bringing together various actors.[12] While significant progress has been achieved on giving developing countries a stronger role on tax with the establishment of the Inclusive Framework, more is needed in other key regulatory decision-making mechanisms such as debt and banking regulation. The strengthening of global platforms should include as well the role of thematic funds that provide for deep systems change. The Co-Impact Platform is a promising model from the philanthropic community.

Some SDG targets must be addressed at a *regional* level, among them migration, food security, epidemics, climate change, political instability and conflict. Holistic FSD strategies could therefore include a supra-national dimension – channelling resources through multilateral and/or regional organisations – that allows economies of scale and greater effectiveness. For example, the Trade for All strategy, adopted after the 2030 Agenda, commits the European Union to a responsible trade and investment policy as an instrument of implementation of the SDGs. The strategy also commits the European Union to include trade and sustainable development chapters in negotiations of free trade agreements.

FSD solutions should also include the financing of *local* solutions, a level of financing long neglected. For example, the R20 (Regions of Climate Action) was created to help sub-national governments around the world to develop and help communicate low-carbon and climate-resilient economic development projects. Its holistic approach allows for a renewed role of decentralised co-operation. Diagnostic tools and innovative instruments could also be explored, for example sub-national pooled financing mechanisms.

Sector-specific and policy-specific needs deserve special attention, especially during graduation periods

Although data is lacking, partial evidence suggests that financing mixes vary across sectors, with some sectors more dependent on public finance and others facing more challenges in creating markets and fostering substitution between public and private finance.

Ongoing OECD research is exploring the sectoral specificity of FSD mixes as countries transition to higher levels of income. Preliminary findings show that substitution of concessional and non-concessional finance takes place at different levels of income depending on the sector. Another preliminary finding is that a transition finance gap appears for sectors like health, suggesting that substitution with domestic or private resources should be prepared by official donors to secure the resilience of health programs and avoid setbacks in the achievement of health-related SDGs as ODA declines. A holistic approach can help prioritise ODA programmes and help prepare the substitution among different sources of FSD.

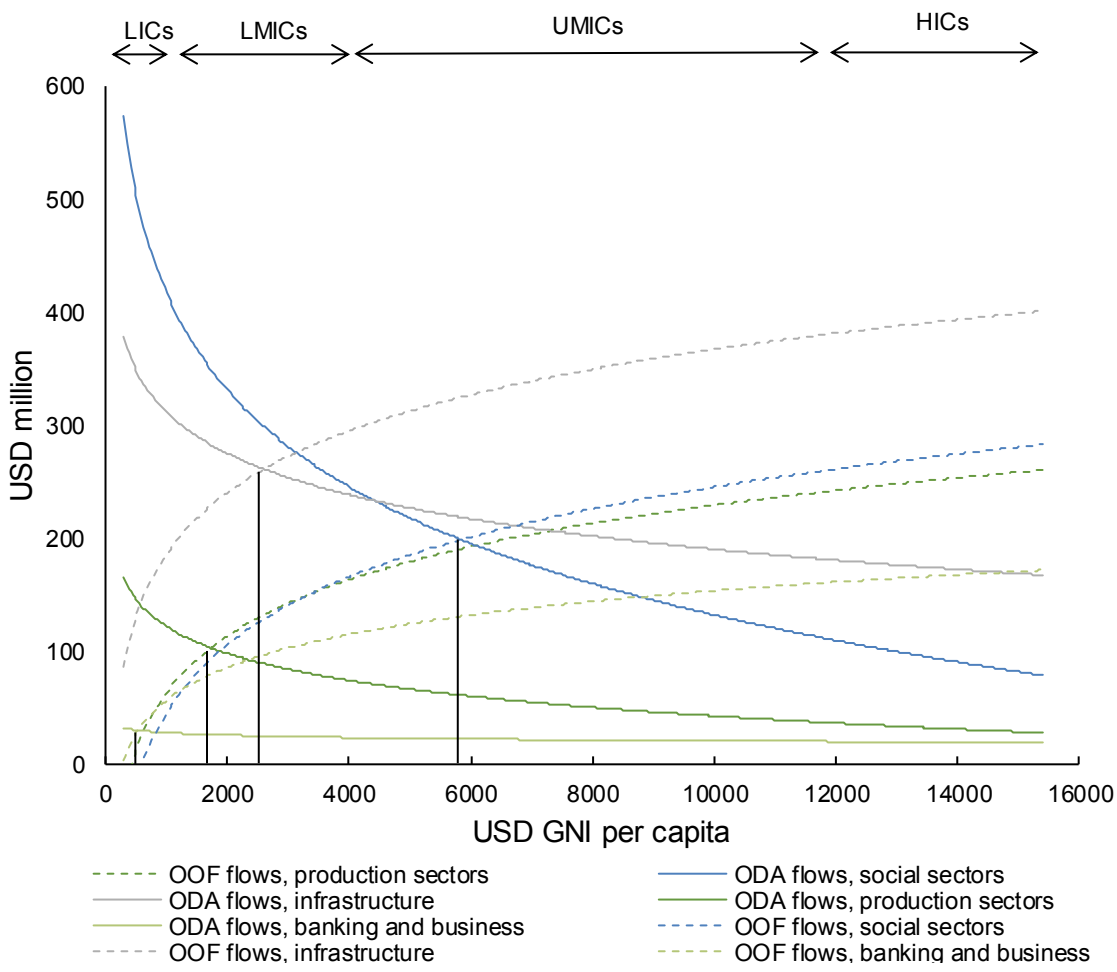
Special attention must be given to specific *policy* goals such as education or health that are subject to potential setbacks as countries transition to higher income and to changes in the finance they can access (Figure 0.14).

Transition finance gaps may appear at different stages of development. Holistic strategies are thus needed to build resilience and prepare the substitution of various sources of financing, for example by supporting domestic resource mobilisation or the creation of markets for private sector development.

Furthermore, bringing various actors together opens opportunities for innovation in the pursuit of cross-cutting goals like gender equality and the transition towards a low-carbon economy. For example, green bond emissions – spurred by new forms of co-operation between governments and the private sector – have surged by 80 % per year on average in the past five years and should grow by a further 30 % in 2018, to reach USD 200 billion. The full range of financing action must be reviewed to be compatible with the Paris Agreement, from investment and mobilising domestic resources to the fulfilment of new partnerships such as the Global Innovation Lab for Climate Finance.

Figure 0.14. Monitoring the sectors at risk: ODA and OOF flows to developing countries 2012-16

From DAC members and multilaterals, 2015 prices, absolute terms.



Source: Author's calculations based on the OECD (2018[11]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for ODA and OOF flows; and the World Bank (2017[21]) "World Development Indicators" (database), https://datacatalog.worldbank.org/dataset/world-development-indicators for GNI per capita.

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Actions to operationalise a more holistic approach to financing for sustainable development

Implementing a more co-ordinated and inclusive FSD approach at global, national, regional and local levels, and in various sectoral and policy contexts, starts by supporting and promoting the global dialogue at Inter-agency Task Force on Financing for Development (IATF), the UN and the G20/G7 across actors.

In addition, the following initiatives can strengthen existing tools at country level:

1. In accordance with SDG 17 (partnerships for the goals) and the Nairobi Outcome Document on development effectiveness, promote co-ordination of actors in the implementation of FSD diagnostics such as next generation, multi-stakeholder partnerships. They also aim to ensure alignment of financing for sustainable development with country development strategies, thus moving from a plethora of diagnostics to a more co-ordinated implementation of recommendations.
2. Build capacity in developing countries to manage the complexity of the FSD market (e.g. training on blended finance and green/blue/development/diaspora bonds), both in driving priorities (ownership) and co-ordinating actors and in filling specific gaps such as forecasting.

Similar initiatives at different levels of governance and in different contexts, sectors or policies include:

1. Promote the alignment of regional integration objectives with the SDGs, e.g. by including a reference to the Goals in regional trade and investment agreements.
2. Promote new financing mechanisms and partnerships at the level of regions, cities and communities in the form of decentralised development co-operation or public-private initiatives to remedy the local financing gap and localise the SDGs.
3. Develop FSD frameworks or strategies adapted to specific situations, such as the Financing for Stability Guidance in fragile contexts.
4. Further explore the role of different FSD actors and sources in sectors and policies as countries transition and make best use of ODA to avoid setbacks as they lose access to concessional finance.

Notes

[1] See World Economic Forum (https://www.growinclusive.org/) and OECD (http://www.oecd.org/inclusive-growth/business.htm) initiatives on business for inclusive growth.

[2] See initiatives in the agricultural sector, such as the New Vision for Agriculture (https://www.weforum.org/projects/new-vision-for-agriculture), Grow Africa (https://www.growafrica.com) and Grow Asia (https://www.growasia.org) that have jointly fostered public and private investment with local government and civil society support.

[3] On the supply side and following the 2018 G7 meeting, governments initiated a call to strengthen the work of the Paris Club as the principal international forum for restructuring official bilateral debt and to work towards the broader inclusion of emerging creditors.

[4] Examples are the Remittance Agenda in the Group of Twenty (G20) and the reduction of costs of transfers.

[5] See Charlevoix G7 Communiqué.

[6] See the Platform for Collaboration on Tax and Platform Toolkits and the Inclusive Framework on BEPS.

[7] The amount of remittances transferred to developing countries has increased nearly fourfold in the last 15 years, to USD 466 billion in 2017.

[8] The average tax-to-GDP ratio in fragile contexts is some 25% lower than in non-fragile contexts (IEO, 2018[24]).

[9] E.g. UNDP/AFD, *Financing the SDGs in LDCs*, or OECD *Financing for Stability Guidance*.

[10] E.g. ECLAC's Structural Gap Analysis approach or UNCTAD's support to graduation from LDC status.

[11] (G20 Eminent Persons Group, 2018[23]) *Making the Global Financial System Work For All*, Report of the G20 Eminent Persons Group on Global Financial Governance (http://www.globalfinancialgovernance.org/)

[12] E.g. the initiative of the Canadian Presidency of the G7 to bring together, in 2018, ministers of finance and development.

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Chapter 1. Financing for sustainable development in a fast-changing environment

Development policies do not take place in a vacuum. The same fast-moving socio-economic, technological, environmental and other changes that are sweeping the world have a profound impact on both development policy objectives and on the availability of resources that can be, and are, dedicated to achieving them. This chapter provides an overview of these changes and constraints as they pertain to financing for sustainable development and the global development agendas. The chapter also provides a forward-looking perspective on what remains to be done to adapt and strengthen the sustainable development financing system.

The 2030 Agenda has raised the level of ambitions and financing needs for sustainable development. But these do not exist in a vacuum. A number of socio-economic, technological, environmental and other factors determine domestic and external financing capacities, hence affecting development policy objectives and the availability of resources dedicated to them. Over the last decade, some of these factors have been under stress.

- **Growth:** Following the 2008-09 crisis, GDP growth in OECD countries has remained slow, with improvements only forecast recently. After a rebound, growth in emerging and developing economies has also slowed, for example, to 6-7% in the People's Republic of China ("China") and around 3-4% in sub-Saharan Africa – far from double-digit growth rates they experienced in the past. This affected both external and domestic capacities to finance development.
- **Commodity prices:** More than 60% of developing countries largely rely on primary commodities as their exports. The end of the commodity super-cycle in 2011 and the subsequent drop in commodity prices have severely constrained their domestic resource mobilisation capacity. The opposite effect was experienced in commodity net-importing countries. Those with diversified economies were most resilient.
- **Debt levels:** An overburden of debt, which has reached historically high levels, increases risks to financial stability. It also constrains the capacity of both providers (reduced budgetary flexibility) and developing country beneficiaries (reduced absorption capacity) to marshal financing for sustainable development resources. At the same time, debt can be a powerful tool to finance productive investments and some countries may have space to take on more.
- **Migration:** Migration flows to OECD countries have increased since 2010. At the same time, remittances have steadily increased, reaching USD 466 billion globally in 2017, or triple the value of official development assistance. A share of development finance resources has shifted to meet in-country costs of hosting refugees.
- **Technology:** The overall effect of technology on resources available for sustainable development is still to be determined. Technological innovations, however, are clearly affecting how sustainable development finance is delivered, as seen in new instruments and more efficient tools to mobilise domestic resources (e.g. mobile payment of utility bills or taxes).

These trends have resulted in a scissor effect of stressed financing capacities at a time of increasing financing needs. Hence reform is urgent. The Addis Ababa Action Agenda (AAAA) has initiated reform but three years into the process, the development community has not fully tapped into the potential of what is called the holistic approach of integrating broader actors, resources and instruments to the financing for sustainable development system.

Financing for sustainable development capacities under stress

Development policies are increasingly interconnected. A number of factors affect the capacity of developing countries and of other actors to mobilise resources for sustainable development.

In the early 2000s, developing countries benefited from favourable global economic conditions in accessing sources of finance. Low interest rates in developed countries motivated global investors to explore high-yield investment opportunities in developing countries. Accompanied by the deregulation of international financial markets, this unleashed massive capital flows into developing countries. In the aftermath of the financial crisis, loose monetary policies in the form of quantitative easing in developed countries further amplified liquidity. The assets of the central banks of the United States, the European Union and Japan have expanded to the unprecedented amount of more than USD 14 trillion by the end of 2017, up from around USD 3 trillion in 2007, and the funds that were released found their way to developing countries.

These trends now are in reverse. A number of factors, shown in Table 1.1 as positive or negative or both, are having a constraining effect on financing for sustainable development.

Table 1.1. Stressors in the system affect financing for sustainable development

Growth	Pre-2008 levels not recovered (-)
Commodity prices	End of super-cycle in 2011 can relieve constraints for net importers but exacerbate constraints for net exporters (+, -)
Debt levels	Historic peak in developing countries and in donor countries (-)
Migration	Increase of flows and in-country refugee costs (-) but increase in remittances (+)
Technology	Mix of threats and opportunities (+, -)

As this report maintains, these pressures make it imperative to effectively engage every actor in the financing for sustainable development system and to make the most out of the resources each can contribute.

As noted and described more fully in this chapter, capacities to mobilise financing for sustainable development are increasingly stressed while, simultaneously, financing needs are growing. The result is a phenomenon that economists sometimes call a scissor effect. The AAAA took note of this and aimed to help to remedy it by expanding the number of actors involved in financing for sustainable development.

Part I of this report introduces these different actors and explores how they and their resources can play a role in financing for sustainable development. The reform initiated in the AAAA, however, is far from complete and much remains to be done. Part II of this report explores what is needed to enable the collective contribution of new and traditional financing actors to reach its full potential.

Slow economic growth is a cause for concern

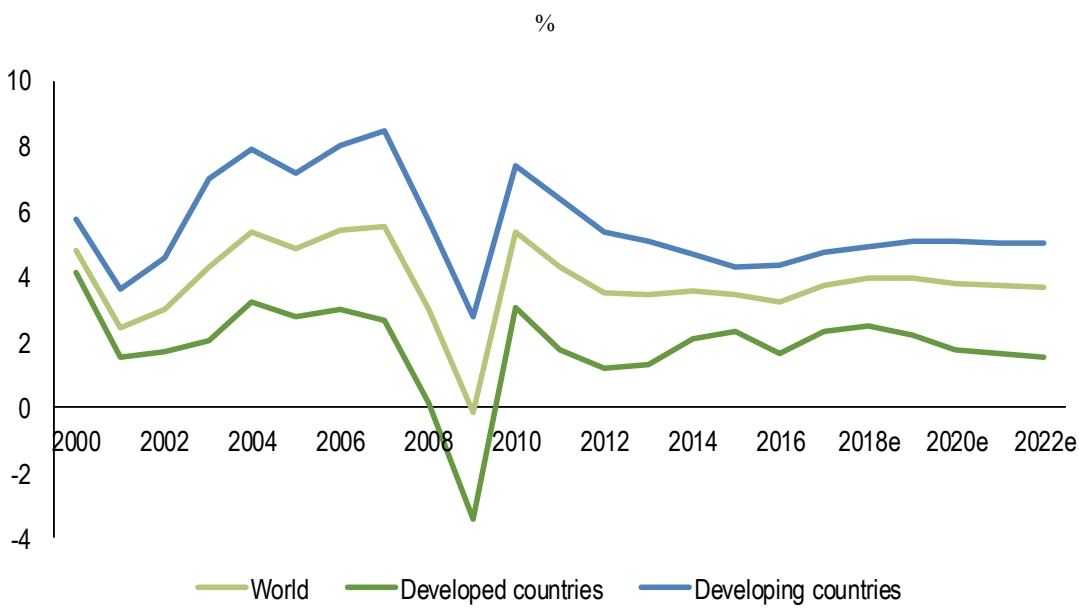
Economic growth is a key determinant of financing for sustainable development capacities both domestically and externally. Global GDP growth in 2017 stood at 3.8%, compared to a pre-global financial crisis level of 5.6% (Gaspar and Jaramillo, 2018[1]). The difference (1.8% points) falls within the range of the estimated investment gap of an incremental 1.5-2.5% of world GDP that is required to finance the achievement of the Sustainable Development Goals (SDGs) in all countries (Schmidt-Traub, 2015[2]).

In the domestic context, economic growth expands the tax base of a country, leading to more domestic public resources. Revenues from corporate and personal income taxes and from value-added taxes increase with higher levels of economic activity. A slowdown in growth in developing countries consequently undermines domestically available resources for sustainable development.

Economic growth abroad matters as well, as it drives the supply of cross-border financing to developing countries in the form of trade, investment and other resources. For example, an internationally agreed target calls for bilateral providers of development finance to devote 0.7% of their gross national income to official development assistance (ODA). Few countries meet this target. However, the 0.7% objective suggests that amounts dedicated to ODA are linked to the size of the economy in provider countries and that low growth translates into less ODA.

In light of the importance of economic growth, the sluggish growth of the global economy since 2009 raises concerns. Figure 1.1 shows that GDP growth in developed countries remains at around 2% following the crisis. Developing countries recovered relatively quickly from the financial crisis, but on average since 2010, their growth rates have declined. The International Monetary Fund (IMF) now projects developing country growth rates will increase slightly to 4.9% in 2018, and to around 5 % over the subsequent two years, although they nevertheless are estimated to remain below pre-crisis levels (IMF, 2018[3]). Another important factor to consider is the slowdown in China's remarkable growth performance; its double-digit growth until 2010 dropped to 6.9% in 2017 (IMF, 2018[3]).

Figure 1.1. Economic growth has remained sluggish since the financial crisis



Source: IMF (2018[4]), "World Economic Outlook" (database), April 2018 Edition, https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx.

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Commodity prices have dropped with the end of the super-cycle

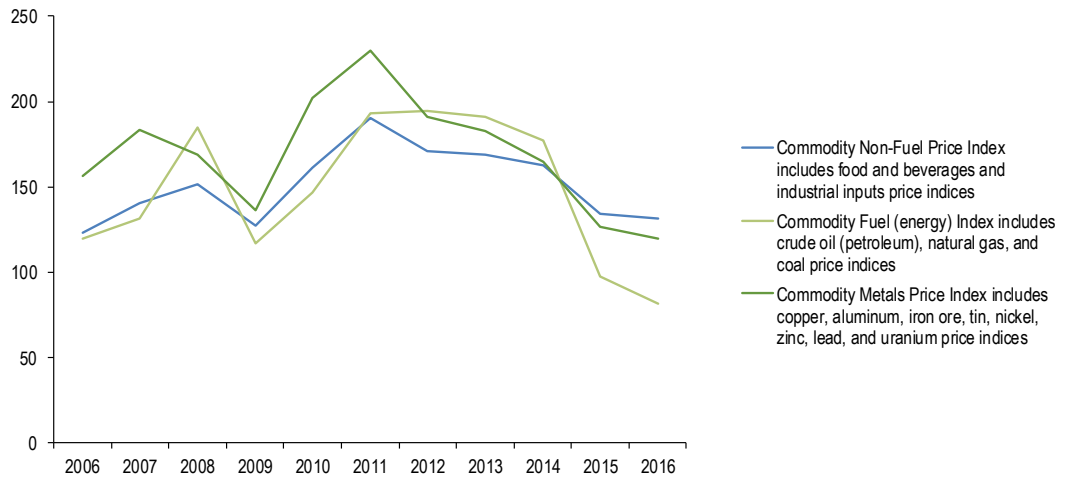
For developing countries, growth performance and prospects are often linked to the trade and price of commodities. On one hand, many developing countries depend on revenues from the export of commodities and natural resources to generate domestic resources. UNCTAD (2017[5]) reports that 64% of developing countries derived more than 60% of their merchandise exports earnings from primary commodities. Moreover, fluctuations in commodity prices can affect a developing country's current account balance, leading to difficulties in meeting debt obligations.

On the other hand, some developing countries are net importers of commodities. These countries are inversely affected by commodity price swings – i.e. they benefit from price drops in terms of improvements in current account positions. For such countries, commodity price volatility can lead to fragile food security.

International prices for most primary commodity categories increased following the global financial crisis, but this recovery was swiftly followed by a significant price drop across commodities since 2011. Between 2011 and 2016, the prices of non-fuel commodities dropped by 26%, fuel by 51% and metals by 36% (Figure 1.2). These price drops adversely affected commodity exporters such as Chile, which until then had registered sufficiently high growth to achieve high-income country status in 2013 (Box 1.1). Commodity price fluctuations, therefore, expose many countries to economic and development setbacks. However, the recent stabilisation in commodity prices promises a gradual improvement for their economic situation. Energy commodity prices in particular were forecast to rise, with an expected increase of 28% in 2017 and 4% in 2018 (World Bank, 2017[6]).

Figure 1.2. Commodity prices have dropped

Indexed 2005=100.



Source: IMF (2018[4]), "World Economic Outlook" (database), April 2018 Edition, https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx.

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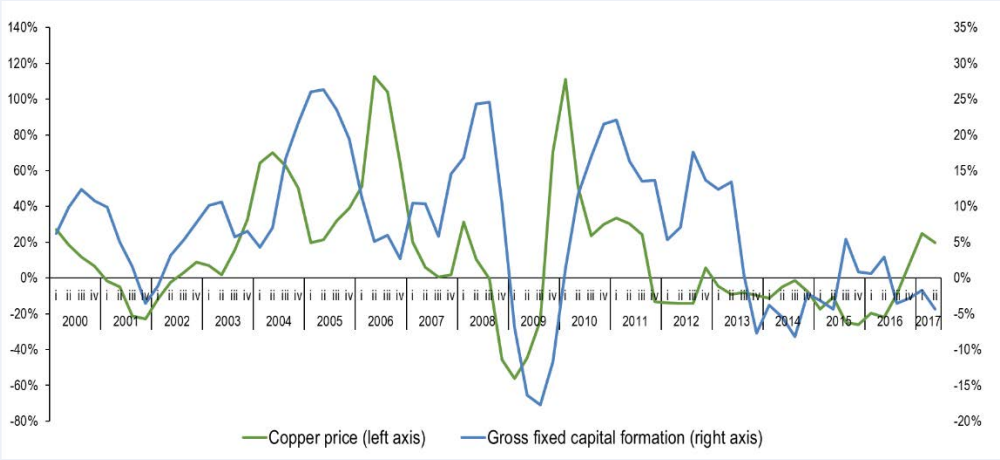
Box 1.1. The Chilean counter-cyclical response to the end of the commodities super-cycle

During the 2000s, the so-called commodities super-cycle generated a terms of trade boom for many commodity-exporting economies that continued during the crisis and until 2011, when commodity prices started to drop. The end of high commodity prices presents a persistent risk of external shocks in commodity-dependent countries. Counter-cyclical approaches can help by acting as a buffer to these vulnerabilities.

Chile became the first South American country to join the OECD in 2011 and graduated from its status as an ODA recipient in 2017. It performs better than most other South American countries with respect to macroeconomic, political, labour and foreign trade risks. However, Chile is highly reliant on a narrow set of commodities, with copper mining making up 20% of its GDP and 60% of its exports. From 2000 to 2011, terms of trade doubled in Chile. As metal prices began their downward adjustment in 2011, real GDP growth and investment decreased continuously (Figure 1.3). The shock to commodity prices led to depreciation of the peso, creating inflationary pressures that reduced the policy space to conduct counter-cyclical monetary policy, pushing the Central Bank of Chile to raise the policy rate in order to keep inflation inside the target range.

Figure 1.3. Effect of copper prices on investment



Source: Copper price data from the Central Bank of Chile (2018[77]), *Base de Datos Estadisticos,* https://si3.bcentral.cl/Boletin/secure/boletin.aspx?idCanasta=FHLES3325; data on gross capital formation from OECD (2018[8]), "National Accounts Statistics" (database), https://www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en.

StatLink https://doi.org/10.1787/888933852540

In 2006, Chile acted to erect a buffer against external shocks, particularly commodity price volatility, by adopting a structural surplus rule, by fixing a 0.5% budget surplus target and ensuring that public expenditure rises when activity is low and decreases during a boom. In 2008, Chile entered into a current account deficit. However, public expenditures declined after the terms of trade shock and quickly recovered surplus levels in 2009-10. The end of the super-cycle impacted the balance and Chile entered into deficit again in 2011. The deficit has been nearly remedied since 2014, rising to just below -2% of GDP and thus approaching the 0.5% surplus target. The fiscal rule adopted by Chile has been effective in allowing for more counter-cyclical fiscal policy. GDP per capita remained stable throughout the commodity super-cycle, further attesting to the effectiveness of the counter-cyclical fiscal rule.

Increasing debt levels result in reduced absorption capacities

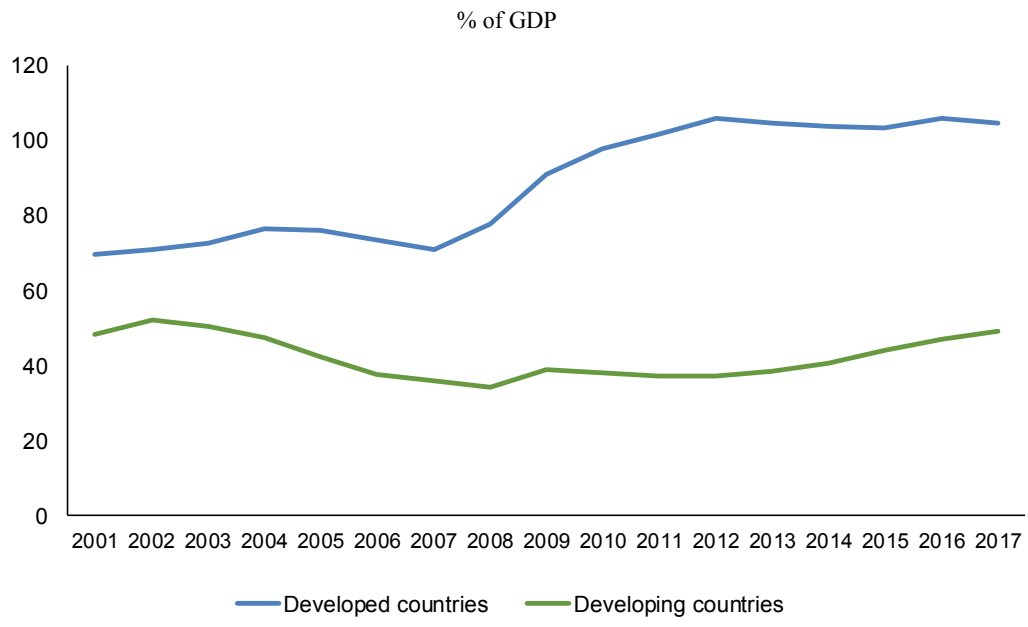
Debt levels are on the rise in both developing and developed countries, putting constraints on resources that can be devoted to sustainable development. Global debt hit a record high of USD 164 trillion in 2016, the equivalent of 225% of global GDP (Gaspar and Jaramillo, 2018[1]).

Domestic debt levels in developing countries are rising and putting absorptive capacities under stress, including countries' ability to channel the funds raised by debt financing to productive activities and countries' ability to take on additional debt.

Increasing levels of debt servicing costs place a burden on fiscal positions and the ability to make investments in sectors that are essential for development such as infrastructure, education and health. Recent trends suggest a widening of fiscal deficits in a majority of developing countries. The IMF (2018[9]) reports that fiscal balances have deteriorated in 70% of low-income countries and public borrowing was associated with higher levels of public investment in only 10 out of 34 countries. The report further finds that the number of developing countries at high risk or in debt distress increased to 24 at the beginning of 2018 from13 in 2013 (IMF, 2018[9]).

Similarly, government indebtedness threatens external financing setbacks. Total general government gross debt has exceeded 100% of GDP in developed economies since 2011 (Figure 1.4). Weakening fiscal positions in developed countries reduce their capacity to allocate funds to development including in the form of ODA.

Figure 1.4. Debt levels have been rising in both developed and developing countries



Note: The figure shows levels of general government gross debt in "advanced economies" (labelled as developed countries in the figure) and "emerging and developing economies" (labelled as developing countries in the figure), using IMF definitions.
Source: IMF (2018[4]), "World Economic Outlook" (database), April 2018 Edition, https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx.

StatLink https://doi.org/10.1787/888933852559

Innovation and technology bring opportunities and threats

Technological progress harbours immense opportunities for sustainable development. It affects economic growth and the social and environmental quality of growth, and it also could transform the way in which resources for sustainable development are being mobilised and spent.

Technological progress can help to create new activities and markets, and leapfrog technology can reshape a country's development path and prospects. The number of jobs related to what has been termed the "servicification of manufacturing" (Kizu, Kühn and Viegelahn, 2016[10]) has rapidly increased in both developing and developed countries. This is because the improved tradability of services through the emergence of global supply chains activities creates jobs, not only in the manufacturing sector itself but also in services sectors, by using more and more services inputs in the manufacturing process. Kizu, Kühn and Viegelahn (2016[10]) noted that based on a sample of 40 countries for 2011, it is estimated that 96.6 million people, or 4.5% of employment, are in services-related jobs that depend on the manufacturing sector – a nearly two-fold increase over 1995.

Innovative technologies such as big data analysis and the so-called Internet of things can have diverse applications in healthcare, agriculture, energy, and water management and quality as well as in terms of monitoring development indicators to assess progress towards the SDGs. Advances in the areas of artificial intelligence and 3D printing also are likely to transform production processes, with associated potential for dramatically lower costs and increased productivity.

Moreover, technology can be harnessed to enhance the effectiveness of financing for sustainable development. For example, financial sector innovations in online payment systems (e.g. PayPal), mobile payment technologies (e.g. M-Pesa), and blockchain-based systems (e.g. cryptocurrencies and the bond-*i* bond for development) promise to lower transaction costs and provide computationally inexpensive methods for securely providing financing (OECD, 2016[11]). These can raise the cost effectiveness of financing within and between countries, for example through remittance transfers. Moreover, e-government can facilitate the collection of taxes, increasing domestic financing capacities.

The 2030 Agenda for Sustainable Development recognises technology and innovation as key drivers enabling and facilitating the transformation towards prosperous, inclusive and environmentally sustainable economies. SDG 9 on infrastructure, industrialisation and innovation explicitly mentions technological progress and innovation in their role of promoting inclusive and sustainable industrial development. SDG 17 also places science, technology and innovation at the heart of international co-operation and global partnerships for development (UNCTAD, 2018[12]). In addition, the AAAA introduces a distinct action area (paragraph 114) for science, technology and innovation and capacity building.

At the same time, accompanying measures must be taken to moderate the disruptive impact that technological progress can have on societies. As noted above, technological innovation triggers a process of creative destruction, transforming economies by increasing productivity and reducing production costs and prices. This profoundly impacts labour markets in both developed and developing countries. Nedelkoska and Quintini (2018[13]), in research conducted for the OECD, find that around 14% of jobs across OECD countries are at high risk of automation and that the trend will especially

affect low-skilled people and youth. Another impact is digitalisation of the economy, which poses challenges for taxation as business models change. As data and intangibles become a greater source of value, additional challenges arise in ensuring that profits are allocated, and taxed, where value is created. To respond to these challenges, the Inclusive Framework's Task Force on the Digital Economy is working towards a consensus-based solution by 2020.

In the absence of policy action to adapt to these changes, inequalities among and within countries can undermine the ability of societies to use technological progress to promote sustainable development and financing for sustainable development. For example, automation of labour in developed countries risks eroding the traditional cost advantage of developing countries that helped them to attract investment. To mitigate these negative impacts, financing needs to be provided to support workers who lose their jobs through technological change and to uphold minimum living standards. New policy responses such as adequate income support and training for displaced workers can be explored to avoid potential negative effects of technological progress on financing for sustainable development (Nedelkoska and Quintini, 2018[13]).

The rise in migration has far-reaching effects

Since the beginning of the millennium, there has been a significant rise in migration, with ambiguous implications for financing for sustainable development. As of 2017, an estimated 258 million people are living in a country other than their country of birth, an increase of 49% since 2000 (UN, 2017[14]).

Forced migration involves enormous human suffering, particularly for the extreme poor and vulnerable. Even voluntary migration can have negative impacts in both home and host countries. In home countries, for instance, migratory outflows can result in a brain drain that affects the skill structure of the labour force, causes labour shortages (e.g. in the health sector), and reduces tax revenues. In host countries, an influx of migrants can increase costs to the social welfare system and divert resources dedicated to development assistance.

Many host countries are themselves developing countries and in these cases, the pressures on social infrastructure and services are even more severe. Forced displacement, in particular, predominantly affects the developing world, as most people who are displaced by conflict cannot flee beyond neighbouring areas. At the end of 2015, developing countries hosted 99% of all internally displaced persons and 89% of all refugees (World Bank, 2017[15]).

The recent influx of refugees into Europe has prompted debate over the costs of hosting refugees and how these costs count towards ODA. OECD DAC countries spent USD 15.4 billion in ODA in 2016 to host refugees, 27.5% more than in the previous year; in 2017, donor countries' aid to refugees within their borders fell by 13.6%, to USD 14.2 billion as refugee arrivals, mainly in Europe, decreased (OECD, 2018[16]).

Migration can also be beneficial to both home and host countries, most notably through remittances. These flows hold great potential in terms of financing for sustainable development. Chapter 2 discusses in greater detail, remittances to developing countries have grown considerably since 2000, amounting to USD 466 billion in 2017, and greatly surpass official development finance. In host countries that are experiencing a shrinking labour force, moreover, migrants can increase the working-age population and fill important niches in both fast-growing and declining sectors of the economy.

Financing for sustainable development needs are increasing

Mounting stresses are affecting the capacity to mobilise financing for sustainable development. In a scissor effect, the needs for such financing also are increasing, in part due to factors that are amplifying development challenges in the poorest countries such as rapid population growth.

The scale of global development ambitions has also expanded, thus requiring more financing. In particular, the 2030 Agenda has raised the bar on ambitions to achieve sustainable development by incorporating into the global goals the broader social and environmental dimensions of development. Urgent action is called for to respond to rising income inequalities and the impacts of climate change. The estimated volumes of financing needed to achieve the SDGs are in the order of trillions of dollars, compared to the billions that were needed to achieve the Millennium Development Goals (MDGs).

While the SDGs constitute primarily a domestic agenda, the capacity of any country to achieve the goals will depend on the performance of other countries. The world is interconnected and interdependent, and individual results depend on collective results. Similarly, the cost of achieving the SDGs at home depends on results achieved by other countries. The less sustainable and inclusive growth there is abroad and the more negative externalities that exist, the higher the cost will be to achieve sustainable and inclusive growth at home. For example, failure to invest in international efforts to strengthen climate change prevention and mitigation can lead to natural catastrophes (IPCC, 2012[17]). Resources spent by OECD countries to achieve the SDGs through financing for developing countries are, therefore, investments in these countries' own sustainable and inclusive growth. Such investments also can potentially lower the cost of implementing the 2030 Agenda within OECD countries.

In the absence of adequate resources to cope with development challenges, developing countries risk experiencing economic, social and environmental crises that also have severe repercussions for other countries. By trying to isolate themselves from such crises, the individual countries may set in motion a vicious and globally debilitating circle where fewer and fewer resources are made available for sustainable development, raising the risk of more crises. Alternatively, the international community can choose to reinforce and renew the financing for the sustainable development system to address the problems with even greater co-ordination and effectiveness.

An increased ambition for the development agenda

Greater ambitions accompany the shift from MDGs to SDGs

Building on the achievements of the MDGs, the 2030 Agenda for Sustainable Development and the new Sustainable Development Goals have broadened the scope of ambitions.

The MDGs were explicitly designed to address the needs of developing countries. The eight goals ranged from eradicating extreme poverty to combating HIV/AIDS and providing universal primary education and they introduced time-bound and measurable targets to map progress and guide international development co-operation.

The 2030 Agenda, with the SDGs, builds and expands on this framework of goals with measurable targets to include 17 SDGs, 169 targets and 230 indicators. Beyond the increased number of goals, the 2030 Agenda also sets more ambitious targets. One

example is hunger reduction. Whereas the MDGs aspired to halve the number of hungry people in the world, the 2030 Agenda aims to end hunger and all forms of malnutrition. (The Annex of Chapter 4 illustrates the broadened scope of the SDGs.) Another example of the more expansive ambitions is that the 2030 Agenda incorporates a goal of reducing obesity in developed countries (Martens and Obenland, 2017[18]). Unsurprisingly, such broadened ambitions expressed in the SDGs translate to greater financing needs to achieve them, estimated at USD 2.5 trillion (UNCTAD, 2014[19]).

Unlike the Millennium Declaration, the 2030 Agenda covers developing and developed countries alike and aspires to a universal transformation of all countries towards inclusive, sustainable growth. A central thrust of the 2030 Agenda is the commitment to leave no one behind by ensuring that the benefits of sustainable development are shared with everyone, including those hardest to reach such as people with disabilities, older people, indigenous peoples, refugees, internally displaced people and migrants.

While the MDGs were largely inspired by the idea of human development, with a strong emphasis on poverty eradication, the 2030 Agenda is grounded in a concept of sustainable development that views the environment, economy and society as embedded systems rather than separate pillars. Reflecting this approach, the 2030 Agenda gives prominence to themes such as energy, water and sanitation, cities and climate change.

Still, the wide array of goals encompassed in the 2030 Agenda can cause tensions among the different goals. For example, conflicts potentially may arise between environmental goals and SDG 8 (decent work and economic growth). Such tensions pose a challenge to the implementation of the SDGs, which call for cross-cutting, comprehensive and well-coordinated approaches.

The good and not-so-good results on the development front

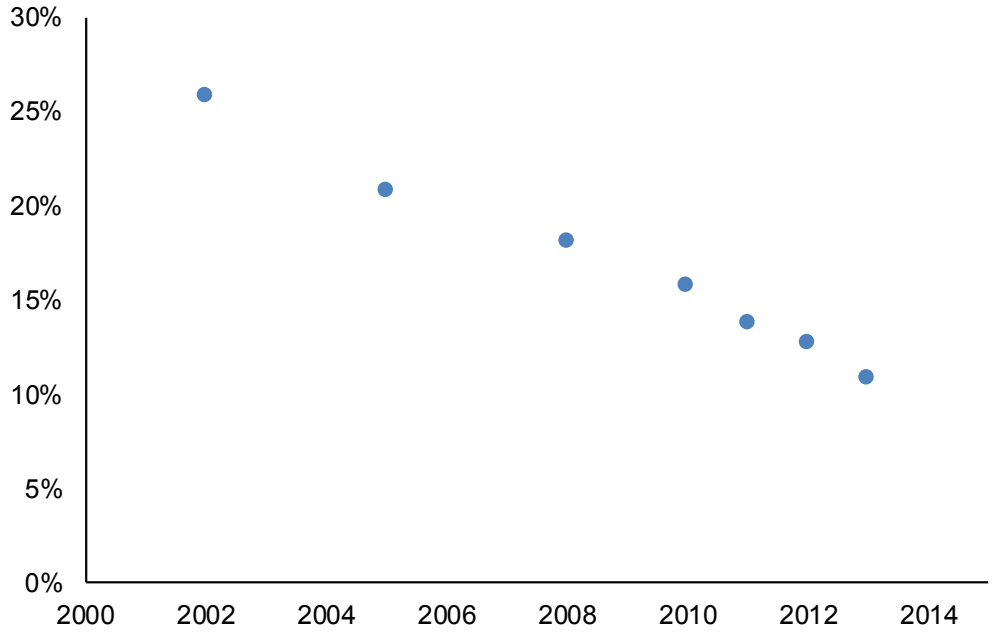
Success and failure to reduce global poverty and inequalities

Assessing the increased needs for financing for sustainable development starts with a review of past progress and remaining tasks. Since the beginning of the millennium, poverty eradication efforts, which were the heart of the MDGs, have proven to be largely successful. However, over the same period, global inequality has been rising, defining new challenges for the development community.

The considerable progress in reducing extreme poverty is a milestone, as MDG 1 called for eradicating extreme poverty and hunger. The percentage of the world's population living in extreme poverty has now more than halved, falling from 25.8% in 2002 to 10.9% in 2013, or from more than one in four people to approximately one in ten (Figure 1.5).

Figure 1.5. The world's poverty headcount has been declining

2011 PPP, % of population



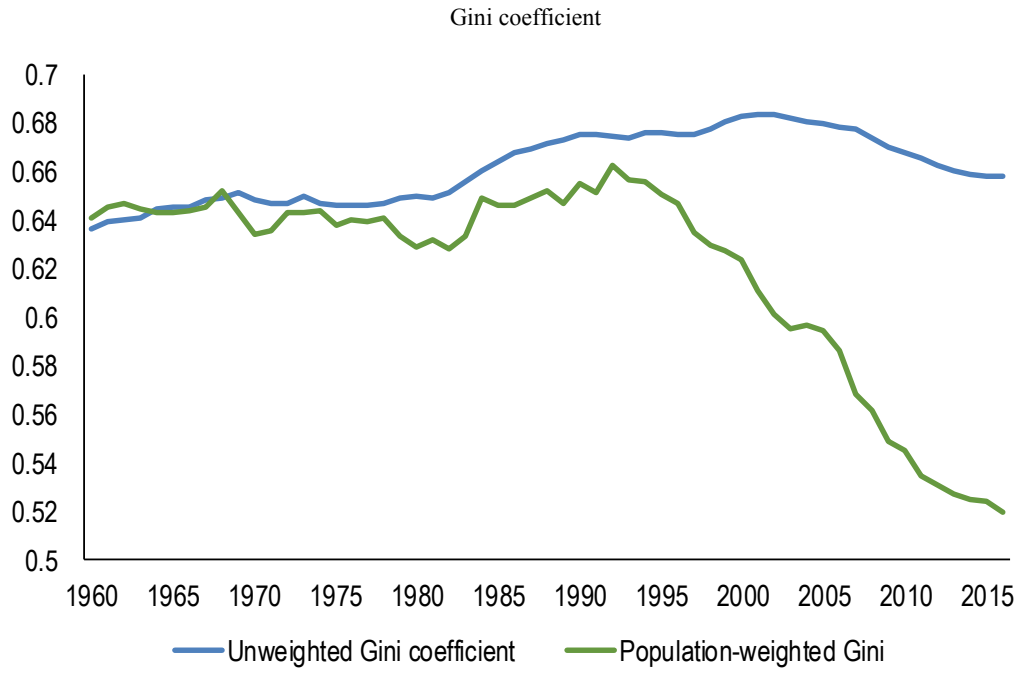
Note: The figures are based on a poverty threshold of USD 1.90 per day.
Source: World Bank (2018[20]), "DataBank: Poverty and Equity", http://databank.worldbank.org/data/reports.aspx?source=poverty-and-equity-database.

StatLink https://doi.org/10.1787/888933852578

Nevertheless, the benefits of global poverty reduction are unevenly distributed. For example, more than 70% of global poverty reduction is attributable to progress in China where, since 1980, 850 million people who lived below the international poverty line of USD 1.90 per person per day (2011 PPP) have been lifted out of poverty. In addition, in 36 of the 152 countries for which extreme poverty estimates are available for 2002 and 2013, the share of people living in poverty rose or remained the same. In 53 of these 152 countries, the absolute number of poor people rose or remained the same. This means that in 17 countries, the absolute number of poor people has increased despite overall reductions in the poverty rates, which is due to population growth. In 13 countries, most of them in sub-Saharan Africa, the number of poor people increased by more than one million (Ferreira, Lakner and Sanchez, 2017[21]).

At the same time, income inequality between developed and developing countries has decreased, as shown in Figure 1.6. Indeed, economic growth in developing countries has exceeded that of developed countries for most of the period since the early 1980s, leading to a convergence in the level of national incomes.

Figure 1.6. Inequality between countries has decreased



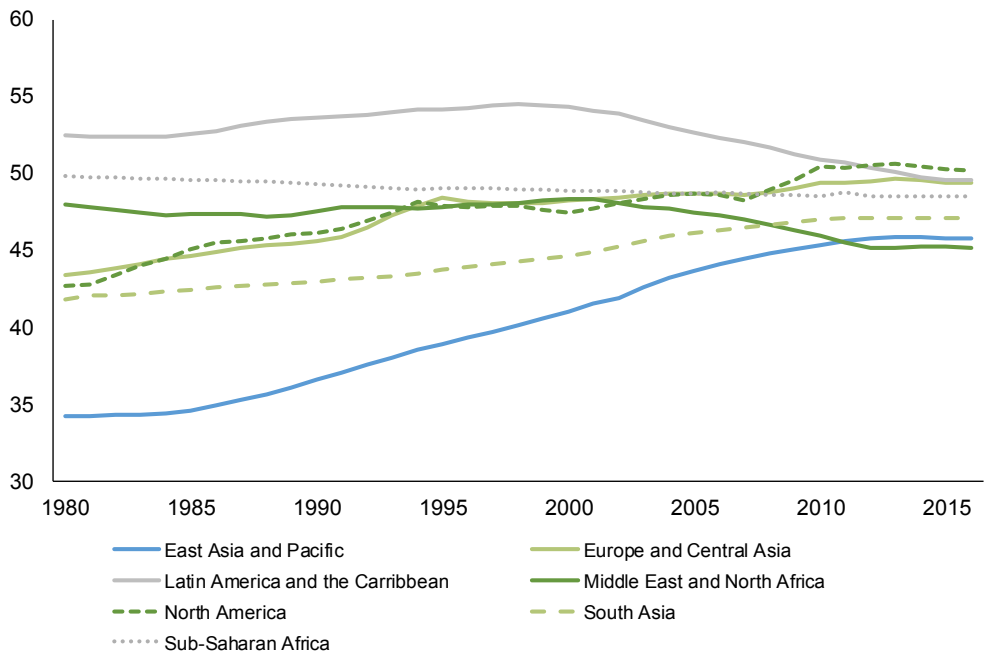
Note: The graph shows two ways of measuring inequality between countries based on Gini coefficients estimated from countries' real per capita GDP. One is the unweighted Gini where each country counts equally and the other is the weighted Gini where countries are weighted by the size of the population. The sample consists of 87 countries for which real capita GDP data throughout the period from 1960 to 2015 are available.
Source: World Bank (2018[22]), "World Development Indicators" (database), https://data.worldbank.org/products/wdi.

StatLink https://doi.org/10.1787/888933852597

However, income inequalities within countries have widened both in developed as well as developing countries (Figure 1.7). In most countries, the gap between rich and poor is at its highest level in 30 years (OECD, 2015[23]). Although high-income countries tend to have the lowest levels of income inequality, these levels are growing. Today, in OECD countries, the richest 10% of the population earn 9.6 times the income of the poorest 10%. In the 1980s, this ratio stood at 7:1; it rose to 8:1 in the 1990s and 9:1 in the 2000s.

Figure 1.7. Inequality within countries is increasing in many regions

Average within-country Gini coefficient



Note: For countries with fewer than ten missing observations for the Gini coefficient, the missing observations have been estimated by assuming the same growth rate for the Gini as the average in the region. Regional averages are weighted by population size.
Source: Solt (2016[24]), "The Standardized World Income Inequality database", https://fsolt.org/swiid/.

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In many developed countries, the costly consequences of rising inequalities are being felt and attest to the need to build more inclusive societies. Not only those at the bottom suffer from inequality; the society as a whole suffers. Inequalities have costly consequences for innovation and economic growth, not least because they hold back the poorest from fulfilling their potential and investing in the education and skills of their children. Rising inequalities during the last decade since the financial crisis have also eroded public trust in public institutions in OECD countries (OECD, 2017[25]).

Income inequality increased by an average of 11% between 1990 and 2010 in developing countries (UNDP, 2013[26]). During this time, income inequality within countries rose on average in all regions of the developing world with the exception of Africa and of Latin America and the Caribbean. In the latter region, inequality levels declined by 5%, driven partly by redistributive policies and labour market changes such as tax reforms. In spite of these trends, however, 10 of the 15 most unequal countries in the world in terms of income are in Latin America and the Caribbean, making it one of the world's most unequal regions (Dugarova and Gülasan, 2017[27]).

More and more challenges extend beyond national borders

In addition to facing development challenges of a primarily domestic nature, the development community is increasingly confronted with problems that extend beyond national borders and call for international collective action. The emergence of global risks such as climate change and infectious diseases in recent years calls for solutions and financing of unprecedented scale and scope. Yet the international community currently does not appear to be ready to tackle these immense challenges.

Climate change: The increasing frequency and severity of climate disasters in various parts of the world point to the need for urgent action and to the massive need for financing to mitigate climate change. From 1997 to 2016, more than 524 000 people died as a direct result of more than 11 000 extreme weather events and losses from such events amounted to around USD 3.16 trillion in purchasing power parities (Eckstein, Künzel and Schäfer, 2017[28]).

Climate change affects both developing and developed countries. In 2017, climate disasters in the United States accounted for USD 306 billion, by far exceeding the previous record of USD 215 billion that was set in 2005. (NOAA, n.d.[29]) However, developing countries are often disproportionately affected by climate change. The Germanwatch Climate Risk Index, which ranks the countries according to their extreme weather risks, shows that all ten of the ten most affected countries from 1997 to 2016 were developing countries. Among those, nine were low-income or lower middle-income countries, while one was classified as an upper middle-income country (Eckstein, Künzel and Schäfer, 2017[28]).

Current financing levels are insufficient. Developed countries made a commitment in 2010 to jointly mobilise USD 100 billion a year in climate finance by 2020 to address the needs of developing countries. This commitment was renewed in 2015, when the 21st session of the Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC) was held in Paris[1] (OECD, 2016[30]). However, even more resources are needed. Some research estimates that USD 12.1 trillion of investments will be needed in renewable energy alone over the next 25 years, which is USD 5.2 trillion above business-as-usual projections (Zindler and Locklin, 2016[31]).

One of the main mechanisms through which international climate finance will be channelled to support this goal is the Green Climate Fund. Established to mobilise climate finance to support climate mitigation and adaptation action in developing countries, the Green Climate Fund has gathered pledges in the amount of USD 10.3 billion.

Pandemics: Over the last 30 years, the frequency and diversity of disease outbreaks, as well as associated financial costs, steadily increased. With growing mobility of people, products and food, the outbreak of an infectious disease is no longer confined to one country or region. Pandemics can affect several countries at once and pose major health, social and economic risks. The West African Ebola virus pandemic from 2013 to 2016 led to 11 310 deaths in nine countries (WHO, 2016[32]) The direct financial cost associated with the pandemic was estimated to be around USD 6 billion and global economic losses over USD 15 billion (Gostin and Friedman, 2015[33]).

The Ebola crisis also demonstrated that the international community is currently ill-prepared to deal with cross-border health crises. In the absence of a financial

mechanism to immediately respond to epidemic outbreaks in resource-constrained countries and to prevent the spread of diseases, it took several months to provide financing for affected countries. Many initiatives have since been launched to deal with this financing gap.[2] However, many countries have been found to chronically underinvest in critical public health systems that help to prevent, identify, contain and respond to infectious disease outbreaks (World Bank, 2017[34]).

Armed conflicts: The rise in the number of armed conflicts in recent years has been accompanied by an increase in global economic costs. In 2016, there were 402 conflicts ongoing, compared with just 278 in 2006. The number of people forcibly displaced by violence and conflict also increased to reach an unprecedented 65.6 million in 2016, compared to 39.5 million in 2006 (UNOCHA, 2017[35]). The Institute for Economics & Peace (2018[36]) estimates the global economic costs of responding to conflict reached USD 1.2 trillion (in purchasing power parities) in 2017.

The economic costs of conflict are unevenly distributed across countries. Violent conflict is a major cause of the reversals in economic growth that many developing countries have experienced in recent decades. For example, due to a series of violent conflicts, Afghanistan's per capita income has remained at the same level since 1970. Somalia's per capita income has seen a more than 40% decline in the same period. It has been estimated that countries experiencing violent conflict suffer a reduction in annual GDP growth of 2-4% – and a reduction of up to 8.4% if the conflict is severe (UN/World Bank, 2018[37]).

The harmful effects of conflict and violence spill across borders. To varying degrees, neighbouring countries and those farther away from the conflict also face consequences in the form of large numbers of refugees, weak confidence and security, and declining social cohesion. Many of these countries are developing countries themselves. The conflicts in the Middle East and North Africa (MENA) have resulted in millions of refugees crossing borders. European Union member countries received 1.2 million first-time asylum applications in 2015. Along with these large-scale migrations, attacks linked to terrorist groups harboured in the conflict-afflicted MENA region have given rise to a growing sense of insecurity and undermined the confidence in the European project (Rother et al., 2016[38]).

Transforming the vicious circle to a virtuous circle

The consequences of capacities under stress

Many of the same stress factors that constrain governments' capacities for financing sustainable development are contributing to a wave of nationalism across developed and developing countries. In many countries, public attitudes have been scarred by the experience of the financial crisis. For example, the rapid rise in long-term unemployment following the crisis[3] has fuelled the populist appeal of economic nationalism. The most recent Global CEO Outlook by KPMG (2018[39]), a survey of 1 300 CEOs in 11 of the world's largest economies, finds that they identify this nationalist approach as the biggest threat to the growth of their companies.

The re-emergence of nationalism, along with other factors, particularly affects trade and foreign investment patterns, which in turn exacerbate the constraints on financing for sustainable development. The rising popularity of nearshoring[4] and job repatriation[5] also has led to a decline in foreign investment, with repercussions on the financing available to developing countries (Chapter 2). The World Trade Organization's latest trade monitoring report registers a rise in the rate of new trade-restrictive measures and notes

that this trend, as well as an intensification of anti-trade rhetoric, raises concerns about a potential escalation in trade barriers and disputes (WTO, 2018[40]).

Measures put in place by governments to protect their countries from the impacts of another international financial crisis may unintentionally leave them more exposed. For instance, the trend of rising protectionism creates uncertainty that can jeopardise the economic recovery underway. An escalation of tariffs risks leading to a decline of as much as 9% in trade flows, equivalent to the drop experienced during the global financial crisis (World Bank, 2018[41]) This in turn could lead to further contraction of the world economy, setting off a vicious circle and resulting in fewer and fewer resources to finance sustainable development.

Linking development and inclusive growth

Countries that lean towards isolating themselves from the international system and that reduce contributions to achieving the SDGs abroad could harm their domestic agendas. The increasing negative externalities of armed conflict, pandemics and catastrophic weather-related events are examples of how international spillovers can hamper achievement of the SDGs. Countries cannot achieve their domestic goals unless other countries also make progress towards the SDGs and negative externalities are minimised.

Unless sustainable development is promoted and achieved everywhere, the goal of domestic inclusive growth, embraced by the governments of many developed countries will remain elusive.

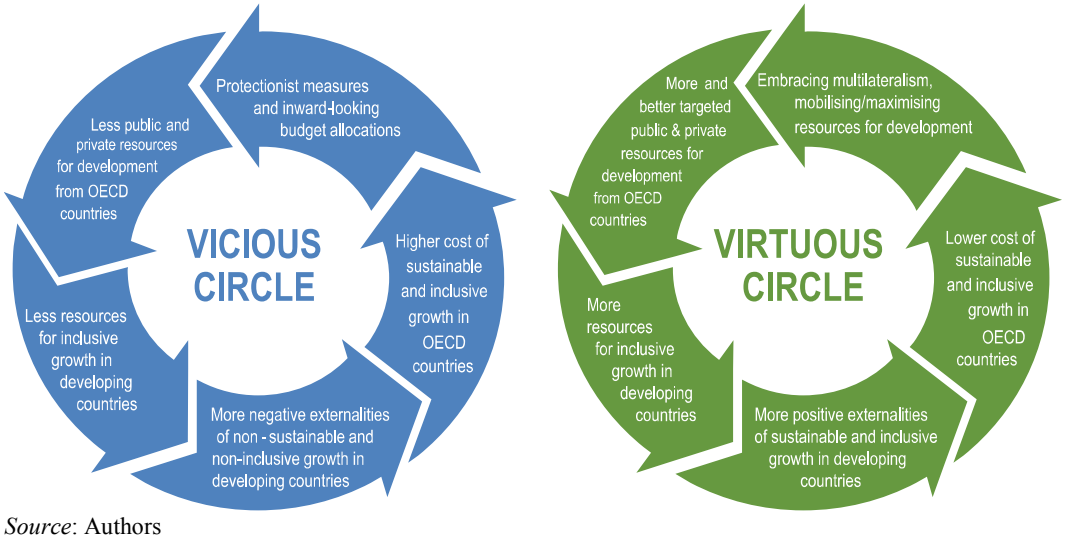
In the face of technological advances and demographic shifts that already are profoundly changing their economies, many developed countries are looking for ways to ensure continued growth and the equitable distribution of benefits. The IMF and the OECD, among other international organisations, also have issued recommendations in recent years to make growth more inclusive and inclusive growth was a lead item on the agenda of the 2018 meeting of the Group of Seven (G7) (G7 Presidency, 2018[42]).

Solidarity and the promotion of inclusive growth cannot stop at national borders, leaving other societies at risk of destabilisation and deprivation. Problems afflicting developing countries are increasingly affecting other developing countries and developed countries in the form of migration pressures, terrorism threats and the spillover of economic crises.

At the same time, sustainable development in developing countries can generate positive externalities for other developing and developed countries. In the ten years since the global financial crisis, developing countries generated much of the limited global growth and contributed to an increasing share of global trade. Many of the benefits from profitable investment and business opportunities in those countries accrued to investors in developed countries.

Achieving the universal 2030 Agenda requires integrating the dual goals of sustainable development and inclusive growth at both the domestic and global level. Countries can reach the hoped-for levels of prosperity and well-being only by co-ordinating and collaborating more – not less. Figure 1.8 illustrates the interrelationship of inclusive growth and sustainable development for financing of sustainable development and prosperity.

Figure 1.8. Transforming the vicious circle into a virtuous circle



Source: Authors

A call to transform the sustainable development finance system

The AAAA lays the groundwork for the implementation of the 2030 Agenda by bringing together different actors and mechanisms to contribute to the financing of the SDGs. However, three years into the 2030 Agenda, not all the potential of the AAAA has been harnessed. The AAAA premise is that winning the global fight against poverty and achieving the SDGs require a holistic approach that mobilises a wide array of actors – public and private, domestic and foreign – in a broad range of action areas from taxes to remittances and from philanthropy to investment. Accomplishing this transformation calls for profound paradigm shifts in the financing for sustainable development system.

In light of the scissor effect – the concurrent stress on capacities for financing for sustainable development and increasing needs for this financing – current efforts to mobilise additional resources are not enough. Not every dollar invested in sustainable development will have the same development impact. It is necessary to better use the AAAA policy levers and interactions among new and existing actors and resources of financing to more effectively shift the trillions present in the global economy towards development impact.

What has changed in the financing for sustainable development system?

The AAAA recognises that implementation of the SDGs calls for a financing framework that is equally ambitious and transformative. The premise underpinning the AAAA is that winning the global fight against poverty and achieving the SDGs require financing that exceeds the amounts that can be raised by official providers alone.

The commitments in the AAAA are across seven main action areas: domestic public resources; domestic and international private business and finance; international development co-operation; international trade as an engine for development; debt and debt sustainability; addressing systemic issues; and science, technology, innovation and capacity building. A distinctive feature is the Agenda's focus on the role of domestic resources and the private sector to help countries pursue sustainable development. The "In My View" piece by Arancha Gonzalez explains the crucial importance of international trade and private investment in raising further private investment.

Box 1.2. In My View: Should public money finance private sector development?
By Arancha Gonzalez, Executive Director, International Trade Centre (ITC)

The world going forward needs inclusive growth. The United Nations 2030 Agenda recognises the roles of both trade and the private sector in making this a reality. Yet there remains sometimes a disconnect between this recognition at the global policy level and at the level where development resources are channelled. Aid for economic infrastructure in 2015 was USD 21 billion. This is understandable as many developing countries have a clear infrastructure deficit.

But modern roads, ports and bridges are only useful if there are products to trade and a healthy domestic private sector to produce such goods and services. Ensuring investment in soft infrastructure – the operating system that allows the hardware to work – is incredibly important.

The relevance of the private sector is recognised in the Addis Ababa Action Agenda. It explicitly calls on all businesses to apply their creativity and innovation to solving sustainability challenges. Can there be a better way to do this than to unleash the immense creativity and innovation capacity among young women and men in the developing world?

Examples of entrepreneurial capacity in developing regions like Africa are myriad. Think of mobile banking solutions, smart chargers empowered by bicycles or pedal-operated toilets for rural areas. The developing world does not lack creativity. What it often lacks is the experience to move from idea via prototype to market; access to finance to make necessary investments; and access to markets large enough to make such investments financially viable. Finance targeted to overcoming those bottlenecks is therefore, in my view, the most effective and sustainable way of providing finance for development. It is very important also to ensure that female entrepreneurs benefit from this, as they often face greater difficulties to access finance via private channels than their male counterparts.

Private sector development contributes to strengthening the role of local business in solving their countries' development problems. But the impact of entrepreneurship development extends beyond the entrepreneurs themselves. Those employed by the targeted businesses will also benefit. Non-competitive, low productivity businesses pay low wages to their employees. Successful, growing businesses can instead afford to offer decent jobs to their employees. Finance for private sector development therefore works into two directions: it supports new generations of shapers and leaders while also supporting households that depend on the success of those leaders.

Technical assistance to private sector development is most effective when supporting activities for which there is demand in the market. This is the principle applied by initiatives that connect developing country providers with established value chain actors. Examples of such initiatives are the Better Work Initiative (ILO and IFC) and the Ethical Fashion Initiative (ITC). The direct or indirect involvement of buyers guarantees the existence of a market for products and services generated with the support of technical assistance. Ultimately, success of such initiatives can be measured by their self-sustainability, as public funding should ideally be a catalyst that ignites domestic and international financial contributions and investment.

The entrepreneurial potential in developing countries is real. But growth of their

businesses can be seriously constrained if they are only serving local demand, rather than reaching markets beyond the country's borders. Access to regional and even global markets increases the likelihood of investments in private sector development being profitable. It also increases the chances of involving global value chain players in technical assistance initiatives. This explains why open borders matter for development, a point made in both the Addis Ababa Action Agenda and the earlier Monterrey Consensus. Ongoing efforts for regional integration in the developing world – the recent signing of the African Continental Free Trade Area is one such example – are an encouraging signal in the right direction.

Let me conclude by drawing attention to the 2030 Finance for Development Agenda's interesting acronym: a quadruple A, or AAAA for the Addis Ababa Action Agenda. This acronym is not only easy to remember but also evokes a terminology used by rating agencies and common in the private sector finance community. Private sector development is the natural component of a development agenda that wants to engage with a private sector seeking returns on investment to achieve sustainable development goals. It is also a key tool for unleashing the developing world's real and growing potential to be the architect of its developmental destiny.

With this approach, the AAAA moves international development co-operation's relatively narrow focus on foreign aid to official development finance and ultimately to financing for sustainable development. Both aid and development finance are resources provided by international public sector actors with the objective of furthering the development of a country, but they differ. Aid, or official development assistance (ODA), comes at concessional terms, i.e. conditions that are more favourable than are available on the international capital market. Official development finance is the sum of ODA and other officials flows (OOF), comprises a wider range of resources invested in sustainable development, and includes but is not limited to aid, that can be concessional or non-concessional. The concept of financing for sustainable development further expands the universe of actors, resources and means to be actively called upon for sustainable development.

The holistic approach of the AAAA is echoed in the development ambitions of major official donors and providers. Recognising that the resources needed for sustainable development are of a different order of magnitude, major institutional providers of development finance have started a drive to mobilise additional resources for development impact. A prime example was the in-depth report presented by a range of international development banks to the Development Committee of the World Bank in advance of the Addis Ababa conference. *From Billions to Trillions: Transforming Development Finance*[6] committed major multilateral financial institutions "to promote and catalyse private investment, addressing risk and uncertainty, helping to mobilize and scale up resources and co-investment from traditional, institutional and other public and private investors". In 2016, the World Bank Group put forward the cascade approach as its new strategy to maximise financing for development by leveraging the private sector and optimising the use of scarce public resources (World Bank Group, 2016[43]). Likewise, bilateral development finance institutions[7] are called to centre stage to engage and enable private sector investors in developing countries. Great emphasis is put on innovative financing solutions to amplify the development impact of different resources, and especially to facilitate engagement with the private sector.

What remains to be done?

With the 2030 horizon only 12 years away, implementation of the global agendas is falling short of expectations and the holistic approach advanced in these agendas entails a series of challenges of its own.

- The AAAA calls upon a greatly expanded number of actors to play a part in sustainable development, bringing greater diversity and complexity. By one estimate, more than 1 000 financing mechanisms exist in the global financing for development system (Hammad and Morton, 2009[44]). In the absence of a clear mapping of the different actors and their roles, there is a risk of dilution of responsibilities. The financing for sustainable development system can become a place where everyone – and thus no one – is responsible. The number of financing instruments available to actors has also grown and, witnessed by the constant creation of new instruments, innovation seems to be driving the financing for sustainable development system. However, these actors' roles will always be context dependent and actors are not always able to navigate this increasingly complex set of options.
- Massive concerted action is needed to ensure that all actors jointly and effectively work towards the common goal of sustainable development. Despite progress in some areas, silos remain among actors and action areas. Synergies and interlinkages (e.g. so-called catalytic effects) among the actors and resources remain underexplored and the risks associated with shifting roles of old and new actors are widely left unaddressed. It is often difficult to ensure that new opportunities are sufficiently exploited.
- While measures are being taken to mobilise more resources for developing countries, the quality (i.e. development) impact of these resources is often overlooked. The AAAA firmly expresses the objective to align all resource flows and policies with economic, social and environmental priorities. Yet different actors all retain their own rationales, roles, resources and instruments, as well as their own incentives and intermediary objectives. The "sustainable" in "financing for sustainable development" therefore remains aspirational in many aspects.

There is room for manoeuvre that should not be overlooked. If all resources from the different actors are counted and included in the AAAA, the trillions needed for sustainable development can be seen to already be there. Yet it is currently impossible to ensure that all financing for development resources are aligned with the SDGs and the objective of achieving sustainable development in all its dimensions. For example, not all official development assistance is compatible with the Paris Agreement and measures are needed to ensure that financing indeed addresses development objectives. In the same vein, enlisting private firms as providers of SDG finance leaves open the question of how much of their activities should be counted as financing for sustainable development. Aligning incentives and measurement, therefore, would effectively mean a massive resource injection into the financing for sustainable development system.

In the current environment, with constraints on public and private resources, there is naturally resistance to an emphasis on additional resource mobilisation. However, there is ample room to focus more on what to do with the existing trillions. The international community can respond to the scissors effect by "shifting the trillions". Scarce public resources should be used as effectively and efficiently as possible and deployed in such a way that they catalyse other forms of finance. Private resources need to be shifted to have more sustainable development impact and to serve the SDGs.

Notes

[1] The Paris Agreement also delivered a framework for post-2020 climate action, committing parties to limit global warming to 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 degrees Celsius.

[2] The World Bank created the Pandemic Emergency Financing Facility (PEF), a USD 500 million insurance facility to support developing countries facing the risk of a pandemic. The Coalition for Epidemic Preparedness Innovations (CEPI) is a public-private initiative funded by the Wellcome Trust, the Bill & Melinda Gates Foundation, the World Economic Forum, and a number of donor governments to finance the development of new vaccines against infections of epidemic potential.

[3] Farber (2015[45]) found that only about 50% of people who lost full-time jobs between 2007 and 2009 were again employed in January 2010 and that only about 75% of these had found full-time jobs.

[4] Nearshoring occurs when an organisation transfers a business operation to a nearby country, especially in preference to a more distant country.

[5] Repatriation occurs when an organisation returns its business operations from foreign facilities to the home country.

[6]The report is available at http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23659446/DC2015-0002(E)FinancingforDevelopment.pdf.

[7] Development finance institutions (DFIs) are government- or quasi government-backed institutions that provide financial support for private sector projects in developing countries.

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Chapter 2. The expansion of the financing for sustainable development system: More actors and resources

The sustainable development finance system has profoundly changed in recent years, with a greatly expanded number of actors. The expansion raises questions about the distribution of the roles and calls for a new mapping of contributions.

This chapter presents snapshots of the sustainable development finance landscape by presenting the volumes provided by different actors – external, domestic, public and private – and the repartition of different sources over time. A more granular picture is given about the different roles of actors and their resources. The chapter further examines the impact of the financial and economic shifts of recent years on these types of finance, with emphasis on the historical context and each financing type's particular niche.

In brief

The Addis Ababa Action Agenda (AAAA) widens traditional definitions of development finance, outlining responsibilities and actions for domestic, international, private and public actors. The potential scope of resources available to finance sustainable development is greatly expanded.

Developing country governments and their resources are the central pillar of the financing for sustainable development landscape. But there is a clear need for more revenue.

- In 2016, tax revenues amounted to **USD 4.3 trillion**, more than twice the volume of cross-border flows.
- But the tax revenue-to-GDP ratios in low-income and least developed countries average 14% and in many cases are **far below the 15% threshold** recommended as necessary for effective state functioning.

Domestic investment makes up a substantial proportion of most countries' GDP, but due to tighter financing conditions private investment appears to be in sharp decline.

- Excluding the People's Republic of China ("China"), domestic mergers and acquisitions declined by over 60% between 2010 and 2017, falling from USD 237 billion to USD 95 billion.

Substantial amounts of **cross-border finance** already flow to developing countries, amounting to a total of **USD 1.7 trillion** in 2016.

Private sector actors provide the bulk of cross-border finance, but these flows show an alarming decline.

- Commercial investors are the single largest provider, with **USD 890 billion** in FDI, portfolio investment and long-term debt in 2016.
- Developing countries have foregone between USD 400 and 450 billion of FDI from 2012-2016. In addition to the substantial decline in financing, this can mean fewer opportunities to access international markets and technical know-how.

Developing country emigrants provide remittances, the second largest and the most stable source of external financing for sustainable development.

- Remitters sent **USD 466 billion** in 2017 and in some smaller economies these flows make up close to or more than 30% of national GDP, the latter being the case in Kyrgyzstan.

Public sector, i.e. official, providers deploy substantial resources and can play a special role in targeting the most vulnerable countries.

- Bilateral and multilateral providers deployed **USD 311 billion** in 2016. Since 2000, financing provided at concessional terms grew most rapidly for the group of low-income countries and fragile and conflict-affected countries.

Philanthropic foundations are key players in the health sector and sometimes pioneer innovative financing solutions, but they have provided smaller volumes than other providers.

- Of the USD **8 billion** of philanthropic giving that flowed into developing countries per year from 2013-2015, an average USD 3.21 billion or 40% of the total targeted the health sector.

Financing the Sustainable Development Goals (SDGs) in developing countries can only be successful if these different contributions are fully understood and exploited. Although the sum of available resources holds great promise to meet the financing needs of the 2030 Agenda, they are not yet sufficiently oriented towards development goals – and, indeed, bringing together this diverse set of actors with different motivations is an enormous challenge in itself.

Data constraints, for example regarding actors in developing countries, make it difficult to fully take in the total picture.

- One example of such constraints is that estimates on the amounts of concessional finance provided by China in a year range from USD 3 billion to USD 7 billion.
- Another example is that while domestic public expenditure and private investment are important drivers of financing for development, data on their volumes and uses are extremely limited.

A further challenge is that the SDGs and the AAAA reflect commitments by countries that are made in the name of non-state, third parties who also have important roles in financing for sustainable development. Decisions regarding some of the largest pools of resources – cross-border investments and remittances – are based on private actors' considerations that are not primarily motivated by the SDGs. A key challenge, then, is to identify win-win opportunities that meet the motives of such private actors and contribute to the achievement of the SDGs at the same time.

Domestic sources of financing and internal drivers

The AAAA underscores that every country has primary responsibility for its own economic and social development (paragraph 9). The ultimate aim of development finance efforts is to achieve a sustainable development finance system that is based on well-functioning and effective domestic mechanisms and integrated into the global system. Effective and efficient tax systems, public financial management systems, governance, and vibrant and resilient markets all play key roles.

While it is the primary role of domestic actors in developing countries to ensure that these internal drivers and domestic resources function properly, the international community and external resources (flows) could support their efforts. The domestic and international spheres are highly interconnected in areas such as taxation and the financial system, highlighting the importance of the international environment and policy framework to support an individual country's efforts.

Domestic public sector

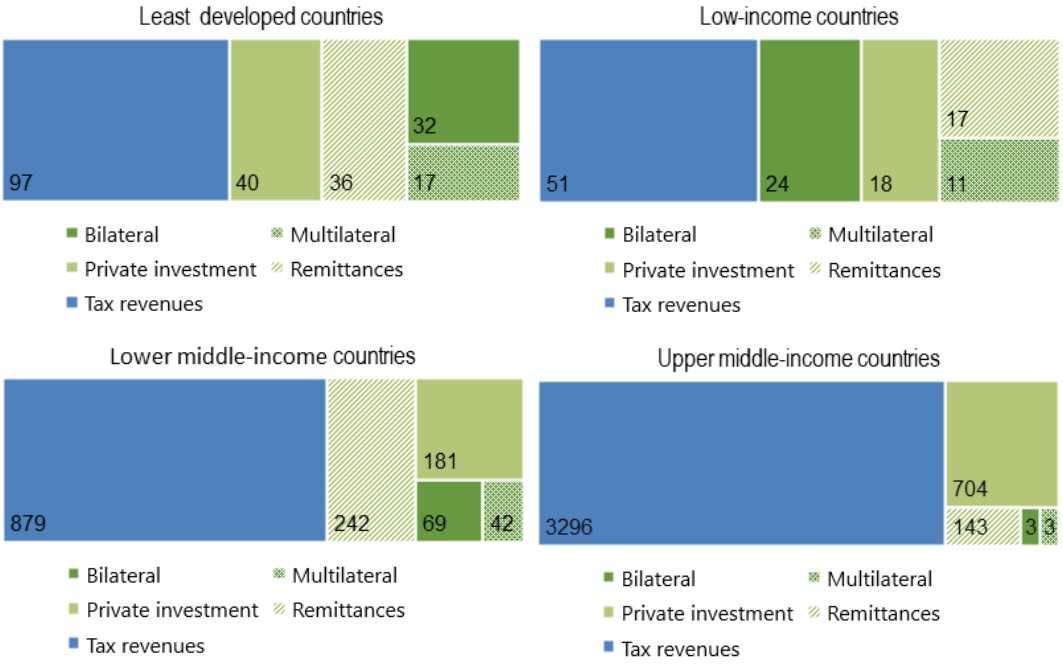
The domestic public sector's resources affect the Sustainable Development Goals

Governments have the primary responsibility for implementation of the 2030 Agenda, through direct financing and setting the regulatory environment for foreign and domestic private investment.

Tax revenues are the largest source of finance, exceeding the volumes of any single cross-border resource. In 2016, tax revenues in developing countries amounted to USD 4.3 trillion. The share of tax revenues in the overall finance mix varied from 42.7% in least developed countries and 42.4% in low-income countries to 62.2% in lower middle-income countries and 78.2% in upper middle-income countries.

Figure 2.1. Mix of financial resources in developing countries

USD billions, 2016



Note: The estimates have been calculated for the list of developing countries eligible for ODA but do not include a number of countries and territories because of lack of data on tax revenue. Those excluded are the following low-income countries (LICs): Democratic People's Republic of Korea; Somalia, which is also a least developed country (LDC); and South Sudan (also an LDC).
Among lower middle-income countries and territories (LMICs), the following are excluded: Bhutan (LDC), Kosovo, Mongolia, Myanmar (LDC), Sri Lanka, Syrian Arab Republic, Vanuatu (LDC), West Bank and Gaza Strip. A third group excluded are upper-middle income countries (UMICs): Cuba, Fiji, Former Yugoslav Republic of Macedonia, Libya, Montenegro, Nauru and Venezuela.
Sources: IMF (2017[1]), "World Revenue Longitudinal Data", https://data.world/imf/world-revenue-longitudinal-dat; OECD (2018[2]), "Global Revenue Statistics Database", https://stats.oecd.org/index.aspx?DataSetCode=REV; OECD (2018[3]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1; World Bank (2018[4]), "Migration and Remittances Data", http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data; IMF (2017[5]), "Balance of Payments" (database) 2017, http://www.imf.org/external/datamapper/datasets/BOP for private investment data.

StatLink https://doi.org/10.1787/888933852635

Greater public resources are associated with greater spending on SDGs such as health (SDG 3) and education (SDG 4).[1] Domestic public resources can help tackle inequality (SDG 10) by redistributing wealth in ways that are acceptable to society as a whole. While evidence on the redistributive implications of tax systems in developing countries remains limited, recent findings confirm that fiscal systems in developing and developed countries can reduce inequality and support inclusive growth (Box 2.1).

Box 2.1. Fiscal policies can help mitigate inequality

The experience of developed countries shows that sound fiscal policies can play an essential role in mitigating inequalities and also can foster sustainable growth. Most countries have experienced a rise in income and wealth inequality in recent decades, but to different extents and at different speeds. The dynamics of inequality are strongly influenced by management of public wealth, regulation of financial markets, labour laws and fiscal policies such as efforts to prevent tax evasion (Alvaredo et al., 2018[6]). The experience of developed countries with regard to inequality and fiscal policies has proven that progressive taxation, well-targeted transfers and quality expenditure to benefit the poor show great potential to efficiently perform redistribution. Indeed, regression-based studies, carried out for the most part in developed economies, suggest that higher spending on social benefits and greater reliance on direct taxes may reduce inequalities (IMF, 2014[7]).

How taxes are structured matters for their impact on inequality. Indirect taxes are usually regressive because poorer populations consume a greater proportion of their income. Direct taxes levied on labour, capital income, wealth and inheritance are more likely to be progressive and are more likely to reduce inequality, if designed to impose higher tax rates on individuals who are able to contribute more (Alvaredo et al., 2018[6]).

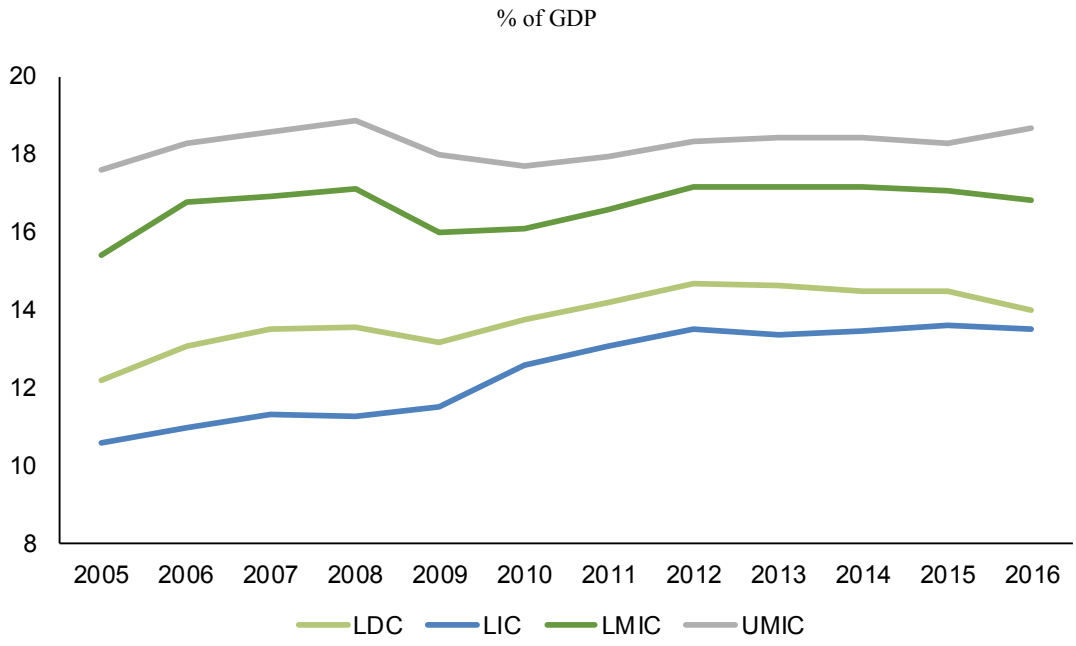
Like taxes, social expenditures can reduce inequality. Expenditure on education and health systems that cover a wide range of the population may bring about better employment prospects, wider participation in the political process and increased well-being, and so foster equality of opportunities (OECD, 2008[8]). Social safety nets such as unemployment benefits and social pensions can improve the resilience of households to economic shocks and, in this way, help to lift the most vulnerable individuals out of poverty (World Bank, 2018[9]).

The composition of spending can be as important as the volume of public resources available, and redistributive spending can help rebalance regressive features in the tax system. It thus is important to look at redistributive impact of the fiscal system as a whole. A commitment to equity in the design of fiscal policies can itself support a reduction of inequality. Social spending as a share of GDP in most low-income and middle-income countries amounts to barely half the average social spending in high-income countries. An ongoing study of 28 low-income and middle-income countries has found that fiscal policies[2] unambiguously reduce inequality and increase equality of income. They also have a poverty-decreasing effect in most countries (Lustig, 2017[10]).

Domestic public resources are not yet sufficient to meet global and country ambitions

Countries may choose different approaches to the financing of development that involve lower tax ratios; different dimensions of development such as fragility, economic vulnerability and human capital development may affect the ability to raise revenues.[3] Without an agreed, ideal tax-to-GDP ratio, a ratio of 15% is increasingly recommended as a minimum benchmark for effective state functioning (IMF et al., 2016[11]) (Gaspar, Jaramillo and Wingender, 2016[12]). As shown in Figure 2.2, low-income and least developed countries remain some distance below this ratio, although since 2005, some progress has been made in increasing the ratios. The average ratio in middle-income countries is above 15% but this is still well below the 2016 OECD average of 34.3%,[4] indicating significant room to grow tax revenues to finance sustainable development. Such growth becomes increasingly urgent if – due to rising debt levels in developing countries – opportunities to finance public spending through debt financing narrow in the future (Chapter 5).

Figure 2.2. Tax-to-GDP ratios by country classification



Note: The ratios are calculated for countries in the OECD list of developing countries receiving ODA.
Sources: (IMF, 2017[1]), "World Revenue Longitudinal Data", https://data.world/imf/world-revenue-longitudinal-dat; (OECD, 2018[2]), "Global Revenue Statistics Database", https://stats.oecd.org/index.aspx?DataSetCode=REV.

StatLink https://doi.org/10.1787/888933852654

There are substantial differences in countries' ability and capacity to increase tax revenues. Moreover, mobilising more tax revenues may not always be desirable given the opportunity costs it involves. Tax effort estimates gauge the ratio between revenue and potential revenue given a country's current GDP, level of development, etc. While there is relatively little research in this area, one study by Fenochietto and Pessino (2013[13]) has found high-income countries showed a higher tax effort (77%) than did low-income countries (65%) and middle-income countries (64%). However, there is significant variation within these categories and a large number of developing countries appeared to be operating close to their potential. Regionally, Africa had the second-highest level of tax effort (71%), behind only Europe (77%) and significantly ahead of Asia Pacific (59%).

Especially where tax effort is already high, increasing revenues often depends not just on tax policy changes and administrative improvements but also on growth and structural changes in the economy. In consequence, growing the domestic private sector is vital, as is discussed further elsewhere in this chapter. Many developing countries also have very large informal sectors and underground economies where cash transactions leave no audit trails for tax purposes. Even where income is declared, it is often grossly underestimated. Many developing countries face additional challenges to growing tax revenues, among them weak revenue administrations and poor governance. But assertive policy approaches can make a difference, as shown in the essay on Indonesia's tax reform (Box 2.2 "Tax reform and quality spending are crucial for a more sustainable and inclusive economy").

International tax policies also have a substantive impact on tax revenues, for example by eroding multinational enterprises' ability to shift profits offshore and avoid corporate taxes in the countries of operation. This is particularly important for developing countries, for which spillovers in international corporate taxation are especially marked and important (IMF, 2014[14]).

Box 2.2. In My View: Tax reform and quality spending are crucial for a more sustainable and inclusive economy, by Sri Mulyani Indrawati, Finance Minister, Indonesia

Reform is essential for revenue collection and equity promotion

Understanding that a sound tax system is a core element to support sustainable development, the government of Indonesia recently implemented the tax amnesty programme. Launched in 2016, this programme has successfully involved 973 400 taxpayers with total redemption payments reaching Rupiahs 115.9 trillion (around USD 8.5 billion) and a total of IDR 4 865.7 trillion (approximately USD 366 billion) worth of assets have been declared to Indonesia's tax office under the programme, surpassing the government's target.

As a follow-up to the tax amnesty programme, the government of Indonesia has also implemented a comprehensive tax system reform to enhance progressivity and to address ineffective and excessive incentives and exemptions. Through simplification of the tax administration process, tax compliance will be enhanced in the short term. To maintain the compliance in the long term, tax education will be integrated into the formal education programme. The use of information technology will facilitate the improvement of tax database management and tax monitoring.

The quality of spending helps drive sustainable and inclusive development

Following an increase in global oil prices, Indonesia undertook reforms in the fuel subsidy scheme in 2015, to increase the fiscal space and to reduce incentive distortions from mis-targeted subsidies. Fuel subsidies amounting to Rupiahs 180 trillion were re allocated to more productive spending such as infrastructure financing, which increased significantly to Rupiahs 410.4 trillion in 2018 from Rupiahs 154.7 trillion in 2014.

Removal of the fuel subsidy also provided the opportunity to increase budget allocations to other priorities such as health, education and social assistance. In addition, the government is currently ramping up the social services programmes and increasing transfers to subnational governments and villages to create a more balanced, inclusive and sustainable economy.

The OECD has an important role to play

Learning from Indonesia's experience, the OECD's role in financing for development can include helping developing countries to bridge their policy gaps in addressing sustainable and inclusive development while also bringing them closer to a level playing field. This means capacity building through country-level policy review and global-level policy and performance benchmarking. In addition, the OECD can help to fine tune and improve the implementation of initiatives and programmes by providing review and assessment on progress, identifying problems, and providing policy recommendations at the global, regional and country level. In addition, and, based on its country-level work, the OECD can provide advice to better link global and regional initiatives to country priorities, thus further enhancing country ownership and commitment.

International efforts are needed for more domestic resource mobilisation

International partners need to consider how best to support developing countries to reach their potential to mobilise greater domestic revenue. For most countries, the most effective actions will be a combination of development co-operation and policy coherence. The Addis Tax Initiative acknowledges this: donor country signatories have committed to collectively double their spending on tax capacity development between 2015 and 2020 and to improve policy coherence for development in tax matters.

Committing resources for capacity building is important, but this must be matched with a commitment to ensuring impact. Even when doubled, ODA to domestic revenue mobilisation will only be USD 445 million and represent just around 0.3% of ODA, so ensuring maximum return is important. To do so may require new approaches to capacity building. One innovative approach is that of Tax Inspectors Without Borders, which deploys experienced tax auditors to work with countries' revenue authorities on live cases and has mobilised USD 414 million in additional tax revenue so far. Its return on investment is thus more than 100:1.

Additionally, domestic policies in developed countries can be aligned to support domestic revenue mobilisation in other countries. The most obvious way to accomplish this is by adopting new international standards on exchange of information and taxation of multinational enterprises and by supporting their implementation. These standards commit countries to co-operation and therefore enhance the ability of all countries to raise revenues (Chapter 5). The automatic exchange of information (AEOI) will enable tax

authorities to automatically receive information about their taxpayers' offshore financial accounts. Over 100 jurisdictions are currently committed to implementing AEOI. Bringing more developing countries into this network offers huge potential, as testified by Indonesia's experience and described in Box 2.2. The OECD/Group of Twenty (G20) Base Erosion and Profit Shifting (BEPS) project provides a range of tools to address the main methods used by multinational enterprises to shift profit offshore. Moreover, the 117 countries and jurisdictions that are members of the Inclusive Framework on BEPS are committed to meeting the four minimum standards that address cross-border challenges. Both information exchange and the BEPS Actions significantly increase the information available to and options for developing countries to effectively tax cross-border activity. To further realise this potential, it is important that the tools are designed in a way that is fit for purpose and especially that takes account of capacity constraints in developing countries. In this regard, the establishment of the Inclusive Framework on BEPS is a significant development as it brings developing countries into the international standard-setting processes on tax on an equal footing.

Efforts to grow tax revenues must be accompanied by support for strong public financial management systems. The role of governments is not only to mobilise resources but also to use those resources to advance sustainable development. Improvements in the tax system that are not accompanied by improvements in the way resources are spent are not likely to achieve the desired development outcomes. To ensure that resources are spent in an effective and sustainable way, it is important to embed domestic resource mobilisation approaches in broader fiscal governance frameworks.

Domestic private sector

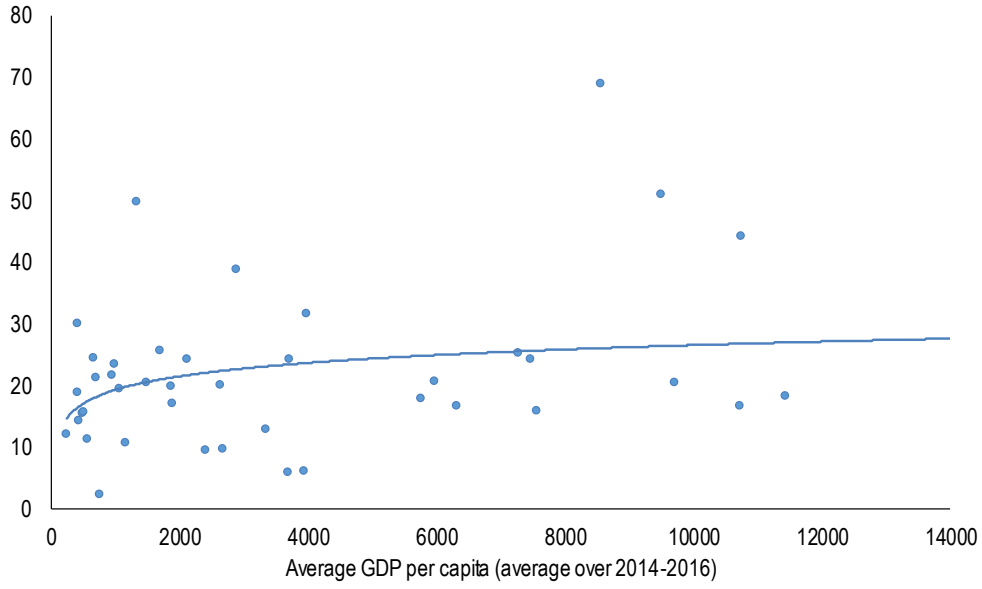
Domestic investment is the main source of capital formation, but it appears to be in decline

Domestic private investment can take the form of investment by private enterprises of retained profits and/or finance from other sources and potentially through banks, private equity or the growing number of stock markets.

Domestic private investment is challenging to measure empirically because indicators are often mingled with other categories. One possible proxy to estimate the portion of capital formation financed by domestic resources is gross fixed capital formation less FDI as a percentage of GDP. Figure 2.3 shows that despite considerable variation across developing countries, total domestic investments generally make up a sizable portion of GDP. The relationship between domestic investments and GDP increases steeply at lower per capita income levels and reaches over 20% of GDP for many developing countries including low-income countries and lower middle-income countries. In comparison, total external financing on average represents less than 20% in low-income countries, less than 10% lower middle-income countries and less than 5% in upper middle-income countries.

Figure 2.3. Domestic private investment against per capita GDP

Gross fixed capital formation in the private sector less FDI, % of per capita GDP, 2014-16



Note: The graph plots domestic resources as captured by the difference between gross fixed capital formation (GFCF) in the private sector and foreign direct investment net inflows. Countries included in the graph are low to upper middle-income countries for which data on GFCF in the private sector, FDI and GDP are available. These are Angola, Bangladesh, Bolivia, Botswana, Burundi, Cameroon, Chad, Republic of the Congo, Croatia, Democratic Republic of the Congo, Egypt, El Salvador, Georgia, Ghana, Guyana, Honduras, the Islamic Republic of Iran, Lebanon, Madagascar, Malawi, Malaysia, Mauritania, Mauritius, Mexico, Nepal, Niger, Pakistan, Panama, Peru, Philippines, Russian Federation, Senegal, Sierra Leone, South Africa, Sudan, Suriname, Swaziland, Thailand, Togo, Uganda, Uzbekistan and Yemen.
Source: World Bank (2018[15]), "World Development Indicators" (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

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Domestic private investment appears to be in decline. Excluding China, domestic mergers and acquisitions (M&A) declined by over 60% between 2010 and 2017, falling to USD 95 billion from USD 237 billion. This decline corresponds closely to the broader downward trend in foreign investment and especially cross-border M&A in developing countries, which fell by about USD 72 billion, or 30%, as discussed later in this chapter. With some notable exceptions,[5] domestic M&A has fallen faster. This suggests that some of the same factors that have reversed the foreign investment trajectory, such as economic recovery in developed countries and record levels of corporate debt in developing countries, are also dampening domestic investment M&A.

To counterbalance these trends, active measures have to be taken to promote domestic investment in developing countries by addressing bottlenecks and risks. The international community can support this by providing technical as well as financial assistance for a better enabling environment including legal and regulatory frameworks.

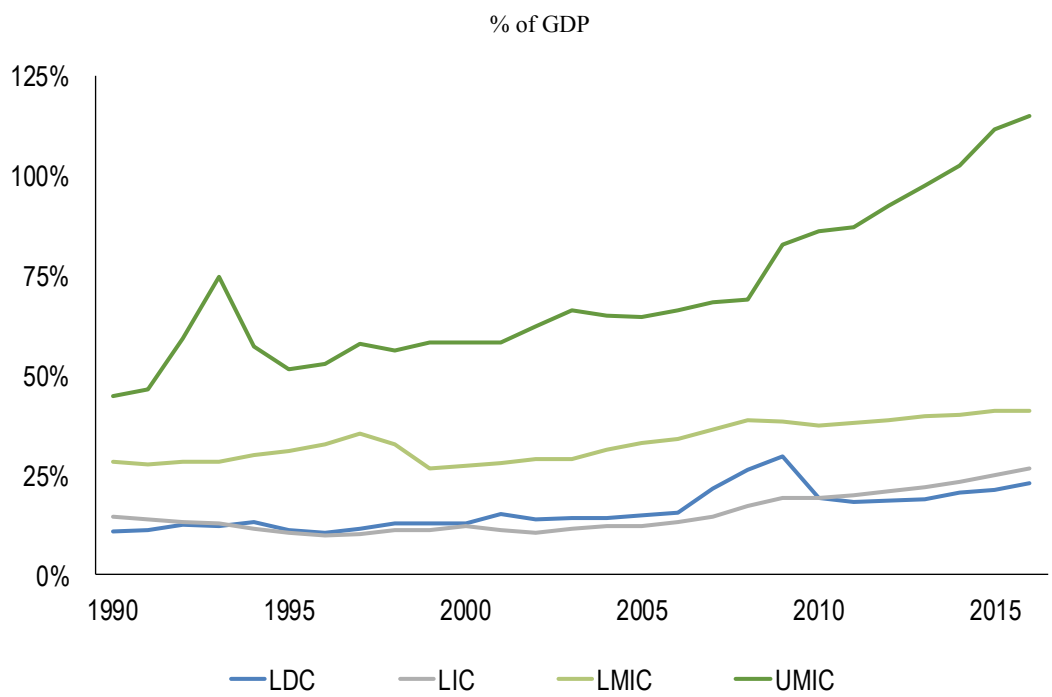
Financial sector development is a key driver of domestic investment

In designing enabling environments, financial sector development will be key. A well-functioning financial system mobilises domestic savings, improves resource

allocation, and facilitates diversification and management of risk (Levine, 2005[16]). Financial sector development is a critical enabler of the 2030 Agenda. Indeed it is included as a target in 8 of the 17 SDGs. These include SDG 1 on eradicating poverty; SDG 2 on ending hunger, achieving food security and promoting sustainable agriculture; SDG 3 on ensuring health and well-being; SDG 5 on achieving gender equality; SDG 8 on promoting economic growth and jobs; SDG 9 on supporting industry, innovation, and infrastructure; and SDG 10 on reducing inequality. SDG 17 on strengthening the means of implementation also includes an implicit role for greater financial inclusion through greater savings mobilisation for more investment and growth (UN Capital Development Fund, 2018[17]).

Globally, some progress is being made in terms of promoting financial sector development. Financial sector deepening, which can be measured by the extent of domestic credit generation and its share in GDP, has increased especially sharply for upper middle-income countries (Figure 2.4). At the same time, the ratio in low-income countries has increased by nearly 50% since 1990 but nevertheless remains very low, suggesting the need for additional deepening. Weak institutional, legal and regulatory environments and capacities are often cited as the main challenges to be overcome to deepen the financial system (IMF, 2012[18]).

Figure 2.4. Domestic credit to private sector as a share of GDP



Source: World Bank (2018[15]), "World Development Indicators" (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

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In addition to depth, financial sector access, efficiency and stability are important for development outcomes (Levine, 2005[16]). Between 2011 and 2017, the proportion of the

world's adult population with an account at a financial institution grew to 69% from 51%, an increase of about 1.2 billion people (Demirgüç-Kunt et al., 2018[19]). Technological advances have led to an expansion of financial services: mobile banking services now are helping to reach large numbers of unbanked people and extend formal financial services to the poor, especially in sub-Saharan Africa. In Kenya, 73% of adults have a mobile payment account and about 50% have one in Uganda and Zimbabwe (Demirgüç-Kunt et al., 2018[19]). Nevertheless, serious concerns remain about the security of transactions that are made through mobile banking, and regulatory mechanisms are not yet in place (Reaves et al., 2017[20]).

Foreign-owned banks dominate the banking systems of many developing countries, notably in Latin America and sub-Saharan Africa. This brings competition and efficiency but also the risk of transmitting external shocks. For developing countries, the median share of assets held by foreign banks rose to 52% in 2008 from 8% in 1995. In comparison, the median share in developed countries rose to 27% from 5% over the same period.[6] Foreign banks can bring competition, efficiency and a stabilising influence on domestic economies in times of crisis (Cull et al., 2017[21]). But the global financial crisis highlighted that foreign banks also can transmit external shocks and crises to the domestic economy by reducing their lending earlier and faster than domestic banks and by repatriating funds to their home countries (Anginer et al., 2014[22]).

There have been efforts since the crisis to ensure that developing country concerns are reflected in the international financial system. At the request of the G20, the Financial Stability Board, in collaboration with the International Monetary Fund (IMF) and the World Bank, has been monitoring the effects of regulatory reforms on emerging markets and developing economies, taking developing country concerns into account in the design of the international regulatory framework. With the recent finalisation of global financial regulatory reforms, international financial organisations also are preparing to step up capacity-building efforts to assist the implementation of the new standards. An example is the launch by the IMF of the Financial Sector Stability Fund in November 2017 to assist low-income and lower middle-income countries as they assess and address risks and vulnerabilities in the financial sector.

Despite significant progress, deficiencies or market failures can often hamper access to finance for segments of society. A lack of sustainable lending to small and medium-sized enterprises (SMEs) constrains growth in low-income countries. The International Financial Corporation (2013[23]) estimates that the credit financing gap for formal SMEs in developing economies is close to USD 1 trillion. A gender gap in access to finance also persists. Globally, 72% of men have a bank account compared to just 65% of women, and the gender gap is even higher – at nine percentage points – in developing countries (Demirgüç-Kunt et al., 2018[19]).

Policy makers have to ensure that the financial sector is socially and environmentally sustainable. Initiatives to build what Grameen Capital India has termed a "capital-with-a-conscience ecosystem" are examples of ongoing efforts described in Box 2.3 "Getting private resources on board for sustainable development". Particular attention has to be given to low-income countries, as financial sector inefficiencies tend to weigh more heavily on these places than on middle-income countries, as the former tend to be more vulnerable to fluctuations in commodity prices and external financing (Eichengreen, Park and Shin, 2017[24]).

Box 2.3. In My View: Getting private resources on board for sustainable development, by Royston Braganza, CEO, Grameen Capital India

GOOOOAAAAAALLLLLL! The frenzied celebration that reverberates across the globe every time a goal is scored reflects the seemingly universal passion for football. The game cuts across generations, blurs political boundaries and traverses ethnic divisions. Sadly, some other things do too – hunger, refugee crises, poverty and global warming, to name a few. And yet, everywhere I look, there also exist shining examples of H.O.P.E.

Holistic approach. Governments, corporations, capital markets, non-governmental organisations, etc. need to find integrated solutions. One exceptional example is the catalytic potential of using corporate social responsibility/philanthropic capital to de-risk investment from the capital markets. The financial sector can help guide companies to look towards a long-term sustainable future. Grameen Foundation's Growth Guarantees programme did precisely that by bringing together donors, international and local banks, microfinance institutions, and poor, vulnerable women borrowers.

Outcome funding. For too long, the focus has been financing for inputs such as grants for health programmes, budget allocations for education outreach and similar targets. However, the recent innovations in outcome financing or "pay for success" seem to be gathering momentum. The Educate Girls programme in Rajasthan, India, aims to improve learning outcomes and enrolment in schools in Rajasthan. This has tremendous potential, as capital market players can collaborate with development agencies to structure innovative financing vehicles that de-risk the investor and ensure outcomes are well-defined, measured and achieved, leading to a win-win situation for all.

Policy-led leadership. Policy makers have a key role as enablers in meeting the 2030 Agenda. Some of the recent policies in India are heartening – changing the country's fund architecture to include social venture capital funds, the Companies Act regulation proposing that 2% of profits be contributed to CSR, the Central Bank regulations related to priority sector lending and small finance banks – and they point as well to a greater sensitivity and a crowding-in of conscious capital. Similar policy initiatives in developing countries could trigger the initial momentum required to catalyse the development of the market. Globally, countries such as the United Kingdom and the United States have also instituted treasury initiatives to attract commercial capital to the impact landscape.

Ecosystem. Each stakeholder has a role to play. But the effect is even more pronounced, scalable and sustainable when an enabling ecosystem is created. It is heartening to witness the collaboration, especially regarding sustainable development, among many multilateral agencies, foundations, corporations and non-governmental organisations (NGOs). The OECD is a stellar case in point with its pioneering work on such issues as impact measurement and blended finance. At Grameen Capital India, we are committed to building a "capital-with-a-conscience" ecosystem, helping to connect enterprises serving the poor with mainstream capital markets. Today a unique debt vehicle has been added, with plans to create a Social Venture Fund and a Social Stock Exchange to democratise funding access for impact enterprises.

Clearly, desperate times call for creative, compassionate and collaborative (and sometimes desperate, out-of-the-box) measures if we are to meet the 2030 Sustainable Development Goals. I can only imagine the universal euphoria that will erupt when each goal is met. I am sure I will be cheering with my loudest "GOOOOAAAAAALLLLLL!"

External actors and financing flows

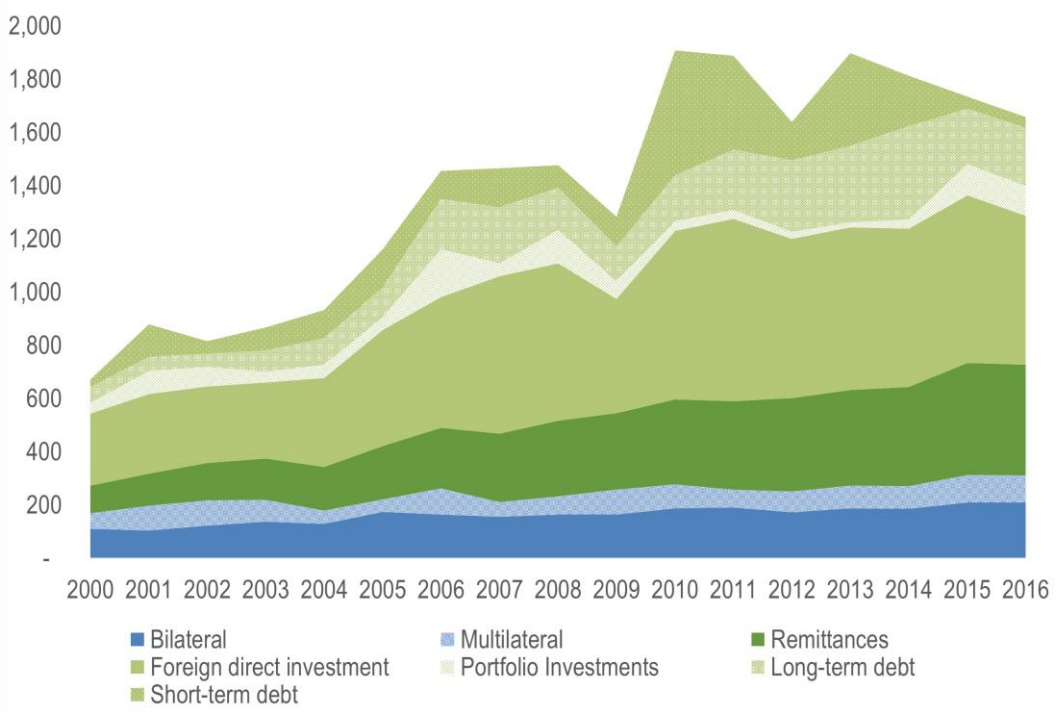
External flows can be crucial in financing the SDGs. They can help to fill gaps in low domestic savings, fund productive investments and promote development of domestic enabling environments. External financing flows are defined by the type of actor. Financial flows that originate from public sector actors, i.e. bilateral and multilateral providers, are referred to as official flows and are either concessional or non-concessional. The financing provided by private actors, on the other hand, take the form of commercial investments, philanthropic flows and/or remittances.

External financing flows increased through the MDG era but have fallen since 2013

The volume of external finance available to developing countries has been substantial, increasing to USD 1.7 trillion in 2016[7] from roughly USD 675 billion in 2000. But trends since 2013 are more sobering, with a decline in total external finance of 12% (see Figure 2.5).

Figure 2.5. Cross-border finance to developing countries, 2000-16

2016 USD billions, constant prices



Source: OECD calculations based on OECD (2018[3]), "Creditor Reporting System" (database), *https://stats.oecd.org/Index.aspx?DataSetCode=crs1* for official bilateral and multilateral flows; World Bank (2018[4]), "Migration and Remittances Data" http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances; IMF (2017[5]), "Balance of Payments" (database), http://www.imf.org/external/datamapper/datasets/BOP for FDI, portfolio investments, and long-term and short-term debt.

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Trends over time of external flows vary depending on the type of flow:

- The rates of increase in private investment flows have declined, a trend that holds across all income groups.
- Official flows to low-income countries have declined recently in favour of a more rapid increase for middle-income countries.
- Growth in remittances has remained stable in the low-income country context while remittances are increasing at a slower pace for upper middle-income countries.

Different actors have different roles

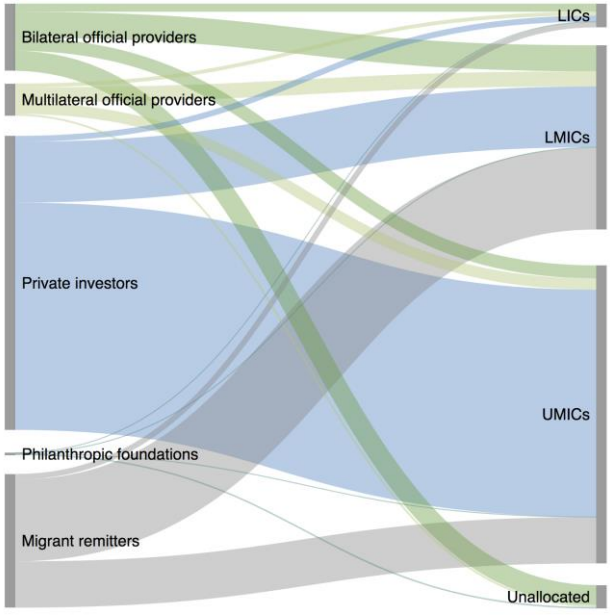
The international community calls on all the various actors to play a part in financing for sustainable development, but this goal is complicated by the individual objectives of different actors.

- Concessional flows as well as philanthropic flows usually aim to further sustainable development.
- Commercial investments are driven by a profit motive.
- Remitters are mainly motivated to contribute to the well-being of individual recipients at the household level.

To evaluate the implications of trends in cross-border actors and their resources, it is important to understand their role in the sustainable development financing system. Private sector actors can bring productivity gains and job creation while the public sector can have a comparative advantage in targeting poverty and gender inequality. Moreover, the sectoral destination may vary according to the type of actor. While the private sector tends to invest in economic sectors such as manufacturing, official flows are well placed to target social sectors such as health and education (see Chapter 4). These roles can change at different income levels (see Chapter 6).

The destination of flows also varies by the type of actor. Low-income countries tend to have a higher reliance on official and especially concessional flows while for lower middle-income countries (LMICs), remittances are a major source of external financing. Non-concessional official flows target LMICs and upper middle-income countries (UMICs). The major share of private finance goes to UMICs but it is an important source for LMICs as well (Figure 2.6).

Figure 2.6. Destinations of external financing in 2016



Source: Authors' calculations based on OECD (2018[3]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for official bilateral and multilateral flows; World Bank (2018[4]), "Migration and Remittances Data"; IMF (2017[5]), "Balance of Payments" (database) for FDI, portfolio investments, and long-term and short-term debt.

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Currently, USD 1.7 trillion in resources are already flowing into developing countries but not every dollar will have the same development impact, as Chapter 4 discusses further. To ensure these are spent in a way that is conducive to sustainable development, the diversity and distinct comparative advantages of actors must be exploited.

Commercial investors

- Private investment including FDI, portfolio investment and long-term debt to developing economies amounted to around USD 890 billion in 2016.
- Investment flows are drying up one after another. This process started with cross-border mergers and acquisitions, which started to decline around 2012 and were down by USD 72 billion in 2017 from the high of USD 234 billion reached in 2011.
- FDI flows, which constitute the largest private investment flow, are following this downward trend. Over the period 2015-16, FDI flows to developing countries fell by USD 70 billion, or 11%, a trend that appears to have continued into 2017.
- Most recently, project finance in the first half of 2018 was down by 30% year on year.

Commercial investors have become increasingly important and diverse

Over the past 30 years, multinational enterprises (MNEs) have become important actors channelling FDI[8] to establish a presence in developing countries. Over the last 20 years in particular, the nature of MNE investment flows to developing countries has evolved beyond a relatively narrow focus on the extractive industries to become one of the cornerstones, along with trade, of global value chains (GVCs) Box 2.4. Many developing countries are now involved in the production of increasingly sophisticated goods and services that feed into the international production networks of MNEs. Global value chains are increasingly used as channels contributing to sustainable development, mostly through financial transfers but also through the transfer of knowledge, standards and skills.

MNEs also engage in portfolio investments, especially within the context of strategic partnerships with other MNEs and domestic firms. Multinational enterprises base their decisions to invest on a broad range of factors including market size, labour force skills, macroeconomic and institutional stability, physical infrastructure, and natural resources.

Other actors involved in portfolio investments include institutional investors such as pension funds, sovereign wealth funds, mutual funds, private equity funds, and hedge funds. Often these investors seek opportunities in developing countries to reduce the risks of their investment portfolios through diversification and higher returns. Since financial assets in developing countries have low correlation with returns in developed economies, they complement the risk-return profile of financial investors in developed countries.

Box 2.4. Trade has been a key driver of development but is slowing

Trade has always been central to economic co-operation and development. The current global system overseeing trade and investment evolved from efforts to create a rules-based system after the Second World War that would regulate investment and business practices, establish labour standards, and promote development. The General Agreement on Tariffs and Trade, or GATT, grew out of these efforts and led to the World Trade Organization (WTO). A series of tariff reductions resulted in significant trade liberalisation and growth in international trade. For several decades, global trade grew substantially faster than global GDP.

Global value chains (GVCs) have had a significant impact on development. These international production and distribution networks have increased developing countries' growth prospects and integration in global markets. For example, their share of global value-added trade rose to 40% in 2012 from 20% in 1990 (UNCTAD, 2013[25]). GDP-per-capita growth rates in economies showing the fastest- growing participation in global value chains are about two percentage points above the average. However, the benefits of GVCs are concentrated in specific regions including North America, Europe and East Asia, meaning many developing countries are being left behind (UNCTAD, 2013[25]).

Multinational corporations generate some 80% of trade flows (UNCTAD (2013[25]), which are intrinsically linked with FDI decisions. Trade and FDI can be seen as two facets of a single economic activity: international production sharing (World Economic Forum, 2013[26]). The positive

correlation between FDI stocks and global value chain participation is especially present in the poorest countries, indicating that FDI may be an important way for developing countries to access and increase their participation in global value chains (UNCTAD, 2013[25]).

Some GVC activities are declining, raising questions about the future of trade's impact on development. Since the Second World War, the volume of world trade has on average grown about 1.5 times faster than world GDP, and in the 1990s it grew more than twice as fast. However, in the aftermath of the global financial crisis, the ratio of trade growth to GDP growth has fallen to around 1:1 and GVC activities also decreased (World Bank Group et al., 2017[27]). It is not yet clear whether this may change the nexus between investment, trade and development, or what the impacts will be on financing for development.

Investors in developing countries themselves account for one-quarter of global FDI outflows, up from around 12-13% before the 2008-09 global financial crisis (World Bank, 2013[28]). The rapid rise of China as one of the world's largest sources of FDI, including through Chinese state-owned enterprises, has been particularly important (Box 2.5).

The growing visibility of this relatively new kind of actor – the state-owned enterprise (SOE) – goes hand in hand with the growing significance of investments from developing countries, as these countries often channel their investment through SOEs. Although not strictly a private sector actor, state-owned enterprises often behave in ways that are similar to their private sector MNE counterparts. This may mask significant government involvement in some cases. Data on FDI do not allow for a distinction between international investments by state-owned enterprises and privately-owned MNEs, but data on cross-border M&A suggest conservatively that the former account for around 10-20% of global FDI flows.

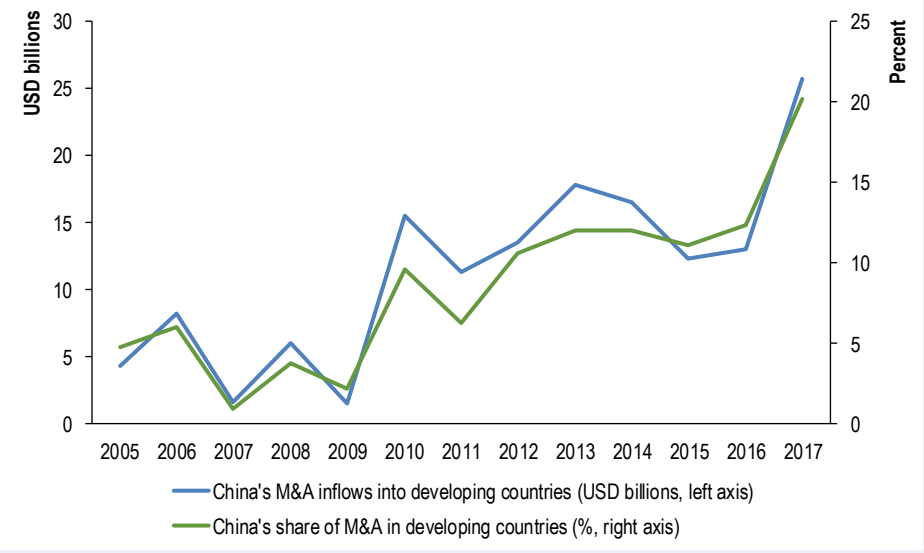
Finally, a multitude of private actors are often involved in project finance, one of the most important forms of investment from a development perspective and a primary method for financing so-called greenfield investments. Project finance usually involves a combination of MNEs and commercial lenders as well as many of the public-sector partners discussed later in this chapter, such as bilateral and multilateral donors, regional development banks, and export credit agencies. Although project finance is smaller in volume terms than are other private flows, it is important from an SDG perspective insofar as it often directly supports specific SDGs. Among these are SDG 7 (the development of renewable sources of energy), and SDG 9 (transport infrastructure).

Box 2.5. China becomes the top source of investment in developing countries for the first time

An increasingly important source of investment in developing countries is China. A major driver of China's outward investment has been its One Belt, One Road initiative, which has channelled billions of dollars into infrastructure projects in the Eurasian countries and beyond (OECD, forthcoming).

One indicator of China's growing influence is the increase in merger and acquisition (M&A) investments. Chinese M&A accounted for 20% of all cross-border M&A received by developing countries, making China the top source of investment into developing countries ahead of Japan and the United States. Chinese investment in developing countries grew rapidly beginning around 2010 and has continued to grow even as the Chinese government has been reigning in outward investment more generally. Overall outward M&A from China declined by USD 115 billion, or 53%, between 2016 and 2017, but M&A to developing countries doubled to USD 25 billion (Figure 2.7).[9]

Figure 2.7. China's growing importance as a source of investment in developing countries



Source: Authors based on data from Dealogic (2018[29]), https://www.dealogic.com/content/.

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This increase in Chinese investment in developing countries would seem to represent a purposeful, policy-driven trend. Most of this investment is being undertaken by fully owned Chinese state-owned enterprises, as it has been since the Chinese investment boom in developing countries started in 2010. Over this eight-year period, fully owned state-owned enterprises undertook 63% of this investment in value terms.[10] These data likely understate the extent to which the government participates in China's outward investment flows, especially in the context of the One Belt, One Road initiative, insofar as they do not include the activities of partially state-owned firms or the role of state-owned banks in financing outward investments by privately owned firms.

Private finance can bring benefits beyond pure financing

Private investors are the single largest providers of cross-border financing to developing countries. This means that encouraging even a relatively small share of this investment to align to the SDGs has significant potential. Even without intending to, private investors and the FDI they generate are particularly relevant for the SDGs for a variety of reasons including but not limited to the following:

- They transmit new technologies
- They provide access to new international markets
- They can fill gaps that domestic investors and other investors or sources of financing cannot reach
- They can generate decent jobs and tend to pay higher wages and better uphold the principles of responsible business conduct than domestic enterprises
- They tend to create business linkages in the economy that support domestic enterprises
- They generate revenues

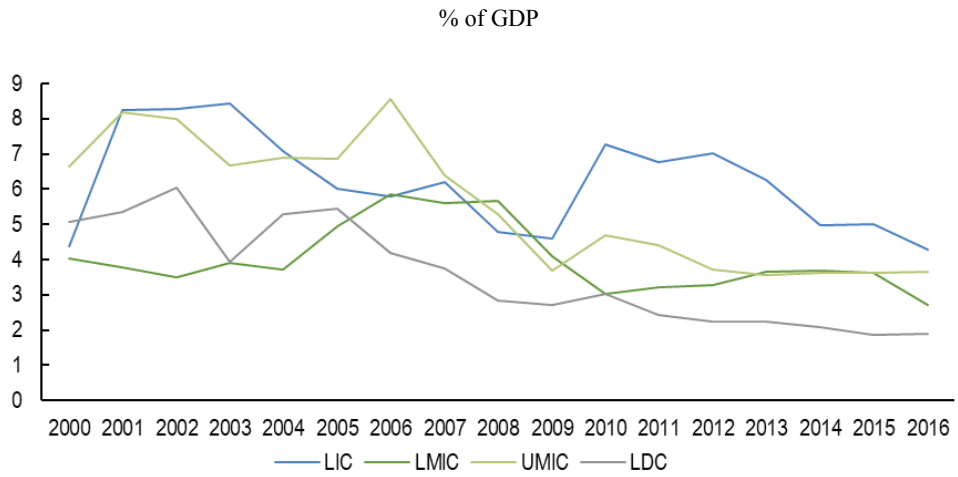
Private sector actors can play especially important roles in the financing of specific Sustainable Development Goals such as SDG 7 (affordable and clean energy) and SDG 9 (industry, innovation and infrastructure). Where public budgets are under strain, private investors can fill infrastructure financing gaps and bring expertise to improve project efficiency. Chapter 4 explores the specific contributions of commercial investors towards the SDGs in greater detail.

These benefits, however, are not always automatic or even guaranteed. The logic and motivations driving private investors differ from those of public actors and investment returns need to be transformed into development gains. To harness the full sustainable development potential of private investors, it is important to identify mutually beneficial opportunities that satisfy the objectives of private actors and contribute to the achievement of the SDGs at the same time. Moreover, a key challenge is to move away from a narrow focus on quantities and volumes to the quality and development impact of financing, as discussed further in Part II.

An era of foreign investment prosperity for developing countries comes to an end

Private investment including FDI, portfolio investment and long-term debt to developing economies amounted to around USD 890 billion in 2016. At their peak in the early 2000s, private investment inflows amounted to more than 8% of GDP for LICs and UMICs.[11] In the period 2000-16, private investment as a share of GDP was on average 6.2% for LICs, 5.6% for UMICs and 4% for LMICs. With fluctuations from year to year, the share of private investment over GDP has generally declined compared to the early 2000s and early 2010s (Figure 2.8).

Figure 2.8. Private investment inflows as a share of GDP in developing countries are declining



Source: Authors' calculations based on IMF (2017[5]), "Balance of Payments" (database), http://www.imf.org/external/datamapper/datasets/BOP; IMF (2018[30]), "World Economic Outlook" (database), https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx.

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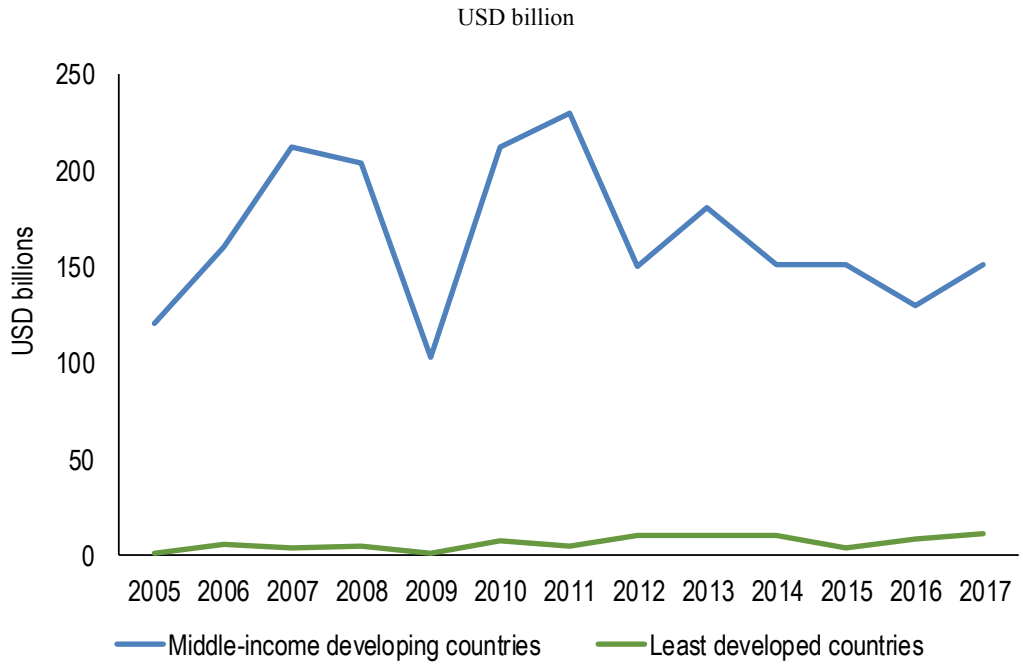
FDI, which makes up the largest part of these flows, has shown relatively solid growth and resilience until recently. Developing economies fared relatively better than developed countries during the financial crisis and experienced a one-year decline in FDI of around 30%, with volumes dropping to around USD 430 billion[12] in 2009 compared to the 40% drop in global FDI flows. FDI flows recovered strongly in 2010, thanks in large part to a 50% increase in flows to developing economies that year. Over the following five years, flows to developing countries were relatively stable, growing to around USD 630 billion in 2015.

This period of FDI prosperity, as some have called it, came to an end in 2016, when FDI flows reversed course at the global level. Over the period 2015-16, flows to developing countries fell by USD 70 billion, or 11%, in a trend that seemed to continue into 2017. The reasons behind these declines include a mix of broad cyclical and more country-specific factors. Among the former are tighter monetary policy in developed economies and the reversal of the commodity super-cycle (OECD, 2016[31]). More country-specific factors include various sources of geopolitical instability, concerns over rising protectionism and record levels of corporate debt in emerging markets (IMF, 2016[32]). FDI outflows to developed countries followed a similarly broad reversal.

Trends in mergers and acquisitions[13] in developing countries show that, in contrast to FDI inflows, M&A inflows were already beginning to decline in 2012 (Figure 2.9). Overall, M&A volumes in developing countries were USD 162 billion in 2017, down by USD 72 billion from the high of USD 234 billion that was reached in 2011. The biggest declines were in upper middle-income developing countries, with annual M&A inflows to China decline by USD 19 billion between 2011 and 2017, to Chile by USD 14 billion, to Turkey by USD 10 billion and to Brazil by USD 9 billion.

Figure 2.9. Inward M&A: middle-income and least developed countries



Source: Authors' calculations based on data from Dealogic (2018[29]), https://www.dealogic.com/content/.

StatLink https://doi.org/10.1787/888933852787

The decline in cross-border M&A would not be a negative development on its own had it been offset by a rise in domestic M&A, since this is a trend generally associated with economic development. Over the past decade, developed countries received 29% of their M&A investment from foreign sources; 71% was generated domestically.

In contrast, developing countries received 44% of their M&A investment from foreign sources and generated 56% domestically. The main reason for this difference relates to domestic market weaknesses, imperfections and failures such as a weak domestic financial sector. These can hold back domestic investors but foreign investors are able to overcome them given their significant resources. However, as noted, domestic M&A in developing countries has trended downward more rapidly than cross-border M&A flows, suggesting an overall decline in private sector investment in developing countries.

This downward trend is mirrored in project finance flows. Despite showing resilience to the overall downward investment trends in 2016 and 2017, project finance in 2018 experienced its worst first half in ten years, with volumes down 30% year-on-year (Figure 2.5) and affecting all regions. The number of new transactions declined by 50% to 377 in the first half of 2018 from 725 in the same period of 2017. In addition, around 38% of project finance was for refinancing purposes, up from 24% in the first six months of 2017. In other words, just as the volume of project finance is declining, a shrinking share is going towards new projects.

Policy action is needed to counteract the decline in foreign investment

Business investment in developing countries is currently like a river whose feeder streams are drying up one after another. This process started with cross-border M&A, which

started to decline around 2012. This was followed declines in FDI and domestic M&A in 2016, and most recently, in the first half of 2018, in project finance. Portfolio investment is also under pressure in developing countries as interest rates begin to rise in the developed economies and record-high levels of corporate debt have raised the spectre of financial turbulence (OECD, 2018[33]).

Whether this situation worsens depends on many variables. But the current trend is clearly not encouraging. Given data limitations, putting a precise number on the extent to which private business investments in developing countries have shrunk is not possible. However, an orders-of-magnitude calculation based upon cumulative declines in FDI against a counter-factual assumption of zero growth from the previous high in FDI in 2011 suggests that developing countries have foregone between USD 400 and USD 450 billion of FDI from 2012-2016.

Given this scenario, which is leading from billions to millions instead of billions to trillions, an urgent and challenging policy agenda suggests itself. Elements of such an agenda might be expected to address the following challenges:

- The global rules for trade and investment need to be improved and made to work better in support of an open, rules-based global economy. One of the greatest threats for developing countries would be the widespread outbreak of protectionist trade and investment wars that could accelerate what to date has been a significant but measured retreat of the private sector from developing countries.
- As private sources of financing that align with and can support achievement of the SDGs retreat, public sources will become relatively more important and will need to play a counter-cyclical role, while recognising that they cannot fill the gap left by the private sector. The author of the essay "Adapt finance and the financial system to "save the world"" calls for the strategic use of public resources to mobilise and attract private capital. This will be difficult in developing countries given that declining business investment has a knock-on negative impact on the ability of governments to maintain adequate levels of tax receipts; this could feed negative spirals as public spending on critical business infrastructure is cut back, further undermining business climates. Co-ordination among donors to maximise the development impact of official development assistance ODA and other forms of public financing becomes critical.
- Considerable scope remains for pursuing domestic policy reform agendas to improve business climates and to put in place investment promotion and facilitation strategies. Private investment has been declining but continues to play a critical role in helping countries to develop critical infrastructure, generate employment and foster innovation. Governments have an important role to play in helping to better align business interests and the SDGs, thus generating more development impact from less investment. Fostering such closer alignment can also be achieved through the promotion of responsible business conduct.

Private flows constitute the largest single source of foreign financing going to developing countries. Looking forward and beyond the looming development crisis, much more needs to be understood about private flows and the full implications of this financing for achievement of the SDGs. The AAAA created high expectations regarding the contribution of the private sector to sustainable development – expectations that stand in contrast to the current trend line of private flows. This points to an important knowledge gap that will need to be filled to inform an empirical policy-oriented agenda in the future.

Box 2.6. In My View: Adapt finance and the financial system to "save the world" by Bertrand Badré, former Managing Director of the World Bank and CEO and founder of Blue like an Orange Sustainable Capital

Without a doubt, 2015 was a pivotal year. The Addis Ababa conference on financing for development. The unanimous agreement in New York by the United Nations of the Sustainable Development Goals. The climate agreement in Paris. A truly ambitious set of goals and commitments and nearly three years on, substantial progress is being made. However, if we are genuinely serious about these agreements and about these commitments, then it is imperative that we adapt finance and the financial system. Both of these must be revamped to meet the expectations we have created. We need to keep pushing hard to make the necessary progress and get points on the scoreboard before apathy sets in.

Collectively, we need to focus on the key tenet of "billions to trillions" that I and others led back in 2015. We must mobilise and attract private sector capital to finance much needed investment in emerging and developing economies. History has demonstrated that this capital will typically not flow there naturally, at least not in the amounts needed. Mechanisms need to be set up that will create that flow.

Here is where the rest of the system has a vital role to play. Embedding such an approach into the overall finance system will drive the capital. This means that every participant, every stakeholder, has to orientate the way it thinks about capital mobilisation. The multilateral development banks and donor countries are pivotal as they have the resources and the appropriate layers of capital and systems that can be brought together with the private sector capital for that clichéd "win-win". Regulators are also critical and need to continually evolve to meet the new paradigms and to help fuel innovation within an appropriate framework. This is not an easy task by any means but is much needed if we are to restore the trust that was lost following the financial crisis. The pressure is even greater now to ensure that we are undertaking more than just superficial changes but rather proper, deep transformations – a real change for many of the incumbent participants.

Co-operation is key. The public and private sectors need to work together. This necessitates a fundamental shift in how each views the other and how, on a basic level, each is willing to engage in business with the other. This will be successful only when both make significant moves. Improved co-operation among public sector actors also is needed. Additionally, the private sector must continually reassess and advance to a more long-term perspective in the way it carries out its business. The real beauty of all this change is that, given the different incentive mechanisms, the new co-operation can be truly symbiotic. Money will follow cultural changes. Shift in culture will mean shift of money!

Fundamental change is needed. Stamina and patience are required. If we can come together and adapt, if we are willing to pay this "price", then we stand a chance of achieving the rightly ambitious goals. The rub? If we are serious, if we are not inconsequential – which like most I hope we are – we do not have a choice.

Migrant remitters

- Beginning in the early 2000s, global remittance flows increased sharply, aided by technological advances in financial infrastructure that significantly reduced the costs of transmitting funds.
- The amount of global remittances rose to USD 466 billion in 2017 from USD 122 billion in 2000, making remittances the second largest type of cross-border financing to developing countries.
- The average cost of sending remittances has remained flat at 7.1% – far higher than the SDG target (indicator 10.c) of less than 3%.

Migrants from developing countries act as providers of financing for sustainable development

Recent years have seen an increase in international migration. In 2015, 3.3% of the world's population or 244 million people were international migrants. This is a significant increase from the estimated 155 million people who were international migrants in 2000 and who then represented 2.8% of the world's population. Many of the migrants come from developing countries and send home remittances to support their families.

Decisions to send remittances are essentially private and personal in nature. Remitters may be motivated by altruism, but they are not necessarily taking into explicit consideration the achievement of the SDGs in their home countries. As outlined in Box 2.7 migrants are influenced by a range of factors that can include a desire to support family members and the intention to prepare for a return to their home country (OECD, 2006[34]). The willingness to remit also depends on the duration of migration (the length of time a migrant intends to stay abroad and whether the stay is temporary or permanent); family situation (whether the migrant is single or married and has children); and network effects (whether the migrant moved alone or with family members and the degree of attachments to those left behind) (OECD, 2006[34]).

Box 2.7. Motivations of remitters

A number of theories to explain the motives for sending remittances have been put forward, ranging from pure altruism (e.g. the migrant's concern for relatives left in the home country) to pure self-interest (e.g. aspiration to inherit or desire to invest in financial assets or real estate in the home country). One theory between those two extremes rests on an insurance model that views migration and remittance as a household risk strategy that builds on informal agreements with family members remaining in the home country. In this scenario, the migrant's family finances the initial costs of the migration project that the migrant alone often cannot cover. In turn and once the migrant secures employment, high enough earnings and positive expectations about further income, he or she sends remittances to the family to finance investments such as education of the younger generation and/or to support the family during emergencies and times of need (OECD, 2006[34]).

Remittances are also sent collectively through migrant and diaspora associations such as hometown associations or diaspora direct investments, often with an explicit development orientation. Diaspora groups form hometown associations in the country of destination to collectively support the country of origin through investments in development projects. Mexican migrants in the United States, for example, form such associations to channel funds back to

Mexico's poorest rural areas with high levels of out-migration. Another form of such financing is investment by diaspora-owned firms or firms with diaspora members in top management in productive activities (Rodriguez-Montemayor, 2012[35]).

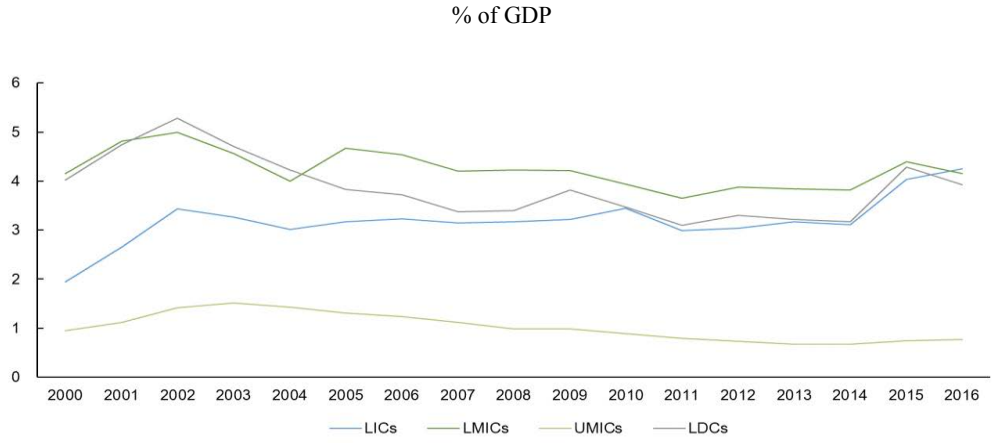
Remittance volumes have surged to become the second largest source of external financing

The volume of remittance flows has continued to steadily climb in tandem with the movement of people. Experience has shown that remittances, constituting a steady stream of foreign exchange, can help to alleviate poverty and stimulate economic growth in migrants' countries of origin (Singer, 2010[36]). A case in point is Korea. Remittances from Korean workers in West Germany and the Middle East and from Korean soldiers deployed to Viet Nam provided foreign exchange that contributed to jumpstarting the rapid economic development in the 1960s.

Beginning in the early 2000s, global remittance flows increased sharply, helped by technological advances in financial infrastructure that significantly reduced the costs of transmitting funds.[14] The amount of global remittances rose to USD 466 billion in 2017 from USD 122 billion in 2000, making remittances the second largest type of cross-border financing to developing countries. Regional growth trends and projections suggest remittances will increase in developing countries overall, following a decline in 2015 and 2016 that is attributed to weak economic growth in the sending countries of the Gulf Cooperation Council and the Russian Federation ("Russia") and to exchange rate movements.

Remittances make up a sizable portion, around 4%, of GDP in both lower middle-income countries and low-income countries (Figure 2.10). For lower middle-income countries, it has remained fairly constant from the early 2000s through 2016. But the share of remittances in GDP increased sharply for low-income countries, doubling during this period. Among the top receiving countries in terms of remittances as a share of GDP are small economies such as Kyrgyzstan, Tonga and Tajikistan, which each receive more than or close to 30% of GDP in remittances. In nine out of ten top receiving countries, remittances correspond to 20% of GDP or more.

Figure 2.10. Remittance inflows as a share of GDP



Source: Author's calculations based on World Bank (2018[4]), "Migration and Remittances" (database), http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances. IMF (2018[30]), "World Economic Outlook" (database), April 2018 Edition, http://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx, for GDP data.

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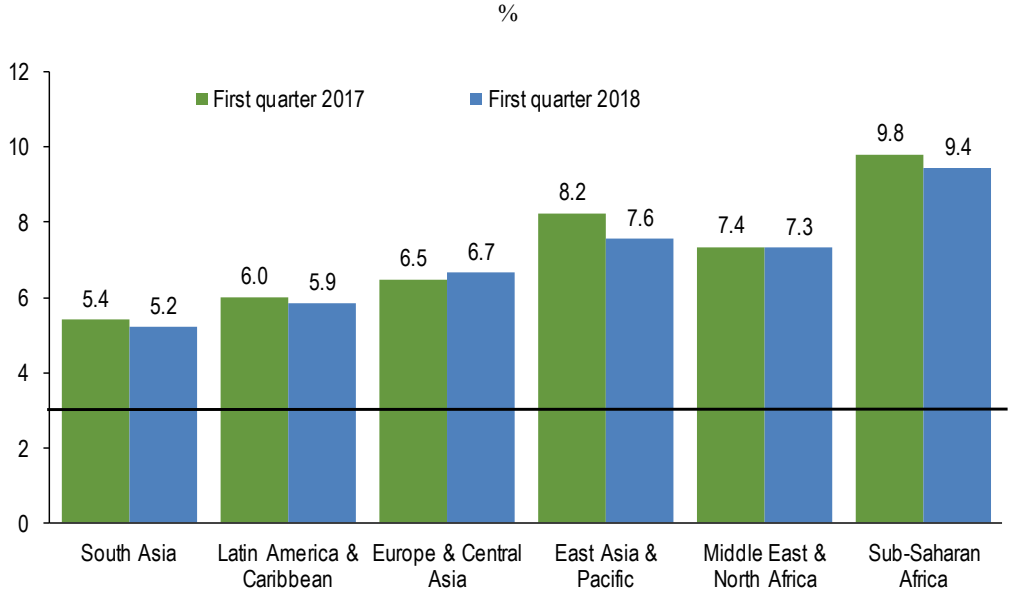
Transaction costs involved in sending remittances to developing countries, however, far exceed the SDG target (indicator 10.c) of less than 3%. The average cost of sending remittances has remained flat at 7.1% (Figure 2.11), with the lowest average transaction costs in South Asia (5.2%) and highest in sub-Saharan Africa (9.4%). Remittance costs across many African corridors and small islands in the Pacific remain above 10% because of the low volumes of formal flows, inadequate penetration of new technologies and lack of a competitive market environment (Ratha et al., 2018[37]). Potential remedies in terms of domestic policy are discussed in the essay "How to mobilise remittances for development financing".

Figure 2.11. Remittance costs across regions exceed the 3% SDG target



Source: World Bank (2018[38]), "Remittance Prices Worldwide" (database), https://remittanceprices.worldbank.org/en.

StatLink https://doi.org/10.1787/888933852825

Box 2.8. In My View: How to mobilise remittances for development financing, by Dilip Ratha, Head of Global Knowledge Partnership on Migration and Development

Remittances can be mobilised for development financing

For a long time, remittances were ignored as small change. But these small sums of money sent by migrants to family back home in developing countries actually add up to more than three times the total of official development assistance (ODA). In 2017, remittances reached USD 466 billion. In contrast to the outlook for ODA – flat at best for the medium term – remittances are expected to rise at an annual rate of over 4%. The true size of remittances, including flows through informal channels, is significantly larger.

Yet remittances are private money and they should not be used (through taxes) for public spending. There is also a concern that most of the remittances received by poor families are used for essential consumption such as for food, clothing and housing, although we know now that they are also used for financing education and business investments. Remittance flows are more stable than private investment flows. These flows are also better targeted to the needs of recipient households, given they are timelier, and better monitored than official aid.

Can these private flows be used for more productive investments and for funding public goods? The answer is yes. Removing regulatory barriers can reduce remittance costs and translate into additional USD 20 billion in flows per year to poorer households in developing countries. Remittances can be used to improve sovereign credit ratings and bond ratings, thereby reducing the costs of financing programmes. And remittance channels can be used to mobilise USD 50 billion or more of diaspora savings through the issuance of diaspora bonds.

Lower regulatory barriers

Today, when the costs of cross-border communication have become negligible, it costs more than 9% on average to send money to a family in sub-Saharan Africa. Except in a few large country corridors, remittance costs on average top 5% in all regions, which is significantly higher than the SDG target of 3% (SDG indicator 10.c). If remittance costs are reduced by 3 percentage points, say, they could save more than USD 20 billion in the hands of migrants and their families. Remittance channels are used not only by migrants to send money to families but also for small payments for trade, investment and philanthropy.

Remittance costs can be reduced rapidly by allowing new remittance service providers into a market dominated by few large players. One self-evident option is to end exclusivity partnerships between the national post offices (especially in the OECD countries) and large money transfer operators. Another would be to recognise that small remittances are overwhelmingly used for personal uses and carry very low risks of money laundering and financing of terrorism. This would open up the market to new players using more efficient and cheaper technologies such as mobile phone or blockchain technologies.

Remittances are the most stable form of cross-border flows and can have a positive development impact

Migrants' remittances present the most stable form of cross-border flows to developing countries. While private capital flows tend to rise during favourable economic cycles and fall in bad times, remittances appear to react less violently and may even rise during recessions in recipient countries. For example, remittances to developing countries continued to rise steadily in 1998-2001 when private capital flows declined in the wake of the Asian financial crisis (Ratha, 2005[39]). While remittances are relatively stable at aggregate levels, inflows to individual developing countries may be quite volatile, impacting on economic stability (Jackman, 2013[40]).

These benefits of remittances enhance the creditworthiness of developing countries. The World Bank-IMF Debt Sustainability Framework allows recipient countries to carry higher levels of debt when the ratio of remittances is higher than 10% of their domestic income and 20% of exported goods and services (IMF, 2017[41]).

At the micro level, too, remittances can have a positive impact on development and poverty. They are shown to increase the income of recipient households and remove financial constraints, reinforcing a household's ability to resist external shocks. In some countries, "households that receive remittances are more likely to engage in productive activities such as owning businesses, real estate or agricultural assets" and tend to spend more on education (OECD, 2017[42]). However, the link between remittances and higher investments is not always straightforward. In some cases, remittance income is spent on the daily consumption of basic goods rather than in investments in human and physical capital (Adams and Cuecuecha, 2010[43]).

Policies in remittance sending and recipient countries can enhance development impact

How can remittances be best harnessed to benefit sustainable development? Although an important source of cross-border financing, remittances must be considered separately from other forms of financing for development due to their essentially personal nature. Not all remittances contribute to sustainable development and measuring the portion of remittances targeting sustainable development is challenging (Chapter 4).

To strengthen the development impact of remittances and make sure that remittances can be used in the most beneficial way for the migrants and their families, policy should focus on creating an enabling environment that supports the use of remittances for long-term investments (OECD, 2017[42]). For example, policies that foster financial inclusion of migrants and remittance recipients and that promote financial literacy can help to channel remittances towards investment in human capital and productive activities.

Domestic policies in remittance-sending countries that help to ensure the effective transfer of remittances at the level of non-state intermediaries also can enhance the development impact of remitters and diaspora communities (Chapter 5). Both the Addis Ababa Action Agenda and the 2030 Agenda point to high transaction costs as a potentially productive area for policy intervention.

Philanthropic foundations

- Philanthropic giving is dominated by a handful of large players based in the United States and Europe. Just 20 foundations provided 81% of total philanthropic giving to developing countries during 2013-15. Nearly three-quarters of the amount originated from foundations based in the United States.
- Philanthropic giving to developing countries amounted to USD 23.9 billion in the 2013-15 period, or USD 7.96 billion per year on average.
- Middle-income countries received 67% of the flows. 37% went to lower middle-income countries and 30% to upper middle-income countries. Only a third of the flows went to least developed countries and other low-income countries.

Foundations continue the long-standing human tradition of philanthropic giving

Philanthropy has been a part of human civilisation for thousands of years. In ancient China, clan-based lineage organisations provided allowances to widows and orphans, distributed grain to the poor and built schools for children (UNDP, 2016[44]) Philanthropy is also deeply ingrained in the Judeo-Christian tradition, evidenced by the ancient Hebrews' gifting of one-tenth of their income to those in need, and it is also a pillar of Islam, which requires zakat giving (Andrews, 1950[45]).

In the 20th century, some of the wealthiest industrialists in the United States, such as John D. Rockefeller and Andrew Carnegie, organised their philanthropic giving at an unprecedented scale with the aim of systematically addressing the social needs of the day. These philanthropists said they considered it the duty of the rich to use their skills and fortune to benefit the wider community and poor.

A surge in entrepreneurial wealth over the last 30 years has brought with it a new class of philanthropists. By bringing a business approach to philanthropy and focusing on strategy, innovation and partnerships, these actors play a unique and pioneering role in the financing for sustainable development system.

In terms of volumes, a handful of large players based in the United States and Europe dominate philanthropic giving to developing countries. A survey conducted in connection with the recent OECD (2018[46]) report, *Private Philanthropy for Development*, finds that just 20 foundations provided 81% of total philanthropic giving to developing countries during 2013-15 and nearly three-quarters of all such philanthropy originated from foundations based in the United States. The Annex to this chapter provides further details. The Bill & Melinda Gates Foundation, headquartered in the United States, alone accounts for nearly half (49%) of total giving, which largely explains the finding about geographic concentration. Of the 143 foundations included in the OECD data survey sample, other top originating countries were the United Kingdom (7% of total philanthropic giving), Netherlands (5%), Switzerland (2%), Canada (2%) and the United Arab Emirates (2%).

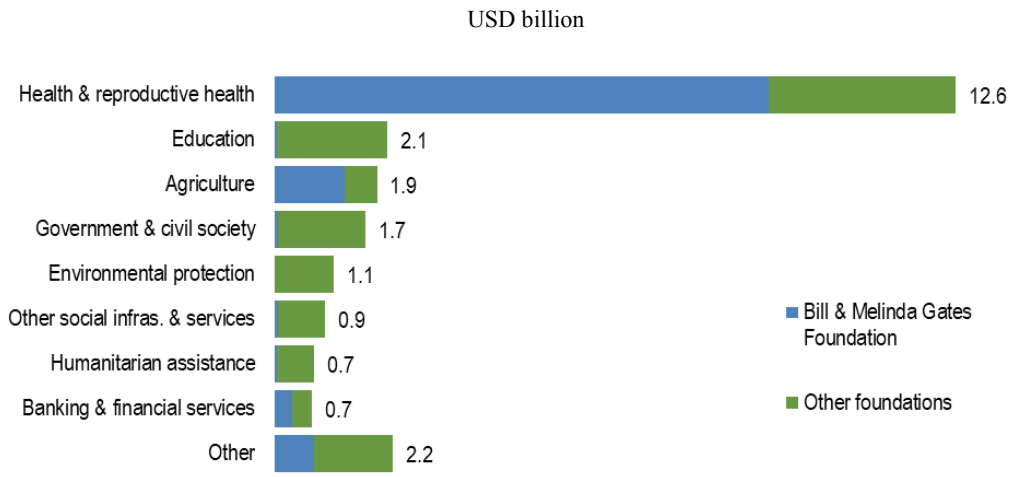
Philanthropic giving nevertheless is relatively small in volume

Philanthropic giving to developing countries amounted to USD 23.9 billion in the 2013-15 period, or USD 7.96 billion per year on average (OECD, 2018[46]). While philanthropic giving remains relatively modest compared to financing for development more broadly, foundations have become major partners in some specific areas. For example, in the health and reproductive health sectors in 2013-15, support from philanthropic foundations constituted the third-largest

source of financing for developing countries, after support from the United States and from the Global Fund to Fight AIDS, Tuberculosis and Malaria.

Almost three-quarters (74%) of foundations' giving in 2013-15 supported activities in social infrastructure and services such as health, education, human rights and social protection (Figure 2.12). Overall, health was the main sector targeted by philanthropic giving – far ahead of other sectors – with USD 12.6 billion or 53% of the total. The Gates Foundation was the major player in this arena, accounting for 72% of total giving to health. The donations of other foundations accounted for only the remaining 28% of the sector total, although the OECD survey shows that health and reproductive health was also their main funding priority.

Figure 2.12. Philanthropic giving by sector, 2013-15



Source: OECD (2018[46]), *Private Philanthropy for Development*, https://doi.org/10.1787/9789264085190-en.

StatLink https://doi.org/10.1787/888933852844

Philanthropy also mainly targeted middle-income countries, who in total received 67% of the flows. 37% went to lower middle-income countries and 30% to upper middle-income countries. Only a third of country allocable funding went to least developed countries and other low-income countries (OECD, 2018[46]).

Some philanthropic foundations play key roles innovating and collaborating with other actors

Philanthropic foundations are increasingly influential actors in international development. The largest players in particular, and notably the Gates Foundation, are actively shaping the agenda setting and funding priorities of international organisations and governments by virtue of the size of their grant making, networking and active advocacy.

In some cases, philanthropic foundations can play a special role in financing for sustainable development because they are relatively less risk averse and relatively more are willing to invest in innovative business concepts and financing models (Marten and Witte, 2008[47]). Box 2.9 "Unlocking financial innovation to accelerate pro-poor innovation" reviews the range of possible collaborative opportunities with philanthropic foundations who can provide the seed capital for innovative solutions to development problems. Yet the vast majority of philanthropic foundations are traditional in the instruments and channels of delivery they use (OECD, 2018[46]).

Box 2.9. In My View: Unlocking financial innovation to accelerate pro-poor innovation, by Mark Suzman, Chief Strategy Officer & President, Bill & Melinda Gates Foundation

Combined with commitment from the global community, technology and innovation can be powerful forces for improving global health and reducing poverty. Think of the potential of new crop varieties to help alleviate extreme poverty by increasing crop yields, resilience and nutritional value. Or the potential benefits of developing and widely deploying digital identification systems that can improve access to government services and give impoverished people a chance to join the formal economy and improve their lives.

But for these visions to become reality, change is needed in how the development community does business. First, governments and donors need to work more closely with those who have special expertise in helping countries adopt innovative technologies. The private sector and philanthropic organisations can and must help in this regard. Second, scaling innovation will require more flexible financing policies and a greater appetite for risk on the part of the largest providers of development finance and most notably multilateral development banks, other development finance institutions, and large institutional and private investors.

One way this can happen is through a segmentation of development finance. Philanthropic capital, which can absorb higher risks than many other types of development finance, should be used to pilot innovation. International financing institutions can then take successful pilots to scale more often than they do now. Philanthropic providers also need to become better aligned to ensure that promising ideas are supported from the conceptual stage through scaled broad deployment.

By focusing on appropriate risk sharing and mitigation, international financial institutions and the donor community can also better unlock private sector investment to do what it does best: finance commercially viable investments and bring to the table the sector's know-how and openness to innovation. Scarce public and concessional resources can then be freed up to focus on where they are most needed.

Donors also need to engage in clear-eyed cost-benefit analyses to determine a risk-adjusted economic (not just financial) rate of return and to guide allocation toward purposes that truly help those in greatest need. The Bill & Melinda Gates Foundation has sometimes learned this lesson the hard way. One example is an investment we made to encourage commercial banks to lend to smallholder farmers. The risk sharing facility we created ultimately did not catalyse greater access to finance for smallholders. And once the facility was withdrawn, the costs to commercial banks to maintain lending were prohibitive and funding dropped.

Greater success is likely through co-operation between international finance institutions and donors. The Climate Investment Funds are a good example. A multibillion-dollar partnership of donors and development banks, the funds offer concessional financing to middle income countries for adoption of renewable energy technologies. This model could be used for scaling other promising innovations.

Another good recent example of such co-operation is the Gates Foundation and the Inter-American Development Bank working together to end malaria in Central America. The foundation's grant money is blended with bank resources in a way that provides strong incentives for countries to implement effective programmes against malaria.

Partnerships are key. At the Gates Foundation, we are ready to partner with governments and the international finance community for the benefit of the poorest and most vulnerable people in the world. Together, we can accelerate pro-poor innovation for developing countries.

Philanthropy can further be used to bridge silos in the financing for sustainable development system, as foundations generally value partnerships and strategically engage in coalitions with government, donors, social entrepreneurs and civil society organisations. Many of the foundations assessed in the "OECD Survey on Private Philanthropy for Development" systematically engage with governments (67%) and with donors (45% when designing or implementing their programmes and projects (OECD, 2018[46]).

Better data and more co-ordination can help even more to harness their potential

- Better and more data are needed to understand and guide the contributions of philanthropic giving to the global goals. Philanthropic foundations are concentrated in a few countries of origin and exhibit similarly significant heterogeneity in terms of the size and scope of their operations. As Chapter 4 discusses in detail, measurement of the global effect of philanthropy is fragmented. The limited availability and transparency of comparable data and measurement standards are additional challenges to mapping their contributions and impact. Recent efforts by the OECD, among them the Survey on Private Philanthropy for Development and the launch of the OECD Centre on Philanthropy in 2018, provide opportunities for improvement in reporting on philanthropic giving.
- There is a need for closer co-ordination with other actors in the financing for sustainable development system. Given their innovative capacities and their focus on partnerships, philanthropic foundations can make a valuable and unique contribution to sustainable development. To make better use of this potential, more institutionalised platforms of co-ordination and knowledge sharing are needed to bring together philanthropic foundations, bilateral and multilateral providers of development financing, and developing country governments. Dedicated philanthropic dialogue platforms at the sectoral, regional and local levels along with international reporting and data collection initiatives (such as the DAC statistics on development finance and the OECD Centre on Philanthropy) can enhance transparency and alignment among actors, ensuring that the flows are mutually reinforcing and complementary rather than duplicative (OECD, 2018[46]).

Bilateral official providers

- Official flows from bilateral providers amounted to USD 210 billion in 2016 and OECD DAC members provided a total of USD 167 billion the same year.
- South-South co-operation flows from ten major countries beyond the DAC are estimated to be USD 6.9 billion in 2015, up from USD 5.2 billion in 2011.
- From 2010-2016, per capita flows going to least developed countries and other low-income countries have declined from USD 38 to USD 32 and from USD 47 to USD 37, respectively, while flows to lower middle-income countries have increased from USD 15 to USD 20.

Bilateral providers can address pressing development needs

Bilateral providers of financing for sustainable development are governments and national development agencies that provide financing, either concessional or

non-concessional, to support the economic, environmental, social and political development of developing countries.[15]

It is sometimes argued that geopolitical self-interest is the ultimate motivator of official development finance, e.g. the possibility to pursue concrete foreign policy interests (Alesina and Dollar, 2000[48]); (Younas, 2008[49]). Development co-operation by official providers became an institutionalised activity after the end of the Second World War and in the wake of the emerging Cold War competition. Bilateral providers deployed aid as an extension of foreign policy with the primary objective of projecting project soft power and also helping to build a vibrant post-war international economy. However, the official objectives of development co-operation, which often are clearly stated in the mission statements and mandates of the implementing agencies, are to promote the development of the recipient country. For instance, a key objective of the European Union's policy on foreign aid is the reduction and eventual elimination of poverty, as mandated by the Lisbon Treaty of 2009.

This formal mandate of bilateral providers – to promote development – requires them to explicitly target the most pressing development needs. Thus, given the role they play, they cannot easily be replaced by alternative providers. As a guardian of development finance, the OECD Development Assistance Committee (DAC) supports members' efforts to comply with this mandate.

Since its establishment in 1960 as part of the OECD, the DAC has institutionalised norms of donor behaviour. The DAC coined new terminology in 1961 by distinguishing concessional flows or official development assistance (ODA) from non-concessional or other official flows (OOF) as a special measure of development assistance, applying softer terms to address the urgent needs of those less developed countries with the most severe economic and debt servicing problems. Building on this definition, DAC members agreed to raise concessional finance in the form of ODA to the level of 0.7% of each donor's national income (GNI).[16]

Another norm for bilateral donors is to explicitly target the most vulnerable countries and sectors with high development impact. In December 2014, DAC members agreed to allocate more ODA to the group of countries and territories that are classed as most in need: least developed countries, low-income countries, small island developing states (SIDS), landlocked developing countries, and fragile and conflict-affected contexts.

Beyond the group of DAC members, there are many bilateral actors who are providing development co-operation, which is also referred to as South-South co-operation. Its steady rise is mirrored in the substantial increase in the number of bilateral providers reporting their development finance to the DAC, which grew to nearly 50 in 2016 from fewer than 20 in 1960.

Moreover, there are many other development co-operation providers who do not report their financing to the DAC. While many of these countries have longstanding development co-operation programmes, their weight in the financing for sustainable development system has increased significantly and reflects their growing importance as drivers of global trade, investment and growth. The lack of transparent data on their activities makes it challenging to understand the full sustainable development finance system and to co-ordinate efforts across different groups of actors (Chapter 4).

As noted in this chapter, many South-South providers extend official financing through state-owned enterprises such as sovereign wealth funds, which often act like private

investors. China's development co-operation, in particular, often mixes concessional with non-concessional resources, which blurs the distinction between public and private actors.

A large portion of bilateral official flows comes from OECD countries and is concessional

Official flows from bilateral providers amounted to USD 210 billion in 2016, of which 74% (USD 155 billion) were concessional flows. In 2016, OECD DAC members provided a total of USD 167 billion, of which concessional flows constituted the majority (71%). South-South co-operation flows from ten major countries beyond the DAC are estimated to be USD 6.9 billion in 2015, up from USD 5.2 billion in 2011. The overall share of these providers in total cross-border financing in developing countries remains small compared to that of DAC members. Nonetheless, some bilateral providers, among them Saudi Arabia and the United Arab Emirates, ranked among the top ten bilateral concessional finance providers in 2015. Moreover, China's development assistance efforts, articulated in the form of megaprojects around the One Belt, One Road initiative are quite substantial in both size and impact, and amounted to USD 3.1 billion in 2015, according to OECD estimates.[17]

However, data constraints mean it is difficult to accurately estimate and fully acknowledge the contribution of South-South co-operation. In the above-mentioned case of China, estimates of the amounts of concessional finance provided in a single year range from USD 3 billion to USD 7 billion. In some cases, a large portion of official finance is channelled through state-owned enterprises and resembles private investments. For example, China's development finance extends beyond the traditional concepts of aid to include "export buyers' credits, official loans at market rates and strategic lines of credit provided to Chinese enterprises" (Lakatos et al., 2016[50]). This can make it even more difficult to fully grasp the full picture of South-South co-operation.

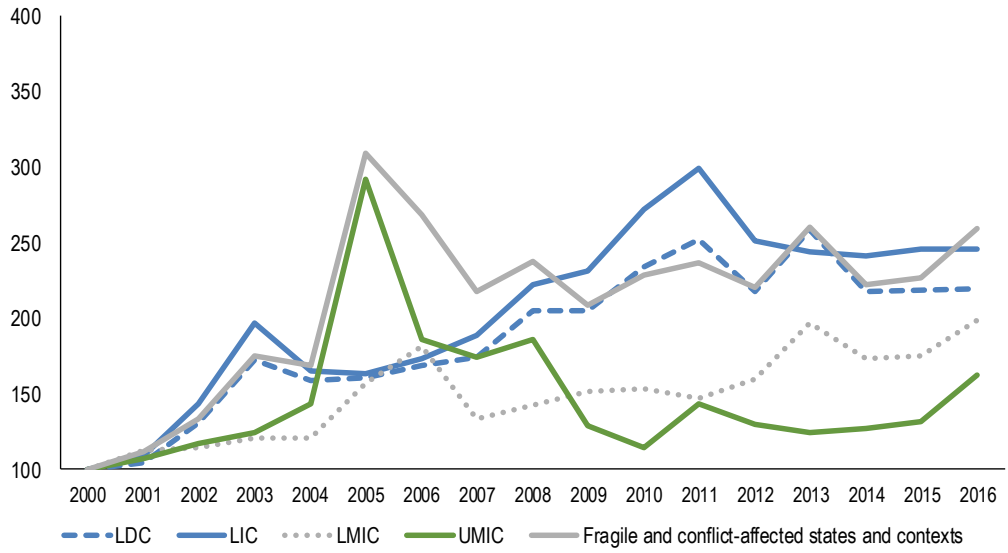
Bilateral flows can target development needs

Bilateral providers are well positioned to target economic and social vulnerabilities, as confirmed by the sectoral allocation of their financing. Due to limited availability of data on the sectoral allocation of flows, the analysis is based exclusively on bilateral providers reporting to the DAC. Compared to multilateral providers, these providers allocate a greater share of flows to social sectors such as government and civil society (11.4%) and education (7.7%). The respective values for multilateral providers are 5.4% (government and civil society) and 3.2% (education). Moreover, a sizable proportion of financing (13.4%) is allocated to humanitarian aid. All of these flows are concessional in nature, as bilateral concessional finance almost exclusively targets economic sectors.

Moreover, bilateral providers have demonstrated a commitment to countries most in need. Since 2000, concessional finance by bilateral actors to countries most in need – including least developed countries, low-income countries, and fragile and conflict-affected countries and territories – increased more rapidly than did financing for other country groupings (Figure 2.13).

Figure 2.13. Bilateral concessional finance to select country groups over time

Indexed: 2000 = 100

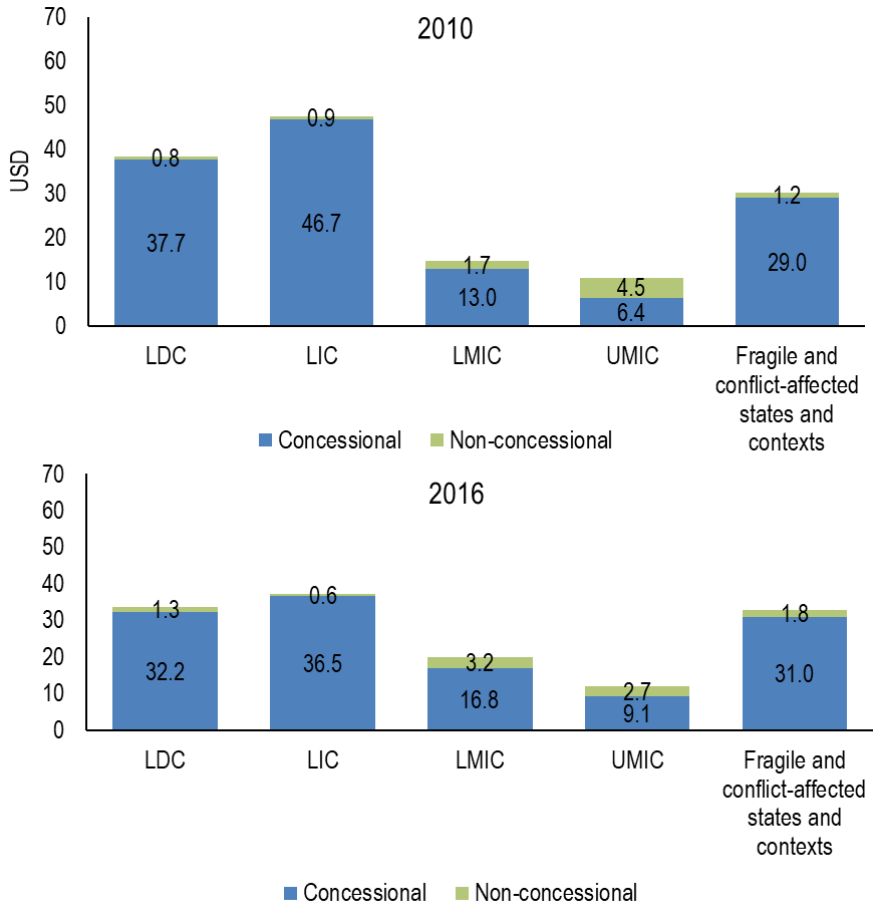


Note: The peaks in 2005 and 2006 for UMICs and fragile and conflict-affected states and contexts are due to high levels of debt relief.
Source: OECD (2018[3]), "Creditor Reporting System" (database), https://stats.oecd.org/index.aspx?DataSetCode=CRS1.

StatLink https://doi.org/10.1787/888933852863

However, more recently, these trends do not seem to continue to the same extent. Figure 2.14 shows that although per capita flows to fragile and conflict-affected contexts have increased from 2010-2016, flows going to least developed countries and other low-income countries in per-capita terms have declined to USD 32 from USD 38 and to USD 37 from USD 47, respectively. This suggests that increases in financing have not been able to keep up with population growth in these countries and contexts. At the same time, concessional and non-concessional flows per capita to lower middle-income countries have increased to USD 20 from USD 15.

Figure 2.14. Concessional and non-concessional financing per capita (selected groups)



Note: The figure includes concessional and non-concessional financing provided by OECD DAC members.
Source: OECD (2018[3]), "Creditor Reporting System" (database), https://stats.oecd.org/index.aspx?DataSetCode=CRS1.

StatLink https://doi.org/10.1787/888933852882

Although it is difficult to make quantitative statements about the destinations and qualities of South-South co-operation, the added value of non-DAC providers often lies in their innovative approaches. South-South co-operation offers opportunities for technology transfers and knowledge sharing at low overheads and draws on the providers' own development experiences. One example was an arrangement to transfer agricultural techniques between and among SIDS. Cuban experts "introduced the drip irrigation technique for adoption by local farmers in other SIDS countries, which proved to be cost-effective and suitable to conditions in small islands where irrigation water is particularly rare" (UNDP, 2016[51]). Enhancing dialogue with such actors is crucial so that their voices, views and lessons from their development experience are integrated in DAC and DAC members' policies and practices.

Bilateral actors can achieve more through co-ordination among themselves and collaboration with others

- The universe of bilateral financing for sustainable development providers is becoming increasingly diverse, and non-DAC providers sometimes set alternative benchmarks for development assistance (Esteves and Assunção, 2014[52]). This leads to more choice for developing countries. But the diversity of providers also raises concerns that lack of co-ordination may lead to fragmentation. While the allocations of official resources are sovereign decisions motivated by poverty alleviation, historical ties, economic interests and/or other factors, the lack of co-ordination in allocation practices can result in gaps if providers choose to focus on the same set of countries or sectors (OECD, 2013[53]).
- Bilateral financing for development providers is well placed to target social needs and vulnerable countries, having clearly demonstrated a commitment to do so. Recent trends, however, suggest that financing to low-income countries and least developed countries, for example, has increased at a slower pace than to financing to other developing countries and lags behind population growth. The relatively high reliance of these countries on cross-border financing suggests that a decrease in the per capita level of official flows into these countries can affect them more severely than other countries.
- Official flows can be used to support the mobilisation of other financing for development resources such as domestic revenues and private sector financing. Development co-operation has the potential to mobilise tax revenues for developing countries and provide needed support to public financial management systems. Given the recent retreat of private investment flows, which has been described earlier in this chapter, official flows can also play a role in mobilising private resources. The targeted support for enabling environments can ensure that both domestic and international resources are channelled to areas with the greatest need and impact and utilised in a way that is conducive to sustainable development. Yet the need to mobilise private sector resources could clash with the commitment to countries most in need, as they are often less attractive to private investors. A careful balance must be struck, as is argued in Box 2.10 “Increasing the pie”, but in the context of clear criteria to guide the allocation of funds to conflicting priorities.

Box 2.10. In My View: Increasing the pie, by Charlotte Petri Gornitzka, DAC Chair

Since the adoption of the SDGs and the Addis Ababa Action Agenda, we have seen new challenges arise. The demand for financing humanitarian assistance and programmes for handling refugees and migration has grown and together with domestic agendas this increases pressure on public resources available for international development finance. In this situation, public sector actors, particularly the 30 OECD DAC members should focus their resources such as official development assistance (ODA) to make sure it delivers maximum impact where it is needed the most.

When planning distribution of ODA, countries should continue to have a focus on supporting those who risk being left behind. Projections from World Bank and UN data tell us that as many as 85% of the world's poor will be concentrated in one group of countries by 2030. Many of these countries happen also to be in conflict or post-conflict situations. This calls for increased investments in prevention of violent conflicts.

The pressure on limited public resources could make countries "stick to the core" and shy away from using ODA to catalyse other financial resources. That would be the wrong thing to do. It is even more important now than it was a few years ago to use public sector finance to leverage private finance for development purposes. We are seeing more and more good examples where the blending of public and private finances is increasing the total resources.

It's a delicate balance: upholding development assistance funding for countries that need it, while simultaneously being innovative and catalytic to "increase the pie" by leveraging other sources of finance, and also making sure there are incentives for partner countries with growing economies to increase their domestic resource mobilisation.

More and more countries and a broader group of stakeholders are increasingly involved in financing for sustainable development. One example is the growth of development co-operation of emerging economies, with China in a leading role and also with many Arab countries showing commitment to international development. Another example is the growing importance of private foundations that play an important role in financing health outcomes in developing countries. A third example is the institutional investors who are increasingly shaping their investment strategies and dialogues with portfolio companies based on the SDG framework.

To maximise the impact of this diverse community, strike the right balance and address the financing gaps, we need a strong global partnership where countries and other actors can co-ordinate. The OECD countries and other emerging donors are dependent on good data, sharp analysis and frank policy recommendations going forward. By increasing the knowledge of what works and focusing on analysis of the development impact of existing and new development financing models, we will build evidence that decision makers can use to make the right choices. The OECD is well positioned to deliver this today and in the future.

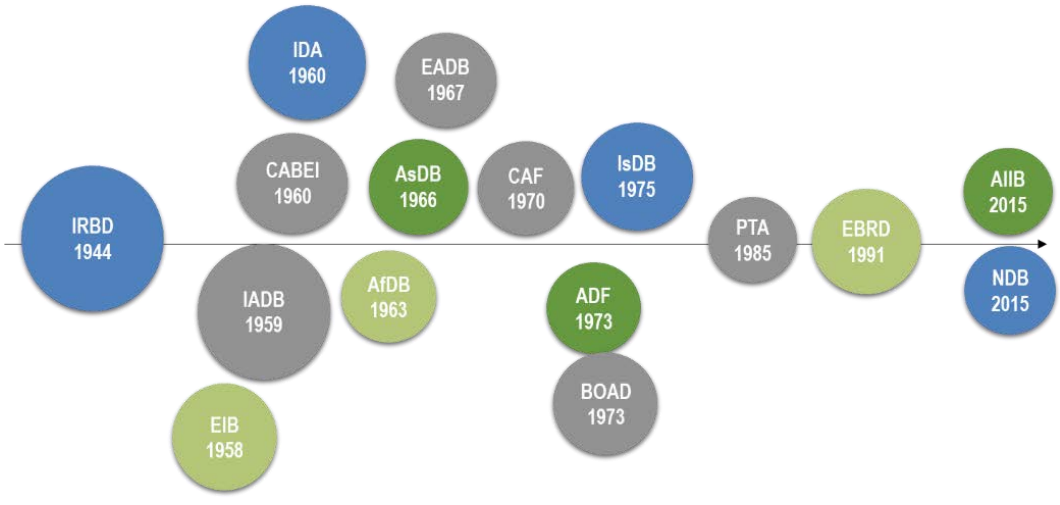
Multilateral providers

- In 2016, multilateral concessional and non-concessional financing reporting to the DAC amounted to USD 33 billion and USD 68 billion respectively.
- 37.2% of all multilateral flows were concentrated in infrastructure.
- Per capita financing from multilateral institutions for fragile and conflict-affected states and contexts increased from USD 14 in 2010 to USD 17 in 2016.

Multilateral actors are a central pillar of the financing for sustainable development system

Multilateral actors are international agencies, organisations and funds that provide financing for sustainable development. The members of these institutions are governments who are represented at the highest decision-making level by persons acting in an official and not individual capacity. Multilateral institutions are a central pillar of the international development finance framework that was founded on the two Bretton Woods institutions, the World Bank and the IMF. The establishment of the International Development Association (IDA) in 1960 was another milestone in the evolution of this framework, reflecting a general sense that a multilateral approach was needed to overcome co-ordination problems that were arising from the large number of individual development co-operation programmes. The 1960s also saw the establishment of an additional tier of multilateral development banks whose governance arrangements more reflected the rise of regional powers. Since the 1990s, vertical funds[18] and trust funds[19] have come on the scene and grown in number and importance. Confined to specific purposes such as regions, countries and thematic focuses, these have contributed to the specialisation and also proliferation of multilateral channels in the financing for sustainable development system (Figure 2.15).

Figure 2.15. The proliferation of multilateral providers



Source: Authors based on Faure, Prizzon and Rogerson (2015[54]), *Multilateral development banks: A short guide*, https://www.odi.org/sites/odi.org.uk/files/resource-documents/10650.pdf.

Multilateral actors, as discussed throughout this chapter, can be categorised as multilateral development banks (MDBs) such as the World Bank Group and regional development banks; the United Nations system;[20] the IMF; and other organisations such as vertical funds. Their functions and relationships are outlined in Box 2.11. These multilateral institutions are simultaneously providers of financing for development in their own right and serve as intermediate channels or agents assisting their member states to implement sustainable development policies.

Box 2.11. Multilateral providers of financing for sustainable development

Multilateral development banks (MDBs) provide financial and technical assistance for development in low-income and middle-income countries. In addition to the World Bank Group, they include regional development banks: the African Development Bank (AfDB), the Arab Bank for Economic Development in Africa (BADEA), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the Islamic Development Bank (IDB), and the Inter-American Development Bank (IADB).

MDBs have two main funding channels, the first providing financing at non-concessional terms and the second providing concessional financing. (The exception is the EBRD, which extends only non-concessional financing.) Non-concessional financing is extended to governments of middle-income countries, some creditworthy governments of low-income countries, and in some cases to private companies. Soft windows provide grants and highly concessional loans to the poorest countries. Most loans are (nearly) interest-free and have a maturity of 25 to 40 years.

In the case of the World Bank Group, the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) function as the non-concessional (hard) and concessional (soft) lending windows, respectively. MDBs can also have commercial arms that invest exclusively in private sector projects in developing countries through loans, equity products and trade finance. The International Finance Corporation (IFC) fills this role for the World Bank Group.

MDBs are being called on to increase their catalytic role in finance to mobilise more financing for sustainable development, especially from the private sector. Discussions also are underway at the G20 to ramp up MDB capital to address challenges to the international financial system and better provide global public goods.

The UN development system consists of 34 UN system entities (funds, programmes and agencies) that received funding for operational activities for development. These include affiliate organisations such as the UN Development Programme (UNDP), the UN Children's Fund (UNICEF) and the World Food Programme (WFP) as well as specialised agencies such as the Food and Agriculture Organization (FAO) and the World Health Organisation (WHO). The International Fund for Agricultural Development (IFAD), the Office for the Coordination of Humanitarian Affairs (OCHA) and the UN Secretariat also are part of the development system of the UN. The mandates of these entities vary widely, ranging from service provision to policy

development and standard setting.

Funding for operational activities for development amounted to USD 26.7 billion in 2015, of which 77% was earmarked to specific projects and entities. Some 80% of total contributions in 2015 were made by governments. The European Commission, non-governmental organisations, public-private partnerships and other multilateral institutions such as global funds provided the remaining 20%.

Within the UN Economic and Social Council (ECOSOC), discussions are underway to reform the UN development system and refocus its functions to better align them with implementation of the 2030 Agenda. In January 2018, UN Secretary-General António Guterres proposed reforms that anticipate an improvement of the UN's country presence by rationalising and streamlining UN country teams and reinvigorating the leadership of Resident Coordinators (UN, 2017[55]) The refocusing of UN functions has implications for its financing model and points in particular to the need for strengthened system-wide funding mechanisms. Given the high reliance on earmarked funding, the reforms aim to enhance the predictability of resources by increasing the share of core funding to individual agencies and the share of pooled funds at the country level (UN, 2017[55]).

The International Monetary Fund (IMF) provides financial support for member countries facing balance of payments crises upon request of the country. The IMF does not lend for specific projects, unlike development banks, and most of its lending is non-concessional. In most cases, a country's commitment to implement the IMF's recommended policies, known as policy conditionality, must be assured before lending is provided.

The IMF also provides concessional financial support, currently at zero interest rates, through the Poverty Reduction and Growth Trust (PRGT), which has three lending windows and a target annual lending capacity of SDR 1.25 billion (USD 2 billion) (IMF, n.a.[56]):

- Extended Credit Facility (ECF): Medium- to long-term engagement for protracted balance-of-payment-crises
- Standby Credit Facility (SCF): Financing for actual or potential short-term balance of payments and adjustment needs
- Rapid Credit Facility (RCF): Rapid financial support as a single up-front payout for urgent balance of payments needs

In addition to its lending activities, the IMF provides technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration, and official statistics.

A large portion of multilateral resources is non-concessional and targets middle-income countries

Depending on the type of organisation, financing flows from multilateral providers can be concessional or non-concessional. Financing from most UN entities is concessional and consists of grants for projects in developing countries. MDBs have both concessional and non-concessional financing windows. Non-concessional financing typically consists of loans extended to middle-income country governments, some creditworthy low-income country governments and in some instances to private companies. Concessional windows of MDBs provide grants and highly concessional loans to low-income country governments.

In 2016, concessional and non-concessional financing provided by multilateral actors reporting to the DAC amounted to USD 33 billion and USD 68 billion respectively.[21] While non-concessional flows are more than twice as large as concessional flows, they are provided exclusively by multilateral development banks (USD 59.6 billion) and the IMF (USD 7.8 billion). Multilateral flows tend to focus on middle-income countries. This is due to the fact that non-concessional financing, which takes up a larger share of the overall financing provided, often targets countries who are able to repay financing at market terms. Regarding non-concessional flows (excluding IMF loans), 41% were allocated to lower middle-income countries and 52% to upper middle-income countries. Low-income countries received 30% of concessional flows and lower middle-income countries 50% of the total.

Multilateral providers have several comparative advantages

Multilateral providers have several advantages that give them a special place within the financing for sustainable development system. Because of their convening power, they are unique in the support they can give to collective international action to provide the global public goods needed to tackle border-transcending problems such as climate change and humanitarian and global health crises (OECD, 2015[57]). By pooling resources from multiple bilateral providers, multilateral providers can help to reduce fragmentation of development efforts and enhance policy coherence.

Multilateral providers often have specialised knowledge in policy reforms and/or specific sectors, for example in infrastructure in which 37.2% of all multilateral flows are concentrated. Multilateral organisations often have extensive country presence and political knowledge, in particular in fragile contexts. From 2010 to 2016, per capita financing from multilateral institutions for fragile and conflict-affected states increased to USD 17 in 2016 from USD 14 in 2010, indicating an increased focus on fragile contexts.

Multilateral providers, and MDBs in particular, are well equipped to leverage resources from private sources to support the shift from billions to trillions for financing the SDGs. As they generally finance only a share of a project, MDBs by design are in the business of mobilising additional investors by setting up pooled funding structures and providing advice and risk mitigation (World Bank, 2015[58]). In addition to participating in the financing of projects, MDBs also explore other means of private sector resource mobilisation, some of which are discussed in Chapter 3. One example is the IFC Asset Management Company (AMC). A wholly owned subsidiary of the IFC in the form of a private equity company, it manages funds from private investors and invests them in companies and projects in developing countries. Since its establishment in 2009, the AMC has raised USD 10 billion across 13 funds (International Finance Corporation, 2018[59]).

Partnerships are key to making the multilateral system fit for purpose

The multilateral system is expanding and becoming more complex. The arrival of new players such as the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) reflects changing dynamics in the financing for development system. The addition of new international agencies may be a double-edged sword. The share of bilateral contributions channelled through multilateral agencies has remained stable. But the increasing number of players, in some cases with overlapping responsibilities, comes at the risk of aid fragmentation.

The best way for multilateral providers to maintain their credibility in this environment is to better co-ordinate their efforts and division of labour. Initiatives aimed at encouraging and enhancing such collaboration are underway to make full use of core comparative advantages. For example, the UN-World Bank partnership framework to build resilience and sustain peace in conflict areas, which has been in place since 2008 and was updated in 2017, provides a platform to "develop joint analyses and tools for more effective solutions; co-ordinate support to address protracted crises; and scale up impact by leveraging financing" (UN-World Bank, 2017[60]).

In order to remain relevant in an increasingly diverse sustainable development finance system, multilateral providers are also pursuing more inclusive partnerships with various financing for development actors including the private sector, civil society and countries engaging in South-South co-operation (Kharas, 2010[61]). MDBs in particular need to act on their ability to catalyse private sector financing. The forthcoming OECD report, *Multilateral Development Finance 2018*, focuses on efforts by MDBs to mobilise private finance (OECD, forthcoming[62]).

Subnational providers

- Funds channelled through decentralised development co-operation are relatively small, with volumes standing at USD 1.9 billion in 2015.
- The portions of decentralised development co-operation going to different sectors is 12% to health; 10% to, agriculture, 8% to education and 6% to water.

Subnational actors are involved in financing for sustainable development at various levels

Subnational actors contribute to financing for sustainable development through activities that are collectively termed decentralised development co-operation. The concept of decentralised development co-operation originated in the 1980s in the context of a retrenchment of central governments in favour of an increased role for local and regional governments to promote public-private partnerships. However even earlier, in 1971, the UN General Assembly recognised in a resolution the practice of municipal twinning as a tool for international co-operation. Over time, these city-to-city partnerships grew to involve other subnational public authorities and public agencies. Examples include water authorities in the case of France and in the Netherlands. In this way, decentralised development co-operation activities were expanded not only in terms of the sectoral focus but also the levels of government involved. The Addis Ababa Action Agenda reaffirmed the growing trend in decentralisation of public spending to local and regional actors across developing and developed countries alike (paragraph 34).

The actors involved in DDC range from governmental to non-governmental and across the local to the regional and provincial levels. The OECD report, *Reshaping Decentralised Development Co-operation* (2018[63]), identifies four tentative categories with respect to roles and responsibilities of various actors, according to whether the lead role is that of a promoter, enabler, facilitator or implementer (Figure 2.16). This section on subnational providers overall is largely drawn from the analysis in this report.

Subnational governments including regions, provinces and municipalities tend to be the primary *promoters* of decentralised development co-operation, together with central government public agencies or sectoral ministries. Beyond central and subnational governments, decentralised development co-operation activities involve diverse partnerships with a wide range of actors. Universities and research centres are often active as *enablers, facilitators* and *implementers*. They can offer support to strengthen the evidence base and evaluation of decentralised projects, leading to a strengthening of local technical capacity. NGOs, civil society organisations and youth volunteers increasingly play a significant role in decentralised development co-operation projects, specifically as implementers.

Figure 2.16. Different roles in decentralised development co-operation

Source: OECD (2018[63]), *Reshaping Decentralised Development Co-operation: The Key Role of Cities and Regions for the 2030 Agenda*, http://dx.doi.org/10.1787/9789264302914-en.

Decentralised development co-operation contributes to the localisation of financing for sustainable development

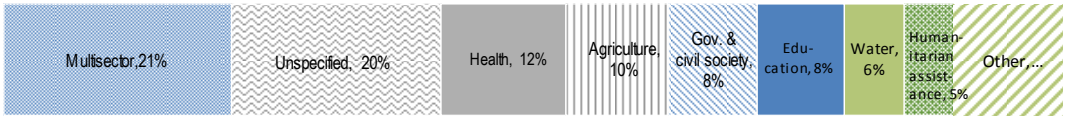
Funds channelled through decentralised development co-operation are relatively small, with volumes standing at USD 1.9 billion in 2015. Variation in volumes across countries and years is quite high – much greater than variations in ODA extended by central governments. Over the 2005-15 period, decentralised development co-operation spending increased for Austria (+360%), Switzerland (+44%), Italy (+39%) and Belgium (+16%). It decreased for Greece (-100%), Portugal (-97%), Spain (-56%), Japan (-46%) and Germany (-4%).

Decentralised development co-operation owes its comparative advantage to its reliance on local know-how and expertise through local governments. *Reshaping Decentralised Development Co-operation* (OECD, 2018[63]) argues that this form of development co-operation contributes to improving the quality of local government services and broadens their coverage, increasing the satisfaction with and trust in local administration, and providing wider access to financing for sustainable development.

Specific challenges such as delivery of public services to informal urban settlements, action led by local governments to face climate change and migration to urban areas are key areas where subnational actors can have a significant development-enhancing role. Local government empowerment is expected to develop competences for local revenue mobilisation and to provide access to long-term financing for sustainable development mechanisms.

In line with these priorities, decentralised development co-operation targets primarily health, education, agriculture and water (Figure 2.17). In 2015, decentralised development co-operation mainly targeted multisector activities, which represented 21% of total sector-allocable resources. The sectors included were education/training, scientific research, rural development, and in-donor refugee costs. Health and agriculture sectors represent 12% and 10% of decentralised development co-operation respectively; education amounted to 8% and the water sector amounted to 6% of total sector-allocable decentralised development co-operation. However, these figures must be treated with caution, as reporting on sector-allocable decentralised development co-operation is limited due to reporting challenges faced by several DAC members.

Figure 2.17. Sectoral allocations of decentralised development co-operation in 2015



Source: OECD (2018[63]), *Reshaping Decentralised Development Co-operation: The Key Role of Cities and Regions for the 2030 Agenda*, http://dx.doi.org/10.1787/9789264302914-en.

StatLink https://doi.org/10.1787/888933852901

Systematic data collection and co-ordination can support subnational actors

- Though small in absolute volumes, financing for development by subnational actors contributes to the localisation of the SDGs. Based on a spirit of voluntarism and commitment to embed in local communities and mechanisms, these activities help to bring global agendas close to home. Further engagement through decentralised development co-operation activities can support and strengthen local governance in developing countries while empowering communities and promoting collaboration between local authorities and civil society.
- Challenges in decentralised development co-operation lie mainly in the high transaction costs associated with the small scale of the projects. National governments, global networks or platforms, and national associations of local and regional governments can play an important role to facilitate the co-ordination of decentralised development co-operation activities. Better reporting on these activities can facilitate the stock taking and information gathering that are pre-requisites for a better and more systematic co-ordination of efforts across levels of government and across sectors.

Moving towards financing for *sustainable* development

The different actors discussed in this chapter make distinct contributions – in volume as well as in type – to financing sustainable development. External finance of many types remains critical, while domestic resources are the predominant form of financing. Sustainable development pathways will see countries growing their own public and private domestic resources while retaining interdependence with the global economic system.

The remainder of this report argues that while it is necessary to mobilise a greater volume of financing, an even more fundamental shift is required – that is, a shift of the trillions of already-available domestic and external finance towards achieving the SDGs.

To achieve this, it is important to exploit the diversity of this financing landscape and the actors within it, effectively creating a financing for sustainable development system. This requires a thorough understanding of the role of different actors, the instruments they use and how they interact. Equally important is the establishment of measurement, policy and operational frameworks to make the most of each actor and each source of financing. However, bringing together this diverse set of actors with different motivations is an enormous challenge. There are **key limitations** that need to be addressed to move from mere financing for development to financing for *sustainable* development. Some examples are:

- Data availability is a serious constraint in mapping the contributions of different actors. While ample anecdotal evidence suggests that new actors in developing countries are providing a larger portion of cross-border finance, the lack of consolidated data (beyond ODA provided by the DAC members) makes it difficult to sufficiently consider their role. For example, estimates of the amounts of concessional finance provided by China in a single year range from USD 3 billion to USD 7 billion. Further efforts are needed to promote transparency and a more systematic and comparable reporting of contributions, such as the measure of total official support for sustainable development (TOSSD), as is recognised in paragraph 55 of the AAAA.
- Different actors have different degrees of obligation towards the SDGs. For example, cross-border investments and remittances are based on inherently private decisions rather than a motivation to achieve the SDGs. Policy, both in developing countries and in sending countries, can influence these private actions. For example, promoting financial inclusion can help to channel remittance flows to areas with high development impact.

These limitations will be addressed in Part II of this report, which introduces action areas to tackle the challenges of measurement (Chapter 4), policy coherence and policy gaps (Chapter 5), and operational choices (Chapter 6).

Notes

[1] Tamarappoo et al. (2016[115]), in a recent study for USAID, estimate that a 10% increase in taxation leads to a 17% increase in public health expenditure in low-income countries, compared to a 4% and a 3% increase in lower middle-income and upper middle-income countries, respectively. See https://sidw.org/sites/default/files/DRM%20and%20Social%20Sector%20Spending%20-%20Pooja%27s%20Doc.pdf.

[2] In the definition used in the study, fiscal policies include direct taxes, direct transfers, indirect taxes, indirect subsidies, and education and health services.

[3] For example, Vulnerability-Adjusted Tax Effort Index, developed by the Foundation for International Development Study and Research (Ferdi), assesses least developed countries' tax effort. It finds that higher "economic vulnerability" decreases potential tax revenue while higher "human assets" increases such revenue. See www.ferdi.fr/en/indicator/vulnerability-adjusted-tax-effort-index-vatei.

[4] This average includes social security contributions.

[5] A notable exception is China, where domestic business investment activity has compensated for declines in foreign investment. In China, a domestic mergers and acquisitions (M&A) boom has offset the decline in cross-border, inward M&A by more than tenfold. Between 2011 and 2017, domestic M&A in China averaged USD 322 billion while cross-border M&A over the same period amount to USD 37 billion.

[6] The estimates are based on sample of 91 countries examined by Cull et al. (2017[21]). See www.imf.org/en/Publications/WP/Issues/2017/03/22/Bank-Ownership-Trends-and-Implications-44753.

[7] These figures, drawn from OECD DAC statistics, include concessional and non-concessional official flows, private market flows, and remittances from OECD and non-OECD countries.

[8] FDI is usually defined as the acquisition of at least a 10% equity stake in a firm and, usually allowing some control allowed over corporate decisions. Portfolio investment is defined as the acquisition of a less than 10% equity stake.

[9] The value of cross-border M&As is usually one of the largest components of FDI flows. This report uses data on cross-border M&As to measure the importance of China as an investor in developing countries because bilateral FDI data does not provide sufficient coverage.

[10] By way of comparison, fully-owned SOEs accounted for only 38% of China's overall outward M&A during this period.

[11] In 2001 and 2006, private investment amounted to more than 8% of GDP in UMICs. For LMICs, the share was more than 8% in 2001-03.

[12] The figures are based on IMF Balance of Payment data and have been deflated using IMF GDP deflators and exchange rates from the April 2018 Edition of the World Economic Outlook and taking 2016 as base year.

[13] M&As are one of the primary vehicles that multinational enterprises use to invest in foreign markets and comprise a major component of FDI. Data on M&A cover a variety of financial transactions that can range from the full merger of two previously independent firms to the acquisition of a minority stake in a strategic partner.

[14] McKenzie (2014[141]) in a World Bank blogpost attributes part of the reported increase in remittances over time to changes in how they are measured. See

http://blogs.worldbank.org/impactevaluations/almost-80-percent-growth-remittances-developing-countries-over-past-20-years-illusion.

[15] The data on non-concessional financing provided by bilateral actors also include export credit that does not serve a development purpose.

[16] While DAC members generally accept the 0.7% target for ODA, at least as a long-term objective, there are some notable exceptions. Switzerland, for one, did not adopt the target, and the United States stated that it did not subscribe to specific targets or timetables, although it supported the more general aims of the Resolution. See http://www.oecd.org/dac/stats/the07odagnitarget-ahistory.htm.

[17] This figure may be subject to under-reporting. Using an open source methodology to track data on Chinese investment found in media sources, China AidData has estimated the volume of investment between 2000 and 2014 at USD 350 billion (2014 deflated USD), including USD 37 billion invested in 2014 alone. Of the estimated totals, USD 80 billion over the entire period and USD 7 billion in 2014 were comparable to ODA. See https://china.aiddata.org/.

[18] Vertical funds are multilateral financing mechanisms that pool financing resources from both public and private sector sources to target needs in single development domains such as health (e.g. Global Alliance for Vaccines and Immunization, or GAVI) and climate finance (e.g. Green Climate Fund).

[19] Trust funds are financing mechanisms administered by multilateral agencies on behalf of one or more bilateral donors to support defined development objectives (e.g. support for specific countries, regions or themes).

[20] The UN system consists of the UN and many affiliated programmes, funds and specialised agencies, each with its own membership and budget. Programmes and funds are financed through voluntary rather than assessed contributions. Specialised agencies are independent international organisations financed by both voluntary and assessed contributions.

[21] This figure does not include concessional finance in the amount of USD 18.6 billion that was provided in 2016 by the European Union, which acts more like a bilateral than a multilateral provider.

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Chapter 3. Increasing complexity in the financing for sustainable development system - instruments, income and interlinkages

Each actor and type of finance for sustainable development has its own comparative advantages, costs and benefits. The wide range and variety of financing actors suggests new opportunities to diversify between and combine financing sources to increase their contribution to sustainable development. In an ideal world, actors would be well informed about these strengths and weaknesses, enabling them to strategically exploit each source to meet the financing needs of Agenda 2030.

This Chapter provides an overview of features and factors that increase the diversity of financing available, but also increase the complexity of financing choices. The Chapter outlines the different instruments available, as well as the way a country's income level affects the financing options it faces. Finally, the Chapter surveys some of the complex interactions between actors and financing sources. These three elements – instruments, income levels, and interactions – reinforce the need for a coherent, holistic approach across actors.

In brief

The wide range and variety of financing for sustainable development actors and their resources bring opportunity as well as complexity. In an ideal world, each of the different actors would make informed decisions about where and how to provide financing to achieve its objectives in the most effective way. Given the individual choices of external actors, developing country governments and private actors could choose the financing that meets their needs and helps to achieve the 2030 Agenda at the lowest cost. They would be well versed about the costs and benefits of choosing a particular resource over another, and could strategically exploit the comparative strengths and advantages of each resource.

Unfortunately, the financing for sustainable development (FSD) system is far from this ideal world and finding that optimal financing mix is challenging for a number of reasons. These can be summarised as three "I's": instruments, income levels and interactions.

Instruments – The first complicating factor is the multitude of financing approaches that are available to the various actors. One defining feature of the new financing for sustainable development system is the emphasis on innovative approaches that widen the choice of instruments.

- Many official providers are exploring this potential, with 33% of bilateral providers who responded to the "Global Outlook Survey on Financing for Sustainable Development" planning to use guarantees in the future and another 13% considering the use of hybrid instruments.
- Despite the buzz around innovation, its promise is nevertheless yet to be realised. The actual volumes raised through innovative approaches remain small. Instruments other than grants and loans account for only 2% of all official development financing.

Income levels –Types of financing available seem to be strongly correlated to income level and changes in country contexts. As countries develop, the financing mix moves from a reliance on external to domestic, and from public to private, finance.

- While tax revenues are slightly less than half the volume of total financing for low-income countries (LICs), they make up more than 70% for lower middle-income countries and around 90% for upper middle-income countries (UMICs).
- While for LICs private flows represent around 30% of external finance, they make up almost 70% for the wealthiest UMICs.

Interlinkages – Interlinkages among actors and resources create synergies and trade-offs, and choices in one domain (such as aid) can impact financing in another (such as tax), increasing or decreasing financing capacities. A lack of understanding of these interlinkages can result in missed opportunities and inefficient policies on the part of both development partners and developing countries:

- Over 80% of LICs and lower middle-income countries (LMICs) offer tax holidays and tax exemptions on investment, while investors report that tax incentives are among the least important factors for investment and location decisions.
- Although some official providers, among them Netherlands and Norway, have changed their policy and no longer seek tax exemptions on goods and services

funded by official development assistance (ODA), this is not yet common practice.

This chapter deconstructs these interconnected factors as a necessary step to design the best solutions for sustainable development. Chapters 4, 5 and 6 will expand on this effort and focus on more holistically measuring, maximising and implementing financing for sustainable development.

Increasing variation in instruments complicate the choice of the financing mix

Instruments can be categorised according to the terms and conditions whereby actors provide financing for sustainable development: as grants, debt, equity, and a miscellaneous category that includes mezzanine finance and contingent instruments such as guarantees.

Traditionally, the different actors engaged in financing for sustainable development used a relatively fixed set of instruments. Bilateral donors and philanthropists largely relied on grants, multilateral development banks mainly provided loans, and private investments took the form of debt and equity.

While these remain the mainstay, actors are exploring new instruments and approaches.

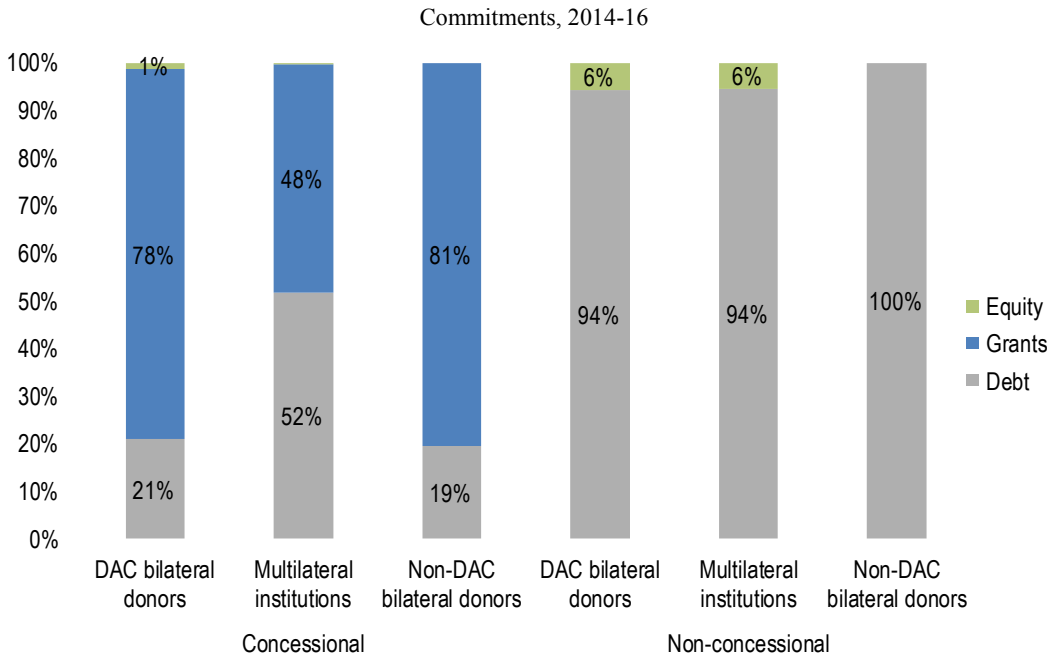
Financing for sustainable development actors choose among a variety of instruments

Grants remain the most popular form of official finance

Grants committed by official providers[1] represented 78% of all bilateral concessional finance committed in 2016 and 48% of multilateral concessional finance.[2] (Figure 3.1).

Grants are also provided by private actors, i.e. private corporations, households and non-profit institutions such as philanthropic foundations. Almost all financing provided by philanthropic foundations takes the form of grants. For example, 99% of the disbursements of the Bill & Melinda Gates Foundation in 2016 were grants.[3]

Figure 3.1. Portfolio of official providers



Note: The estimates are based on data on concessional and non-concessional finance excluding debt relief. Guarantees, insurance and hybrid investments, each taking up less than 1% of the portfolio, are not shown in the figure.
Source: OECD (2018[1]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1.

StatLink https://doi.org/10.1787/888933852920

The choice between grants and loans is sometimes guided by the World Bank/International Monetary Fund Debt Sustainability Framework (DSF) for low-income countries. The World Bank determines the allocation of grants on the basis of debt sustainability assessment results. Countries with a low risk of debt distress receive loans; countries with a moderate risk receive a mix of 50% loans and 50% grants; and countries with a high risk of debt distress and those in debt distress receive only grants. A number of bilateral providers have adopted a similar grant allocation strategy (Cassimon, Verbeke and Essers, 2016[2]).

Debt brings benefits and risks, and is widely used

Debt financing is a widely used instrument, publicly and privately. Since debt needs to be repaid, it can create positive incentives for borrowers to exercise fiscal discipline. Once debt is repaid, it can be used to finance other needs. At the same time, the obligation to pay back the debt, in many cases with accrued interest, can place a fiscal burden on the borrower[4] and unsustainable debt levels can lead to currency and banking crises, especially in a developing country context (Aghion, Bacchetta and Banerjee, 2004[3]).

Debt finance from official providers mostly takes the form of loans, both on concessional and non-concessional terms.[5] Standard loans constitute a relatively small portion of concessional flows but make up the majority of non-concessional flows, ranging from a share of 94% for bilateral OECD Development Assistance Committee (DAC) providers

to 100% for non-DAC providers (Figure 3.1). Multilateral providers tend to have a relatively larger portion of non-concessional finance in their portfolios and so are leading providers of loans. In 2016, loans comprised 94% of their non-concessional commitments and 75% of their total commitments.

Debt is also the most commonly used instrument for private sector flows. Most privately extended debt in developing countries takes the form of loans. However, in line with a global shift towards more capital market and bond financing (OECD, 2017[4]), the portion of tradable securities (e.g. bonds) to total debt levels of developing countries has risen steadily.[6] While this is especially true in upper middle-income countries, governments and companies in lower middle-income and even low-income countries are increasingly accessing capital markets.

This increasing use of debt capital markets has led to a change in the composition of the providers of financing. Unlike the providers of non-tradable loans, investors in debt capital markets can easily sell their debt to new creditors. This can have negative consequences for any required debt restructuring, as it can become more difficult to ensure the creditor co-ordination needed to produce comprehensive agreements acceptable to all major creditors (IMF, 2018[5]).

Equity investments share risks, and are increasingly popular among public sector actors

Equity, traditionally a private sector instrument, has a more stabilising effect than debt on recipients of finance because the risks of the investments are shared with the providers. However, for providers, this means equity investments are riskier than debt, generally bringing more volatile but higher returns.

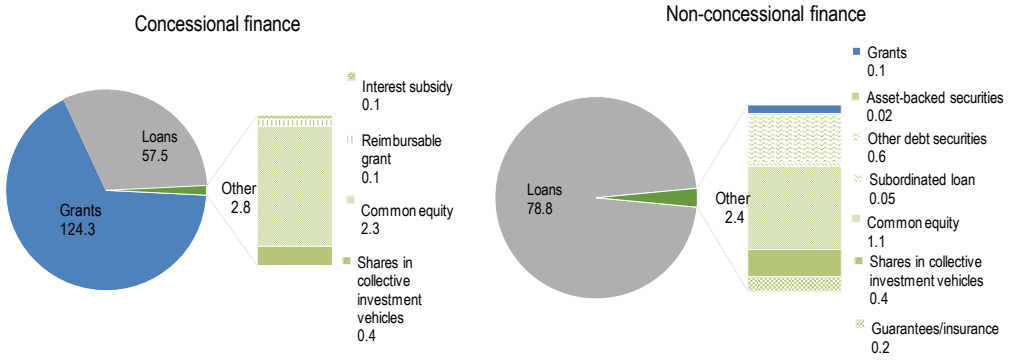
Equity instruments are mainly used for private sector investments, with over 80% of net foreign direct investment (FDI) holdings taking the form of equity.[7] Equity also constitutes a substantial part of portfolio investments, making up more than half of portfolio investment holdings.[8]

Recent years have seen a shift away from equity towards more debt financing in developing countries, with possible repercussions on debt sustainability and vulnerability to macroeconomic shocks (Chapter 5). This shift corresponds to a global pattern driven by a multitude of factors including demographic changes and financial regulatory reforms that make debt more attractive than equity (Roxburgh et al., 2011[6]).

At the same time, equity investments are receiving increasing attention from the public sector.[9] While the equity portion of the finance provided by multilateral actors is still quite low – 6% in 2016 across non-concessional finance, as shown in Figure 3.2 – there is variation across agencies. Equity investments make up 25.5% of the portfolio of the International Finance Corporation (IFC), which holds an equity stake in private companies. Moreover, many bilateral providers make equity investments through their development finance institutions, where the equity portion exceeds 80%. The Annex provides more detail.

Figure 3.2. The portfolio breakdown of bilateral sustainable development finance providers

Commitments in 2016, USD billion



Source: OECD (2018[1]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1.

StatLink https://doi.org/10.1787/888933852939

Since equity investments have a different risk-return profile than debt and can produce much more volatile returns, the growth in the equity portfolio of official providers can bring new risks. Most development finance institutions making use of equity instruments obtained double-digit returns before the 2008 financial crisis, but then suffered major losses (Michelitsch et al., 2017[7]).

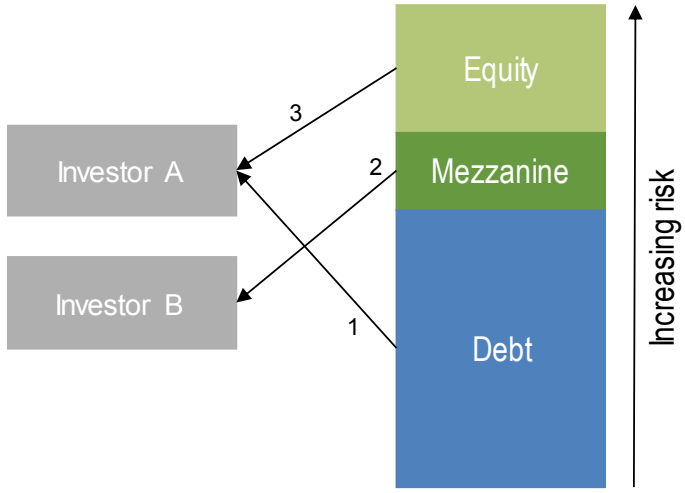
Other instruments that share risks are also drawing increased interest

Instruments that go beyond standard grants and loans are drawing increasing interest from (official) FSD providers. Mezzanine finance and guarantees both have variable returns and outflows, since they involve sharing risk between the provider and recipient.

Mezzanine finance

Mezzanine finance is a hybrid instrument situated between debt and equity and used mostly by private sector actors[10] and institutional investors. In the event of bankruptcy, mezzanine investors have lower rankings than other creditors but higher rankings than equity investors. In an investment transaction depicted in Figure 3.3, profits would be first used to pay back debt finance provided by Investor A. Only after all debt is paid back would Investor B be paid back his investment in mezzanine finance. Because of the later pay-out, Investor B would be promised a higher return than that obtained by Investor A in terms of interest on the debt financing portion. Returns on equity financing from Investor A would correspond to how much is left after both debt and mezzanine finance have been repaid.

Figure 3.3. The pay-out from mezzanine finance



Source: Author

From its beginnings in the 1980s, the commercial mezzanine finance market has developed mostly in advanced economies. Investors usually use mezzanine instruments to hold long-term positions in relatively large and growing companies. Policy makers in some OECD countries and in international organisations have sought to use mezzanine instruments to provide finance to small and medium-sized enterprises, either by creating investment funds targeting specific companies or by providing direct financing (Cusmano and Thompson, 2013[8]).

The share of mezzanine finance is small, estimated at less than 1% of official provider portfolios[11] However, some bilateral development finance institutions and multilateral development banks have adopted the practice of using mezzanine finance backed by official funds. It is also used to finance the operations of private sector entities in developing countries. Often, the use of mezzanine finance serves the purpose of private sector mobilisation.

Guarantees

Guarantees provide protection against political and/or commercial risks of an investment. A guarantee obliges the provider of the guarantee to pay to the investor (e.g. lender) an agreed-upon amount in the event the guaranteed party is not able to pay back claims. Both private and public entities provide guarantees, typically in return for a premium. Private entities[12] are profit-motivated in the pricing of the premium, while official providers take other objectives into consideration (OECD, 2018[9]).

Although guarantee activity is still relatively small compared to other forms of development finance, guarantees are receiving increasing attention from official providers. They especially are being considered as a tool for blended finance, an approach to use development finance for the explicit purpose of mobilising different resources. Since guarantees involve the risk of disbursement rather than the immediate disbursement of donor funds, some donors allocate a smaller proportion of capital to the guarantee than they would to an equivalent loan. This means that, depending on the donor's risk management policies, guarantees can be very efficient mobilisers (Box 3.1). The 2016 OECD-DAC Survey on amounts mobilised from the private sector in 2012-15 found that 20 of the 35 development finance organisations surveyed issue guarantees for the purpose of leveraging private resources (Benn, Sangaré and Hos, 2017[10]).

Box 3.1. Guarantees can leverage private resources: the Bosnia and Herzegovina example

The use of guarantees to leverage private resources is at the heart of a programme of USAID and the Swedish International Development Cooperation Agency (Sida), which issued guarantees to ProCredit Bank and Sparkasse Bank in Bosnia and Herzegovina to cover 50% of the loan principal extended to local small and medium-sized enterprises. These guarantees lowered the risk exposure of the banks, enabling them to make loans to borrowers who otherwise would not be eligible and/or to make loans at terms more favourable than what would be possible under each bank's regular lending parameters (USAID, 2017[11]).

The financial instruments discussed in this section are used for cross-border flows. It should be noted that the same instruments are also used within developing countries. For example, domestic debt is taking on a bigger role as a source of public finance in developing countries, due largely to significant development of their financial sectors (IMF, 2015[12]). Tax is another key instrument in financing sustainable development used by domestic public sector actors, as described in more detail in Box 3.2.

Box 3.2. Taxation as an instrument of financing for sustainable development

Taxation is an important component of fiscal policy and a key public sector instrument to augment financing for sustainable development.

- Revenues raised through taxation can be used to provide public goods that otherwise would not be financed. Tax revenues in developing countries are 2.5 times larger than all cross-border financing combined (Chapter 2) and can be used for public investments in infrastructure, agriculture, health, education and other sectors.
- Taxation can also be used to enable redistribution and reduce inequalities (Chapter 2).
- Taxes can set incentives to promote behaviour that is conducive to Sustainable Development Goals (SDGs) such as climate change mitigation. The government of Viet Nam announced in April 2018, that it would raise the consumption tax on gasoline by 33.3% to Dongs 4 000 (USD 0.1754) per litre, to reduce pollution and pay off public debt (Vu, 2018[13]).

However, for tax to work as an instrument to finance sustainable development, the revenues that are raised must be directed towards sustainable development. Unfortunately, this is not always the case.

Analysis on public expenditure in support of the Millennium Development Goals (MDGs) found that in a sample of 66 low-income and middle-income countries, public spending rose by 3.2% of GDP, to 29.8% from 26.6% of GDP, between 2008 and 2014. However, this rise in expenditure was not matched by a rise in spending on MDGs. MDG spending as a share of GDP stagnated at around 11% since 2010 (Martin and Walker, 2015[14]).

To ensure that the revenues raised through taxes are effectively contributing to sustainable development, accountable and transparent systems governing the use of public resources need to be put in place. This calls for the active implementation of measures to align public expenditures with sustainable development objectives by integrating SDGs into national budgeting and tracking spending on SDGs (Hege and Brimont, 2018[15]).

The case for innovation: delivering more and smarter financing for sustainable development

Expansion of the financing for sustainable development system, as described in Chapter 2, calls for and gives rise to innovative approaches that will embrace the different strengths of actors and instruments and enable collaboration across the different actors. The Addis Ababa Action Agenda (AAAA) emphasises the need to harness the potential of new instruments and innovations to mobilise more resources for sustainable development (paragraphs 43, 45, 48, 69, 75, 102 and 107).

While the quest for innovative financing mechanisms is not new, it is more urgent than ever (Chapter 1). The development community began exploring and experimenting with new initiatives in the early 2000s to help assure achievement of the Millennium Development Goals. The 2030 Agenda, with its increased ambitions, requires enormous financing efforts that cannot be met by traditional methods alone. Every year, an investment gap of USD 2.5 trillion needs to be filled to achieve the SDGs (Chapter 4).

Innovation in financing sustainable development covers a wide range of approaches that aim to raise more resources for sustainable development or enhance the efficiency and development impact of existing resources (World Bank, 2010[16]). As Box 3.3 "Official development assistance remains essential to make innovative financing work" argues, the objective of innovation is to mobilise "more money" and "smarter money". The implicit baseline is a world where development finance comes mainly from official providers who predominantly rely on traditional instruments such as grants and loans.

Instruments that adopt elements of private sector practices are often referred to as innovative even if they have been in existence for a long time and have been widely used in commercial investments. The example of mezzanine finance cited above illustrates this point. Although private sector investors have used mezzanine finance for several decades, the fact that official providers are increasingly embracing it to finance development projects is deemed innovative.

Innovation in instruments thus reflects the sweeping changes that are taking place in the sustainable development finance system. With the proliferation of actors, new opportunities for collaboration and mutual learning arise to increase financing volumes and/or impact for sustainable development. The examples discussed in this chapter of blended finance, social impact investment and triangular co-operation further demonstrate this paradigm shift in the financing for sustainable development system. These help to shift and reallocate the risks and returns related to sustainable development efforts among public and private actors, thereby introducing collaborative models in which different types of actors leverage their comparative advantages to increase financing for sustainable development.

Box 3.3. In My View: Official development assistance remains essential to make innovative financing work, by Jérôme Olympie, Ministry of Foreign Affairs and International Development, France

Donors originally advocated for innovative financing so as to raise additional resources to invest in sustainable development, stabilise and improve the predictability of aid, address market failures, and ensure a fairer distribution of wealth. Innovative financing, then, must be understood both as a way to mobilise more money and a way to mobilise smarter money.

Mobilising more money

Solidarity taxes (such as the financial transaction tax and the air ticket levy) are good examples of innovative sources. These two examples have proven to be very effective, especially in France where both have been implemented, and they have raised more than EUR 3.715 million since 2006.They also contribute to a better distribution of wealth and help to address global challenges. Several characteristics define them as innovative. First, they allow ring-fencing resources for development. Second, they provide more predictability. Third, they allow new contributions from globalised activities.

However, solidarity levies are now seen as complementing a broader paradigm shift where public development finance is increasingly used to catalyse more private investments for sustainable development. New tools have been emerging in recent years, such as guarantee mechanisms to incentivise private investments and other instruments (blending mechanisms, matching funds, etc.) based on leverage effects.

Mobilising smarter money

Engaging in sustainable development is an issue not only of the quantity but also the quality of the resources. Result-based mechanisms allow to incentivise beneficiaries and implementing actors, therefore improving development results and ownership of policies. However, such mechanisms usually rely on official development assistance (ODA) as the donor country acts as the "outcome payer". Examples include risk transfer mechanisms and new insurance mechanisms including financing products like the very concessional countercyclical loans offered by the French Development Agency (AFD) and regional-led facilities such as the African Risk Capacity.

The need to strike a right balance between public and private funds

Mobilisation of both private sector and domestic resources in developing countries is key to any long-term sustainable development. But public funds are still needed. Indeed, they can have a real impact in least developed countries, which the private sector too often overlooks; maximise the leverage of private funds; or even help to accelerate the take-up of innovative instruments through technical assistance. Their potential impact is one reason France committed to expanding its ODA to 0.55% (from 0.43% in 2017) of national income by 2022.

The way forward

Promising food for thought is likely to emerge from discussions in the coming months within the Leading Group on Innovative Financing for Development, a gathering of 66 stakeholders who include states, foundations, nongovernmental organisations and companies. They will be focused on some of the following questions. How can better mechanisms be introduced to encourage migrant workers to invest their assets (i.e. remittances) in development activities? How can greater responsibility be required of those operating in the maritime transport sector and how can they be encouraged to actively reduce their environmental footprint. And can development impact bonds contribute to increasing the impact of ODA?

Feeling hungry for innovative thinking on innovative financing? Come and join us.

Certain innovative instruments are intended to mobilise additional resources in support of targeted development outcomes.

- The collection of international solidarity levies from air passengers when they purchase their tickets. The governments of Brazil, Chile, France, Norway and the United Kingdom launched this initiative in 2006, aiming to directly tap household and industry resources and link them to sustainable development efforts. Most of the funds raised are used to finance UNITAID, the United Nations agency charged with funding the treatment and care for patients affected by HIV/AIDS, tuberculosis and malaria.
- Green bonds, which are debt securities that tap capital markets to raise financing specifically to support climate-related or environmental projects: Most green bonds carry a green "use of proceeds" proviso, meaning that proceeds from these bonds are earmarked for green projects, and provide for the issuer's entire balance sheet to back repayment of the principal and interest. Water bonds, also known as blue bonds, are a special subcategory of green bonds that raise capital for the sustainable ocean economy.

Other innovative instruments are devised to increase the efficiency of financing efforts. These instruments reduce the time and costs involved in matching the supply of financing with needs, e.g. by bringing together public and private actors or by adopting structures that have been tried in the private sector.

- An example is the Caribbean Catastrophe Risk Insurance Facility (CCRIF), a multi-country risk pool that provides natural disaster insurance to member governments. Unlike traditional insurance settlements that require an on-the-ground assessment of individual losses before a payment can be made, the parametric mechanism of the CCIRF makes pay-outs once a pre-agreed threshold value of an index is met. Resembling the settlement mechanism for financial derivatives, this structure allows for faster compensation, but carries a trade-off in that the contracted compensation can differ markedly from actual assessed damage.
- Another instrument is advance market commitments, contractual partnerships between donors and pharmaceutical companies that aim to ensure research on neglected diseases. Donor governments commit to ensuring predictable demand for the products once research is completed, while companies have the contractual obligation to do the necessary research and commit to the distribution of medicines on the market at affordable prices for developing countries.

Some instruments are intended to enhance development quality by aligning financing with development outcomes. Often, these instruments make financing conditional upon the delivery of concrete development results. Results-based financing is an umbrella term for mechanisms such as output-based aid and pay-for-performance that use incentive schemes, traditionally a private sector practice, to enhance the performance of aid. In this group of instruments, the payment is not made for the input required for the project or programme but for achieving an effect.

Development impact bonds, for example, create a contract between private investors and donors or governments who have agreed on a shared development goal. Private investors provide the principal amount as starting capital to a development service provider. If the project achieves a pre-agreed development outcome, the donors or governments are committed to pay. The donor/government pays back the principal and returns. This

innovative financial instrument shifts the financial risk of development challenges from the public sector to the private sector. One example is the humanitarian impact bond, pioneered by the International Committee of the Red Cross, which is described in Box 3.4.

Box 3.4. The humanitarian impact bond - Innovative bonds can raise financing for humanitarian purposes

The humanitarian impact bond is an innovative financing mechanism developed by the International Committee of the Red Cross (ICRC) and the first of its kind in the humanitarian sector. This new fundraising instrument is intended to catalyse private and public capital to finance vital services for people with disabilities in conflict-hit countries.

The five-year programme funds the construction and operation of three new physical rehabilitation centres run by the ICRC in Maiduguri (Nigeria), Kinshasa (Democratic Republic of the Congo) and Mopti (Mali). The programme also covers the training of new staff and the design and testing of rehabilitation efficiency initiatives in eight existing ICRC physical rehabilitation centres for a period of three years. It additionally includes the development and deployment of an information communication technology tool for physical rehabilitation centre management.

Private capital from social investors of about CHF 18.6 million has been mobilised and provided to ICRC to support humanitarian outcomes and provide services during the five-year programme. The outcome funders (Belgium, Italy, Switzerland, United Kingdom, and the Spanish bank, La Caixa) made a conditional pledge to pay ICRC for concrete results achieved in five years. The higher the efficiency in the new centres, according to the pledge, the higher their contribution. An external provider is in charge of verifying ICRC-reported data and establishing the outcome measure to determine the exact payment owed by the outcome funders.

Although official providers in particular are increasingly interested in the use of innovative instruments in financing for sustainable development, other actors – notably foundations – can also play an important role in increasing innovative finance (Box 3.5).

Box 3.5. Philanthropic foundations can act as innovation catalysts

Most foundations rely exclusively on grants to provide financing for sustainable development. But some foundations are using new financial tools and act as pioneers and catalysts of innovative financing for development. These foundations have relatively low levels of risk aversion and are willing to invest in innovative business concepts and financing models. Consequently, they are also becoming increasingly important players in the blended finance market where their participation aims to mobilise additional finance.

Moreover, foundations are playing a critical role in the evolution of the social impact investment market through market-building activities (research and knowledge exchange) and mission-related investments (MRIs).

MRIs, which are investments of foundations' endowment into ventures that are related to their core mission, can be viewed as a type of social impact investment. Through MRIs, foundations no longer distinguish between investments to maintain and expand their endowment and their grant-making strategies. A foundation focused on fighting climate change, for instance, will give out grants to nongovernmental organisations that are implementing recycling initiatives and it also will invest its endowment in renewable energy companies or funds.

Foundations in the United States are subject to a legal requirement to annually disburse 5% of their assets – called the pay-out – to keep their tax exemptions. Whereas grants are typically included in this pay-out, MRI investments are made directly from the endowment. Thus, MRIs have the potential to leverage the untapped 95% capital. In 2017, the Ford Foundation made the largest commitment to MRIs to date by devoting USD 1 billion out of its USD 12 billion endowment to MRIs over the subsequent ten years. With this move, the Ford Foundation aims to help build the market for MRIs by creating impact funds and to encourage other foundations to follow its lead.

Source: OECD (2018[91]), *Making Blended Finance Work for the Sustainable Development Goals,* http://dx.doi.org/10.1787/9789264288768-en.

Blended finance gains traction as a tool to mobilise the private sector

Beyond the specificities of individual instruments, an overarching paradigm shift underlies financing for sustainable development innovations. The rising popularity of blended finance practices especially reflects this. Blended finance is not an instrument. It is a new approach to better use existing and new financial instruments. The OECD defines blended finance as the "strategic use of development finance for the mobilisation

of additional finance towards sustainable development" in developing countries, where additional finance is primarily private commercial finance (OECD, 2018[9]).

Official providers increasingly engage in blended finance operations. At least 17 members of the OECD DAC currently undertake blended finance operations at different stages, using a range of financial instruments and sometimes differing in how blending is carried out. According to one estimate, over 300 blended finance transactions have been closed from 2005-2017, representing an aggregate amount of over USD 100 billion in financing for sustainable development in developing countries (Convergence, 2018[17]).

Many bilateral providers rely on development finance institutions (DFI) to engage in blended finance. DFIs are government-controlled institutions that invest in sustainable private sector projects. While many DFIs have a long track record of investing in private sector projects, having done so since the 1960s and 1970s, the amount of support they are offering to the private sector has increased sharply in recent years. At the European level, the consolidated portfolio of the 15 members of the association of European Development Finance Institutions (EDFI) has more than tripled, to EUR 37 billion in 2017 from EUR 11 billion in 2005 (EDFI, 2018[18]).

Blended finance transactions often are innovative in the way they structure and/or calibrate traditional financial instruments to address private investor concerns regarding the risk-return profile of investment opportunities. If equity and debt are provided on concessional terms, they can shift the risk-return relationship of a project in order to facilitate commercial investment. Even if non-concessional terms are applied, the mere presence of DFIs as investors can contribute to raising investor confidence, thanks to their due diligence capacities and ability to deal with political risks. This benefit is even amplified when DFIs are invested in the riskier parts of the balance sheet – for example, when they use equity or mezzanine instruments (Benn, Sangaré and Hos, 2017[10]).

Mobilisation through blended finance also can take the form of indirect investments. For example, collective investment vehicles (CIVs) or funds are legal entities in which different actors pool their resources to make collective investments in specific segments, such as climate finance or small and medium-sized enterprises. CIVs utilise different kinds of instruments including equity, debt or guarantees. A CIV can be structured so that all investors are exposed to the same risk-return profile (flat structure). In this case, the presence of development finance providers can have a signalling or demonstration effect. Development finance providers also can provide technical assistance to support the project and make it more attractive to private investors. However, CIV can also be structured in such a way that some investors, especially official providers, have subordinated repayment claims. Taking a first-loss position, development finance providers thus can act as a cushion for private investors (OECD, 2018[9]).

Guarantees are a commonly used instrument in blended finance. During the period from 2012 to 2015, development finance organisations mobilised USD 35.9 billion,[13] according to the 2016 OECD-DAC Survey, which also finds that guarantees are the main leveraging instrument used by development finance agencies (OECD, 2018[9]). The Elazig Integrated Health Campus project, described in Box 3.6, illustrates how official finance can be combined with private sector resources from commercial investors to finance a development project, including through the use of guarantees.

Box 3.6. Mobilisation through blended finance - Elazig Integrated Health Campus project

Promoting the participation of untapped investor classes in the healthcare sector through the Elazig Integrated Health Campus project

The Elazig Health Campus project, initiated by the government of Turkey as part of its health transformation programme to improve the healthcare services across the country, is an example of strategic use of blended finance on a non-concessional basis to mobilise additional commercial investment (OECD, 2018[9]).

The project is a EUR 360-million greenfield[14] project structured as a public private partnership that handles the design, construction, finance and maintenance. The Turkish Ministry of Health will be responsible for the core medical services. The Elazig project was realised with the help of innovative financing structures and credit enhancements that resulted in the issuance of bonds with an investment-grade rating (Baa2 by Moody's), two notches above Turkey's sovereign rating at that time. The combination of Multilateral Investment Guarantee Agency (MIGA) political risk insurance and European Bank for Reconstruction and Development (EBRD) liquidity facilities during both construction and operation, helped to make this rating possible. The Euro-denominated project bonds were issued in different tranches; the senior A1 bonds are enhanced by EBRD liquidity facilities and the MIGA political risk insurance guarantee. Bond investors include Mitsubishi UFJ Financial Group (Japan), Intesa Sanpaolo (Italy), Siemens Financial Services (Germany), PROPARCO (France), the Netherlands Development Finance Company (FMO), and the Industrial and Commercial Bank of China. The International Finance Corporation invested in the unenhanced A2 bonds.

Social impact investment is in the early stages but can help to engage private sector actors more directly in the financing of the SDGs

Social impact investment (SII) encompasses a variety of innovative approaches to deliver on the SDG, and can be defined as the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, environmental and/or financial return (OECD, 2015[19]). The Transforming Education in Cocoa Communities project in Côte d'Ivoire (Box 3.7) is an example of innovative use of financing instruments – in this case, with a philanthropic foundation providing seed finance for investment in education programmes. The private sector brings capital to the market as well as innovative approaches to address the pressing issues framed by the SDGs.[15]

SII uses innovative instruments, among them pay-for-performance instruments like the development impact bond and the social success note. However, SII also makes use of traditional instruments such as debt and equity in innovative ways. Social enterprises often struggle to raise funding in their early stages of development. Grants, from foundations or the public sector, are also used alongside SII to provide first loss or catalytic funding. The grant provider bears the business risk of the enterprise at the seed stage, which serves to attract additional funding (GIIN, 2013[20]). The goal, however, is to help the enterprise to ultimately make profits while generating sustainable impact.

Box 3.7. Social impact investment helps to provide quality education in Côte d'Ivoire

In 2015-16, only 5.32% of the bilateral ODA going to Côte d'Ivoire targeted education.[16] The Transforming Education in Cocoa Communities (TRECC) programme, using a social impact fund set up by the Jacobs Foundation of Switzerland, aims to improve the livelihoods of individual households by providing quality education, empowering women and assuring child labour remediation. The programme will run from 2015 to 2022.

The impact fund is dedicated to investments in the education sector and has CHF 3.7 million in a portfolio of five investees in 2017. It provides risk finance and technical assistance to small and medium-sized enterprises in order to grow innovative solutions to Ivorian education challenges. The TRECC programme brings together governments, civil society and corporate players for partnerships in the cocoa sector. Already these include public-private partnerships with corporations such as Mars, Incorporated, Mondelēz International, and Nestlé. The Jacobs Foundation also has signed a memorandum of understanding with the government of Côte d'Ivoire to improve the quality of education in the country. The programme further has formed alliances with organisations such as Brookings and the International Cocoa Initiative to support research and capacity building.

Social impact investing has the potential to catalyse new capital flows and thus translate experiences, policies and approaches from developed countries for the developing country context. While the social impact investment market is still in the early stages of development and is only a small share of the global capital markets today (OECD, 2015[19]), it has been growing significantly and attracting increasing interest, including in specialist areas such as gender impact investment (Chapter 6). In order to build the SII market, a broader evidence base is needed to inform market stakeholders – governments, development finance institutions, private sector investors and social entrepreneurs – about activity and performance of social impact investments. Greater transparency, measurement and accountability for outcomes and impact are critical to scaling up social impact investment.

Triangular co-operation is on the rise

Triangular co-operation refers to development co-operation partnerships between two or more developing countries, with the support from a developed country or multilateral organisation. Triangular co-operation. It provides another example of how innovative financing can lead to the formation of new constellations of actors to finance sustainable development. Introduced in the 1970s, triangular co-operation gained popularity in recent years as a modality by which partners leverage and combine different types of resources (financial, in-kind, knowledge, technology or other resources). This type of co-operation harnesses and capitalises on the comparative advantages of each partner, resulting in an impact that is greater than the sum of their individual interventions (Box 3.8). Such next- generation partnerships (Chapter 5) have the potential to mobilise more and smarter financing for sustainable development.

Box 3.8. Triangular co-operation brings together diverse resources in support of sustainable development

Triangular co-operation supports innovative and collaborative ways to achieve the Sustainable Development Goals and can provide solutions to overcome today's environmental, economic and social constraints to development. Triangular co-operation is on the rise, according to results of surveys and analyses conducted by the OECD. This trend is confirmed by data collected by the Ibero-American General Secretariat (SEGIB) that show the number of triangular co-operation projects in Latin America and the Caribbean increased eight-fold between 2005 and 2015 (SEGIB, 2017[21]). There are a number of reasons for such growing interest in and demand for this way of working in development co-operation.

First, 1+1+1 > 3. Triangular co-operation multiplies the contributions and participation of the different partners in terms of results in the target country. It also encourages building strong and trusting partnerships that often continue beyond the lifetime of the triangular project.

Second, small can go very far. On average, the budgets of triangular co-operation projects tend to be relatively small, particularly in comparison with bilateral and regional projects. However, technical co-operation can go far without large budgets. Additional funds can also be leveraged through a triangular intervention. Triangular co-operation projects are often funded by DAC and non-DAC providers of development co-operation, international organisations or a partner organisation in the target country. For instance, in a triangular co-operation project of Brazil, Germany and Peru, the DAC member provided EUR 1 million of the EUR 3.9 million project budget and Brazil together with Peru provided the remainder.

For many providers who are not DAC members, triangular co-operation is a way to increase the scale and scope of their development co-operation while sharing the costs (and risks) associated with the intervention. For example, the Islamic Development Bank's reverse linkage modality can fund only one-third of any given triangular project. It should be noted, however, that the budgets of triangular co-operation projects in the Middle East and North Africa tend to be bigger than those of such projects in other regions, suggesting the need to better understand and capture how this modality is being used in all regions and how the leveraging effect can be amplified.

Third, knowledge is gold and sharing it is cost efficient. Knowledge, solution sharing and joint learning are core elements of triangular co-operation. In the spirit of mutual interest and benefit, countries share their experiences and expertise. The partners in triangular co-operation can often find innovative, cost-effective, flexible and context-specific solutions to development challenges. These solutions may have been tested by a country with similar conditions, often in the immediate neighbourhood, and can most likely be better adapted to the context of the beneficiary partner through the financial or technical support of a third

partner. The impact may be large and affect the lives of many people while the financial cost is low. Triangular co-operation activities increasingly are being used to provide solutions and answers to some of the most pressing global challenges such as the refugee crisis and climate change. As such, triangular co-operation is increasingly being used beyond niche thematic areas.

Fourth, triangular co-operation offers flexibility in fast-changing environments. The ideas for triangular initiatives often are born in bilateral co-operation projects that can be scaled up or, in the case of larger bilateral or regional programmes, can include a trilateral component. Triangular co-operation is flexible in its forms and in the way that the partners work together. If major events such as elections or natural disasters affect the political priorities and implementation capacities of one partner, other partners can step in and ensure that the project delivers.

Fifth, triangular co-operation transcend divides between South-South and North-South co-operation. Triangular co-operation has a strong strategic and political dimension. Partners build trust through negotiating and jointly implementing projects. Over time, they understand the perspectives, management methods and policies of the other partners. This mutual understanding can contribute to overcoming divides between South-South and North-South co-operation and encourage use of best ways of working to support development for those most in need. Collaboration in development also at times fosters collaboration in other areas such as foreign policy, environment or trade.

Despite such benefits and successes, doubts persist about triangular co-operation. However, OECD analyses find that, contrary to widespread assumptions, triangular co-operation is not scattered, small in scale and scope, and not only relevant in niche areas; that clear planning and implementation mechanisms are followed; that it offers clear value added in comparison to bilateral or regional co-operation; and that it is found beyond Latin America and the Caribbean. To address the persistent doubts, the OECD has been working to track and provide tools to better capture the value added of triangular co-operation and to correct these misconceptions (OECD, 2017[22]), (Casado-Asensio and Piefer, 2018[23]).

Contributed by Nadine Piefer and Juan Casado-Asensio, Policy Analysts, Foresight, Outreach and Policy Reform Unit, OECD Development Co-operation Directorate.

Innovative finance has not yet reached its full potential

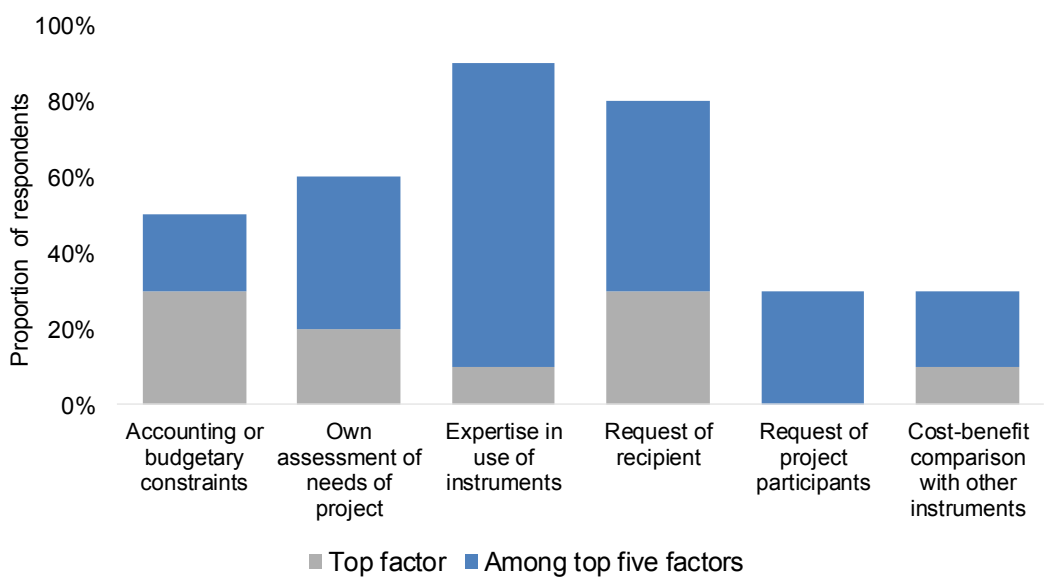
Despite the potential of innovative approaches and the enthusiasm of providers, only a small volume of financing has yet been raised through these approaches. Official providers still rely mostly on standard instruments such as grants and loans. As was shown in Figure 3.2, instruments other than loans or grants still make up a fraction of their portfolio. This also can be seen in the green bond market, whose rapid growth in recent years is a major and much-acclaimed success, with new issuances nearly quadrupling to USD 42 billion in 2015 from USD 11 billion in 2013. However, even with this strong performance, the green bond market remains small in comparison to the overall volume of debt issued by public and private sector borrowers in developing

countries on international markets, which amounted to USD 198 billion in 2015. Similarly, development impact bonds have been slow to gain traction to date, and while 21 of these bonds are being designed but only 6 have been implemented (Instiglio, n.a.[24]).

Because innovative instruments involve a high level of technical and legal expertise, they can bring high transaction costs and opportunity costs. For example, guarantees for investments require that three actors – the guarantee provider, the investor and the recipient of the investment – are brought together and thus are more complex than traditional, bilateral instruments such as grants and loans (Criqui and Vaillé, 2017[25]) and entail higher transaction costs (Humphrey and Prizzon, 2014[26]).The growing popularity of climate and disaster insurance mechanisms is accompanied by concern that their use risks diverting scarce public resources from more effective (and cost-effective) resilience-building strategies (ActionAid, 2015[27]). Spending public resources on insurance premiums involves opportunity costs that must be considered in the adoption of insurance products for financing sustainable development purposes.

Capacity building, exposure and experience are needed to bring innovative instruments to scale, including assessing when their use is most appropriate. The recent "Global Outlook Survey on Financing for Sustainable Development" found that OECD members rank the lack of familiarity with financing sustainable development instruments as one of the main challenges to their use. More than 80% of respondents reported that two of the top five factors influencing their choice of financial instrument are expertise and familiarity with the instrument, while only around 20% of respondents said their choice is influenced by a cost-benefit comparison with other instruments (Figure 3.4). This suggests that harnessing the potential of innovative instruments requires a long-term learning process and targeted investment in capacities.

Figure 3.4. Factors influencing the selection of instruments of bilateral providers



Source: OECD (2018[28]), "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm.

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Income levels influence sustainable development financing patterns

While the concept of development includes many different dimensions, income per capita remains an important indicator in terms of both growth and economic outcomes and countries' access to finance. A country's gross national income (GNI) is particularly important as it directly affects the country's eligibility to access concessional public finance (ODA) and can be highly correlated with access to non-concessional sources of finance, including international financial markets.

The financing available goes through a dual shift as countries move along the development continuum

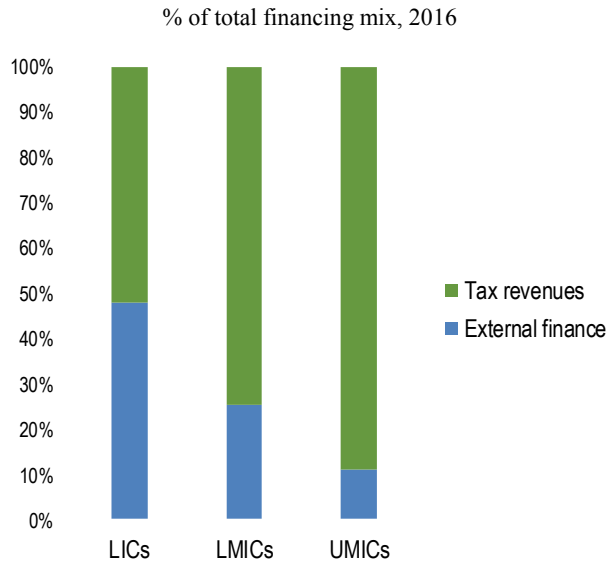
As countries experience growth and transition through the development continuum, it is possible to observe some distinctive patterns for each of the resources composing the global financing mix available to developing countries (Kharas, Prizzon and Rogerson, 2014[29]).

A dual shift in the financing mix accompanies the development transition as countries' income increases – from external to domestic financial resources and from public to private forms of investment in sustainable development.

Countries tend to rely less on external finance and more on their own resources

Reliance on domestic finance increases substantially for middle-income countries. While tax revenues are slightly less than half the volume of total financing for low-income countries, they make up more than 70% for lower middle-income countries and around 90% for upper middle-income countries. (Figure 3.5) The ratio of tax revenue as a share of GDP ranges from 11% for low-income countries to over 18% for some upper middle-income countries. Only lower middle-income countries and upper middle-income countries exceed the threshold of 15% of tax-to-GDP ratio that is considered the minimum for effective state functioning.

Figure 3.5. Domestic vs external resources in the financing mix



Note: The resources include concessional flows (ODA), non-concessional flows (OOF), private flows (foreign direct investments, private securities, and claims from banks and other sources such as bonds, equity, etc.), and remittances.
Sources: OECD (2018[1]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for official bilateral and multilateral flows; World Bank (2018[30]), "Migration and remittances" (database) http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances; IMF (2017[31]), "Balance of Payments" (database) http://www.imf.org/external/datamapper/datasets/BOP for FDI, portfolio investments, and long-term and short-term debt.

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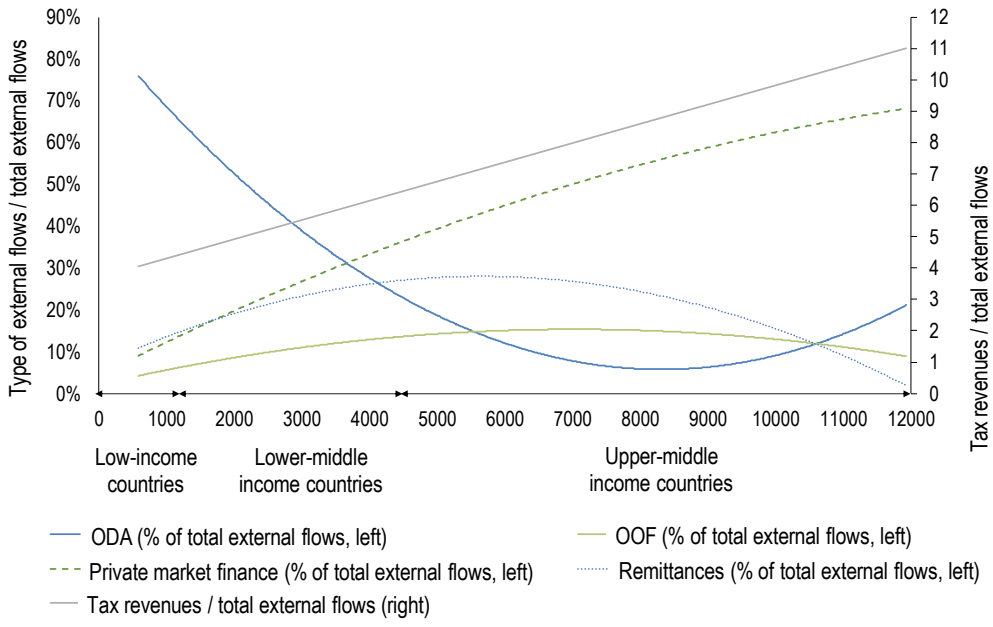
The structure of countries' taxation has generally shifted over time but is generally driven by per capita income levels. During the period from the 1980s to the 2000s, developing countries tended to have a high reliance on indirect taxes such as VAT, which constituted between 70%-75% of total tax revenue, and without significant differences between low-income and middle-income countries. This contrasts with high-income countries, where the split between direct and indirect taxes is roughly 1:1. The difference is mainly driven by differences in the share of personal income taxes and social security contributions, which take up a much greater portion of revenue (35%-40%) in high-income countries than they do in low-income and middle-income countries (10%-11%) (Lemay-Boucher and McNabb, 2014[32]). This phenomenon may be explained partially by the challenges in collecting personal income taxes due to the size of the informal economy in developing countries (UNESCAP, 2017[33]).

Countries tend to shift from public to private financing as income rises

The composition of cross-border finance also changes along the development continuum. The weight of international public finance declines as national income status improves. Official flows, and concessional finance (ODA) in particular, are the dominant component of external resources for low-income countries and lower middle-income countries. They become less important for upper middle-income countries.[17] Low-income countries are highly dependent on official flows, especially ODA; concessional flows

constitute 50%-60% of total external flows to these countries. ODA and other official flows (OOF) become less relevant for upper middle-income countries, making up less than 10% of external finance (Figure 3.6).

Figure 3.6. The availability of financing resources at different income levels



Note: The resources include concessional flows (ODA), non-concessional flows (OOF), private flows (foreign direct investments, private securities, and claims from banks and other sources such as bonds, equity, etc.), and remittances.
Sources: OECD (2018[1]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for official bilateral and multilateral flows; World Bank (2018[30]), "Migration and Remittances" (database) http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances; IMF (2017[31]), "Balance of Payments" (database), http://www.imf.org/external/datamapper/datasets/BOP for FDI, portfolio investments and long-term and short-term debt.

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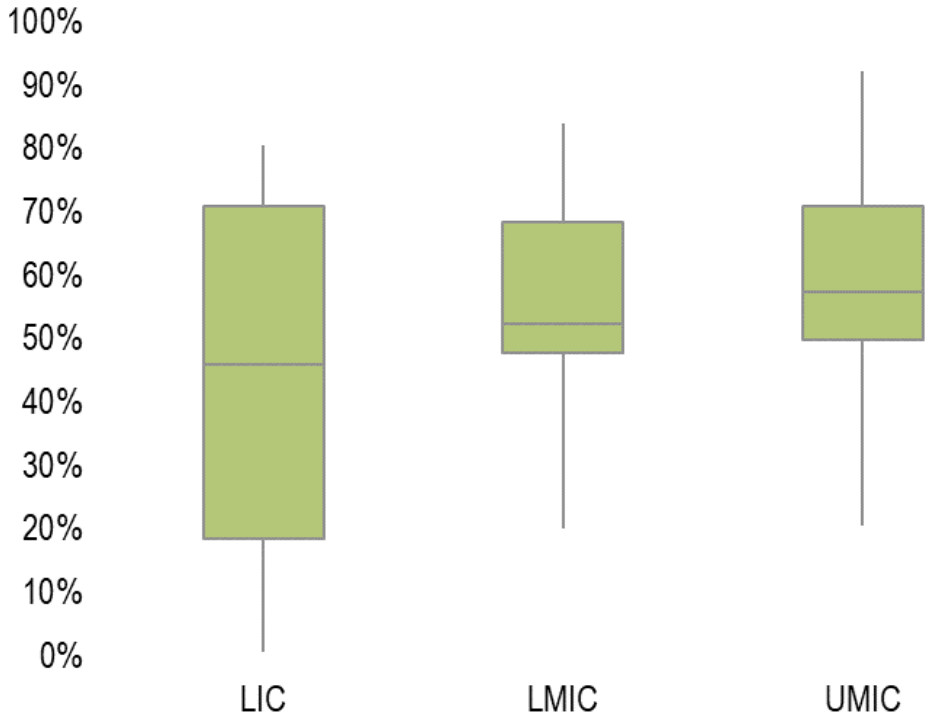
Private finance dramatically rises in importance at higher income levels as access to international capital markets offers a greater choice. Remittances are important for low-income countries, but their share in external financing is highest for LMICs and UMICs. While private flows represent around 30% of all external financing for low-income countries, they make up 70% of external finance for the richest of upper middle-income countries.

As countries develop and move towards more reliance on private finance, they also gain access to a larger set of capital sources and available instruments. For example, middle-income countries have easier access to international debt capital markets than do low-income countries. Between 2012 and 2017, only 4 out of 31 low-income countries had access to cross-border loans but no outstanding tradable debt, while 22 out of 51 lower middle-income countries and most upper middle-income countries (37 out of 50) raised debt in international markets during the same period.[18] While there is great variation in the share of tradable over total external debt, it appears that with higher income levels the portion of debt raised in international capital markets tends to rise (Figure 3.7).

Figure 3.7. Share of tradable debt securities in overall external debt

2012-17, % of capital market debt



Note: The share of capital market debt was estimated on the basis of the average outstanding international debt securities between 2012 and 2017, as compared to the share of outstanding cross-border loans from BIS-reporting banks in the same period.
Sources: Author's calculations based on Bank of International Settlements (2018[34]), "Debt securities statistics", https://www.bis.org/statistics/secstats.htm.

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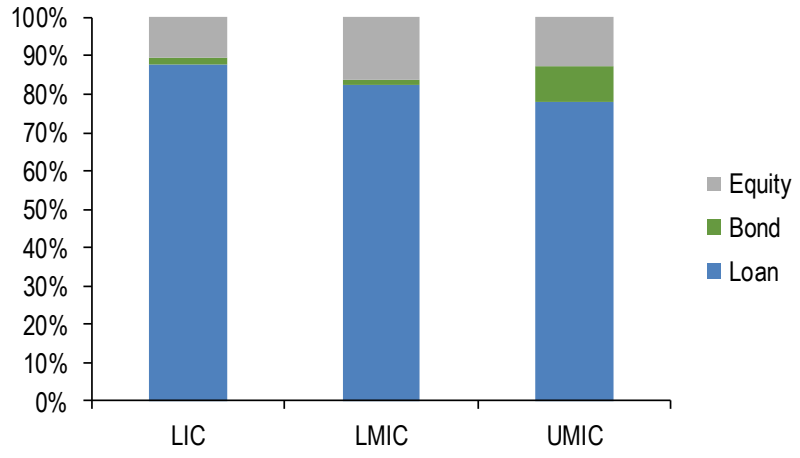
The financing mix of debt to equity finance also tends to vary according to income level. Typically, financing in low-income countries has a higher debt to equity ratio, which is due to the higher risks and makes fixed return investments more attractive than variable returns. This is evident in project finance, for example (Figure 3.8). Project finance can take the form of loans, bonds and equity. The loan component is proportionately highest for low-income countries (88%) and lowest for upper middle-income countries (78%). For upper middle-income countries, on the other hand, capital market bonds present a viable alternative to loans and equity investments and constitute close to 10% of overall investments.

Figure 3.8. Use of instruments in project finance transactions

2012-2016, % of instruments used



Note: Average values over the period between 2012 and 2016.
Source: OECD calculations based on data from Dealogic (2018[35]), https://www.dealogic.com/content/.

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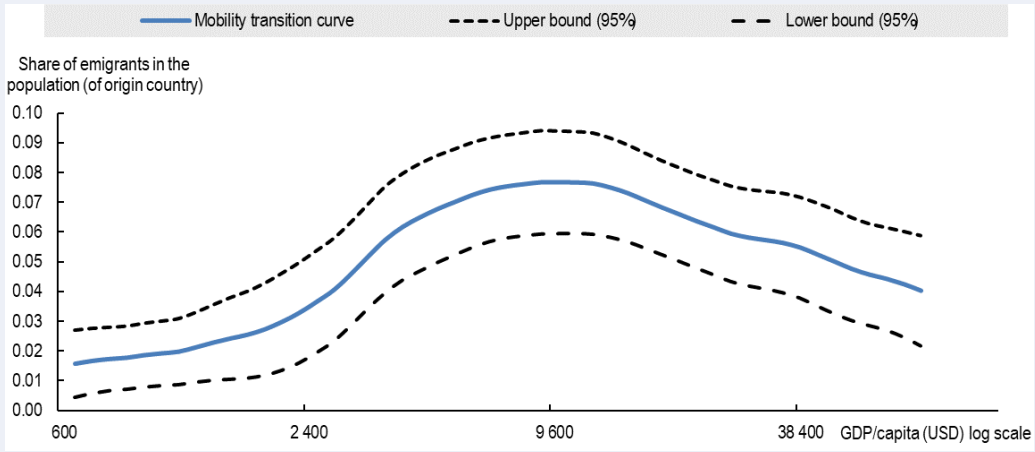
Economic growth also drives changes in migration that lead to changes in remittances (Box 3.9). At low national income levels, increasing incomes lead to more opportunities to migrate. At higher income levels, people may have access to greater domestic opportunities and so migrate at a lesser rate. This does not mean that remittances are not important for low-income countries, which rely overall on external financing to a much greater extent than do middle-income countries. Five of the top ten remittance-receiving countries in terms of percentage of GDP are low-income countries.

Box 3.9. Migration hump

The relationship between economic development and the emigration rate is called the mobility transition curve (Zelinsky, 1971[36]) or migration hump. When the GDP per capita increases in countries with low incomes, the emigration rate rises. Additional income can allow people to migrate who had aspired to do so but were constrained by a lack of financial resources. In countries with high levels of GDP per capita, financial constraints are less relevant and the aspiration to migrate diminishes as domestic opportunities increase.

Emigration first increases as income levels in a country rise, but it eventually decreases. The estimated turning point in 2010 was around USD 7 200 (in 2011 PPP). As Figure 3.9 illustrates, in the countries with per capita income above this threshold, an increase in the GDP per capita translates into lower emigration rates. On the other hand, the share of emigrants in the population is expected to increase in the countries with GDP per capita that is lower than this threshold. This suggests that economic development is likely to spur emigration from these countries (OECD, 2016[37]).

Figure 3.9. The share of emigrants in terms of percentage of population rises with GDP per capita, 2010



Source: OECD (2016[37]), *Perspectives on Global Development 2017: International Migration in a Shifting World*, http://dx.doi.org/10.1787/persp_glob_dev-2017-en.

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This is reflected in the inverse U-shape of remittance flows in Figure 3.6. Remittances first tend to rise as countries transition from low income to lower middle income. As is the case with the emigration rate, the trend is reversed as the per capita income growth level passes from the lower to the upper middle-income level.

Remittances also are significant in some middle-income countries and can constitute the largest proportion of external flows, or close to 20% on average. An income level of around USD 6 000 to USD 7 000 per capita, on average, is the turning point at which remittances reach a peak in terms of the share in total external finance. Another reason is that at this stage of a country's progression on the development continuum, concessional financing decreases and private sector investments are increasing at a lower rate.

The case for holistic approaches: accommodating and supporting transition

As discussed above, the availability of different sources of finance evolve with growing levels of income, with implications on financing for sustainable development. This is further illustrated by the essay "Transitioning to middle-income status: Implications for financing development".

The actual financing mix might not reflect the changing needs of a country. Currently, a lack of understanding on the evolving needs of countries limits the ability to adapt development finance to take account of these needs and shifting financing patterns as countries transition. Part of the future work is to identify any potential gap between availability of financing and the needs.

Moreover, if the phase-out of concessional finance is not well co-ordinated with the increase in other sources, countries may struggle to address core development needs to continue their progress. However, existing processes overseeing graduation from concessional finance do not sufficiently address the challenges related to the changes in the financing mix.

Box 3.10. In My View: Transitioning to middle-income status: Implications for financing development, by Annalisa Prizzon, Senior Research Fellow, ODI

Over the past 15 years, 35 poor countries have joined the ranks of the world's middle-income countries, a reflection of the strong and sustained economic growth achieved in most parts of the developing world. An improved income status is likely to affect every aspect of a country's development finance and notably the volume, terms and conditions of external finance as well as the type of projects supported (Prizzon and Rogerson, 2017[38]). Some examples of these likely impacts include:

- Falling volumes. A country might find itself stuck in the missing middle of development finance until it is well into middle-income status (Kharas, Prizzon and Rogerson, 2014[29]). This is because middle-income countries are likely to see a reduction in funding from bilateral donors, especially grant financing, as they grow. Additionally, when countries start to emerge from very low income, their growth often is constrained as domestic revenue mobilisation fails to expand fast enough to compensate for the fall in external assistance. This trend is particularly acute for lower middle-income countries.
- Changing terms and conditions of external finance. Middle-income countries are usually in a better position than low-income countries to borrow from capital markets and to service loan repayments. Grants tend to be prioritised in countries that do not have alternative financing options or cannot afford external borrowing. Multilateral development banks impose harder terms and conditions on sovereign loans once a country meets the criteria to graduate from the concessional windows.
- Shifting sectoral composition of external finance. The shift from grants to so-called soft loans and then hard loans also can alter the way in which aid is allocated among sectors. Economic infrastructure projects (e.g. toll roads and utilities) tend to attract funding that is less concessional, given their potential returns and/or ability to generate cash flows. Conversely, the social sectors (e.g. education and health) tend to be supported either by public taxation or grants rather than loans from donor governments. There is mixed evidence on this point, though. For example, in the case of Indonesia, the share of external assistance to the education sector expanded during the transition back to non-concessional finance (Prizzon and Rogerson, 2017[38]). Some countries are also willing to borrow to support projects in the education sector (Rogerson and d'Orey, 2016[39]).

Most low-income countries aim to become middle-income countries and have strategies in place to reach this goal. Partner country governments and providers of development finance should therefore understand, plan for and address the likely changes to financing volumes, conditions and allocation such transitions entail. This can include developing financing and debt management strategies that reflect the future composition of countries' external resources. They should continue strengthening their tax policies and revenue collection.

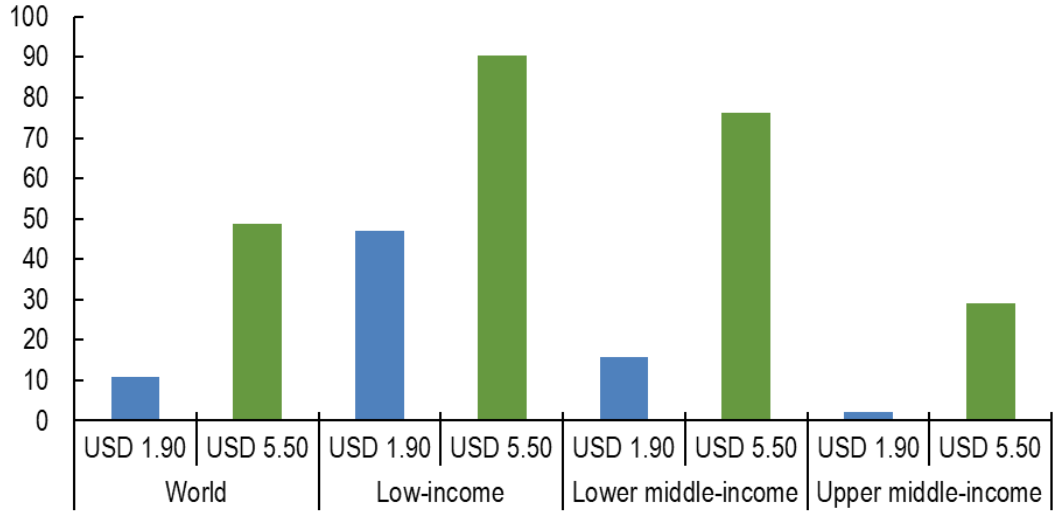
Multilateral development banks should consider smoothing their graduation policies and boosting resources for lower middle-income countries to address the missing middle of development finance. Bilateral donors should also review their approaches to transition and exit strategies; plan and communicate these strategies in advance to governments; and co-ordinate with other development partners.

One of the main reasons that fluctuations in income levels have an impact on the financing mix is that at higher income levels, countries gain and lose access to financing sources and specific instruments. This can be seen in terms of the availability of concessional finance, for instance, because it is partially determined by the national income level. Eligibility for ODA is based on a country's per capita income level,[19] and the process of International Development Association (IDA) graduation is triggered when a country exceeds a certain per capita income level.[20] As this happens, countries also lose preferential market access such as lower tariffs or duty-free and quota-free access to third country markets. Graduating from least developed country status depends on a combination of factors including per capita income, but once a country does make that transition, it is no longer eligible for special and differential treatment regarding World Trade Organization obligations.

At the same time, rising levels of national income can mask large and persistent development challenges. For many countries, economic growth has not been inclusive. Large pockets of the population can remain in extreme poverty, as evidenced by recent findings that, for the first time, a large share of the world's poorest are living in lower and upper middle-income countries. A significant share of the population in middle-income countries lives below the poverty threshold of USD 5.5 per day (Figure 3.10). In addition, almost half of all middle-income countries have high levels of inequality. Key social outcomes and indicators for health literacy and the quality of the urban environment show that many middle-income countries face the same or more severe challenges as low-income countries. In one-fourth of middle-income countries, more than half of the urban population live in conditions qualified as slums by the United Nations. Indeed, 16 lower middle-income countries and 2 upper middle-income countries are still classified as least developed countries.

Figure 3.10. Poverty headcount ratio (2011 PPP) is still high in middle-income countries

% of population, 2013



Source: World Bank (2018[40]), "Poverty and equity database", http://databank.worldbank.org/data/reports.aspx?source=poverty-and-equity-database.

StatLink https://doi.org/10.1787/888933853072

After reaching higher levels of national per capita income, several countries have fallen back to lower income categories and many lower and upper middle-income countries remain trapped, unable to make a transition to high-income status. Since the 1960s, only 13 middle-income countries, among them Korea, have been able to move to high-income status (World Bank, 2013[41]). The Philippines, among others, has not been able to make that transition. Since the founding of the IDA, 44 countries have graduated and 9 of these graduates have since re-entered ("reverse graduated") IDA eligibility (World Bank, 2018[42]).

Higher national income levels also do not automatically translate into access to more private external financing sources. Empirical evidence suggests that domestic enablers such as political stability, fiscal discipline, and the quality of governance and institutions determine not only whether these countries can access international debt markets but also at what cost (Presbitero et al., 2016[43]) (Gelos, Sahay and Sandleris, 2011[44]). FDI in-flows, for example, are not equally distributed among countries with a similar level of national income. FDI is concentrated in a handful of countries, among them the People's Republic of China, Indonesia and Colombia; variables apart from income such as trade openness, infrastructure availability and business environment also weigh heavily in determining access to foreign investment flows (Tampakoudis et al., 2017[45]), (Ranjan and Agrawal, 2011[46]).

To address the financing challenges, different enablers should be prioritised as countries grow. For example, the efficiency of the domestic financial system is importantly related to the growth rate in low-income countries. However, the level of financial system development matters less as countries move up the income scale. As they advance, other variables negatively affect growth including the occurrence of banking or currency crises, the extent of capital inflows excluding FDI, and government debt as a share of GDP (Eichengreen, Park and Shin, 2017[47]).

Given these considerations, the phase-out of concessional finance has to be carefully managed in co-ordination with the increase in other sources. If international assistance tapers faster than improvements in domestic resource mobilisation and an increase in private external financing, countries may struggle to address core development needs to continue their progress. Moreover, a sudden increase in external financing through debt accumulation can affect a country's creditworthiness and lead to financial crises, impeding its growth prospects. Currently, different processes overseeing graduation from concessional finance do not sufficiently address the challenges related to the changes in the financing mix.

Innovative approaches such as blended finance and social impact investment need to address these opportunities and risks; the use of concessional finance in countries preparing to graduate from ODA/IDA eligibility can focus on mobilising and catalysing other sources of external financing that are sustainable and conducive to development in the long term.

Development finance also needs to more carefully work with countries to prepare for these transitions in a holistic way, including through mobilising and catalysing other forms of finance and investing in enablers and support for enabling domestic policies. Box 3.11 and Part II discuss this further.

Box 3.11. Holistic approach in action - The OECD DAC work on transition finance

The holistic approach seeks to leverage the dynamic effects of financing and policy (Chapter 5) to strengthen the FSD system for self-sustaining finance over the long term. The OECD DAC has started to look at the issue of transition finance through the lens of the holistic approach by unpacking the implications of graduation processes. It is also starting to explore how the international community collectively can better support countries as they transition through the development continuum. Concretely, the questions under discussion include the following:

- How can DAC members continue to support countries beyond ODA and through new strategic partnerships and innovative forms of co-operation?
- How can the DAC assist in a phasing-out of ODA; secure the progressive growth of other sources of financing (e.g. private or domestic); and secure long-term, sustainable financing (e.g. by preserving debt sustainability) for transitioning countries?
- How can the DAC increase the effectiveness of ODA by identifying the best and most innovative tools, policies and partnerships available along the development continuum to best serve the financial needs of transitioning countries?
- How should ODA be used to prepare transitions and avoid economic setbacks, given that what matters from a DAC perspective is to ensure long-term sustainability of financing for development as the country transitions?

Source: OECD-DAC (2018[48]), "Transition finance: Update on ongoing discussions and work", https://one.oecd.org/document/DCD/DAC/STAT(2018)9/FINAL/en/pdf

Interlinkages among sustainable development finance resources complicate the financing choice

Expanding the financing for sustainable development system (Chapter 2) means acknowledging that different actors and resources interact with each other, creating synergies and trade-offs for sustainable development. The AAAA makes it a key challenge to understand and fully exploit these interlinkages among different resources.

Yet the impacts that different resources and policies have on each other remain largely underexplored. How can one type of flow help unlock another? How can crowding-in and crowding-out effects among ODA, tax, remittances, philanthropic flows, commercial investment, and domestic public and private resources be harnessed? What do these interactions mean in terms of policy interlinkages?

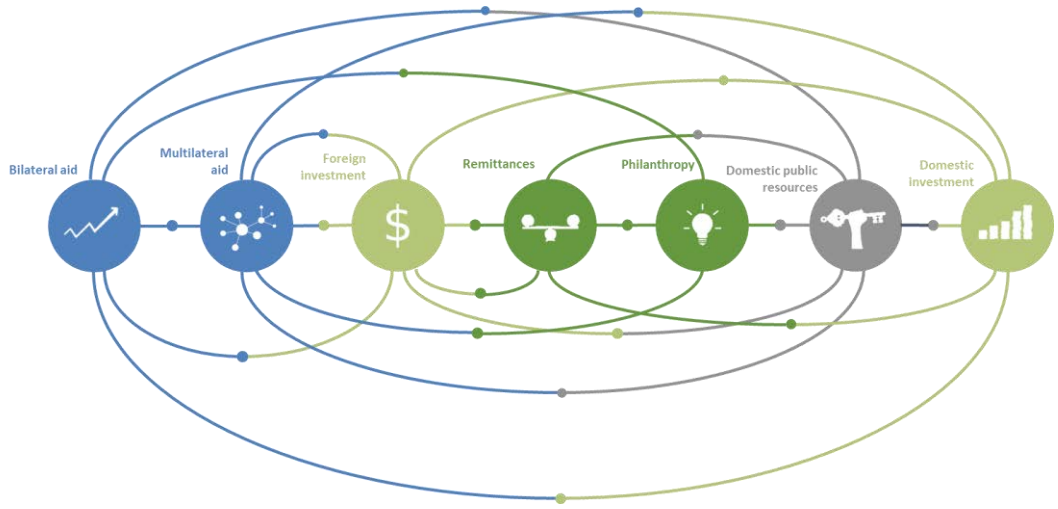
While not exhaustive, this section presents some illustrative examples of possible interlinkages and focuses on the largest external resources by volume: foreign investment and trade, domestic investment, and domestic public resources; and remittances, foreign investment and domestic resources.

Looking forward, different policy communities in various areas such as investment, tax, migration, etc. need to be brought more closely together to deepen the collective understanding of such interlinkages and to translate this understanding into policy action

to collaboratively achieve sustainable development. Part II highlights some of the work that is already underway.

FSD resources can crowd each other in or out

Figure 3.11. Interlinkages among financing sustainable development resources



Source: Authors

Foreign investment can crowd in but also crowd out domestic private investment

Access to international private capital can be a lever for mobilising more resources for sustainable development. For example, foreign direct investment can be a critical part of scaling up domestic private investment. By entering domestic markets, multinational enterprises (MNEs) can enhance competition, resulting in higher productivity levels of domestic firms. By fostering business partnerships with domestic firms, they can bring technology and productivity spill-overs and attract more investments into the intermediate inputs required. Hence, FDI may crowd in domestic private investment. FDI can also promote the development of the domestic private sector by spreading best practices in corporate governance, accounting rules and legal traditions and by providing employee training. Finally, by bringing in external capital resources, FDI can increase local liquidity and loosen financial constraints for domestic investment (Harrison, Love and McMillan, 2004[49]).

FDI may also crowd out domestic investment by displacing domestic players or pre-empting their investment opportunities. For example, competitive pressures due to the entry of MNEs may be so great that domestic players abandon investment projects, reduce production capacities or are altogether driven out of the market (Agosin and Machado, 2005[50]). Moreover, foreign-owned companies may compete for scarce capital resources with domestic players. Since foreign-owned affiliates tend to have higher solvency rates due to the financial guarantees provided by the parent MNE, they could also be favoured by local financial institutions, harming domestic private investment.

The relationship seems to depend on country contexts and sectoral patterns. The relationship between foreign and domestic investment is likely to be complementary when foreign investment takes place in an undeveloped sector of the economy and brings new technologies and knowledge to local markets. Conversely, FDI is more likely to

displace domestic investment when it occurs in sectors where domestic firms already operate (Agosin and Machado, 2005[50]). Foreign affiliates engaged in local production activities also are more likely to spur domestic capital accumulation than are foreign affiliates performing different trade-related activities such as sales, marketing and client support (Amighini, McMillan and Sanfilippo, 2017[51]).

Domestic private investment and local capacities, notably financial sector development, play critical roles – not just in attracting external investment but also in allowing countries to make the most of external finance. Foreign investment tends to be strongly attracted to countries with high levels of domestic investment that can signal to MNEs the profitability of investments (Lautier and Moreaub, 2012[52]) (Ndikumana and Verick, 2008[53]). Local financial sector development in a country also is a key element to ensure that external financing is allocated in a way that is efficient and conducive to sustainable development. Some research has shown that sectors that are more dependent on external financing grow faster in countries that themselves have greater financial development (Rajan and Zingales, 1998[54]).

Based on this preliminary sketch of the complex relationship between foreign and domestic investment, sustainable development financing strategies should be designed in a way to unleash the crowding-in potential of foreign investment. For example, FDI should be promoted in sectors that are underdeveloped and/or in sectors through which linkages to upstream and downstream sectors will bring most benefits for local private sector development. This is discussed further in Chapter 6.

Foreign investment and trade are highly complementary but not in all sectors

The emergence of global value chains or distribution networks spanning the globe has resulted in an increasing complementarity between foreign direct investment and trade. Firms in developing countries have gained access to the global market through participation in global value chains (GVCs), often specialising in specific stages of production and thereby exploiting their comparative advantage without having to develop all of the capabilities needed for the entire production process (IMF, 2013[55]) As a result, they have become attractive investment destinations for MNEs. Notably, countries in East and Southeast Asia have benefited from FDI linked to their growing participation in global value chains. From 2001 to 2016, Asia's share of global FDI increased to 28% from 12% (Asian Development Bank, 2017[56]).

However, this complementary relationship does not extend across all industries equally. Nor are benefits in terms of global value chain-linked FDI evenly distributed. A significant number of global value chains are associated with little or no foreign direct investment. This is particularly the case in so-called buyer-driven chains, notably in labour-intensive consumer goods sectors such as the apparel and textile industries where global buyers create a supply base of contractors without direct ownership. These can be distinguished from producer-driven supply chains, which are present mainly in capital-intensive and skilled labour-intensive industries, such as automobiles and the IT industry, where the production process tends to be vertically integrated under one corporate entity. Developing countries initially start participating in buyer-driven networks. Some countries enter into producer-driven networks, where the link between trade and FDI is much stronger.

Both the benefits from trade and the benefits from FDI linked to trade vary depending on the position of a country within a global value chain. Countries upstream produce the raw materials or intangibles involved at the beginning of the production process (e.g., research

and/or design), while countries downstream do the assembly of processed products or specialise in customer services. Usually, more downstream specialisation is associated with lower value added, while a higher share is reaped in the initial stage of the production process. This effect is larger in high-tech manufacturing such as electrical equipment and chemicals, where upstream specialisation typically involves research and development activities. However, when upstream activities are confined to the export of primary inputs or basic manufacturing products, the share of benefits from participation in global value chains and structural transformation resulting from it tends to be low.

Recent research also suggests that the participation and position in global value chains determine the size of potential spill-over effects of FDI on the domestic private sector. In countries and sectors heavily involved in global value chains, foreign investors are more likely to source their inputs locally. Moreover, upstream specialisation in phases of the production process that are far from the final demand leads to higher shares of local sourcing from foreign investors (Amendolagine et al., 2017[57]).

Taking into account the impact of trade on FDI and access to foreign resources, promotion of global value chain participation is an important component of sustainable development financing strategies. Especially for countries with an upstream participation, domestic policies to foster local inputs sectors can complement participation in global value chains. Official providers, for example, can also provide targeted support for these sectors through capacity building and/or facilitation of access to credit.

Foreign investment can be conducive to domestic public resource mobilisation

External private investment can increase tax revenues in developing countries by creating and taxing more jobs, profits and consumption. The degree to which FDI may affect the tax base depends on how labour intensive it is (Becker, Fuest and Riedel, 2012[58]) and how effective corporate taxation is. Taxation of MNEs in particular can be challenging to implement, as these enterprises can reduce tax burdens artificially, for example through excessive interest payments back to the parent company. The OECD/G20 BEPS Actions provide a range of tools to help address these challenges. Examples include requiring companies to file country by country reports to help tax authorities undertake better risk analysis and identify potential profit shifting, and new limits on interest deductibility to reduce the payment of excessive interests to affiliated entities offshore that leave the MNE with lower profits to pay taxes on.

Developing countries frequently use tax incentives to attract investment without paying enough attention to whether a proportional increase in investment flows will result (Chapter 5). Over 80% of low-income and lower middle-income countries offer tax holidays and tax exemptions on investment while redundancy rates are high. This can lead to a detrimental race to the bottom. Tax incentives are rarely an important factor in investment and location decisions. Indeed, a UN survey found they were ranked as only the 11th of 12 most important factors in such decisions for investors in Africa (UNIDO, 2011[59]).

More than tax incentives, local capacities and enabling environments greatly influence external private investment decisions. The quality of regulatory and legal capacities in developing countries is often cited as an important factor that encourages external investment flows. This recognises that the investment policy principles of transparency, property protection and non-discrimination underpin efforts to create a sound investment environment for all and underscores the importance of enforcing investment-related and other laws. While many countries have laws and regulations to protect intellectual

property rights, they often lack effective enforcement mechanisms and this lack can discourage foreign direct investment in innovation and technology transfer (OECD, 2014[60]).

Due to the complementarities between tax and foreign investment, then, investment policies may lead to greater availability of overall financing for sustainable development resources if they are based on measures other than tax incentives to encourage foreign investment.

The size and impact of remittances depend on external flows and domestic drivers of financing for sustainable development

Remittances, too, can leverage other external financing flows. Large volumes of remittances sent by diaspora communities appear to encourage other types of capital flows such as foreign investment (Shafqat et al., 2017[61]). Migrants can be important sources of information about their home countries for potential investors. They may also create or integrate into international business and financial networks, thereby enhancing financial transactions between their home and host countries (Kugler, Levintal and Rapoport, 2013[62]).

Remittances also interact with domestic resources. The impact of remittances on domestic investment depends on the level of financial sector development. Remittances can boost domestic investment through an induced rise in savings and easing of financial constraints (Javaid, 2017[63]) (Sabra, 2016[64]). Like FDI, remittances can be considered a substitute for credit opportunities in the presence of market failures and low financial market development (Dzansi, 2013[65]). In this process, remittances can promote financial sector development by increasing the aggregate levels of savings and credits intermediated by the local banking sector. The inverse is also true: lower barriers to bank depositing, for example, facilitates the channelling of remittance flows into formal, loanable funds and increases participation in the formal banking sector, thus stimulating domestic investment (Aggarwal and Martinez-Peria, 2006[66]) (Gupta, Pattillo and Wagh, 2007[67]) (Gheeraert, Mata and Traca, 2010[68]). Policy makers and development partners can harness the potential of remittances to enhance other financing for sustainable development resources by supporting the development of the domestic financial sector – especially by facilitating access to finance for recipient households. Box 3.12 "The impact of remittances on international debt financing" describes how innovative financing mechanisms can be used to leverage interlinkages between remittances and foreign investment.

Box 3.12. In My View: The impact of remittances on international debt financing, by Dilip Ratha, Head, Global Knowledge Partnership on Migration and Development

Remittances can reduce the interest rate on international borrowing

In countries such as Lebanon and the Philippines where remittances provide the largest source of foreign currency earnings, remittances can improve the sovereign rating of the country, which in turn would reduce interest rates on all cross-border borrowings. A more direct path to reduce borrowing costs, especially in times of financial crisis, is to use future flows of remittances as collateral for international bond placements. A well known example is Banco do Brasil's issuance in 2002 of USD 250 million worth of bonds that were backed by remittances from Brazilian migrants in Japan and carried a significantly lower interest rate (9-11%) than sovereign interest rates (over 18%) at the time (Ketkar and Ratha, 2010[69]). Several emerging economies have raised tens of billions of dollars by issuing future-flow, remittance-backed bonds, among them El Salvador, Egypt, Mexico and Turkey.

Remittance channels can be used to sell diaspora bonds

Even as migrants send money home, they also save money in banks and financial institutions in the country of residence. Some studies estimate that the savings of migrants from developing countries exceeds USD 500 billion annually (Mohapatra and Ratha, 2010[70]). Since the interest rate on bank deposits is negligible in many OECD countries, a diaspora bond issued by the country of origin, offering an interest rate of 4% or 5%, say, can attract purchases by diaspora members. It is in the realm of possibilities to raise as much as USD 50 billion, only one-tenth of the total diaspora savings, through diaspora bonds.

Israel has been issuing diaspora bonds since 1951, raising over USD 40 billion over the years. Historically and until the early 1990s, the interest rate on Israel bonds was around 4% even as United States Federal Reserve interest rates rose to double-digit levels in the 1980s. Thus, these diaspora bonds enabled Israel to benefit from a significant "patriotic discount" (Ketkar and Ratha, 2010[69]). India, too, successfully raised USD 9 billion in two separate bonds issued in 1998 and 2000, at a time of financial crisis globally and when it was facing sanctions from the international community. More recently, in June 2017, Nigeria raised USD 330 million by issuing a diaspora bond that carried the same interest rate as the plain sovereign Eurobond.

These types of bonds generally appeal to a wider investor base beyond traditional institutional investors. Diaspora members are more willing than institutional investors to buy a diaspora bond at a lower interest rate because their base comparison rate is the bank deposit rate rather than LIBOR (a discount of over 2.5%). In addition, their perception of the home country's sovereign risk can be more favourable than that of a professional institutional investor.

Before launching a diaspora bond, a country needs to survey its diaspora members in the countries of destination to understand their willingness and abilities to invest back home. Also, it must register the bond with the appropriate securities and exchange authorities (e.g., the Securities and Exchange Commission in the United States) to comply with regulations meant for investor protection. Finally, the bond proceeds must be used for a programme or project that yields sufficient return on time to avoid debt repayment difficulties.

Development finance and policy should be a catalyser

Given these complex interactions, an integrated approach can yield greater results and help to manage potential trade-offs between sources of finance and their related policies. Chapter 5 discusses this in greater depth by explaining the holistic approach to financing for sustainable development. An integrated or holistic approach, however, is extremely challenging to achieve. The relevant decision makers span public and private sectors in a variety of countries. Within the public sector, even when areas of common action can be identified, policy communities still operate in silos and cross-cutting dialogue and collaboration require great political will.

Within this landscape, official development finance and development policy occupy a special position and should play the role of a catalyser. These constitute the one form of (external) finance and policy with an explicit development mandate. For those countries most in need, official development finance remains a lynchpin form of finance. For emerging economies, official development finance and policy can have an important role in catalysing other forms of finance as a mechanism through which OECD member governments can directly and indirectly impact overall FSD. Part II of this report explores this role further.

Development finance is scarce and needs to be deployed strategically to target areas where it has the greatest direct and indirect catalytic effect. The direct catalytic effects of development finance are currently most visible in relation to private sector flows through mobilisation. Mobilisation refers to the use of development finance to address the risk and uncertainty associated with investment opportunities that have a development impact and thereby make them more appealing to other actors.

Development finance can also have indirect effects that promote development enablers, which are domestic capacities in developing countries to achieve finance for sustainable development. These indirect effects can amplify volumes of financing for sustainable development (*quantitative effect*) but they can also improve the development footprint of different sources of financing (*qualitative effect*).

For example, development finance can have a quantitative effect if it provides targeted support to create a sound policy and regulatory framework and a competitive market to attract investment. Thus aid for productive and public infrastructure and for human capital development can have a significant crowding-in impact on foreign investment (Selaya and Sunesen, 2012[71]), (Kapfer, Nielsen and Nielson, 2007[72]); aid in support of good institutions and the banking sector can also have this impact (Karakaplan, Neyapti and Sayek, 2005[73]).

Another channel through which development finance can target enablers to mobilise more volumes of financing is support for tax collection (Box 3.13). The Addis Tax Initiative is a significant recent development in this regard. Donor country signatories commit to collectively double their spending on tax capacity development between 2015 and 2020 and to improve policy coherence for development in tax matters. The Platform for Collaboration on Tax conducted a comprehensive review, finding that political will and country commitment are indispensable prerequisites for revenue collection reform. The Platform identified five key enablers to building tax capacity (IMF-OECD-United Nations-World Bank Group, 2016[74]). These are

- A coherent revenue strategy as part of a development financing plan
- Strong co-ordination among well-informed and results-oriented providers
- A strong knowledge and evidence base
- Strong regional co-operation and support
- Strengthened participation of developing countries in international rule setting

Box 3.13. Development finance in support of domestic resource mobilisation

Development co-operation can help developing countries to strengthen their capacity to generate tax revenues. Since 2015, a dedicated purpose code in ODA reporting[21] has enabled the tracking of ODA commitments to domestic revenue mobilisation. With only two years of data to assess, it is difficult to draw clear conclusions. But some initial findings are worth noting:

- Most financing comes from a few countries. This was clear in 2015, when just three countries provided 61% of the financing, and in 2016, when the top three donors provided 72% of the total.
- Financing also goes to a limited number of recipients. In 2015, 56% of all financing went to only ten recipients; their share rose to 79% in 2016. In 2015, 47% of ODA (USD 85 million) to domestic resource mobilisation was well-targeted to least developed countries. However, the picture changed significantly in 2016, with only 17% (USD 56 million) targeted to these countries.
- The support appears to remain targeted to countries with low levels of taxation measured as tax to GDP ratios below 15%, with 50% of financing going to such countries in 2015 and 57% going to them in 2016.

The potential for returns from ODA to domestic resource mobilisation is likely to be greatest in middle-income countries as they transition, given their larger economies. However, this does not mean that countries of lower national income should not receive support. Tax system reform can play a role in improving the growth environment of a country directly. Additionally, enabling the tax system to adequately capture a share of the proceeds of growth earlier in the development pathway will ultimately lead to significantly higher volumes of funds available for development over the longer term (Box 3.14).

Box 3.14. Removing ODA tax exemptions can amplify the catalytic effect of development finance

The tax status of ODA-provided goods and services is one area where official providers may wish to start using development finance as catalysers for more domestic revenues. In many countries, official providers have requested tax exemptions on goods and services, which can have potentially significant impact on domestic revenue mobilisation, especially for low-income countries where ODA often represents a higher share of the economy. Some countries, among them Netherlands and Norway, have changed their policy and no longer seek such tax exemptions on ODA-funded goods and services. But this is not yet common practice. The Platform for Collaboration on Tax is planning to review the draft guidelines from 2007 to assist countries in reviewing their policies in this area (Chapter 5).

Support for enablers also can have a catalytic effect on the quality and development footprint of other forms of finance. For example, development finance can support policy makers in developing countries to harness investment inflows in order to generate

maximum development benefits through employment, technology transfer, competitiveness, and growth of domestic enterprises and industries in host countries.

Such enabling policies are important to ensure that private sector investments, both international and domestic, are done in a socially and environmentally responsible way. This is a main finding of OECD investment policy reviews that have analysed the experience of developing countries over the past few decades. Similarly, support for development enablers matters for the development impact of remittances, as discussed elsewhere in this chapter. The level of financial development and the institutional environment influence the impact of remittances on domestic investment. High-quality institutional frameworks and well-developed credit markets are seen as enabling environments to increase investment, rather than consumption through remittances. (Bjuggren, Dzansi and Shukur, 2010[75]).

These catalytic effects are only beginning to be understood and they can be highly specific to country contexts. More research and monitoring are needed on these interactions to inform policy choices for developing country governments and for official providers who can provide targeted support for policy areas with the greatest catalytic effect.

Conclusion: New opportunities and risks require new approaches to measurement, policy and implementation

The diversity of actors and their resources offers new opportunities for financing for sustainable development. It also signifies greater complexity. For now, developing countries and the international community do not possess all the capacities required to navigate the complex and increasingly broad range of options. For example, the choice of FSD instruments often cannot be based on a careful evaluation of costs and benefits, but may rather be based on factors such as familiarity and fashion.

The complexity arising from the widening range of instruments, the development continuum and its transitions, and interlinkages among actors and resources highlights the key challenges of the financing sustainable development system. This system is characterised by asymmetric information and lack of transparency as well as the absence of policy guidance and clear mechanisms for implementation. The examples below give an indication of the challenges and opportunities that are emerging:

- The growing use of equity and mezzanine investments by donor agencies can bring higher returns – but with higher volatility – to their own balance sheets. This can hamper agencies' ability to provide stable and predictable funding to developing countries. Most development finance institutions making use of equity instruments obtained double-digit returns before the 2008 financial crisis, but then suffered major losses (Michelitsch et al., 2017[7]). In the absence of the necessary capacities to manage relevant risks, the use of innovative instruments can come at a considerable cost.
- With greater access to debt capital markets, developing countries face new risks from increasing debt levels. This is especially the case in their move away from traditional creditors such as multilateral organisations and official bilateral lenders and towards private sources of lending, a move which threatens to push up servicing costs and make debt resolution harder (IMF, 2018[5]).

- While they are promising, innovative instruments need to be scaled up significantly if they are to fulfil their potential to help to close the financing gap for sustainable development. Fear of risks still unknown and lack of familiarity with the new instruments are barriers that need to be overcome. For innovative financing for sustainable development to reach a critical mass, different groups of actors have to come together and work more closely to share experiences.
- The relative weight of financing flows changes along a country's development continuum. As each flow has different objectives and characteristics, the shift in the financing mix can give rise to gaps and disruptions. It is important to better understand and deploy catalytic effects upstream and to carefully devise exit strategies for development finance so that developing countries can achieve self-sustaining financing flows.
- Tight constraints on public funding are confronting policy makers with a difficult trade-off. Blended finance and innovative approaches to catalyse other financing sustainable development resources can be useful to ensure a smooth transition for countries faced with receding concessional flows. However, a focus on mobilisation should not be considered exclusive, as broader catalytic effects must be seen in terms of poverty eradication, social needs, policy reform, infrastructure and other enablers.
- More research and monitoring are needed on these interactions to inform policy choices for developing country governments and for official providers who can provide targeted support for policy areas with the greatest catalytic effect. For example, developing countries frequently use tax incentives to attract foreign investment without devoting enough attention to whether a proportional increase in investment flows will result.

Given the special place of development finance and policy, Part II of this report explores further how OECD countries and actors can make use of these catalytic effects, taking a more holistic approach to development finance measurement, policy and implementation. An important part of this approach is to embed development perspectives throughout the actors and policies affecting development. The interlinkages will be explored in the future throughout the OECD work programme.

Notes

[1] These include DAC providers, non-DAC bilateral providers who report to the DAC and multilateral providers.

[2] The share is calculated only for the sample of DAC providers.

[3] The share is calculated on the basis of data from OECD (2018[1]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1.

[4] The reversal of debt flows also exerts strong downward pressure on the exchange rate. A subsequent depreciation or devaluation will raise the value of the debt service of any debts denominated in foreign currencies. Since almost no developing country borrower can issue debt in its own currency, the borrowing capacity of developing countries is limited. Reinhart, Rogoff and Savastano (2003[86]) discuss this at http://www.nber.org/papers/w9908.

[5] Loans can be concessional or non-concessional, according to the terms at which they are provided. By definition, the share of loans in concessional and non-concessional flows refers to concessional and non-concessional loans, respectively.

[6] The share of tradable securities in developing countries, calculated by dividing the amount of outstanding international debt securities by the sum of cross-border loans outstanding and international debt securities outstanding, has risen to 37% in 2017 from 29% in 2011. The estimates are based on Bank of International Settlement (BIS) statistics on international debt securities and cross-border loans by BIS reporting banks.

[7] FDI financial transactions comprise mainly three types of financing from the private sector: acquisition or disposal of equity capital; reinvestment of earnings that are not distributed as dividends; and inter-company debt (payables and receivables, loans, debt securities). According to IMF Coordinated Direct Investment Survey (http://www.imf.org/en/data) data, inward direct investment positions in developing countries amounted to USD 6.072 billion, of which equity holdings amounted to USD 4.994 billion (82%), at the end of 2016. It is impossible to infer directly from these stock data statements about equity investment flows, as variations in these stocks can result from changes in market valuations, currency rates, etc., rather than arise from the acquisition or disposal of equity.

[8] According to data from the IMF Coordinated Portfolio Investment Survey (http://www.imf.org/en/data), equity investments made up 55% the portfolio investment holdings in developing countries, amounting to USD 1.8 trillion at the end of 2016. It is impossible to infer directly from these stock data statements about equity investment flows, as variations in these stocks can result from changes in market valuations, currency rates etc., rather than arise from the acquisition or disposal of equity.

[9] The share of equity instruments in ODA and OOF flows from bilateral donors was 0.4% (USD 795 million) and 1.4% (USD 218 million), respectively. These figures may underestimate the true equity portion of the flows due to specificities of equity reporting standards under current ODA regulations. The purchase of equity is counted at face value as a positive ODA flow and at the time of disposal, proceeds from that equity constitute a negative ODA flow, which can lead to the underestimation of gross equity flows.

[10] In reported data, mezzanine finance instruments are often grouped into equity or debt categories.

[11] This is an estimate based on the OECD's Creditor Reporting System (OECD, 2018[1]). DAC data on the use of mezzanine finance are subject to under-reporting.

[12] Some private entities also extend guarantees that are not motivated by profit. One example is the Children's Investment Fund Foundation. See https://ciff.org/grant-portfolio/contraceptive-implant-volume-guarantee/.

[13] The non-guaranteed portions of the loan are included in counting the amounts mobilised through guarantees, the implicit assumption being that the private investor would not have provided the loan without the official guarantee.

[14] Greenfield projects occur when investors begin a new business by constructing new facilities as opposed to purchasing existing facilities.

[15] An upcoming OECD publication will examine the role of SII for the SDGs, including an analysis of regions, policies and data on social impact investment. The report will be published in January 2019.

[16]For bilateral ODA by sector to Côte d'Ivoire, 2015-16 average, see http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm.

[17] The upward slope of the curve in Figure 3.6 is due to the quadratic fitting model and does not reflect a real trend.

[18] These data are based on Bank of International Settlement (BIS) statistics on international debt securities. See https://www.bis.org/statistics/secstats.htm.

[19] The list of ODA-eligible countries consists of all low-income and middle-income countries (based on gross national income per capita, as published by the World Bank) with the exception of Group of Eight (G8) members, European Union members and countries with a firm date for entry into the European Union. The list also includes all of the least developed countries as defined by the United Nations.

[20] Eligibility for International Development Association support depends first on a country's relative poverty, defined as GNI per capita below an established threshold that is updated annually and in fiscal year 2018/19 is USD 1 165. IDA also supports some countries, including several small island economies that are above the operational cut-off but lack the creditworthiness needed to borrow from the International Bank for Reconstruction and Development.

[21] In the OECD Creditor Reporting System, data on the sectoral destination of a development finance contribution are recorded using purpose codes.

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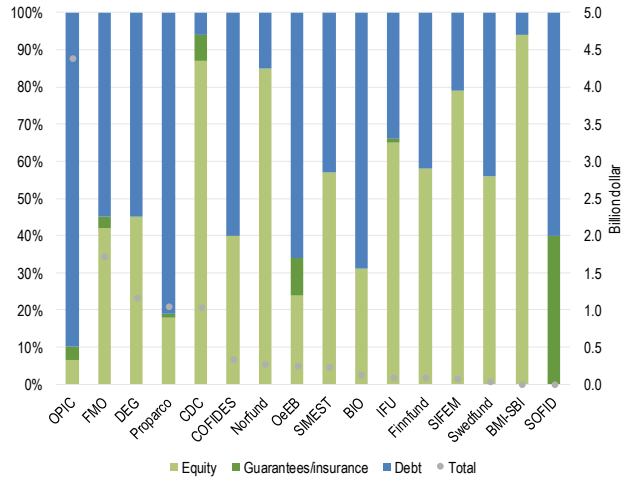
Annex 3.A.

Annex Figure 3.A.1. Instruments used by bilateral development finance institutions

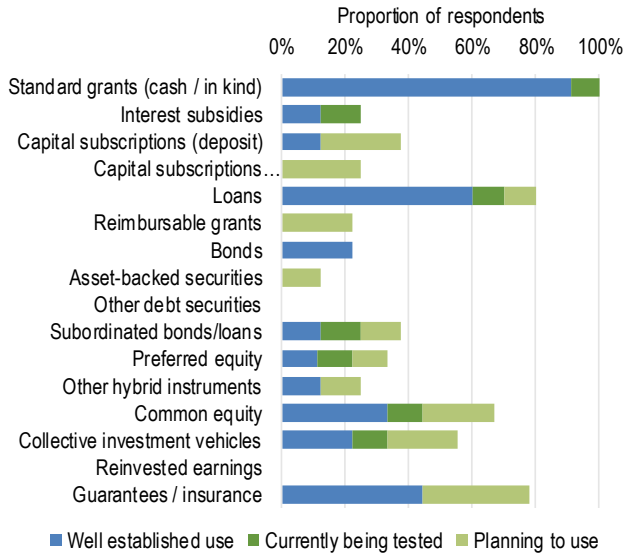
%, USD Billion, 2015 commitments



Source: OECD (2018[1]), "Creditor Reporting System" *(database)*, https://stats.oecd.org/index.aspx?DataSetCode=CRS1.

StatLink https://doi.org/10.1787/888933855276

Annex Figure 3.A.2. Planned and current use of sustainable development finance instruments by DAC members



Source: OECD (2018[28]), "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm.

StatLink https://doi.org/10.1787/888933855295

Chapter 4. Better measures of financing for sustainable development

A revolution is underway to promote better measures of financing for sustainable development. The estimated volumes of financing needed to achieve the global sustainable development agenda are unprecedented – in the order of trillions of dollars. Successful delivery of the different resources by the different actors, targeted where the resources are needed most and where they can have the greatest impact, will rely on better measurement frameworks and tools. These must recognise the development footprint of all actors connected to sustainable development targets and provide a mapping of actions to identify the financing gaps, imbalances and opportunities for dynamic interactions among resources and goals. They must further leverage the opportunities to provide reliable impact-driven data, harmonising approaches across actors. For this revolution to succeed, holistic approaches will be needed to design a new financing for sustainable development compass that integrates the synergies and trade-offs of both domestic and external resources, including and beyond traditional development finance.

In brief

The fast-changing system of financing for sustainable development (FSD) raises new challenges to measure the volume, development qualities and development impact of myriad contributions. While the Millennium Development Goals (MDGs) relied primarily on official development assistance to measure the financing needed to reduce poverty, the 2030 Agenda and Addis Ababa Action Agenda (AAAA) call for unprecedented levels of financing from new actors to advance sustainable development and to end poverty (Chapter 1).

An estimated USD 2.5 trillion in financing is needed to achieve the Sustainable Development Goals (SDGs). This amount is 17 times greater than current volumes of official development assistance (ODA), which in 2017 reached USD 146.6 billion, and more than 10 times greater than the estimated MDG financing gap. In consequence, the financing for sustainable development framework that emerged from the AAAA and previous financing for development fora seeks to align all financing flows and policies – public, private, domestic and international – with economic, social and environmental priorities.

Yet crucial data are still missing to fully track the true distance to reach financing goals. The AAAA underscores the importance of overcoming this data gap. It calls "on relevant institutions to strengthen and standardise data on domestic and international resource mobilisation and spending, as well as data on other means of implementation" (United Nations, 2015[1]). Flows from OECD Development Assistance Committee (DAC) members and ODA are still measured with a narrow lens. This lens must widen. With the horizon for achieving the sustainable development ambitions fast approaching, fundamental changes are needed to understand the distribution of roles of emerging providers, foundations, multinational enterprises and diaspora communities, among others.

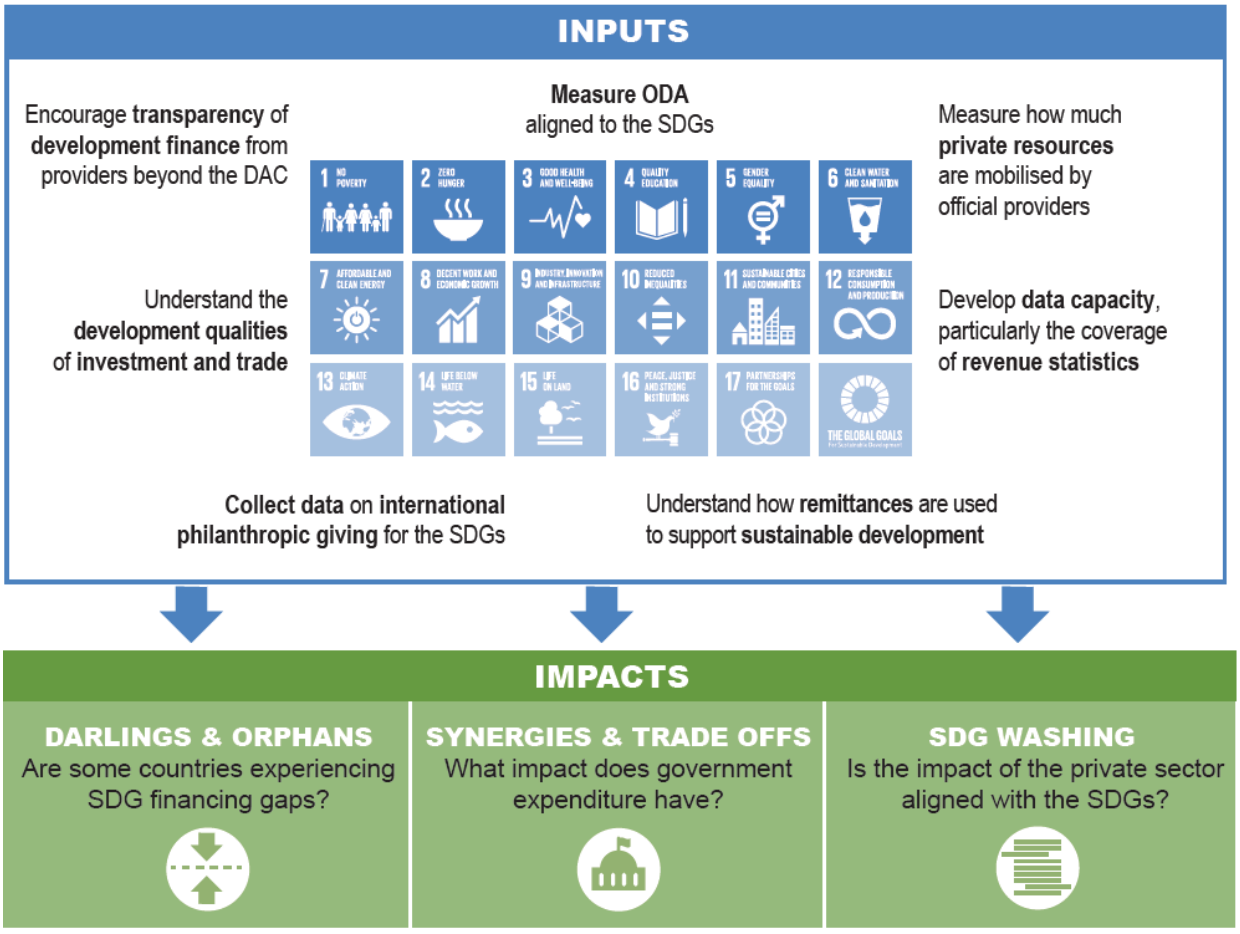
As the guardian of ODA, the OECD DAC faces a dual challenge. It must continue to provide robust ODA data for reliable comparison of existing donor commitments while also keeping pace with rapid changes in the financing for sustainable development (FSD) agenda and new sustainable development objectives. Understanding the development footprint of private sector resources is key to gauging the distance to the goals, as are measuring these resources and their impact on development results.

Better measurement is needed as well to help to mobilise the necessary finance aligned to the 2030 Agenda. To deliver on SDG financing, OECD constituencies will need tangible evidence of the positive results and impact of collective, multilateral action to advance sustainable development. Since 2016, 86% of OECD countries (31 out of 36) have carried out the United Nations SDG Voluntary National Review process. However, the SDGs appear to be largely unknown to the broader global public. A 2016 survey found that only three in ten people said they had heard of the SDGs, reflecting the need to better demonstrate the importance of the SDGs in people's everyday lives and futures (GlobeScan, 2016[2]).

A new FSD compass is needed to understand the contribution and complex interaction of different actors and sources of financing. Policy coherence of both domestic and international financing must be fully integrated into measurement frameworks. Looking forward, new and existing mechanisms must be strengthened for more comprehensive reporting across all actors and sources in support of sustainable development.

Figure 4.1 gives an overview of the challenges that remain to better measure resources and results for sustainable development.

Figure 4.1. Tracking the contribution of various financial flows to the SDG targets and indicators demands new metrics



Source: Author

To deliver, efforts to measure and monitor sustainable development contributions must progress along three dimensions:

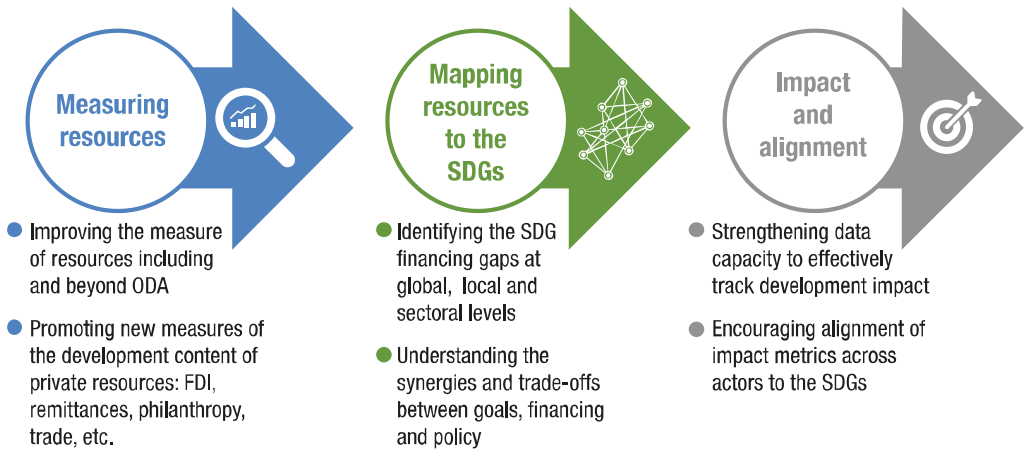
1. **Measures of all resources that impact sustainable development are needed.** The total official support for sustainable development (TOSSD) measurement framework holds the potential to ensure a more comprehensive measure of broader official and officially-supported resources beyond ODA and including non-DAC bilateral providers such as the BRICS countries[1]. While TOSSD provides a first step in the right direction, other initiatives and measures will be needed to assemble a full picture of resources targeting the SDGs. To ascertain how external flows support the SDGs, efforts are underway to provide better measures of the development content, or footprint, of resources, particularly private finance such as philanthropy, remittances, foreign direct investment (FDI) and trade in value added.

2. **Mapping resources to the SDGs is necessary to identify gaps.** The SDG measurement framework itself lacks reliable data beyond ODA. Nearly half of the agreed SDG financing targets rely on indicators exclusively based on ODA. Only 9 out of 32 SDG financing indicators utilise data beyond ODA, i.e. other official

flows (OOF), FDI and remittances. Better data and tools to empower countries to assess the contributions of different actors and to strengthen the ability of countries to measure and finance their national development strategies. Private sector financing will be needed to fill over 50% of the financing gaps for transportation infrastructure, energy, telecommunications and agriculture sectors in developing countries. Yet on average, the private sector contributes to only 25% of all the SDG targets, raising the possibility that these sectors could be left behind as what are termed SDG orphans. There are also limits to measuring the dynamic effects among resources, for instance targeting the enabling environment for sustainable development.

3. **Measuring impact and aligning measures is required of all actors**. A broader mandate for the development effectiveness agenda has emerged and has been extended to both public and private actors. However, development of reliable measures that connect the financial inputs to the sustainable development results articulated in the SDGs is far from complete. For instance, SDG indicator 12.6.1 calls on governments to encourage companies to improve sustainability reporting as well as to adopt sustainability practices. The absence of a common framework for private sector actors to report against is increasing the risk of what has come to be called SDG washing.[2] There is a need to harmonise approaches to measuring results and to leverage the growing demand for heightened accountability across actors. Figure 4.2 illustrates the way forward through measuring, mapping and aligning metrics.

Figure 4.2. The way forward



Source: Author

Financing for sustainable development measurement: All resources linked to sustainable development must be measured

The emergence of new actors and instruments in the system of financing for sustainable development presents challenges for the tracking and monitoring. Section III of the AAAA, which covers data monitoring and follow-up, recognises the need for better harmonisation, transparency, capacity building, and access to qualitative and quantitative data for accountability across the AAAA action areas. Research commissioned by the OECD further demonstrates that data sources pertaining to these important, non-

traditional providers are highly fragmented across regions, sectors, instruments, flows, thematic and policy-related issues, and include more than 200 individual databases (Prada, 2014[3]).

The measurement of international public resources is improving but remains politically challenging

For nearly 50 years, the donor community has adopted and strengthened accountability for international commitments in support of sustainable development on a collective basis, thanks to a common accounting of aid. The measure of ODA and its internationally agreed targets have served to maintain and improve donor provision of development finance and co-operation, shaping national strategies and informing policy decisions.

The definition of ODA itself, as Hynes and Scott (2013[4]) noted, is "a compromise between political expediency and statistical reality". The OECD DAC strives to ensure that the reporting of ODA enables the stability and quality of measurement and allows for comparison of members' commitments over the long term.

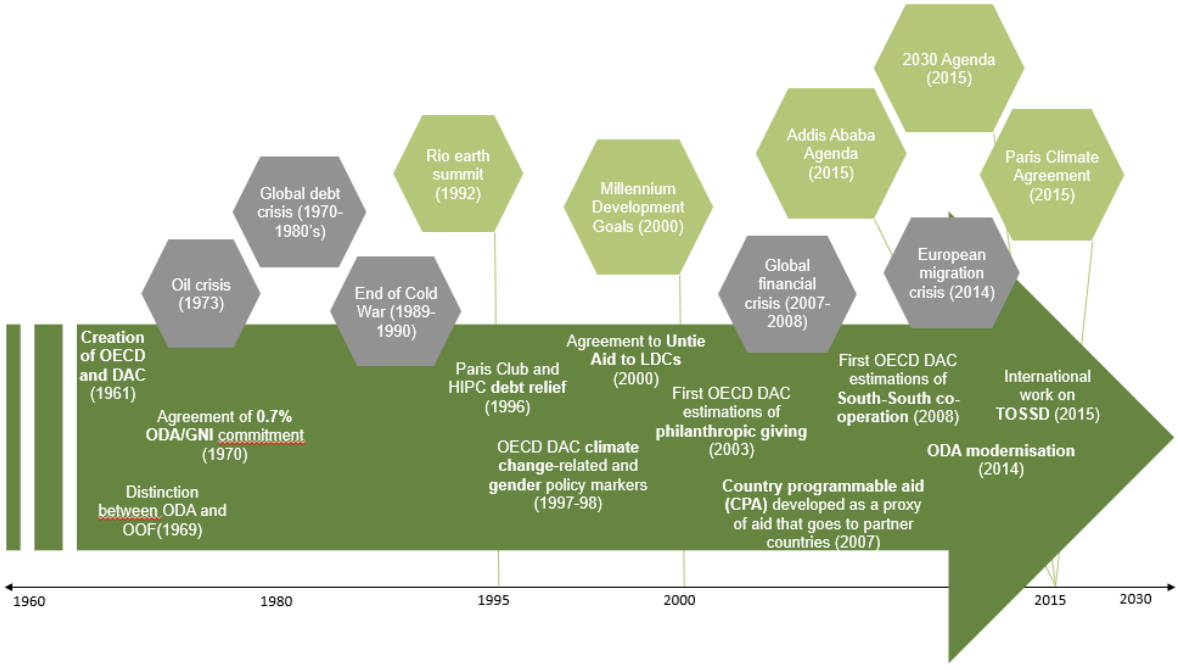
Still, developing countries and the United Nations have expressed concerns over how inflows they receive are measured. A number of efforts have been made to address the divergent expectations and strike new compromises. One of these is reflected in the OECD DAC concept of country programmable aid.[3] Several areas of measurement, however, remain contentious.

The measure of ODA must be continually modernised to maintain its integrity and ensure it is fit for purpose

The modernisation of ODA measurement, initiated in 2014, aims to clarify and improve a number of aspects that have an impact on measurement. Efforts aim to maintain the integrity of ODA through reporting incentives that promote spending of highly concessional resources targeted to developing countries with the greatest needs and to provide greater transparency to activities beyond official aid flows. OECD members are further responding to changes in the financing sustainable development system by developing measurement frameworks to capture development contributions such as blended finance.

The range of activities that qualify as development finance is also being updated to reflect global shifts that have affected development financing needs and capacities. Figure 4.3 presents a timeline of key development co-operation milestones. An example is the increased global movement of people through forced displacement and migration, which has an impact on what is counted as ODA. As Chapter 1 notes, spending on refugees that traditionally was considered as humanitarian assistance and intended as short-term emergency relief is more and more recognised as contributing to long-term development programming.

Figure 4.3. Measuring development finance in a fast-changing world



Note: Entries on the dark green arrow are the milestones in the evolution of the measurement of traditional development finance. Grey icons show major international events that made an impact on the measurement of development finance. Light green icons show key international agreements to finance sustainable development.
Source: Author

Measures of international public finance other than official development assistance remain limited

The AAAA and the 2030 Agenda call on all governments to contribute to SDG implementation. Non-DAC providers are increasingly engaged in the delivery of development finance and co-operation activities, yet publicly available data remains limited (Chapter 2). A diverse group of countries are considered non-DAC providers, among them several Arab countries, the BRICS nations, central European members of the European Union, and several Asian and Latin American countries. The estimated volume of development finance provided by these countries is growing each year, and in 2014 amounted to nearly USD 300 billion (Benn and Luijkx, 2017[5]).

However, transparent statistics are not available for many of the non-DAC providers. While 20 countries that are not DAC members report on their development co-operation programmes to the OECD, only 8 of these are reporting detailed information on all projects they carry out. The OECD provides estimates of the development co-operation programmes of an additional ten countries that do not report to it (Benn and Luijkx, 2017[5]).

Transparency challenges limit data and reporting on official flows beyond ODA, such as Other Official Flows (OOF). The number of DAC and non-DAC members reporting on OOF has increased, but reporting remains uneven among DAC members. Discrepancies in reporting among countries make it difficult to know whether differences in

non-concessional financing are due to data availability or to the preference of some donors for certain financing mechanisms.

Recent work on TOSSD aims to address the challenge of going beyond ODA and traditional providers (see Box 4.1). For example, in an era of increased globalisation, support provided to advance global goods is all the more crucial. Research to combat global pandemics, new technologies to reduce greenhouse gas emissions, and support for multilateralism to carry out global/regional policy discussions and international negotiations are just a few of these global goods that are core to financing sustainable development (Kenny, Snyder and Patel, 2018[6]). While some ODA spending that supports global public goods is reported, there is currently no comprehensive measure of these flows beyond the OECD (OECD, 2018[7]). Of those countries that responded to the "2018 Global Outlook on Financing for Sustainable Development Survey", only three DAC member countries (Ireland, France and Japan) have developed metrics to track financing for global public goods and to address global challenges.

Box 4.1. How is TOSSD contributing to the measurement of financing for sustainable development?

Implementing the ambitious SDGs will require maximising the full potential of all forms of financing for sustainable development. Total official support to sustainable development (TOSSD) is a new statistical framework, specifically designed to measure external officially supported finance for sustainable development and the SDGs. It is designed to provide a coherent, comparable and unified system for tracking SDG–relevant investments that can inform strategic planning, identify emerging gaps and priorities, and assess progress in matching supply with needs.

A wide range of investments and contributions are covered in the scope of work to develop the TOSSD framework. Resources mobilised from the private sector by official development finance interventions are included. Also included is information collected on cross-border flows to help developing countries to track external resources in support of their national sustainable development strategies and support their national budgeting and financial planning processes. The work also will cover global public goods for sustainable development, which are essential for the implementation of the SDGs although they involve no direct resource transfers to developing countries. This information is currently not captured in any internationally comparable statistics.

In the spirit of SDG 17 (revitalising the global partnership for sustainable development) and the call of the Addis Ababa Action Agenda to "hold open, inclusive and transparent discussions" on TOSSD, an international task force was established in the second quarter of 2017 to further clarify the scope and statistical features of TOSSD. The composition of the task force ensures a balanced representation between traditional and South-South providers and partner countries, national statistical offices, development co-operation policy bodies, and international organisations. The task force has concluded its discussions on a number of key features of the TOSSD framework, such as the operational definition of TOSSD and the main statistical concepts and reporting principles.

TOSSD provides transparency of official resources beyond ODA and in support of sustainable development. However, it remains limited to total official support for sustainable development and officially-supported flows for sustainable development. The work on the framework intends to include so-called satellite indicators on other external private flows in an aggregate. Yet

measures of the development footprint[4] of vast amounts of external private finance such as remittances, FDI and private giving remain challenging to ascertain.

The development footprint of private flows is difficult to capture, but new data are emerging

The AAAA recognises international and domestic private finance and business as crucial to support SDG financing. Private sector actors are called on "to engage as partners in the development process, to invest in areas critical to sustainable development, and to shift to more sustainable consumption and production patterns" (United Nations, 2015[1]). Although the AAAA encourages private sector actors to play a role in financing development, not all private sector resources can be counted as financing *for* development.

To maximise the development footprint of resources beyond development finance, the AAAA cites in particular "positive spillovers" from FDI (paragraph 45) and the need to "increase world trade in a manner consistent" with the SDGs (paragraph 82) (United Nations, 2015[1]). Measures of trade and investment are crucial to strengthen job creation and economic growth in developing countries. New data is emerging on how and to what extent different types of multinational enterprises (MNEs) and FDI flows are targeted to support sustainable development outcomes.[5]

Several initiatives have emerged recently that can help to better assess the quality dimensions of private finance:

- The OECD Quality FDI Toolkit aims to measure how FDI may contribute to economic (e.g. economic diversification), social (e.g. gender equality) and environmental (e.g. green infrastructure) aspects of sustainable development.[6] The toolkit looks beyond country averages and studies heterogeneity with regard to FDI benefits and costs that is sectoral, within-country and subnational; and within-firm, such as in small and medium-sized enterprises versus large firms. The Quality FDI Toolkit builds on two core OECD instruments: the OECD Policy Framework for Investment (PFI), which provides policy guidance for mobilising private investment that supports steady economic growth and sustainable development, and the OECD Guidelines for Multinational Enterprises, which address responsible business conduct. It is expected to help improve assessments on how FDI contributes to sustainable development and supports achievement of the SDGs (Wermelinger, Mantovani and Montinari, 2017[8]).
- The OECD Activity of Multinational Enterprises, or AMNE, database also provides insights on the impact of MNEs on host economies in terms of production, employment, value added, research and development, labour compensation, and exports (OECD, 2018[9]).
- The OECD and World Trade Organization (WTO) Trade in Value Added (TiVA) initiative permits a better understanding of commercial relations between nations and the capture of value added by developing countries in the production of goods and services. The 2016 version of the TiVA database contains data from 28 developing economies including People's Republic of China, Brazil and India (OECD-WTO, 2016[10]). Trade data provide insights on the following indicators:
    - How developing countries are tapping into global value chains, including where the different stages of production are carried out across different countries.

- Whether and under what conditions it is possible to upgrade and avoid being caught in low value tasks.
- The type of employment and social gains that global value chains may generate and whether these foster greater gender equality in the workplace.
- Whether global value chains increase the vulnerability and exposure of a country to footloose investment[7] and external shocks.

Measuring the development footprint of remittances requires innovative approaches

Remittances must be considered separately from other forms of financing for development because they are transferred at the level of households and not controlled by governments (Chapter 2). Nevertheless, remittances play an important role in a developing country's progress towards sustainable development and in its overall financing context.

As is the case with other non-ODA flows, measuring the share of remittances that contribute to sustainable development is challenging. Some remittances can contribute to property market speculation or disincentives to participate in local labour markets. Further, large volumes of remittances transit through informal rather than formal channels like banks. In Nigeria, which receives the largest volume of remittances of any African country, the Central Bank of Nigeria has neither a method to track formal and informal transfers nor a national policy to guide efficient use of remittance flows towards sustainable development (Oluwafemi and Ayandibu, 2014[11]).

Well-known mechanisms to mobilise remittance financing, such as innovative, diaspora-based financial instruments can also facilitate understanding of how remittances contribute to development. Diaspora investment initiatives provide transparency for how remittance flows target specific projects linked to sustainable development, e.g. infrastructure projects or to secure balance of payments. An example is the Calvert Foundation, which was created in 2015 with the support of a development credit guarantee from USAID and aims to mobilise at least USD 50 million in impact investment from the Indian private sector diaspora in the United States.

International efforts increasingly seek to measure the development footprint of philanthropic giving

Standardising international measurement of the development footprint of philanthropy faces specific, but significant, challenges regarding transparency of data. These relate mainly to the accounting incentives or constraints placed on philanthropic actors by their boards or investors and by domestic laws and regulations that limit obligations to publicly disclose financial information (Box 4.2).

Box 4.2. The challenges of measuring philanthropy for development

Before the recent OECD survey undertaken in connection with its report on philanthropy, global, comparable and publicly available data on philanthropic giving in support of development were virtually non-existent. In most countries, neither governments nor private philanthropic organisations collect and share data on philanthropic giving. In addition, definitions, legal status and regulations underpinning philanthropic giving vary dramatically from country to country. This hampers the ability of researchers, donors, governments and the philanthropic community itself to compare or aggregate data to map these actors accurately.

There are several reasons for this dearth of data:

- Foundations differ from official development agencies in their lines of accountability. Rather than being accountable to taxpayers, foundations answer to their boards and/or to their funder (often an individual, family or private company). As a result, in most countries, foundations are not registered at the national level. They often have limited obligations to disclose financial data to the public.
- Funding by philanthropic organisations that goes outside their home countries is hard to compare to financial flows like ODA. This is especially true for what is called overseas funding that might include grants not aimed at supporting development per se. For example, grants might support countries not included on the DAC list of ODA recipients or they might focus on causes that fall beyond the definition of development used by the OECD DAC.
- In some cases, foundations themselves have led the call to produce more and better data and standards on data and accountability. The Global Philanthropy Data Charter, developed by the Worldwide Initiatives for Grantmaking Support, encourages and helps guide foundations' efforts on transparency.
- While these are positive developments, none of these standards are binding. Nor have they been widely adopted by the philanthropic actors. The degree of transparency and the extent of reporting practices remain heterogeneous among foundations.

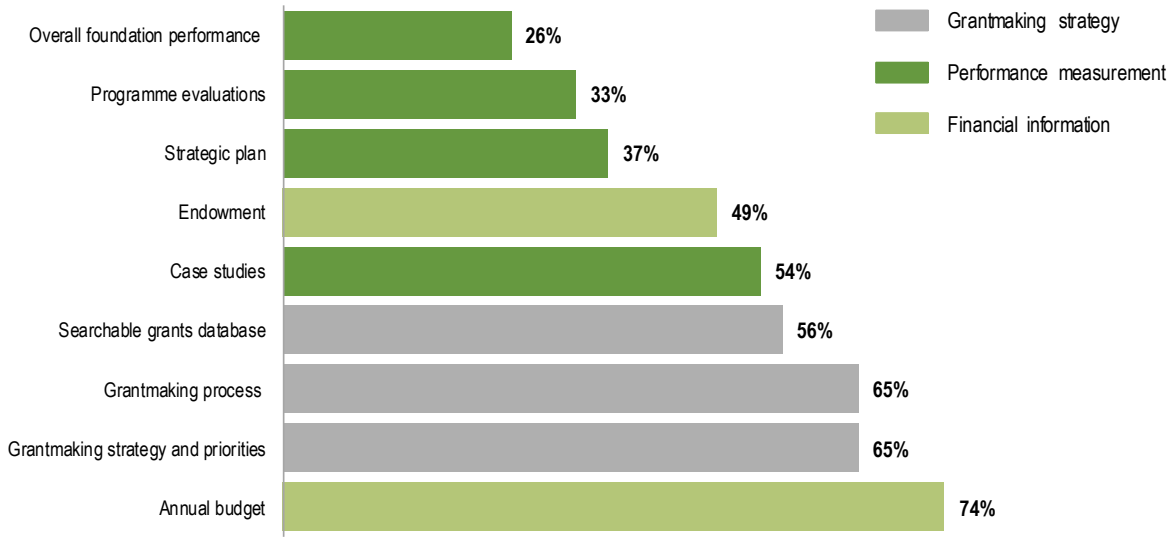
Source: OECD (2018[12]) *Private Philanthropy for Development*, http://dx.doi.org/10.1787/9789264085190-en.

In connection with its (2018[12]) philanthropy report, the OECD undertook a large-scale survey of private philanthropy for development that explored the feasibility of collecting data on these flows on a basis comparable to ODA. The survey was conducted in 2016-17, and targeted all countries, including and beyond the OECD, covering 147 foundations in total. It aimed to identify philanthropic flows supporting the economic development and welfare of developing countries as their main objective. It also provided an opportunity to engage with these institutions about regular statistical reporting, in a standardised manner, of philanthropic investment for sustainable development.

The survey also provided important data on the kind of information shared publicly by foundations. As shown in Figure 4.4, 74% of responding foundations provide financial

information on annual budgets but only 33% of these disclose performance measurement of programme evaluations (OECD, 2018[12]).

Figure 4.4. Types of data shared publicly by foundations



Source: OECD (2018[12]), *Survey on Private Philanthropy for Development 2013-15: Qualitative questionnaire,* http://dx.doi.org/10.1787/9789264085190-en.

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Mapping Sustainable Development Goal financing: Better data are needed to assess SDG financing needs and gaps

In the past, the financing needs of the MDGs were estimated by calculating the additional ODA required to cut poverty levels by half by 2015, which translated to a doubling of official aid flows over 2000 levels. (Radelet, 2009[13]). This estimation was carried out based on the financing of the eight MDGs that mainly correspond to sectors such as health and education.

The SDGs comprise 17 goals and 169 targets. Each requires high-quality data and financing of external flows as well as domestic financing levels. As discussed in Chapter 2, domestic public resources present the largest source of financing for sustainable development. Even if all countries met their ODA targets, this would not cover the total SDG financing gap. The majority of financing (77%) for the MDGs relied on domestic resources (Martin and Walker, 2015[14]). The SDGs also will rely heavily on domestic finance, but will further require private financing to succeed.

International collaboration is needed to tackle country-level data gaps

National governments require data that measure external resources received and also domestic resources and how these are marshalled and retained. Data that provide an understanding of the availability of domestic resources are a prerequisite to design and implement national SDG strategies that successfully guide all actors (Chapter 6).

Strengthening developing country data capacity and country ownership is the first step to address SDG financing gaps

Limited statistical capacity in developing countries hinders measurement of SDG financing gaps. In 2015, developing countries had the capacity to report on only 68% of the MDG indicators (United Nations, 2015[15]) and even today, 44% of countries do not have comprehensive birth or death registration data (OECD, 2018[16]). The data gap inevitably will increase because the SDGs have 169 targets, a sharp increase over the 21 targets of the MDGs.

Indeed, data capacity (SDG 17.18) in developing countries is itself a financing gap. The 2004 Marrakech Action Plan for Statistics (MAPS), led by the World Bank, the OECD and regional development banks, estimated additional annual financing needs for data capacity at USD 140-160 million per year. The (2016[17]) Global Partnership for Sustainable Development Data estimated the cost of producing data for the SDGs in 144 developing countries at between USD 2.8 billion and USD 3 billion per year until 2030. International aid for statistics reached USD 541 million in 2015, when it represented less than 0.3% of annual ODA (PARIS21, 2017[18]). This suggests that the remaining funding gap for data capacity is an estimated USD 635-685 million once available domestic budgets are taken into account. The global fund on data for development proposed by PARIS21 calls for reliable and sustainable resources to fund development data needs (Box 4.3).

Box 4.3. PARIS21 Initiative: Prospects for a global fund on data for development

The 2030 Agenda has set an ambitious objective for monitoring and implementing the Sustainable Development Goals that require more frequent and comprehensive data in a wider range of areas than ever before. Unfortunately, the call for producing more and better data has not yet translated into increased support for national statistical systems. While more resources are required to ensure SDG monitoring objectives are met, as the 2030 Agenda underscores, these resources also need to be reliable and sustainable. The current financial landscape for the sector is unbalanced since new actors focus on sectoral needs and thus overlook the broader structural needs and capacity challenges of national statistical systems.

Previous global action plans on statistics, such as the Marrakech Action Plan for Statistics (MAPS) and the Busan Action Plan for Statistics (BAPS), have managed to secure a stable funding source for their implementation because they were closely related to a broader policy agenda. The MAPS, established in 2004, was responsible for the implementation of national sustainable development strategies in International Development Association countries and establishing the International Household Survey Network (IHSN) and the Accelerated Data Programme (ADP). The BAPS prolonged this effort, integrating national statistical activities with national planning, promoting open access and increasing knowledge to use statistics effectively.

The Cape Town Global Action Plan for Sustainable Development Data

(CTGAP), endorsed by the UN Statistical Commission in 2017, outlines the actions necessary to generate quality and timely data to inform sustainable development at the requested level of disaggregation and population coverage. This plan provides a framework for discussion, planning and implementation of statistical capacity development to achieve the 2030 Agenda. However, it has not yet been integrated into policy processes like its predecessors. The High-Level Group for Partnership, Coordination and Capacity-Building for statistics for the 2030 Agenda for Sustainable Development (HLG-PCCB) has drawn attention to the importance of securing financial resources for the successful implementation of the CTGAP, particularly in developing countries where the capacity gap is significantly higher.

In this context, PARIS21 offers its support to assess the scope and feasibility of setting up a Global Fund on Development Data. The aim is to understand whether such an instrument would attract the attention of donors and encourage national investment. Drawing on lessons learned from existing global funds, the project will explore the opportunities and risks of such an instrument and provide insight into its design, especially its structure, institutional setting and mechanisms. The project will inform the discussion and activities of the High-level Group related to financing data in the future.

Source: PARIS21 (2017[18]), *Partner Report on Support to Statistics,* http://www.paris21.org/sites/default/files/2017-09/PRESS2017_infographic.pdf

International support can improve developing country data on domestic revenue statistics

Although domestic resources represent the greatest source of financing for sustainable development (Chapter 2), developing countries face significant challenges to collect detailed and comparable revenue statistics vital to benchmark performance against the SDGs. Some of these challenges little co-ordination across revenue collection agencies, little availability of historical data and the absence of appropriate IT systems to record revenue data. Revenue statistics are a valuable policy tool for benchmarking with similar countries and for analysing factors driving changes in revenue overtime.

The OECD Revenue Statistics series,[8] a collaboration of the OECD, regional organisations and participating countries, is helping to improve high-quality, internationally comparable, publicly available revenue statistics in national currency, in US dollars and as a percentage of GDP. The series also tracks revenue by different types of tax categories and by level of government. Since 2012, coverage of developing countries in the Revenue Statistics series has increased across the regions of Africa, Asia and Pacific, and Latin America and the Caribbean. In 2018, the series is expected to cover 90 countries.

International co-operation can increase data availability to revenue authorities

Increasing data availability to tax authorities is a vital part of support to increasing tax revenues. This is especially challenging when the data required are held in and/or by other countries. Developing countries are especially vulnerable in this regard given their

high reliance on corporation tax (often from MNEs headquartered overseas) and the high level of assets held offshore. Getting access to the data required for effective risk analysis of taxpayers is therefore reliant upon international co-operation. Developments in recent years have significantly increased the opportunities for such co-operation.

New global standards on exchange of information (EOI) and automatic exchange of information (AEOI) provide frameworks for countries to both request specific information from other countries and to receive a range of information on financial accounts held by their taxpayers on an automatic basis.

The Base Erosion and Profit Shifting (BEPS) Actions provide countries with a number of data tools to help address the challenges of effectively taxing MNEs. One of the key tools is the requirement that MNEs produce a country by country report that breaks down their operations on a country basis. This provides the data needed to undertake high-level risk analyses and to identify avenues for further investigation and auditing.

These new sources of qualitative and quantitative data have huge potential value to developing countries, although ensuring that developing countries have the systems in place to be able to protect and use such data effectively is challenging. As such, international co-operation is needed – not just in willingness to provide the data but also in helping to support countries' ability to make effective use of the data.

Challenges remain in estimating domestic revenues that are lost and financial flows that are leaving countries

Box 4.4 discusses the challenges of estimating the amount of domestic financing that is lost due to causes such as money laundering, stolen assets, trade mis-invoicing, etc. Improved understanding of these outflows could help identify further tools to track and reduce them and thus increase the domestic financing available for sustainable development.

Box 4.4. The challenges of defining and measuring illicit financial flows

Given their illicit nature, illicit financial flows (IFFs) are difficult to measure and understanding the full scale of IFFs is challenging. Nonetheless, these flows have become a prominent issue in financing for sustainable development as they deprive developing countries of significant volumes of capital that could be invested domestically and be subject to taxation. Recent efforts seek to understand the scale of all resources lost due to money laundering, stolen assets, trade mis-invoicing and other such causes. A recent estimate put the total value of IFFs between USD 1.4-2.5 trillion in 2014 (Spanjers and Saloman, 2017[19]), but there is currently no agreed international definition of IFFs or methodological framework for measuring their volume.

Measures of good governance, anti-corruption performance and similar conditions can provide indicators of a country's capacity to effectively retain and spend resources in support of the SDGs[9] (Chapter 6). For instance, current measures of governance and quality of public spending by the Extractive Industries Transparency Initiative (2016[20]) show that some developing countries potentially have substantial financing that could be redirected towards sustainable development. One example is Peru, where only 15% of revenues from the mining and hydrocarbon sector now are used for developmental

spending on programmes such as infrastructure and economic diversification. Actions can also be taken in the countries where these outflows end up. The Financial Action Task Force monitors progress against a number of standards for combatting money laundering, yet compliance is often low; a 2014 review of OECD countries found none were fully compliant with the beneficial ownership recommendations for legal arrangements (OECD, 2014[21]).

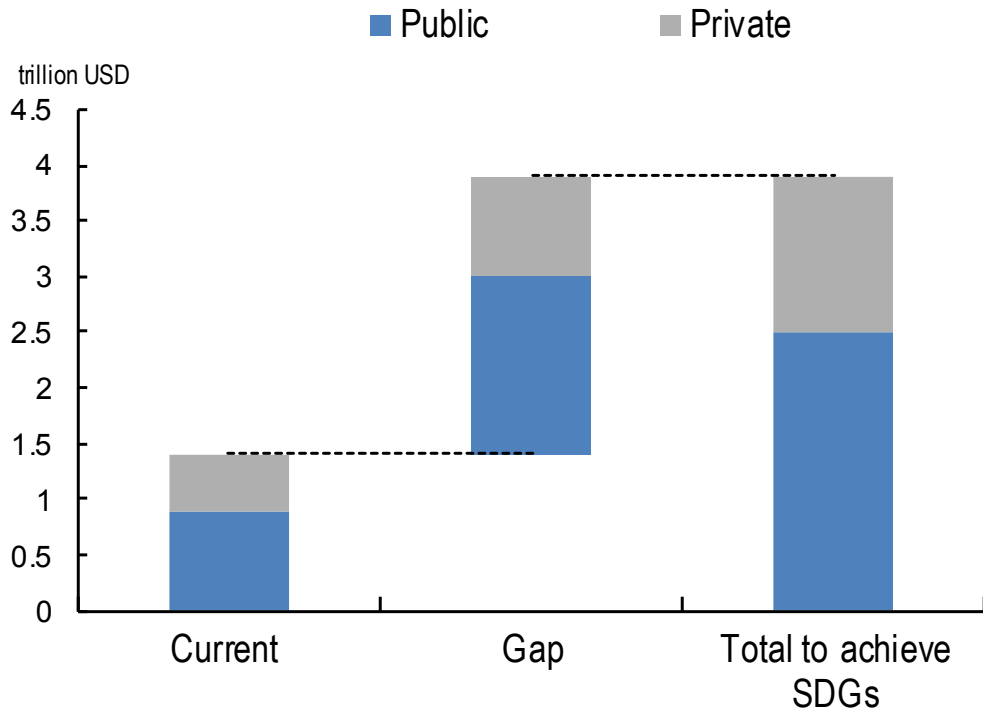
Mapping techniques must help identify potential SDG orphans and darlings

The SDGs call for a more complex distribution of financing across sectors for broad-based economic transformation to eradicate poverty by 2030. Estimations of gaps in SDG financing measure the domestic and external resources required to fulfil projected needs estimates. Needs assessments aim to systematically identify the discrepancy between current conditions of financing and development progress, with domestic revenues and external finance, on the one hand, and desired levels of finance and progress, on the other.

The costs of achieving the SDGs in developing countries, as shown in Figure 4.5, are estimated at USD 3.9 trillion annually while current public and private annual investment in SDGs estimated at USD 1.4 trillion – leaving an investment gap of USD 2.5 trillion each year (UNCTAD, 2014[22]).

The recent retreat of private sector financing to developing countries (Chapter 2) may call for even more, and particularly better targeted, support from the public sector for the SDGs. In Box 4.5, Chantal-Line Carpentier discusses the need for partnerships to fill SDG financing gaps. Based on its current share of investment in SDG areas, the private sector would be expected to cover USD 900 billion of this gap, leaving USD 1.6 trillion to be covered by the public sector including ODA (UNCTAD, 2014[22]). Other, more conservative estimates project that ending poverty in low-income and lower middle-income countries will cost USD 1.4 trillion per year in public and private investments (Schmidt-Traub, 2015[23]).

Figure 4.5. Public/private SDG financing gaps



Source: UNCTAD (2014[22]), *World Investment Report 2014: Investing in the SDGs, An Action Plan,* http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf.

StatLink https://doi.org/10.1787/888933853110

It is important to underscore that these results are highly sensitive to projections of GDP that may be considered optimistic in today's economic climate. Lower GDP growth rates would reduce domestic resource mobilisation and thereby increase the external financing gap. Moreover, the potential for better redistributive mechanisms through improved fiscal policy in developing countries may contribute to advancing progress to fill the gap. Complicating mapping further, SDG forecasts, such as the World Poverty Clock (World Data Lab, 2015[24]), cannot fully account for future interactions among sources of financing, technological advances, global shocks, and other impacts and trends.

Box 4.5. In My View: Financing and partnerships to fill the Sustainable Development Goal financing gaps, by Chantal-Line Carpentier, Chief New York Office, UNCTAD

Although estimates vary, the United Nations Conference on Trade and Development (UNCTAD) has estimated a USD 2.5-trillion per year gap to finance the SDGs in developing countries. We must find a way to incentivise investment in innovations and partnerships to eradicate poverty, mitigate inequality and broaden access to basic services by unlocking the USD 12 trillion of new market opportunities related to achieving the SDGs. The potential for increased private sector investments, especially in infrastructure, is significant.

Yet as it stands now, there is not enough to fill this gap. For example, UNCTAD estimates the total cost of universal access to modern energy in least developed countries (LDCs) is somewhere between USD 12 billion and USD 40 billion per year, even without considering the need to meet productive capacity. Although the share of gross ODA disbursements to the energy sector in LDCs increased to 5.7% in 2015, funding tends to be concentrated in a few countries, with 43% going to only five LDC recipients. Moreover, foreign direct investment (FDI) makes up 39% of total inflows in developing countries and represents their largest external source of finance. But it constitutes less than 25% of the inflows for the LDCs and its share in such countries has been declining since 2012. This and other alarming trends, such as the 17% drop in FDI in 2017 and falling exports from LDCs, are incompatible with the key principle of the 2030 Agenda – leave no one behind.

Funding and partnerships will be crucial. Country ownership based on the priorities outlined in voluntary national reviews (VNRs) provide the basis to strengthen a global positioning system to finance the SDGs. These priorities need to be included in the UN development assistance frameworks of developing countries and in the local and national sustainable development strategies of OECD countries. They should likewise serve as a signal to DAC members in setting their funding priorities. These reviews add certainty that investment will flow into priority sectors, thus serving as powerful signals to capital markets.

A partnership between the OECD and the UN entities offers great potential to help fill the SDG financing gap. Such a partnership, among other benefits, could help to reform the investment regime to facilitate attainment of the SDGs – including the unprecedented USD 58.7 trillion in wealth transfer to women and millennials that will occur over the next 35 years. This partnership could muster evidence-based consensus on which sectors need to be funded and which can be financed – and it could do so with the sense of urgency that the 2030 Agenda requires. To achieve this vision, we must be proactive, united and focused.

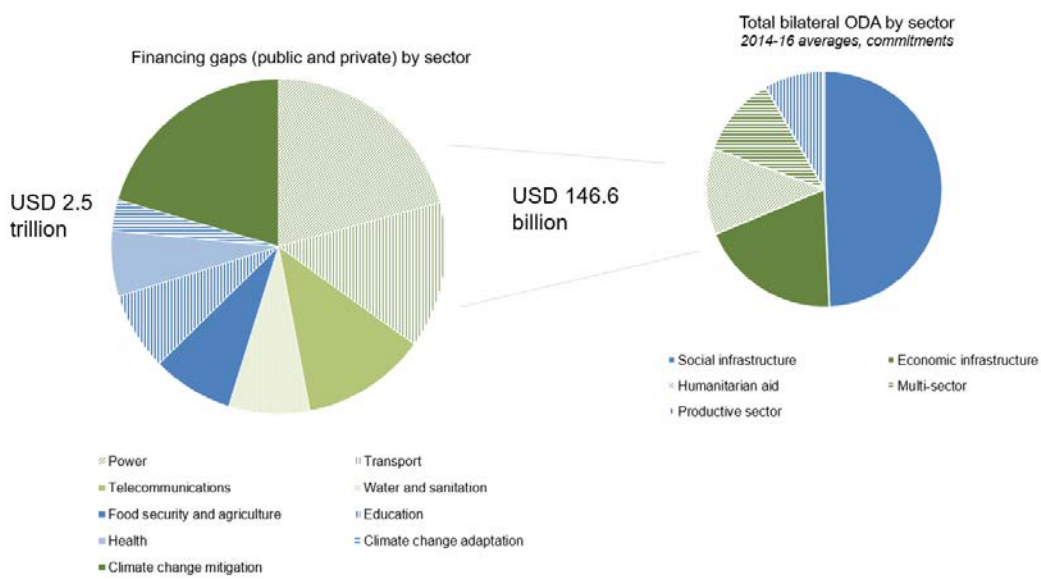
Efforts to map official development finance to the SDGs have gained momentum yet remain conceptually challenging

Assigning sectoral or policy objectives to ODA is conceptually and empirically challenging. This is due to the cross-cutting nature of the SDGs, which also makes it difficult to avoid double counting across financing and to achieve harmonisation across actors on reporting. For example, SDG 1 (no poverty) is also an underlying objective of all ODA, raising the question of how the portion of ODA targeted to this goal should be measured. The OECD DAC policy markers traditionally provide one way to weight cross-cutting policy objectives such as gender and environmental issues[10 11] (OECD DAC, 2016[25]). They provide a qualitative approach to measure the degree to which finance targets multiple objectives while avoiding double counting.

Future work will establish an SDG data field to identify linkages between inputs and desired SDG outputs and outcomes. Recent discussions have resulted in the introduction of a new system of multiple purpose code reporting better aligned to the SDG targets (OECD, 2018[26]). To enrich future SDG sectoral analysis, a pilot case study was carried out with Finland to assess multi-sector reporting (OECD, 2016[27]). Work is also underway to leverage the potential of machine learning to assess SDG financing gaps.

Measurement of how private sector resources target the SDGs is needed to identify imbalances among public and private resources. According to a recent OECD (2015[28]) study, the USD 146.6 billion of ODA in 2017 mainly targets social and administrative infrastructure in the sectors of basic education, primary healthcare, nutrition, and safe water and sanitation. Figure 4.6 shows that total public and private financing gaps are much larger than ODA volumes and are concentrated in other economic infrastructure sectors. These sectors include climate change mitigation (a gap of USD 380-680 billion per year); power (a gap of USD 370-690 billion per year); water and sanitation (a gap of USD 260 billion per year); and transportation (a gap of USD 50-470 billion per year) (UNCTAD, 2014[22]).

Figure 4.6. SDG-related sectoral financing gaps



Source: Author's illustration based on UNCTAD (2014[22]), *World Investment Report 2014: Investing in the SDGs, An Action Plan*, http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf and OECD (2018[7]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1.

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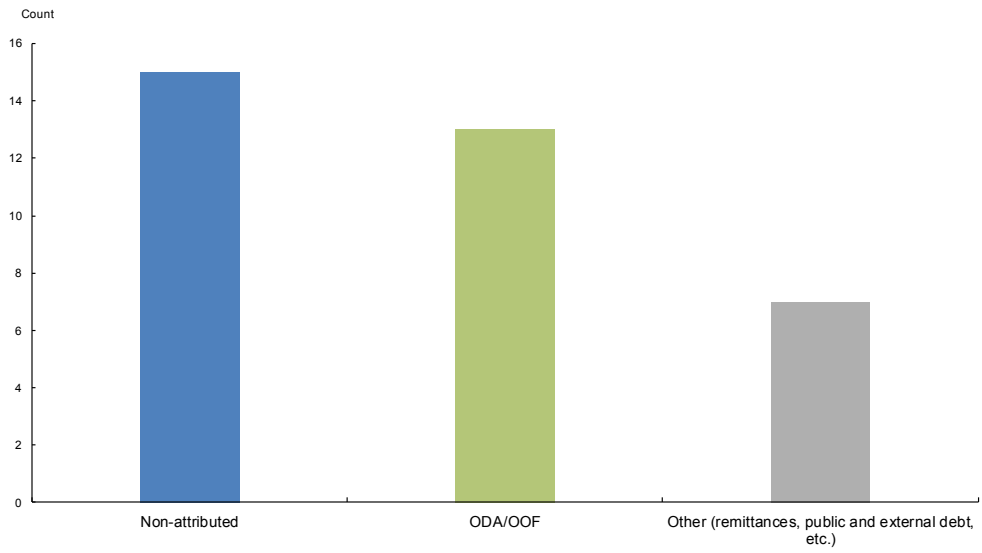
A lack of internationally agreed SDG indicators presents a challenge to map resources beyond aid

Although SDG 17.3 calls on countries to measure efforts to "mobilise additional sources of financing", indicators are mainly limited to measures of official development finance provided by members of the OECD DAC (Figure 4.7). This underscores the need to look beyond ODA and towards better measures that connect broader public and private financing sources with the development impact. As further detailed in Annex Table 4.A.1, 13 of the 32 SDG financing indicators rely on ODA and/or OOF data; 15 indicators lack data; and only 9 indicators include non-ODA data and 4 of these rely on solely non-ODA data.

Figure 4.7. Financial indicators of SDG Indicators Framework



Source: Author's calculations based on the database of the global indicator framework for the Sustainable Development Goals and targets of the 2030 Agenda for Sustainable Development. (United Nations, 2018[29]). *Accessed on 21 March 2018.*

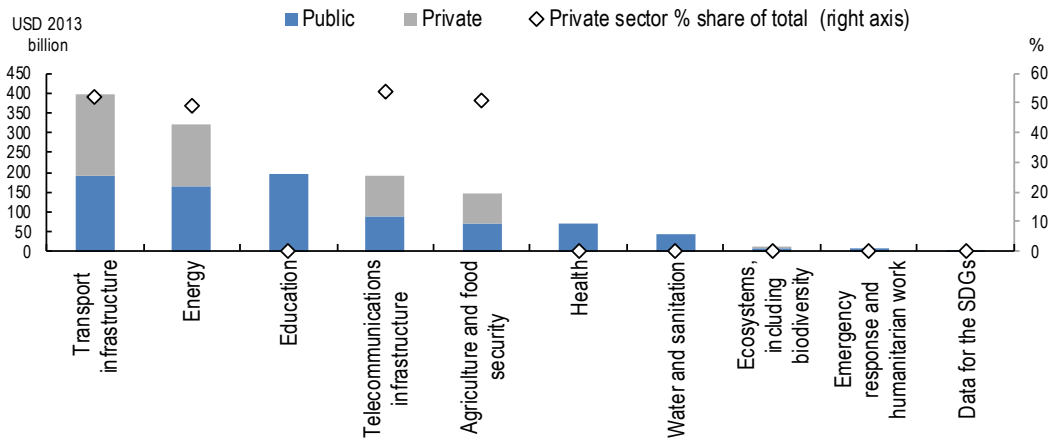
StatLink https://doi.org/10.1787/888933853148

Data can help articulate the roles of public and private actors to fill the SDG financing gaps

Certain SDGs, such as those related to infrastructure, represent areas where the private sector is already contributing. The AAAA emphasises the importance of bridging the global infrastructure gap of USD 1-1.5 trillion[12] and urges "enhanced financial and technical support" (paragraph 14). Figure 4.8 illustrates that the public and private sector infrastructure financing should cover nearly equal shares of the gaps in the transportation infrastructure, energy, telecommunications and agriculture sectors in developing countries. In this way, private flows align closely with infrastructure-related SDGs such as SDG 6 (clean water and sanitation), SDG 7 (affordable and clean energy), SDG 9 (industry, innovation and infrastructure), and SDG 10 (reducing inequalities, which

indirectly covers transport infrastructure as part of the target of reducing the cost of exporting).

Figure 4.8. Public and private financing needs by sector



Source: Authors based on UNCTAD (2014[22]), *World Investment Report 2014: Investing in the SDGs, An Action Plan*, http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf.

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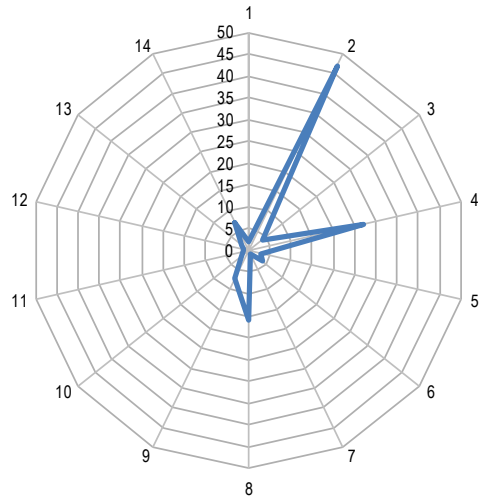
Recent studies of private sector contribution to the SDGs demonstrate further convergence with other SDG-related areas beyond infrastructure that can be scaled up. One such study stems from an initiative led by the World Bank, the World Economic Forum and the International Development Research Centre with support from the GrowInclusive platform of the German Federal Ministry for Economic Cooperation and Development (BMZ). The study finds that support is reaching several goals including SDG 8 (job creation), SDG 2 (zero hunger), SDG 4 (quality education), SDG 10 (reducing inequalities), and SDG 17 (partnerships for the goals). However, these hits were highly concentrated in 40 of the 169 SDG targets or 6 of the 17 SDGs.[13] It shows that more than 75% of SDG targets are not yet supported – they had no so-called "hits" – by private sector activities, suggesting that 11 SDGs are underfunded Figure 4.9.

Figure 4.9. SDG hits per business case study



Source: (World Economic Forum, International Development Research Centre, World Bank Group, 2018[30]), "GrowInclusive Initiative", *https://www.growinclusive.org/data-and-methodology/our-solution/*.

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Further analysis of how both public and private resources are targeting SDG-related sectors is important, particularly in cross-cutting areas, to address potential gaps in support. Better data is needed to ascertain the characteristics, particularly of private sector activities. As demonstrated in the studies above, the coverage of private sector actors in survey data can be scaled up to encompass a wider range of SDG-related sectors where the private sector is playing a role.

Measuring the catalytic effects of resources as countries transition through levels of development

Since the Monterrey Consensus (United Nations, 2003[31]), governments have sought to maximise the catalytic effect of ODA to unlock other sources of financing in order to fill financing gaps. The Addis Ababa Action Agenda also emphasises the need to more effectively maximise the catalytic role of development finance, and particularly ODA, to mobilise domestic resources, strengthen public services and private sector development, and unlock additional finance through blended or pooled financing and risk mitigation (paragraph 54).

As discussed in Chapter 3, to assess financing needs and gaps, it is necessary to measure the dynamic effects among resources in the form of synergies and trade-offs as countries' income per capita or level of development changes.

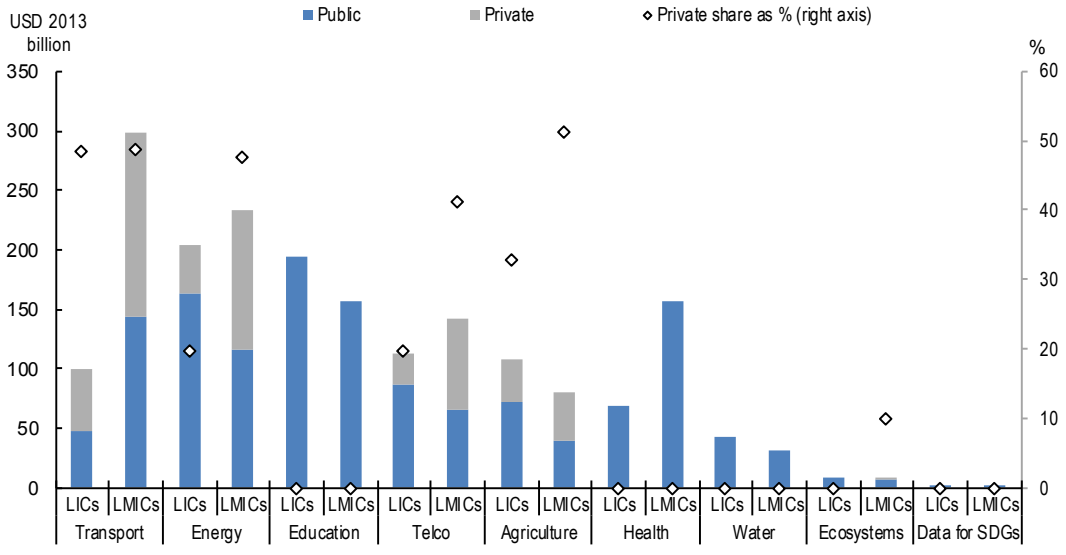
The measurement of blended finance provides an understanding of some but not all catalytic effects

Instrument-based approaches offer opportunities to measure the catalytic effects of official support to mobilise public and/or private financing for development[14] (Chapter 3). A greater share of private sector resources is expected to fill larger gaps in higher-income countries (in absolute terms). There is a concentration of private sector mobilisation in middle-income countries, which demonstrates the need to examine how official

development finance should be targeted to promote access to financing in lower income countries.

While lower middle-income countries have the potential to raise domestic financing to nearly self-finance the achievement of the SDGs, low-income countries will require, by some estimates, USD 152-163 billion per year (Schmidt-Traub, 2015[23]). As Figure 4.10 shows, private sector investment is projected to provide nearly half the resources that will be needed in lower middle-income countries in key SDG sectors such as agriculture and energy.

Figure 4.10. Public and private investment needs by income level



Source: UNCTAD (2014[22]), *World Investment Report 2014: Investing in the SDGs, An Action Plan*, http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf.

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Alignment and impact: Efforts to deliver impact-driven data aligned towards sustainable development rely on a new culture of evaluation

Not every dollar spent on development has equal impact, and measuring just the financing will not reveal development impact. The 2005 Paris Declaration on Aid Effectiveness provided the first international agreement on how to maximise the impact of aid.[15] It reaffirmed the importance for donors to "increase the impact aid has in reducing poverty and inequality, increasing growth, building capacity and accelerating achievement of the MDGs". However, several challenges limit assessments of the SDG impacts of different actors and sources.

A broader set of actors also is demanding better measures of impact to assess actual SDG outcomes. A report by the Business and Sustainable Development Commission (2017[32]) estimates the potential economic output of delivering the SDGs at close to USD 12 trillion per year across 60 new markets in four economic systems, which far outstrips the estimated cost of USD 2.5 trillion to deliver the goals. A stronger common framework of

indicators and targets, aligned both to the SDGs and returns on investment, is key to reaping these benefits, particularly for private sector actors.

Harnessing impact-driven data for the SDGs to drive a race to the top

Governments are stepping up efforts to put impact measurement at the heart of financing aligned to the SDGs

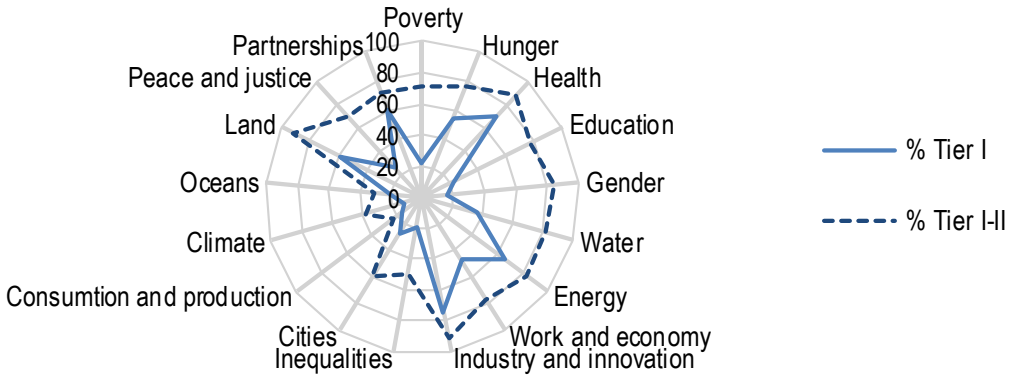
Development co-operation providers use output, outcome and impact information (i.e. results data) at different levels such as corporate, country and project level to communicate and account for what has been achieved and to enable learning, informed decision making and course corrections.

OECD members are incorporating SDG targets and indicators into existing development results frameworks. A study conducted for the results community of the OECD DAC finds that results frameworks can be strengthened by SDG targets and indicators (Engberg-Pedersen and Zwart, 2018[33]). Box 4.6 discusses the findings in greater detail. Notably, providers and partners can use the SDG targets as a common framework to prioritise relevant development goals, measure progress towards the goals and assess the challenges to reaching them.

However, more robust data for impact are needed. The indicators developed to track SDG progress provide the basis for assessing the impact of finance for sustainable development. Yet, 60% of these indicators are not considered robust in terms of coverage or methodological definition. The UN Inter-agency and Expert Group on SDG Indicators has established a classification system of SDG data by tiers, with Tier 1 signifying most robust and Tier 3 signifying least robust data (Figure 4.11).

Across the SDGs, better data and indicators of impact from private sector actors will be required. Robust data from the private sector are lacking for a number of SDGs including: SDG 8 (decent work and economic growth) to measure not only the number of jobs but also the quality of jobs created, which encompasses measures of gender equality, inclusiveness, contract duration, impact on poverty rates, etc.; SDG 10 (reduced inequalities), for which recruitment costs require employer data; SDG 11 (sustainable cities and communities); SDG 12 (sustainable consumption and production); SDG 13 (climate action); and SDG 14 (sustainable marine and ocean development) (OECD DAC, 2018[34]) (United Nations, 2018[29]).

Figure 4.11. SDG indicators by goal and tier



Source: United Nations (2018[29]), "The Inter-Agency and Expert Group on SDG Indicators" *(website),* https://unstats.un.org/sdgs/iaeg-sdgs/.

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Despite this lack of data, governments are seeking to improve reporting on SDG implementation and commitments through the voluntary national review (VNR) process.[16] VNRs are emerging as an important tool to ensure policy coherence on SDG implementation at both domestic and international levels. In 2016-17, 65 countries conducted VNRs. The number of OECD members conducting VNRs has increased to 9 on average (2016-18). However, 5 out of 35 OECD members have yet to carry out a VNR. Although annual reporting is not required, it is recommended that all countries carry out the process at least once before the end of the 2016-18 cycle.

Box 4.6. Using the SDGs as a common framework to strengthen results-based management

The 2030 Agenda for Sustainable Development expresses the visions and aspirations of the international community and sets up an ambitious results framework with goals, targets, indicators and deadlines. Providers can strengthen their results frameworks and results-based management by incorporating SDG targets and using SDG indicators.

At country level, providers and partners can identify a commonality of priorities and targets and establish country results frameworks around the SDG targets that are most relevant to their goals for the country's development. They can also identify gaps in development efforts to meet the partner country's needs and priorities. Within the government's development priorities, the parties can discuss particular challenges related to the distance to the estimated end values of the 2030 targets.

Many providers and partners already identify SDGs and SDG targets that fit with their respective development goals and priorities and can be incorporated in their results framework. This requires selecting from among the 169 SDG targets those targets that are supported by robust indicators. It also means differentiating among the SDG

outcome targets and indicators and those indicators that address the means of implementation.

To support these efforts, the OECD Development Co-operation Directorate (DCD) results team screened the 169 targets to present a menu of 60 SDG targets and indicators that can strengthen providers' results frameworks. This menu comprises, first, 42 SDG outcome targets supported by 53 robust SDG indicators agreed by the UN Statistical Commission and that providers and partners can consider as components of results frameworks for development co-operation. Second, the menu includes 18 SDG targets and indicators covering "means of implementation" that can be included in Tiers 2 or 3 of results frameworks concerning provider performance and outcomes.

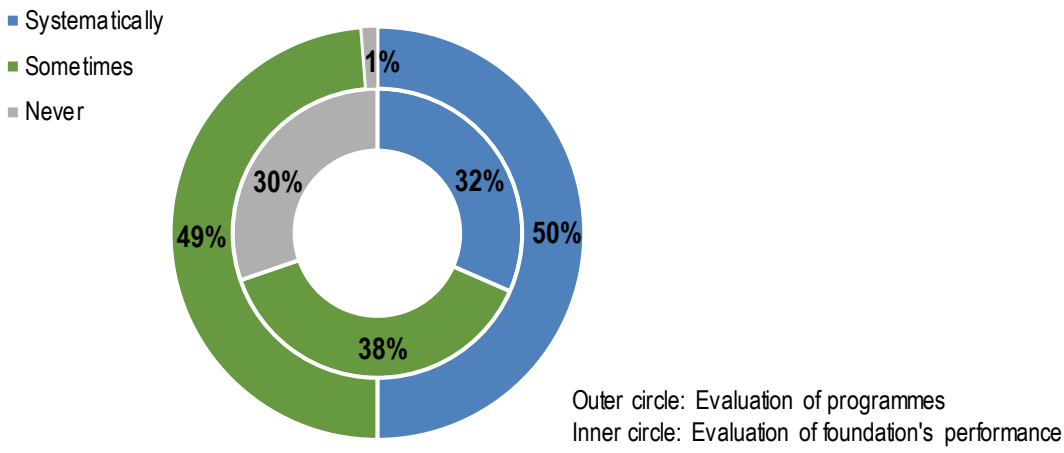
An assessment of the standard indicators applied by eight bilateral and multilateral providers shows that there is scope for linking these directly to SDG targets and indicators. This would be instrumental in reducing the number of indicators. These can be unwieldy. For example, under target 6.1, providers utilise seven different indicators to measure SDG indicator 6.1.1 on the proportion of the population using safely managed drinking water.

Source: (Engberg-Pedersen and Zwart, 2018[33]) *The 2030 Agenda and Development Co-operation Results*, https://doi.org/10.1787/24140929 and (Zwart, 2017[35]) *Strengthening the results chain: Synthesis of case studies of results-based management by providers,* https://doi.org/10.1787/24140929.

While private sector actors increasingly utilise measures of sustainable development impact, these measures must be improved for reliability

Certain private sector actors are increasing efforts to measure and monitor the development impact of their activities. The recent OECD (2018[12]) survey on philanthropy finds that foundations are increasingly measuring impact and integrating monitoring and evaluation in their processes (Figure 4.12). Nearly all foundations responding to the survey reported that they evaluate their programmes, with half confirming they do this "sometimes" and half "systematically" (OECD, 2018[12]). Targets and indicators of private sector participation in developing countries are also being improved by initiatives that aim to better harmonise data such as the Global Impact Investing Network's IRIS metrics catalogue, the Harmonized Indicators for Private Sector Operations (HIPSO) and the OECD Social Impact Investment (SII) initiative.

Figure 4.12. Foundations' use of performance evaluation mechanisms



Source: OECD (2018[12]), "Survey on private philanthropy for development, 2013-15, qualitative questionnaire", www.oecd.org/site/netfwd/.

StatLink https://doi.org/10.1787/888933853243

The number of private sector actors engaged in measuring development impact is increasing. Beyond philanthropic actors, 73% of United States investors incorporate environmental, social and particularly governance issues into investment analysis and decisions (CFA Institute, 2017[36]). In addition, 93% of the 250 largest corporations in the world report on their sustainability performance (KPMG, 2015[37]).

The reliability of impact assessments is being called into question, given that many public and private sector actors develop and cite such assessments as to improve their reputation and to reassure stakeholders. The "In My View" piece by Eric Berseth and Vincent Mudry in Box 4.7 argues that impact measurement is becoming a hollow "buzzword". Ensuring a high standard for assessing impact is essential to strengthen accountability.

Box 4.7. In My View: The challenges of measuring the impact of investments, by Eric Berseth, Executive Director, and Vincent Mudry, Head of Operations, Philanthropy Advisors

Impact measurement has become a buzzword for social change actors, impact investors and donors in the humanitarian and development community. These actors are giving increasing importance to evidence-based results and performance measurement to better track inefficiencies and to ensure greater value for money. This trend has pushed programmatic and implementing institutions, including foundations, to talk about impact. Today, most organisations say they run impact programmes, implying that they measure impact. Yet strictly speaking, impact measurement is rare and most of these claims are unsubstantiated.

As with any other buzzword, the term impact measurement has been used in so many different ways that its meaning has become unclear to many actors of change. A precise description starts by defining the impact of an action as the context that results from all significant and lasting changes in the life and environment of individuals and groups of people, whether they are directly or indirectly connected to the action. These changes can be positive or negative, foreseen or unforeseen. Impact is therefore the new context that results from the combination of outcomes derived from the action.

When an organisation intends to measure the impact of its programmes, it requires a level of expertise and significant financial means to carry out all related activities over a relatively long period of time. Impact involves a variety of variables that are often independent of the action itself, which means that reliable measurement of causality is challenging to identify. Impact measurement is therefore difficult to carry out in a systematic manner. Overcoming the challenges of impact measurement can be difficult and carries the risk of over-simplifying the process and watering down its meaning. There is no easy answer to get around the costs.

Conscious of the challenges of impact measurement, some actors prefer to measure the likelihood of impact in order to circumvent some of the costs. This helps to address what the programme does and how it could achieve desired impact. Measurement of the likelihood of impact provides a middle ground between deploying expertise and resources that are not necessarily available, on one hand, and being accountable for the programmes that are being implemented, on the other.

Innovative financial instruments, such as the well-known Humanitarian Impact Bond, can also present a suitable solution to combine the different requirements that stem from impact and accountability. Traditional donors transfer risk – for a profit – to private investors, while assigning verification and performance measurement. Although "impact" bonds do not fall within the boundaries set by the academic definition of impact measurement, they are built on a solid theory of change with measured results and thus offer greater assurance vis-à-vis the overall quality of programmes.

Leveraging measurement for SDG impact

There is a demand for more effective measures of sustainable development impact from both public and private actors. Stronger measurement tools are needed to cultivate and develop this emerging new culture of evaluation to deliver value for money and maximise available

resources (Chapter 5). Traditional donors have a longstanding history of carrying out evaluation and assessment of development co-operation activities and can provide capacity support.

Innovative tools can help to measure sustainable development impact

Tools for results-based evidence provide greater opportunities to identify win-win solutions in support of the SDGs based on empirical evidence. For example, private sector actors could benefit from the experience of multinational development banks to improve the quality of measurement frameworks for assessing the impact of activities. The International Finance Corporation (IFC), for one, has instituted a new tool called Anticipated Impact Measurement and Monitoring (AIMM), which is meant to "identify and catalogue IFC interventions that contribute to market creation" (International Finance Corporation, 2018[38]).

In addition, the effectiveness of private sector engagement can be increased by improving alignment of results frameworks to the SDGs. For example, the Commonwealth Development Corporation (CDC), the United Kingdom's development finance institution, is working to implement a new strategic approach that will require it to align investment to all the SDGs, broadening measures of development impact beyond job creation to include impact in the priority sectors such as women's economic empowerment, climate change, job quality, and skills and leadership (Commonwealth Development Corporation, 2017[39]).

Private sector actors are also turning to environment, social and governance (ESG) metrics as a tool to use market forces that align their contribution to social, environmental and economic impacts. For institutional investors, asset managers, financial institutions and other stakeholders, ESG performance metrics bring transparency to investor decisions and reinforce investor confidence by quantifying environmental and social outcomes. In this regard, Morgan Stanley Capital International (MSCI) developed the ESG Sustainable Impact Metrics, a framework to measure and monitor sustainable impact. It covers 2 500 companies for social impact themes and 8 500 companies for environmental impact themes (MSCI ESG Research Inc., 2016[40]).[17]

Challenges remain to translate sustainable development objectives into corporate evaluation techniques

ESG metrics rely mainly on self-assessment, which presents significant risk of SDG washing. SDG indicator 12.6.1 calls on governments to encourage companies to improve sustainability reporting as well as to adopt sustainability practices. However, there is no common definition of ESG metrics, and reporting practices vary from business to business. For instance, some companies may prioritise gender equality and women's empowerment while others focus solely on reducing carbon emissions.

Some private sector actors are calling for a move towards a unified framework for corporate sustainability metrics aligned to the SDGs. One initiative that is gaining traction is the SDG Compass for Business, developed by the Global Reporting Initiative, the UN Global Compact and the World Business Council for Sustainable Development. In adopting the Compass, companies commit to align their strategies and measure and manage their contribution to the SDGs. Nevertheless, self-reporting practices continue to represent cause for concern over the reliability and accuracy of impact measurement, as highlighted in the "In My View" piece by Pietro Bertazzi in Box 4.8.

Box 4.8. In My View: The importance of integrating SDGs in corporate sustainability reporting, by Pietro Bertazzi, Head of Sustainable Development, Global Reporting Initiative (GRI)

The Sustainable Development Goals (SDGs) have ushered in a new era of global development with their aim of addressing the world's most pressing challenges. The active participation of business is essential to achieve these goals. By upholding and respecting recognised standards and principles, business makes an essential contribution to the SDGs.

Many companies already act and report on topics covered by the SDGs such as climate change, sustainable water management, gender equality, or employment and decent work. Over time, sustainability reporting has evolved into a strategic tool for organisations to support decision-making processes at all levels. Reporting is used to shape business strategy, guide innovation, drive better performance and value creation, engage stakeholders, and attract investments.

Integrating SDGs in corporate sustainability reporting means measuring companies' impacts and performance against the ambitious sustainable development agenda and ultimately driving their positive contribution to the SDGs. It is essential that companies report on the topics, SDGs and targets on which they have the highest impact. And this requires prioritisation.

GRI and the United Nations Global Compact have established an Action Platform, Business Reporting on the SDGs, to drive corporate reporting on the global goals. Together we have developed a principles-based approach to SDG prioritisation that provides the basis to identify the SDGs on which companies have the most significant impact. This is done as part of a materiality assessment. The approach is based on corporate baseline responsibilities identified in the Ten Principles of the UN Global Compact, the UN Guiding Principles on Business and Human Rights, OECD Guidelines for Multinational Enterprises, and the related OECD Guidance on Due Diligence.

Principled prioritisation will help avoid common pitfalls such as SDG washing (i.e. focusing on or accounting only for positive impacts on the goals) and cherry picking (i.e. selecting goals based on what is easiest or most profitable for the company to do and ignoring important negative impacts). Only then are investors and other stakeholders able to assess the real progress towards the Sustainable Development Goals.

Better incentives frameworks are needed to align the behaviour of actors to the SDGs. Private sector actors do not have the same legal responsibility to fulfil the SDGs as do governments. Yet all private sector actors have a responsibility to comply with relevant domestic legislation, uphold internationally recognised minimum standards and respect universal human rights.

OECD members have a role to play to strengthen the development footprint of the private sector and to ensure that domestic legislation guides companies to adhere to a common framework for reporting. Delivering the right policy mix to guide business and investment practices will rely largely on governments setting the right incentives frameworks. Chapter 5 discusses this issue further.

Looking forward: Towards a new financing for sustainable development compass

The AAAA (paragraph 2) aims to provide a "holistic and forward-looking framework" and "concrete actions to deliver on the promise of the agenda". To meet this call, a revitalised FSD compass is required to guide all actors, sources of finance and policy in support of collective and coherent global action for sustainable development.

Domestic efforts to advance sustainable development also come with the risk of impeding progress elsewhere. Policy areas such as international taxation or migration can have important positive or negative spillover effects in developing countries and careful consideration of these effects must be accounted for. The "In My View" piece by Guido Schmidt-Traub in Box 4.9 provides insights on the challenges of measuring the spillover effects of SDG financing among countries.

An overarching challenge of implementing the ambitions of the AAAA is the cross-cutting and integrated nature of the SDGs, meaning that successful achievement of one goal must not come at the expense of the other goals. Nor should achievement of one country's SDG implementation come at the expense of another country's progress.

Box 4.9. In My View: International spillover effects of SDG financing, by Guido Schmidt-Traub, Executive Director, Sustainable Development Solutions Network

One country's progress towards achieving the Sustainable Development Goals (SDGs) depends in part on actions by other countries. Such international spillover effects cover environmental dimensions (transboundary pollution, climate change or supply chain impacts on biodiversity); social dimensions (labour standards); security (weapon exports or conflict); and financing (international development finance, banking secrecy, unfair tax competition, etc.). For this reason, the SDGs are a truly universal agenda.

The 2018 SDG Index and Dashboards Report prepared by the Bertelsmann Stiftung and the Sustainable Development Solutions Network (SDSN) shows that high income countries generate large negative international spillover effects, particularly on environmental dimensions and finance. Variations across countries at similar levels of per capita GDP are high. For example, Denmark and Switzerland have comparable levels of per capita income, but Switzerland exhibits vastly higher negative spillover. This evidence suggests that negative spillover effects can be curbed through appropriate policies.

Among international development finance flows, official development assistance (ODA) and non-concessional finance are among the best-studied and most comprehensively-reported, thanks in large part to the OECD DAC. In particular, we now have clear measure of programmable aid. One worrying trend, however, is the growing dilution of the ODA definition and the difficulties of matching provider data with records from recipient countries. Here, mechanisms like the International Aid Transparency Initiative have been very helpful. In recent years, efforts have also been undertaken to collect and harmonise data on private

philanthropic giving, which also is becoming an increasingly important source of development finance.

A greater challenge is understanding non-concessional public finance and the volume of private finance that is leveraged through public-private partnerships and other blended finance mechanisms. Many providers and particularly multilateral development banks use different standards for reporting. In some cases, they have been suspected of inflating such development finance flows, which generates suspicion among developing country finance ministries about the quality of the data. It is therefore vital to make underlying project data publicly available in order to harmonise reporting standards and to cross-check provider reporting with recipients' records. Another major challenge is the need for better and transparent reporting of development finance flows from China and other non-OECD countries.

We also lack sufficiently harmonised data on commercial foreign direct investment. Databases maintained by UNIDO, the OECD and the IMF are not fully consistent. Not all FDI contributes towards the SDGs. Some foreign investment may even be harmful if – for example – it undermines environmental objectives. The largest incremental volumes of such financing are coming from China under the Belt Road Initiative, but we lack a clear understanding of the volumes and composition of these flows.

The most controversial aspect of international spillover effects on SDG financing concerns banking secrecy and unfair tax competition. Data produced by Oxfam and other organisations show that OECD member countries, including their overseas territories, operate banking systems that promote large-scale tax evasion and hide the beneficial ownership of companies and trusts. While there have been significant improvements in getting financial centres to comply with OECD transparency standards, the Panama Papers and other leaks underscore the vast scale of tax evasion and money laundering that occur today. Given their pernicious impact on public finances, public trust and countries' ability to finance the SDGs, greater action is required on reporting and curbing these illicit flows.

Given as well the importance of positive and negative international financial spillovers, it is critical that work continues by the OECD and other organisations help to clarify definitions and reporting standards. Partnerships with China and other providers are needed to increase the transparency and coverage of data. Such flow data must be matched against assessments of development finance needs across the key SDG dimensions, as provided by the SDSN for low-income and lower middle-income countries, to determine the finance gaps and to foster discussions on how they can be closed in time for the 2030 deadline.

Measuring the trade-offs and synergies across the goals is needed to avoid setbacks

The SDGs can be articulated as a network of targets, a perspective and approach that allow for clearer understanding of areas where synergies among goals can potentially be leveraged to positive effect (Le Blanc, 2015[41]). Shared targets such as those to end poverty and inequalities (SDG 1 and SDG 10) indicate opportunities to impact progress across goals simultaneously. They also call for deeper analysis into how a network approach could help to maximise the development effectiveness of financing.

To accelerate progress, measures must identify how all SDGs reinforce or cancel out one another. For all countries, SDG 1 (end poverty) is associated with the greatest number of positive synergies across the SDGs and is statistically linked with progress in SDG 3 (good health and well-being), SDG 4 (quality education), SDG 5 (gender equality), SDG 6 (clean water and sanitation), and SDG 10 (reduced inequalities). In contrast, SDG 12 (responsible consumption and production) is the goal most commonly associated with negative trade-offs (Pradhan et al., 2017[42]).

A more holistic approach is required to measure the spillover effects of domestic and external SDG financing

OECD members have initiated efforts to break the policy silos of SDG implementation. A focus solely on commitments to mobilise financing, whether framed as the target of 0.7% ODA/GNI or as billions to trillions, misses how financing actually impacts sustainable development progress. Ensuring a whole-of-government approach to SDG monitoring, such as voluntary national review reporting and implementation across institutions and policy communities, is needed. The discussion of policy coherence in Chapter 5 makes this clear.

Some OECD members are acting to develop new measurement tools to guide implementation at the domestic and international levels. One promising example is a recent French government invitation to all ministries to evaluate the alignment of policy to the SDGs. A recent study conducted by the Institute for Sustainable Development and International Relations (IDDRI) identifies opportunities in support of the French initiative to break the silos between goals and to ensure the policy coherence of financing to advance progress at domestic and international levels. This study is discussed in Figure 4.6.

Box 4.10. Measuring Sustainable Development Goal implementation in France: The challenge of breaking down the SDG silos

Are the SDGs relevant for an OECD country like France? Given current trends France will have difficulty meeting a number of targets, including reducing inequalities in education and conserving biodiversity. Hence, although France has managed to tackle a lot of development challenges in the past, new challenges emerge questioning the sustainability of its development model.

The SDGs are not the only tool and policy framework for sustainable development, but they are the most overarching ones. A question for OECD countries like France is how to move beyond raising awareness of the SDGs and their relevance to concrete action through existing tools.

The main added value of the SDGs lies in advancing policy coherence by promoting synergies and avoiding trade-offs among different policies and budget lines. In order to be used as such, the SDGs need to be taken out of their own silo and become relevant for policy making and budgeting.

In September 2017, the Ministry of Ecology and Solidarity announced on behalf of the French government that an SDG roadmap would be developed. At an inter-ministerial meeting on 8 February 2018, in the framework of the Interministerial Committee for International Co-operation and Development, the government reaffirmed its intention to rapidly set up a roadmap and announced it would include the SDGs in the budget process and in the evaluation of future laws, public policy reviews and mobilisation of a broader array of actors.

How the SDGs will be included in the budget process still needs to be clarified. The government has said that "where relevant and possible" it will align its budget performance indicators with the SDGs. It is hoped this will permit better measurement of the impact of public budgets on the SDGs internally and externally. The revision of budget performance indicators in light of the SDGs, if not carried out purely as a token gesture, may indeed prove useful, in that the SDGs provide a coherent framework.

Advancing policy coherence also means limiting negative impacts on third countries. At the moment, the link between the external and internal dimension of the SDG implementation is still a blind spot in the French SDG implementation approach. The SDG roadmap could remedy this omission by emphasising SDG implementation measures that limit negative impacts on third countries.

France is accelerating SDG implementation and is moving in the right direction. The ultimate success of the announced projects to remove the SDGs from their silo and integrate them into policy and budget choices depends on how they are translated into concrete measures and whether they garner political buy-in.

Source: Elisabeth Hege and Damien Demailly (IDDRI).

Future work must seek to establish a new FSD compass, one that builds on the existing initiatives to guide actions across actors and sources of financing. The OECD (2017[43]) report, *Measuring the Distance to the SDG Targets,* includes analysis of spillover effects of actions that help other countries in meeting the targets. As noted in this chapter, the Index and Dashboard 2017 report (Bertelsmann Stiftung-Sustainable Development Solutions Network, 2017[44]) provides another methodology to assess the spillover effects of SDG implementation and financial contributions such as international tax transparency and including and beyond ODA. Similarly, the new index launched by the Center for Global Development (2017[45]) assesses policies and financial contributions of OECD countries to the SDGs.

New tools and measurement frameworks can help governments take a more holistic approach to measuring the contribution and progress of all actors – whether they are private sector actors, civil society organisations, academics, philanthropists or diaspora senders of remittances. These tools and frameworks already are helping to strengthen reporting in the context of SDG implementation (e.g. the formulation of voluntary national review reports).

Conclusion and recommendations

Measurement is the first step to setting goals and targets, and ultimately to defining strategies and policies that maximise development impact and advance progress toward the global agendas. A crucial lack of data is impeding understanding of progress to finance sustainable development and identify potential gaps. The current SDG targets and indicators framework relies primarily on official aid data provided by the OECD DAC to track SDG financing, leaving the development content of the majority of financing unknown.

Measuring the volume of flows is not enough. There is a demand for a more holistic approach and effective measures of development impact from both public and private actors, with public actors seeking to demonstrate value for money of public funds and private sector actors looking to increase economic, social and environmental returns on investment. A culture of evaluation and impact can be leveraged.

Efforts should be made to measure how much the various flows, including and beyond aid, actually contribute to sustainable development and the 2030 Agenda. Several policy recommendations can help to achieve this level of ambition:

- To support the transparency initiative, develop local capacities to better measure the flows, map flows to the SDGs (including through TOSSD), and assess SDG financing needs and gaps. Explore new technologies (e.g. machine learning) that can be adapted to measure resources and results linked to sustainable development.
- Develop evaluation and impact assessment tools (e.g. business self-assessment tools to benchmark performance against specific SDG and SDG results frameworks for governments) to measure the quality and development footprint of various FSD actors and sources.
- Launch discussions about moving from measuring financing for development to financing for sustainable development, addressing a broader array of resources and actors (what to include and exclude?), and about exploring the trade-offs and spill-overs among SDGs.

Chapter 5 applies these emerging findings to maximise financing by strengthening the effectiveness and coherence of policies in support of sustainable development. It calls for a second paradigm shift to make the best use of existing resources, by both seizing new opportunities and managing potential risks.

Notes

[1] The BRICS group of countries is Brazil, Russian Federation, India, China and South Africa.

[2] SDG washing is a recent term that signifies a marketing or branding strategy showcasing SDG impact without evaluation or monitoring of potential negative impacts of actions. For example, electric car companies may wish to emphasise their contribution to renewable energy and climate change action (SDGs 7 and 13) without acknowledging that labour rights (SDG 8) may have been violated in the mining of the cobalt used in their batteries (SDG 8).

[3] Country programmable aid is defined as is the portion of aid that providers can programme for individual countries or regions, and over which partner countries could have a significant say. Developed in 2007, country programmable aid is a closer proxy of aid that goes to partner countries than the concept of official development assistance.

[4] The term "development footprint" is meant to signify a certain class of resources with the potential to produce development results and should not be used interchangeably with development results, i.e. output, outcome or impact.

[5] The potential consequences of gaps in measurement were highlighted by the 2013 Rana Plaza disaster in Bangladesh, in which more than 1 100 people died in the collapse of a building housing garment factories. The incident demonstrated how unsustainable upstream production at the domestic level can become embedded in products that move through global value chains and impact FDI-based production networks of MNEs.

[6] The work will draw on OECD and other international statistics including the OECD FDI statistics, the World Bank Enterprise Survey (WBES), the Bureau van Dijk's ORBIS firm-level dataset, the International Trade Centre (ITC) Investment Map database, the UNIDO INDSTAT database on manufacturing, the ILO database on employment (LABORSTA), FactSet Supply Chain Relationships database, the United Nations Statistics Division (UNSD) database on gross value added across sectors, the Financial Times fDi Markets statistics on greenfield foreign investment, and Dealogic on cross-border mergers and acquisitions activity.

[7] Footloose investment is commonly defined as manufacturing industries that are not dependent on any particular location and thus can relocate across national borders to produce goods.

[8] For more information on the OECD Revenue Statistics series, see: http://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm.

[9] For example, the Transparency International Perception of Corruption Index and the International Budget Partnership's Open Budget Survey provide proxies of developing countries' capacity to effectively allocate financing in support of sustainable development.

[10] Projects can be identified as targeting the policy marker to varying degrees, i.e. "significant" or "principle".

[11] Climate change mitigation and adaptation are recorded in ODA using the Rio policy markers as cross-cutting objectives, recognising the importance of mainstreaming climate change-related finance across sectors. Climate change-related aid represents roughly 20% of total bilateral ODA in 2016. See https://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/Climate-related-development-finance-in-2016.pdf.

[12] The Woetzel et al. (2017[46]), in a report published by the McKinsey Global Institute, argue that about USD 3.7 trillion a year must be invested in economic infrastructure to maintain current growth trajectories, with 63% of that annual investment needed developing and emerging economies. The OECD (2017[47]) is projecting even greater infrastructure needs of USD 6.3 trillion per year over the period 2016-30. See https://www.oecd.org/env/cc/g20-climate/Technical-note-estimates-of-infrastructure-investment-needs.pdf.

[13] The limited scope of hits is due in part to the nature of several targets that could not be included in the survey because the private sector could not meet the level of detail of reporting required. For example, in order to report on SDG indicator 5.5.2 (the proportion of women in managerial positions), companies must report on the payroll of each of the beneficiaries of a specific project to assess the career level.

[14] In the case of reporting on private sector instruments in DAC statistics, an official transaction is considered "additional" because of its financial additionality, value additionality or both.

[15] OECD DAC defines "effectiveness" as "a measure of the extent to which an aid activity attains its objectives".

[16] As part of the follow-up and review of the 2030 Agenda for Sustainable Development, governments have committed to carry out voluntary national reviews to assess the domestic and international impact of implementation efforts (2030 Agenda paragraph 84). The VNR follow-up process aims to strengthen reporting to the annual UN High-Level Political Forum on contributions to SDGS by national government and private sector actors, civil society organisations, youth, sub-national government, and academia. VNRs are individual self-assessments provided by governments on a voluntary basis to indicate quantitative and qualitative contributions of domestic and international support of individual SDGs.

[17] According to MSCI, the framework aims to enable investors to make informed decisions regarding the exposure and ESG compliance of companies based on five impact themes: basic needs, empowerment, climate change, natural capital and governance (MSCI ESG Research Inc., 2016[40]).

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Annex 4.A.

Annex Table 4.A.1 takes the current, internationally agreed SDG indicators framework and highlights the agreed measures of SDG financing. This table shows that ODA/OOF represents the main source of data for indicator across goals.

Annex Table 4.A.1. SDG financing indicators

Inter-agency and Expert Group on SDG Indicators-agreed indicators of SDG financing		
SDG financial indicators	**Source of financing**	**Custodian agency**
1.5.2 Direct economic loss attributed to disasters in relation to global GDP	economic loss, monetary value	UNISDR
1.a.1 Proportion of domestically generated resources allocated by the government directly to poverty reduction programmes	metadata NA	NA
1.a.2 Proportion of total government spending on essential services (education, health and social protection)	metadata NA	NA
1.a.3 Sum of total grants and non-debt creating inflows directly allocated to poverty reduction programmes as a proportion of GDP	metadata NA	NA
1.b.1 Proportion of government recurrent and capital spending to sectors that disproportionately benefit women, the poor and vulnerable groups	metadata NA	NA
2.a.2 Total official flows (official development assistance plus other official flows) to the agriculture sector	ODA,OOF	OECD
3.b.2 Total net official development assistance to medical research and basic health sectors	ODA	OECD
4.b.1 Volume of official development assistance flows for scholarships by sector and type of study	ODA	OECD
6.a.1 Amount of water- and sanitation-related official development assistance that is part of a government-co-ordinated spending plan	ODA	OECD
7.a.1 International financial flows to developing countries in support of clean energy research and development and renewable energy production, including in hybrid systems	Total ODA, OOF and total public investment flows	OECD, IRENA
7.b.1 Investments in energy efficiency as a proportion of GDP and the amount of foreign direct investment in financial transfer for infrastructure and technology to sustainable development services	metadata NA	NA
8.a.1 Aid for trade commitments and disbursements	ODA	OECD
9.a.1 Total official international support (official development assistance plus other official flows) to infrastructure	ODA,OOF	OECD
10.b.1 Total resource flows for development, by recipient, donor country and type of flow (e.g. official development assistance, foreign direct investment and other flows)	ODA, OOF, and Private flows	OECD
10.c.1 Remittance costs as a proportion of the amount remitted	metadata NA	NA
11.4.1 Total expenditure (public and private) per capita spent on the preservation, protection and conservation of all cultural and natural heritage, by type of heritage (cultural, natural, mixed and World Heritage Centre designation), level of government (national, regional and local/municipal), type of expenditure (operating expenditure/investment), and type of private funding (donations in kind, private non-profit sector and sponsorship)	metadata NA	NA
11.c.1 Proportion of financial support to the least developed countries that is allocated to the construction and retrofitting of sustainable, resilient and resource-efficient buildings utilising local materials	metadata NA	NA
12.a.1 Amount of support to developing countries on research and development for sustainable consumption and production and environmentally sound technologies	metadata NA	NA
13.a.1 Mobilised amount of USD per year between 2020 and 2025 accountable towards the USD-100 billion commitment	metadata NA	NA
15.a.1 Official development assistance and public expenditure on conservation and sustainable use of biodiversity and ecosystems	ODA	OECD
16.4.1 Total value of inward and outward illicit financial flows (current USD)	metadata NA	NA
16.6.1 Primary government expenditures as a proportion of original approved budget,	National budget	World Bank

by sector (or by budget codes or similar)	data	
17.1.1 Total government revenue as a proportion of GDP, by source	metadata NA	NA
17.1.2 Proportion of domestic budget funded by domestic taxes	metadata NA	NA
17.2.1 Net official development assistance, total and to least developed countries, as a proportion of the OECD DAC donors' gross national income (GNI)	ODA	OECD
17.3.1 Foreign direct investment, official development assistance and South-South co-operation as a proportion of total domestic budget	ODA	OECD
17.3.2 Volume of remittances (USD) as a proportion of total GDP	Remittances	World Bank
17.4.1 Debt service as a proportion of exports of goods and services	Public and publicly guaranteed external debt	World Bank
17.7.1 Total amount of approved funding for developing countries to promote the development, transfer, dissemination and diffusion of environmentally sound technologies	metadata NA	NA
17.9.1 USD value of financial and technical assistance (including through North-South, South-South and triangular co-operation) committed to developing countries	ODA,OOF	OECD
17.17.1 Amount in USD committed to public-private and civil society partnerships	metadata NA	NA
17.19.1 USD value of all resources made available to strengthen statistical capacity in developing countries	ODA, survey	OECD DAC CRS, PARIS21

Source: United Nations (2015[15]) *SDG Indicators Metadata repository*. Retrieved from the SDG indicators metadata repository on 21 March 2018: https://unstats.un.org/sdgs/metadata/.

Chapter 5. Better policies to finance sustainable development

In addition to the need for better measures of finance for sustainable development, policies need to be designed in a way that can deliver the ambition of an integrated Addis Ababa Action Agenda. The trillions required to finance the Sustainable Development Goals are present in the global economy. However, a focus on smarter policy design to shift the trillions is needed to make the best use of existing resources and strengthen the development footprint of different actors. This means minimising leakages and maximising catalytic effects in support of sustainable development. Competition in the form of more suppliers and instruments is increasing within the financing sustainable development market, which calls for better policy guidance and coherence mechanisms to manage the risks and seize opportunities. Although sustainable and inclusive growth is primarily a domestic agenda, tackling global inequalities and poverty reduction, addressing potential shocks, and delivering on international commitments in support of the global goals cannot be achieved without stronger international solidarity and co-operation among countries and actors.

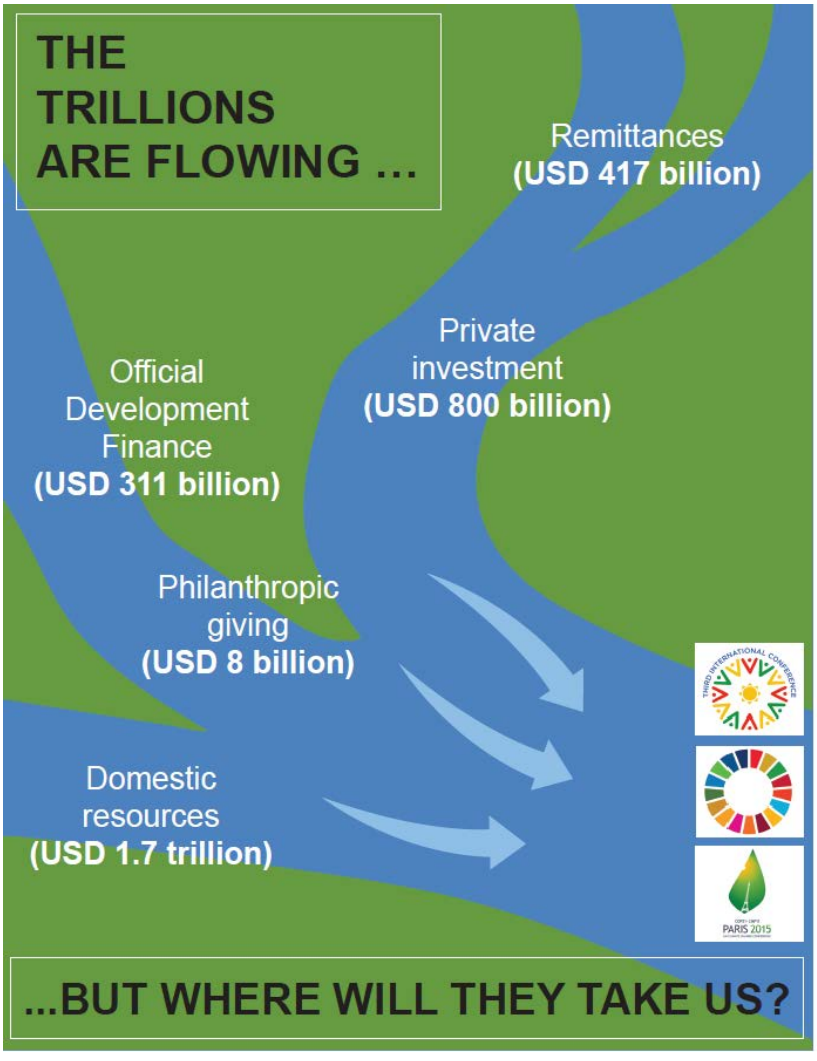
In brief

Spurred by the Addis Ababa Action Agenda (AAAA), the global community is beginning to turn towards an approach that makes better use of all existing resources to finance sustainable development. With unprecedented financing challenges, the call to deliver a "holistic and forward-looking framework" and "concrete actions to deliver on the promise of the agenda" has never been more timely (UN, 2015[1])). All action areas or policy levers identified by the AAAA must be fully activated to address the estimated USD 2.5 trillion gap in financing needed to achieve the Sustainable Development Goals (SDGs). These areas cannot be considered in isolation from each other and the trade-offs and synergies must be carefully weighed.

However, certain areas of the AAAA are losing steam, creating a context that especially complicates efforts to mobilise financing. As Chapter 2 demonstrates, traditional forms of business investment in developing countries are drying up one after another. There are progressive declines in cross-border and domestic mergers and acquisitions, foreign direct investment (FDI), and project finance. Another important source of investment in developing countries, portfolio investment, is also coming under growing pressure as interest rates begin to rise. At the same time, a trend of record-high levels of corporate debt has raised the spectre of financial turbulence. By some estimates, the present drop in private sector resources in developing countries is equivalent to approximately USD 400-450 billion forgone over the past six years.

The trillions required to finance the SDGs are in theory present in the global economy. As discussed in Chapter 4, however, the SDG impact of these resources is not currently measured (Figure 5.1.). According to recent estimates, investing in the SDGs could unlock economic opportunities worth at least USD 12 trillion a year by 2030 (more than 10% of global GDP) and generate up to 380 million jobs, mostly in developing countries. (Business and Sustainable Development Commission, 2017[2]). Yet, fully leveraging and maximising these resources in support of the SDGs remains challenging. The interactions among the new actors of the financing sustainable development system, discussed in Chapter 3, have not been exploited to their full potential.

Figure 5.1. Better aligning the trillions to support sustainable development gains



Source: Author adapted from World Bank (2015[3]) *Annual Report 2015,* http://www.worldbank.org/en/about/annual-report-2015; OECD (2018[4]), "Global Revenue Statistics" https://stats.oecd.org/index.aspx?DataSetCode=REV and IMF (2017[5]), "World Revenue Longitudinal Data" https://data.world/imf/world-revenue-longitudinal-dat for domestic resources; OECD (2018[6]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1, for official bilateral and multilateral flows; World Bank (2017[7]), "Migration and remittance data" (database), http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data for remittances; IMF (2018[8]) "Balance of Payments statistics" (database), http://www.imf.org/external/datamapper/datasets/BOP, for FDI, portfolio investments, and long-term and short-term debt making up private investment.

This chapter demonstrates that smarter policy design is needed to maximise the contribution of different actors and resources while eliminating the risk of costly spillovers. Shifting resources in this way requires policies that recognise the full cost of environmental, social and economic factors in financing sustainable development. Box 5.1. reviews global commitments to end fossil fuel subsidies as a pertinent example of the challenge of ensuring better policies to shift the trillions.

Box 5.1. Phasing out fossil fuel subsidies to maximise financing for sustainable development

Accounting for potential environmental, social and economic impacts leads to smarter policy design that minimises additional costs to finance sustainable development. One example is the commitment by world leaders to phase out fossil fuel subsidies. Every year since 2009, the Group of Seven (G7) and the Group of Twenty (G20) have committed to phase out fossil fuel subsidies and to act on related pledges under the Sustainable Development Goals (SDGs) and the Paris Agreement. Coady et al. (2015[9]), in a paper for the International Monetary Fund (IMF), argue that damages from the use of oil, gas and coal are estimated to cost nearly USD 5.3 trillion and that this cost is in addition to the direct cost of the USD 500 billion in fossil fuel subsidies. By phasing out fossil fuel subsidies, OECD members can take a first step to strengthen the coherence of policies aimed at maximising available finance in support of sustainable development.

The chapter further raises the growing risk of imbalances among the actors within the financing for sustainable development market. Competition in the form of more providers and instruments has increased within the financing sustainable development market. But market forces do not always lead to positive sustainable development impacts. For example, the share of debt in low-income countries held by commercial investors and by bilateral, non-Paris Club lenders doubled over the 2007-16 period, to an amount that is eight times the volume of debt held by Paris Club members. Due in part to opaque terms and conditions of new providers of financing, the number of developing countries that are in debt crisis or are at high risk of debt crisis has doubled.

Finally, while financing the SDGs will ultimately rely on domestic agendas, these must also advance the global goal of leaving no one behind. With one in five people in the world still living in extreme poverty, maximising the effectiveness of financing for sustainable development can no longer be viewed as a top-down challenge. It is a circular agenda. In seeking to reach these collective goals, international solidarity and co-operation among countries and actors are needed. Tackling global inequalities, addressing potential shocks and delivering on international commitments will rely on a strong multilateral system. The support of OECD members will be crucial to build a conducive environment for collective success. In his “In My View” piece in Box 5.2, Jeffrey D. Sachs argues the importance of efforts to share wealth and ensure inclusive global growth.

Box 5.2. In My View: Global solidarity to finance the Sustainable Development Goals, by Jeffrey D. Sachs, Director, UN Sustainable Development Solutions Network

Achieving sustainable development depends on incremental investments in six priority transformations: building human capacities (health, education, new job skills); decarbonising energy; promoting sustainable agriculture and biodiversity; building smarter cities; implementing the circular economy; and harnessing the digital revolution. As such, sustainable development and the 17 Sustainable Development Goals (SDGs) in particular pose a financing challenge. There are three distinct financing conundrums to solve: financing complex infrastructure, financing public services and amenities, and shifting investments from unsustainable to sustainable technologies. I discuss these in turn.

Sustainable development requires new forms of sustainable infrastructure. Sustainable infrastructure projects include a wide range of activities, among them zero carbon energy sources, smart power grids, resilient coastal management, urban high-speed broadband, smart transport infrastructure, and others. All of these projects involve complex issues such as land rights, public-private interface, public acceptance, liability rules, and multi-jurisdiction politics that often include multiple cities within a single country or multiple countries within a transnational region. Renewable energy sources are often far from population centres, in deserts, mountains or offshore (wind), and therefore require long-distance transmission lines passing through several jurisdictions, each needing to give right of way.

The financing issues are therefore complex as well. The issue is not only how to raise the funds (public borrowing, private borrowing, blended, etc.) but more importantly how to plan, design, win public acceptance, organise the operating and legal responsibilities, and then implement the investments. Many development finance institutions, such as the World Bank, structure their lending to single member states and have great difficulty in structuring multi-country projects. The challenge in short is a lot more about project planning, design and organisation than about financing per se.

Our national governments are not very good at solving these problems, either. Many of them lack the planning institutions for long-term, complex projects. During the 1980s and 1990s, public investment planning agencies were often supplanted by the privatisation of infrastructure, only to discover that the private sector was far less able than the public sector to structure complex projects because of lack of public legitimacy, regulatory tools and practical experience.

A second SDG financing challenge revolves around core public services and amenities including health, education and public housing. Health and education are of course an investment in human capital. In the low-income countries, the basic hard truth is that national budgets lack the funding necessary to provide decent healthcare services and quality education through to secondary schooling. Either the rich countries help poor countries to fund education and healthcare, or poor children will continue to die from preventable causes and to lack adequate schooling.

Without larger flows of development assistance, low-income countries won't come close to achieving universal health coverage (SDG 3) and 100% completion of secondary education (SDG 4). The rich world has long promised 0.7% of GNI in aid but typically delivers around 0.3% instead, for a shortfall of 0.4% of GNI. In today's terms, that

amounts to a gap of around USD 180 billion per year, easily enough to close the financing needs for health, education, and crucial local infrastructure (water, sanitation and electrification of all households). OECD countries must find alternative policy levers. Although not a substitute for ODA resources, one way to raise financing is to tap larger philanthropic flows from the world's billionaires. There are now 2 208 billionaires, according to Forbes magazine, with a combined net worth of USD 9.1 trillion. Even just 1% per year of this net worth would reap USD 91 billion per year.

The third financing challenge is to shift investment flows from unsustainable to sustainable technologies. The world currently invests around USD 700 billion per year in fossil fuel exploration and development. There are similar investments in unsustainable land use, such as timber and ranching in protected areas. Such investments are contrary to the SDGs and the objectives of the Paris Agreement. The challenge here is not so much financing as it is curbing the power of incumbent sectors. When higher levels of taxation are needed to fund public services and provide greater transfers to those in need, tax cuts are often preferred over crucial tax increases. While this may look like a financing challenge, it is actually more a political economy challenge: that is, moving beyond politics as usual to steer the economy through regulation, corrective taxes, public procurement and budget policies towards the SDGs.

The SDGs are therefore certainly not free from political contention. In addition to requiring more planning and forward thinking and more co-operation across regions and nations, the SDGs are a call for social justice. Achieving them requires a more equal sharing of income, wealth and power. Success will usher in a more prosperous, equitable, peaceful and sustainable world for current and future generations.

As demonstrated in this report, not all resources are contributing to sustainable development. The following chapter explores the ways in which better policies can help to ensure that greater amounts of financing are achieving greater sustainable development impact. Companies and investors, multilateral organisations, diaspora communities, local and regional actors, philanthropists, and traditional providers each have distinct roles that must be co-ordinated. To ensure an integrated and holistic approach to financing sustainable development, this chapter provides a way forward to manage the risks and seize opportunities.

Better policies are needed to move from mobilising to maximising financing for sustainable development

Commitments to development have long been measured in terms of resources mobilised. For decades, public sector resources (ODA) and more recently private sector resources (blended finance, etc.) have served as the basis for measuring financing in support of international development. The language and practice of major institutional actors have progressively shifted, reflecting the drive to maximise financing. The Development Committee of the World Bank Group (2017[10]), for instance, has moved to the concept of maximising finance for development or prioritising different kinds of financing tailored to the most appropriate development contexts.[1]

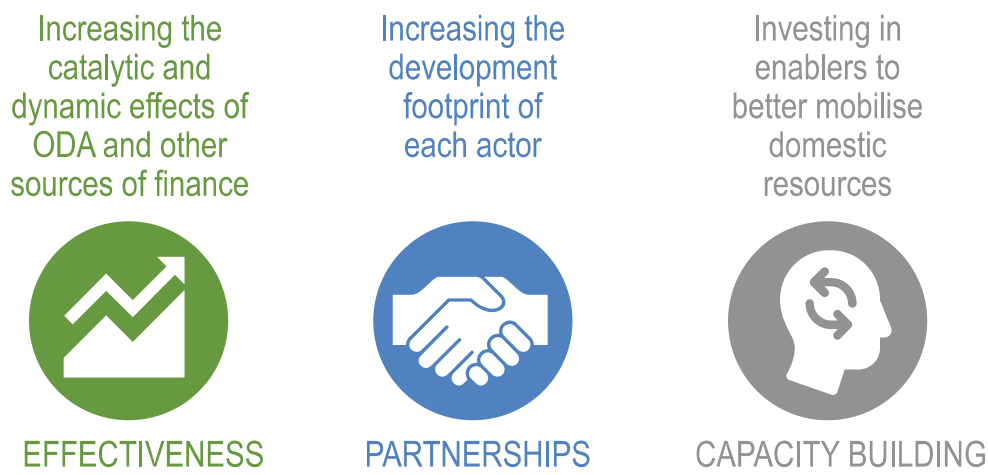
Local capacity to shift behaviours, leverage domestic resources and align financing with sustainable development needs is central to maximising resources. The AAAA framework recognises the importance of national ownership in efforts to strengthen mobilisation and effectively use domestic resources to achieve the SDGs (paragraph 20).

An example is the importance of redistributive levers such as tax to support national financing strategies.

There is a risk of generating negative spillover effects if larger amounts of private sector (or other) finance are mobilised without symmetric efforts to guide these amounts towards the SDGs. As noted in Chapter 2 and Chapter 4, the multiplication of actors has contributed to a dilution of responsibilities and SDG gaps are emerging. A three-pronged approach is therefore needed to achieve the objective of shifting the trillions to the SDGs (Figure 5.2):

- Effectiveness. From the Monterrey Consensus to the 2030 Agenda, the global agendas that guide the effectiveness of development co-operation have been extended to actors beyond traditional providers. The next frontier to strengthen effectiveness will rely on better sequencing of actions and roles among actors to maximise catalytic effects and achieve systemic impact.
- Partnerships. Next generation partnerships can serve to enhance the development footprint[2] of all actors based on shared value. Seizing one such opportunity, private sector actors increasingly are recognising the business case for the SDGs. Operationalising these partnerships will require platforms capable of leveraging respective strengths to achieve common goals.
- Capacity building. Investing in financing sustainable development enablers can help to unleash domestic resources and progressively reduce dependence on foreign financing sources. Creating a virtuous circle of financing can be achieved through ripple, or transformative, effects across key SDG sectors. These effects maximise the potential for developing countries to achieve self-sustaining finance over the long term.

Figure 5.2. Three opportunities to maximise the impact of financing on sustainable development



Source: Author

Better articulate the different sources of financing for sustainable development: A review of the role of external public funding

The potential for new synergies and catalytic effects (Chapter 3) has yet to be fully explored or tapped into. Nor are the catalytic effects of all public and private resources

and silos across the AAAA areas well understood yet (Bruno, Estrin and Campos, 2018[11]) (Bourguignon and Gunning, 2016[12]). However, there is general agreement that aid can be used catalytically to increase the volume of resources (e.g. crowding in) and/or to kick-start economy-wide impacts (e.g. dynamic effects).

But the question remains as to who, among all the FSD actors, should do what. A roadmap is missing to effectively leverage, sequence and deliver a broader array of public and private actors to achieve these effects (Rogerson, 2011[13]).

The development impact of a broader set of actors must be evaluated to maximise finance

Since the 2002 Monterrey Consensus, efforts to maximise development resources and improve outcomes have focused on raising the standard of self-assessments. Traditional providers have developed longstanding methods to improve self-assessments (Bigsten and Tenstam, 2015[14]). The Paris Declaration on Aid Effectiveness in 2005 and the Busan High Level Forum on Aid Effectiveness in 2011 represent important milestones to establish principles for self-assessment of the effectiveness of development co-operation. Additionally, over the past 20 years, the DAC Network on Evaluation has contributed to the creation of shared norms and standards for evaluation and capacity building for evaluation in developing countries.

The newest iteration of the aid effectiveness and development effectiveness agendas (Janus, Klingebiel and Paulo, 2014[15]) recognises that policies beyond those directly related to traditional development finance will have an impact on the development footprint of resources (e.g. South-South co-operation, trade and tax policy, private sector engagement). In 2011, for example, the United Kingdom Department for International Development (DFID) stated that it wanted "private sector thinking to become as much part of [our] DNA as our work with charities and governments" (DFID, 2011[16]).

Evaluation frameworks have been fine-tuned for compatibility across a broader range of actors. The Global Partnership for Effective Development Co-operation (GPEDC), which emerged from the Busan High Level Forum, became the core international mechanism to promote mutual accountability[3] through a monitoring framework of targets and indicators for the tracking of progress on development co-operation. Traditional providers, emerging providers and philanthropic organisations are increasing efforts to improve the mutual accountability of aid:

- The Nairobi outcome document of the High-level United Nations Conference on South-South Cooperation presented the first set of principles for South-South co-operation (UN, 2009[17]). The AAAA further emphasises the role of South-South and triangular co-operation in contributing to poverty eradication and sustainable development and stresses the need for further efforts to ensure effectiveness (paragraph 57).
- A growing number of philanthropic organisations recognise the need to scale up financial contributions by capitalising on other resources and capacities. In the United States alone, the evaluation capacity of philanthropic organisations has risen by 8% in the past six years and several actors are integrating the use of big data and pay for performance to strengthen evaluation techniques (Innovation Network, 2016[18]).

The next step to improve the effectiveness of aid will require consideration of how it targets cross-cutting policy objectives (reflected in the 2030 Agenda). Cross-cutting areas

will require additional efforts to integrate policy coherence within development programming, as discussed further in Section 5.3: Forward look. An example of one such effort underway, the French Development Agency (AFD) this year committed to ensure all development co-operation interventions are "100% Paris Agreement compatible" and consistent with low-carbon and climate-resilient development (AFD, 2018[19]).

Blended finance is a key lever to maximise financing for sustainable development

Development co-operation carried out jointly with the private sector provides new opportunities to extend the effectiveness agenda beyond aid. Today, more than half of all DAC members engage in blended finance. Ten of these members report having well-established programmes that have been in operation for a number of years and/or cover a range of instruments. The OECD (2018[20]) report on blended finance highlights important characteristics of several projects that help to connect private sector financing with sustainable development outcomes, including:

- **Enhancing local bond markets for WASH infrastructure.** The Water and Sanitation Pooled Fund[4] finances municipal water, sanitation and hygiene (WASH) infrastructure in the state of Tamil Nadu, India. The project enhanced the local bond market, advanced WASH infrastructure development, and thus contributed to SDG 9 (industry, innovation and infrastructure) and SDG 11 (sustainable cities and communities).
- **Reducing debt burdens to finance polio vaccines.** The Japan International Cooperation Agency and the Bill & Melinda Gates Foundation recently implemented a loan conversion programme to help developing countries pay for polio eradication. The programme supports SDG 3 (good health and well-being), with approximately 460 million polio vaccination doses procured to vaccinate children under the age of five in Nigeria alone from 2015 to 2017.
- **Strengthening microfinance institutions that contribute to job creation.** The Microfinance Initiative for Asia is a USD 175 million, private-public structured fund focused on refinancing Asian microfinance institutions that operate sustainably.[5] The initiative contributes notably to SDG 8 (decent work and economic growth) and SDG 17 (global partnership).

Better policy safeguards are needed to create an enabling environment that promotes quality blended finance aligned to sustainable development objectives and minimises the risks associated with private sector engagement. The Global Partnership for Effective Development Co-operation, in a 2016 progress report,[6] underscored the potential for development co-operation actors to partner with the private sector in developing countries, in particular to improve the legal, regulatory and administrative environment for private investment and to ensure a sound policy and regulatory environment for public-private partnerships (OECD-UNDP, 2016[21]). The implementation of public-private dialogues at country level is explored further in Chapter 6.

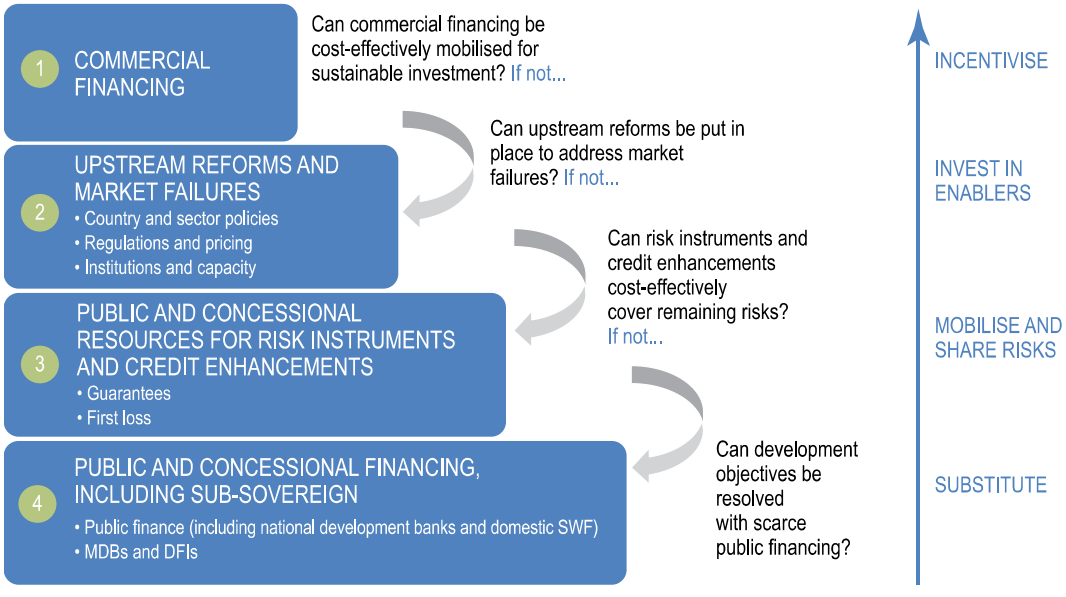
Beyond mobilisation, the catalytic and dynamic effects of public-private co-operation remain underexplored

Current attempts to maximise effectiveness largely omit the catalytic and dynamic effects of financing (Chapters 3 and 4). Maximising systemic effects requires the creation of market opportunities. The cascade approach prioritises commercial private resources as a first course of action in cases where these resources can be mobilised effectively in

support of sustainable development. Scarce public finance is provided as a last resort. The aim of sequencing public and private financing is to ensure the most efficient use of resources by tailoring them to the local investment and regulatory environment, governance and institutional capacity, and development needs. The "In My View" piece by Stephanie von Friedeburg in Box 5.3 provides insights from the International Finance Corporation (IFC) into the potential systemic impact of successful implementation of the cascade approach.

OECD members' role in the cascade is to adapt support to minimise the risks and help to correct market failures – from upstream support to incentivise private sector engagement and support regulatory governance frameworks to downstream support to supplement domestic resources with concessional finance when necessary. Figure 5.3 shows how this role can play out. In the two extreme situations in this figure, shown as scenarios 1 and 4, either the private sector or the public sector entirely fill the demand for FSD. In between, public resources are used to create markets and move to another equilibrium through capacity building (scenario 2) or risk sharing (scenario 3).

Figure 5.3. OECD members' role in the cascade approach



Source: Based on World Bank Group (2018[22]), Approach Paper "Creating Markets for Sustainable Growth and Development" 2018, https://ieg.worldbankgroup.org/sites/default/files/Data/reports/ap-creating-markets.pdf.

Box 5.3. In My View: Implementing the cascade approach and creating markets strategies, by Stephanie von Friedeburg, IFC Chief Operating Officer

The world has made impressive development progress in recent decades, but the gains have been uneven. While the extreme poverty rate has continued to fall globally, just under 800 million people lived on less than USD 1.90 a day in 2013, the latest year for which global data are available. While South Asia and sub-Saharan Africa make up the bulk of global poverty, African poverty is of particular concern given its sheer depth, with many living well below the international poverty line. Meanwhile, access gaps in education, health and infrastructure continue to persist, while income inequality in many developing countries has been on the rise.

These challenges, and others such as climate change and conflict, must be addressed for the world to deliver on the promise of the 2030 Agenda for Sustainable Development. The Sustainable Development Goals (SDGs) represent an ambitious and holistic vision to foster inclusive and sustainable development with scaled-up impact. However, financing the goals will require a shift from billions in official development assistance to trillions in investments of all kinds by unlocking, leveraging and catalysing public and private resources. Estimates vary, but clearly trillions will be needed annually to finance the needs of developing countries, a big share of which will be for infrastructure.

Since the Addis Ababa conference on financing for development (FfD) in 2015, IFC has worked closely with the United Nations, confirming the central role of the private sector in achieving sustainable development and delivering on the 2030 Agenda. Most importantly, though, our contribution is being made through a novel approach to FfD.

Our work on the "Billions to Trillions" agenda has made clear that we need to rethink development finance. IFC and our colleagues across the World Bank Group are meeting the challenge with our "Maximizing Finance for Development" approach. This involves a decision making "cascade" that prioritises private sector solutions to promote the judicious use of scarce public resources. Where markets are not conducive to private investment, we focus on reforms that address market failures and other constraints to private sector solutions at the country and sector level. Where investment risks remain high, we apply de-risking instruments such as guarantees and risk-sharing facilities. Only where market solutions are not possible will official and public resources be used.

At the core of IFC's strategy is our "Creating Markets" approach. To promote private sector development, we aim to create new markets or expand the pro development attributes of existing markets in a significant and systematic way. We are guiding structural reforms to facilitate private investment, address market and institutional failures, and strengthen regulatory conditions and the rules governing competition. We are working across the World Bank Group to deliver advice, investment and mobilisation. Country private sector diagnostics are used to improve policy and legal frameworks, and project preparation support is deploying private sector

solutions and helping mobilise new forms of private capital.

Our cascade and Creating Markets strategies are yielding results. Take the World Bank Group's efforts to bring affordable housing to West Africa, where the population is projected to double over the next two decades. Working through the regional mortgage refinance company, Caisse Régionale de Refinancement Hypothécaire (CRRH), IFC and the International Development Association (IDA) are expanding the mortgage market in the West Africa Economic and Monetary Union. IFC invested in the company's equity, supported its long-term bonds and provided advice to improve its lending processes. Our investment will enable the company to expand its portfolio of housing loans by USD 500 million while deepening the local bond market. At the same time, IDA helped the company refinance mortgages to lower-income groups. With World Bank Group support, CRRH is also working with government and regulatory bodies to implement mortgage market reforms that harmonise standards across West Africa. The result of the combined intervention: more mortgages and more people in more homes.

We are confident the world can make significant progress over the SDG period. But it will take deep and lasting partnerships, and it will require the development community to make the most of its resources, leveraging its own funds and official development assistance to attract much more financing from the private sector. IFC's strategy takes this approach and systematises it throughout its operations.

Increase the development footprint of the private sector through next generation partnerships

Opportunities exist to operationalise partnerships with a wider array of actors who are pursuing their own interests while also maximising their value added in support of collective goals. Global companies, impact investors, emerging economies, multilateral organisations and local actors all hold the potential to contribute to sustainable development outcomes. OECD members have a role to play to facilitate next generation partnerships among actors by creating a platform for market-making and the creation of shared value in the financing sustainable development system aligned to the SDGs.

For example, trade facilitation, technology transfers, innovation, etc. depend on both legal/regulatory environment (public) and business behaviour (private). The same holds true for gender, social standards and many other policies. As the private sector recognises the business case for the SDGs, new forms of win-win partnerships are emerging that allow for increasing their development footprint.

Next generation partnerships must leverage shared value across actors in support of sustainable development

Next generation partnerships aim to maximise the value added of all actors based on shared value creation. An example is the Shared Value Initiative,[7] which recognises business opportunities in social challenges. Kramer and Porter (2011[23]), creators of the initiative, argue that "shared value is not social responsibility, philanthropy, or sustainability, but a new way for companies to achieve economic success". Another

example is the Danone Ecosystem Fund, which works in close partnership with local non-governmental organisations (NGOs) to connect business with social returns and aims to strengthen value chains by improving the economic, social and environmental ecosystem, from sourcing to distribution.[8]

To operationalise next generation partnerships, actors must take a whole-of-value chain approach to sustainable development. Questions about procurement and tied aid, among others, have long overshadowed the role of business in the FSD system. Changes have occurred. Governments have an important role to play in promoting responsible business conduct and in promoting and facilitating investments with qualities that align with the SDGs. The objective should be to increase the development footprint of business or investment, and initiatives along global value chains that could simultaneously involve donors, local governments, private business, investors, philanthropists and civil society organisations.[9]

Opportunities exist to scale up best practices in support of the SDGs through platforms that bring together diverse actors. For example, global lithium-ion battery production is predicted to increase significantly and global demand is set to double by 2025. At the same time, the promotion of sustainable development depends on capacities to ensure that the production and recycling of the global battery stock do not harm the environment. In this way, partnerships must create a mutually-reinforcing dynamic in support of both SDG 7 (affordable and clean energy) and SDG 12 (responsible consumption and production). Box 5.4 presents other examples of platforms that operationalise next generation partnerships.

Box 5.4. Next generation partnerships create shared value for the Sustainable Development Goals

Global Battery Alliance

SDG 7 (responsible energy) and SDG 12 (responsible consumption)

The Global Battery Alliance, initiated at the World Economic Forum Sustainable Development Impact Summit in 2017, seeks to accelerate action towards a battery value chain that benefits sustainable development. It brings together leading businesses from the entire battery value chain, governments, international organisations and NGOs. Analysts project that a 12-fold increase in battery capacity is needed to meet beneficiary demand and the promise of a low-carbon economy. The market is likely to reach USD 100 billion by 2025 and batteries installed in homes and businesses will account for 57% of the world's energy storage capacity by 2040. In 2014, all electronic waste discarded was worth USD 52 billion. This waste contained 300 tonnes of gold and significant amounts of silver and palladium.

Moving towards a circular economy for battery production requires shifting actions along the value chain. The chain can be optimised for greater development impact. Sustainable solutions can be put into action starting with the initial stage of raw material extraction in developing countries (e.g. child labour laws, health and safety standards) and extending to recycling such as through fostering a circular economy for the 11 million tonnes of lithium-ion forecast to be discarded by 2030.

Source: World Economic Forum (2018[24]) Global Battery Alliance, https://www.weforum.org/projects/global-battery-alliance. World Economic Forum (n.d.[25]), Cleaning up battery supply chains, https://www.weforum.org/our-impact/cleaning-up-battery-supply-chains.

Australia's Business Partnerships Platform

SDG 8 (better jobs) and SDG 12 (responsible consumption)

The Business Partnerships Platform (BPP) is founded on the concept of shared value – that business can deliver sustainable social impact while achieving commercial returns. Firms can create shared value opportunities by:

- reconceiving products and/or markets
- redefining productivity in the value chain
- enabling local cluster development.

Consistent with the gender equality and women's empowerment strategy of the Department of Foreign Affairs and Trade, BPP initiatives must positively impact gender equality by promoting women's economic empowerment; enhancing women's voice in decision making, leadership and peacebuilding; and/or ending violence against women and girls. To show this, applicants include analysis of the gender dynamics, i.e. the specific experiences of women and men, and how these will be impacted by the initiative.

Source: OECD (2018[26]) "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm.

Grow Africa Partnership Platform

SDG 15 (life on land) and SDG 12 (responsible consumption)

The Grow Africa Partnership Platform aims to realise the potential of the agriculture sector for economic growth and job creation, particularly among farmers, women and youth. It was founded jointly in 2011 by the African Union, the New Partnership for Africa's Development (NEPAD) and the World Economic Forum, and is funded by USAID. More than 200 companies and governments in 12 countries are part of Grow Africa, which promotes responsible investments by fostering an environment in which companies can achieve competitive advantage from delivering positive impacts while mitigating negative ones.

Grow Africa's core work is to convene public and private sector partners around the collective goal of addressing weaknesses in value chains and market systems, thereby reducing the risks and costs of investing in African agriculture. This work helps companies to take a longer-term view on their investments and embrace commercial strategies that build shared value with the communities and stakeholders around them, including through job creation, increased incomes, and better access to affordable and nutritious food.

For example, in 2015, companies reported that their investment commitments resulted in over 10.4 million smallholders being reached through sourcing, services or training. These investments created over 30 000 jobs in 2015.

Source: Grow Africa (n.a.[27]), Grow Africa Partnership, https://www.growafrica.com/about/who-we-are.

Korea's Inclusive Business Solution Program

SDG 9 (sustainable infrastructure) and SDG 12 (responsible consumption)

Since 2016, KOICA is providing the Inclusive Business Solution (IBS) program. The IBS programme aims to help achieve SDGs by leveraging private sector expertise and strategies, and corporate social responsibility (CSR) funding to complement traditional ODA resources and create value chains in industries of developing countries. The partnership also seeks to promote small and medium-sized inclusive business model that engages local key economic players as sellers, manufacturers, employers and labourers.

Companies participating in IBS program share the expense with KOICA. By size of companies, large-size companies and middle-size companies bear 70% and 50% of the cost respectively. Meanwhile, mid-and-small size companies and social enterprises share 30% and 20% of cost respectively. In 2016, KOICA mobilised private financing that reached KRW 5.7 billion.

Source: OECD (2018[26]) "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm .

Build capacity to reduce dependence on foreign aid: The role of domestic resources

Operationalising the partnerships discussed above requires strengthening local capacity, including national policy frameworks for investment (PFIs) to better harness potential sources of external financing for sustainable development. At the 2018 G7 Summit, development and finance ministers said in a statement that they "stressed the importance of strengthening the capacities for public financial management, and underscored the importance of domestic resource mobilisation, including effective tax administration, to advance sustainable development in developing economies".[10] Some domestic enablers that can unleash the potential of beneficiary countries include capacity building for domestic resource mobilisation, aid for trade programmes and information and technology (IT). Further discussion of enablers is presented in Chapter 3.

Yet there is no clear classification or ranking of enablers that providers of financing for sustainable development should aim to deliver as countries undergo development transition. The enablers to improve investment climate and business environment include investment in quality infrastructure and technologies, aid for trade, domestic resource mobilisation, private sector development, competition and regulatory reforms. The economic literature[11] and donors have assigned different roles and priorities to the various enablers.

The current mandate of OECD DAC reflects a shift to better respond to these challenges. It aims to secure a future in which no country will depend on aid and recognises this will require support to strengthen long-term financing capacities, as endorsed by the 2017 High Level Meeting (OECD DAC, 2017[28]). USAID recently committed to "ending its need to exist" by developing a new strategic approach to more systematically build countries' capacity to "plan, finance and manage their own development".[12] A key component of what USAID has called its "journey to self-reliance" framework is a set of metrics that will help through strategic planning to assess each country's progress along its journey and help to inform thinking about strategic transitions.

Investing in domestic resource mobilisation requires a more holistic approach

Direct budget support, technical assistance and capacity building are traditional ways of supporting domestic resource mobilisation. However, there is a need for support to target the broader enabling environment[13] for domestic resource mobilisation. As the "In My View" piece: Is 'maximising finance for development' selling out to the private sector?" in Box 5.5 argues, strong and transparent government is a prerequisite to mobilise resources, including from the private sector.

Box 5.5. In My View: Is "maximising finance for development" selling out to the private sector? by Caroline Heider, Director General, Evaluation, IEG, World Bank Group

Since 2015, a common mantra in development circles has been the mobilisation of the private sector. How can "they" (the many actors in the private sector that is) contribute more to the development endeavours of so many countries around the world?

At the forefront of this discussion has been the money. The 2030 Agenda requires more funding than official development assistance and public sector investments could ever invest. But other good reasons exist. The private sector brings the power of innovation, which is badly needed to address Sustainable Development Goals with inherent resource conflicts and to deliver better and cheaper service delivery to people.

So, is the wholehearted embrace of the private sector into development "selling out" to profiteering companies that pay their bosses extraordinary bonuses and contribute to the increasing inequality? Ever sharper inequality where a few families own as much wealth as half of the world's population, lobbyists who ensure policies favouring industry interests, and an increasing sense of disempowerment - all have understandably triggered fears and strong reactions among people in many countries.

For me, some of the most important lessons from the work we have done at the Independent Evaluation Group point to the need for a holistic approach that ensures all parts of society play an important role. Mobilising the private sector is not possible without a strong, transparent public sector.

Over the years, the World Bank has loaned billions of dollars to client countries to invest in private sector development.

Evaluations that we have undertaken, including on competitiveness and jobs (2016), capital markets (2016), reform of business regulations to improve investment climate (2014), small and medium-sized enterprises (2013), and support for public-private partnerships (2013) have shown that private sector development always requires strong government. This does not mean strong in the sense of all-pervasive governments and state-owned enterprises.

Instead, strong governments are those that act responsibly with the capacity to:

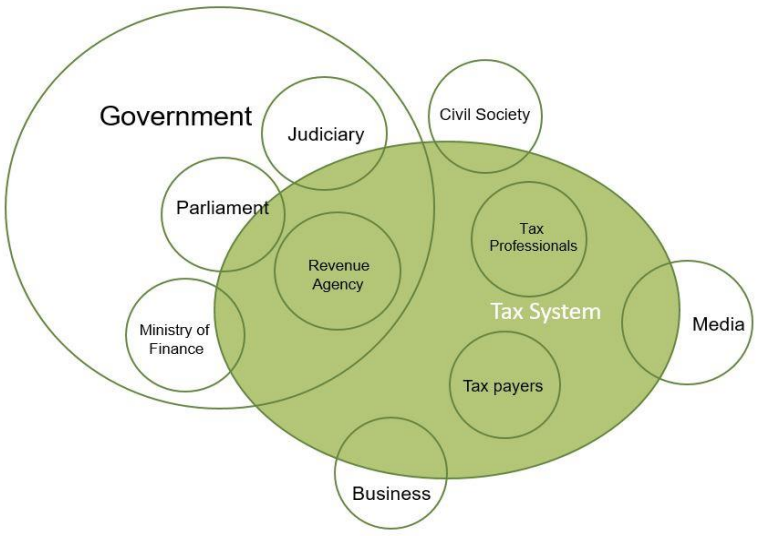
- develop and pursue clear policies
- create a level playing field for all actors
- manage and oversee contracts with the private sector to deliver services
- determine and implement fair tax policies
- efficiently manage public resources
- monitor development progress
- evaluate the effectiveness of policies and programmes

Why is this important for "maximising finance for development"?

It is strong institutions that create a transparent and level playing field. Private investors, from large international to small domestic investor and anything in between, thrive in steady and predictable environments. They need strong governments that play their part. For instance, most public-private partnership deals fall through because government capacity and commitment are lacking. Private investments will not be mobilised in the absence of clear policy frameworks.

Strengthening domestic revenue mobilisation will depend on support to a range of public institutions, including many not directly involved in domestic revenue generation. Figure 5.4 illustrates that in a holistic approach, such institutions indeed extend far beyond a country's revenue authority – across all branches of the government and to businesses and civil society. In addition to direct support to tax authorities, for example through the Addis Tax Initiative, deep-rooted commitment to reform across society is needed to sustain increases in revenues raised.

Figure 5.4. A holistic approach to strengthen revenue systems



Source: IMF-OECD-UN-World Bank Group (2016[29]), *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries,* http://www.oecd.org/tax/enhancing-the-effectiveness-of-external-support-in-building-tax-capacity-in-developing-countries.pdf.

Additionally, to be effective, the Addis Tax Initiative commitment to double spending on tax capacity building needs to do more than just double spending along existing lines; it must also support building capacity across all the actors in the tax system. As tax systems depend significantly on voluntary compliance, building tax morale among taxpayers is a vital part of domestic revenue mobilisation. Even within more traditional concepts of tax capacity building, significant potential still exists for new approaches to improve results. An example is Tax Inspectors Without Borders (Box 5.6).

Box 5.6. Tax Inspectors Without Borders

Tax Inspectors Without Borders (TIWB), a joint initiative of the OECD and the United Nations Development Programme (UNDP), is a recent innovation in the niche of international tax audit assistance. TIWB is primarily focused on addressing base erosion and profit shifting issues and abusive tax avoidance by some multinational enterprises.

TIWB experts provide audit support for transfer pricing and international tax audits as well as advance pricing agreements across a broad number of commercial sectors. The objective is to assist developing countries to become self-reliant in auditing multinational enterprises. TIWB experts provide practical hands-on assistance by working alongside local tax officials on current tax audits and international tax issues.

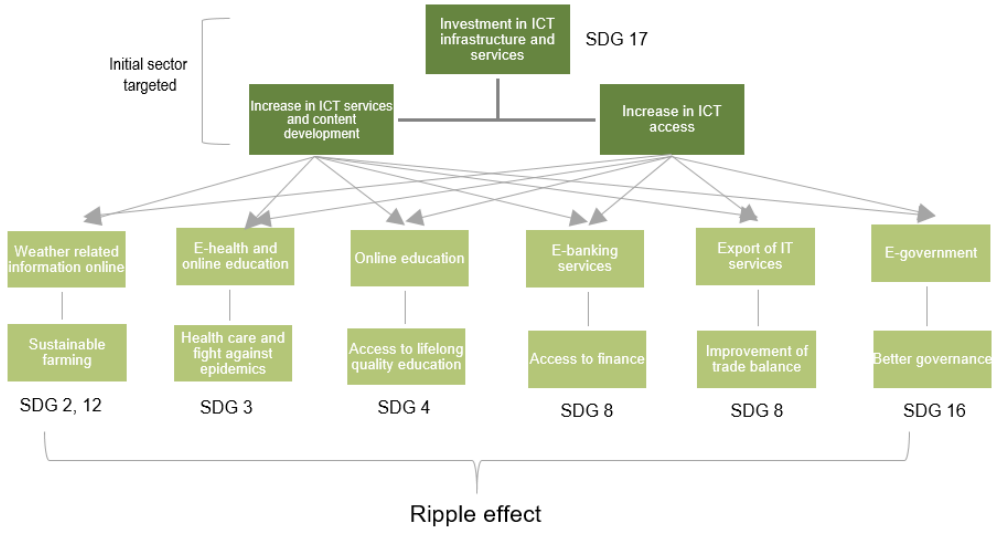
Demand for TIWB continues to grow. There are 44 ongoing or completed programmes worldwide and over 20 programmes in the pipeline. The objective remains 100 programmes by 2020. To date, USD 414 million in increased tax revenues are attributable to TIWB support offered in partnership with the African Tax Administrations Forum and the World Bank Group.

TIWB represents value for money: on average, more than USD 100 in additional tax revenues have been recovered for every USD 1 spent on operating costs. While revenue impact is important, TIWB also has gathered evidence of other long-term outcomes, including skills transfer, organisational change and taxpayer compliance. TIWB programmes complement the broader efforts of the international community to strengthen co-operation (including South-South) on tax matters and contribute to domestic resource mobilisation efforts.

Aid for trade is another means to further increase domestic resources. It can encourage more inclusive private sector engagement to promote job creation and can extend the positive effects of trade – whether in terms of technology transfers, tax revenue, competition or other effects - across the economy. To leverage the role of the private sector, aid for trade can help developing countries in economic upgrading and removal of barriers to more comprehensive private sector investment (World Bank, 2011[30]). In this regard, the Enhanced Integrated Framework (EIF), which was launched in 2007, aims to ensure a more inclusive global trading system for least developed countries. The EIF targets supply side constraints to trade including productive capacity, infrastructure and trade diversification (EIF, 2017[31]).

Targeting support to ICT is also necessary to raise domestic resources, most directly through the enabling of improvements in tax administration and more notably by generating ripple effects in the SDG-related sectors**.** SDG 17 calls for support to ICT, particularly in least developed countries. ICT investments have far-reaching effects across the economy. By encouraging private investment in ICT infrastructure, for example, the government of Ghana was able to trigger digital transformation in other key strategic sectors such as agriculture, health, financial services, education and government (SDGs 3, 4, 8, 12 and 16) and give rise to new services such as e-health, e-learning and mobile banking. Figure 5.5 shows some of the broad catalytic effects of support to the IT sector.

Figure 5.5. Ripple effects of support to the ICT sector across SDGs



Source: World Bank Group (2017[32]), *Creating Markets in Ghana: Country Private Sector Diagnostic,* https://www.compactwithafrica.org/content/dam/Compact%20with%20Africa/Countries/Ghana/CPSD-Creating-Markets-in-Ghana-Nov-2017_v1.pdf.

Financing for sustainable development enablers must also support efforts to better direct domestic resources toward the SDGs

While it is important to generate domestic resources, it is equally important that these resources are retained and effectively guided in support of SDG implementation. Significant amounts of resources generated in developing countries are not deployed for development outcomes in those countries. By some estimates, the informal sector can account for over half of GDP and employment in low-income countries (Pratap and Quintin, 2006[33]). Development partners can help developing countries make the link between tax revenue and development outcomes, as discussed in (Box 5.7).

Box 5.7. Better collecting and spending of domestic resources

The European Union delivers the Collect More, Spend Better approach that promotes sound domestic public finance systems to foster effective domestic revenue collection and use. "Collect more" in this context means increasing the efficiency, effectiveness, fairness and transparency of tax systems while also tackling tax avoidance, tax evasion and illicit financial flows. "Spend better" means improving the efficiency and effectiveness of public spending by addressing public investment expenditures, public procurement and debt management for sustainable development. The approach is a key contribution to the Addis Tax Initiative.

A lack of governance mechanisms to guide resources through productive or redistributive channels is often the reason the informal sector in many developing economies is so pervasive (World Bank, 2016[34]) (de Soto, 1989[35]). A study on employment in the informal economy shows that the perception of government corruption can negatively

impact tax revenue and increase the size of the informal sector, thus diverting potential resources from financing sustainable development (Williams, 2014[36]).

The promotion of greater transparency can help to increase accountability for public spending directed to the SDGs. The Extractive Industries Transparency Initiative (EITI), for instance, sets the global standard for transparency across value chains in the oil, gas and mining sectors by requiring governments to strengthen reporting on their legal framework, revenue allocation, social and economic spending, and other pertinent areas.[14] The EITI includes 51 reporting countries and represents USD 2.44 trillion in government revenues disclosed in open data formats (Paris, 2011[37]).

Better policies to increase the efficiency of the sustainable development market

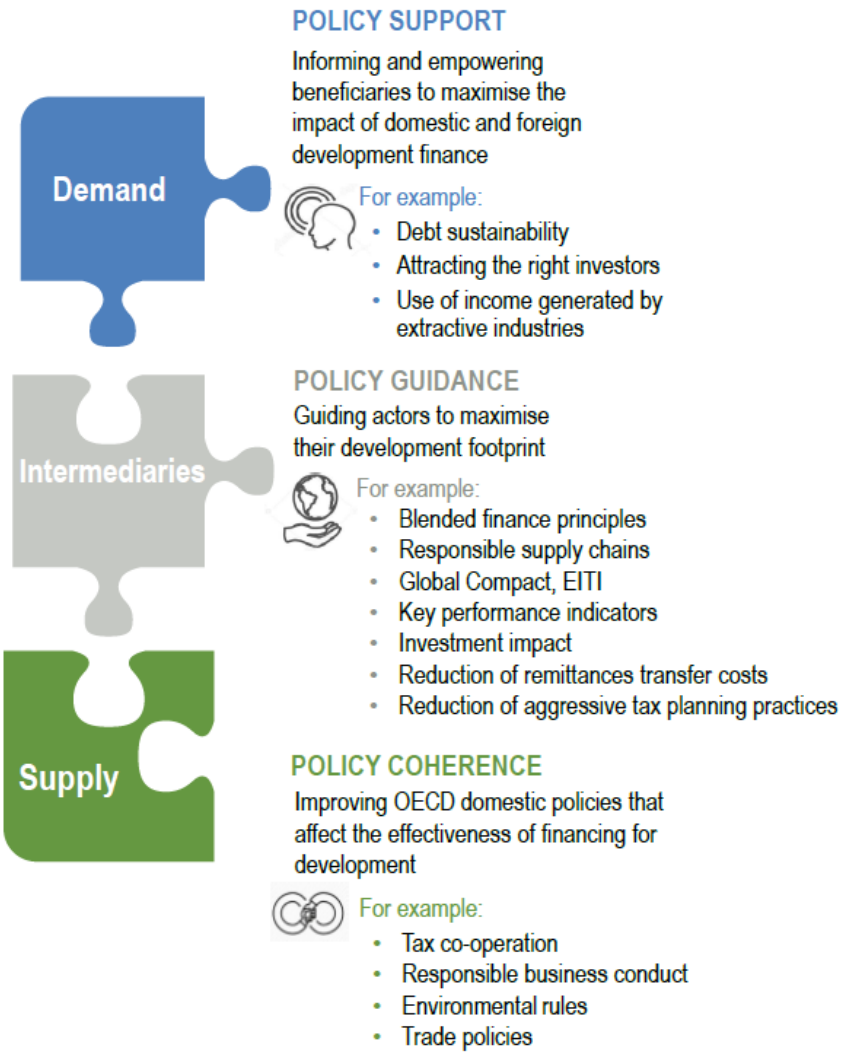
There are two ways, at least, to see the complexity of the FSD system. In a positive light, competition within the FSD system can help to drive innovation, tailor financing to the needs of beneficiary countries, and promote higher development returns on financing. From a negative perspective, the system can be seen as a market that is not mature, lacks transparency, and also lacks policy guidance and coherence mechanisms to tackle asymmetries of information (e.g. availability of instruments or the best financing mix) and emerging policy gaps (e.g. debt sustainability, development impact metrics for investors). To minimise the risk of setbacks in this market, then – for instance, a setback such as high-risk debt levels policy levers must be used at the level of beneficiaries (customers), intermediaries and suppliers. In this way, the proper functioning of the market can be ensured, meaning that each dollar spent is maximised in support of sustainable development.

Indeed and as noted in Chapters 2 and 3, some of the risks associated with recent changes in the FSD system suggest that this financing for sustainable development market is not yet mature. Addressing these risks requires better policies at these three beneficiary levels and raise related questions:

- **Policy support to beneficiaries.** Developing countries create the demand for a more diverse choice of financing sustainable development resources. How can OECD members help to promote the transparency of terms and conditions of new sources of financing? Which incentive frameworks are needed to ensure that beneficiaries can maximise the contribution of new actors to finance their sustainable development strategies?
- **Policy guidance to the intermediaries.** Intermediary actors and tools connect demand with supply, and can be on either the provider or the beneficiary side. Intermediaries are not always aligned in support of the SDGs. How can OECD members strengthen voluntary and regulatory frameworks so they are more comprehensive and inclusive and integrate a wider array of actors to fill the demand for sustainable development? How can existing policy guidance mechanisms help to ensure more effective safeguards?
- **Policy coherence of providers.** Providers of financing for sustainable development, including OECD members, are beginning to recognise that domestic policies have an impact on sustainable development. How are OECD members integrating the universal 2030 Agenda into domestic policy and how can they better deliver the policy coherence needed to ensure collective success?

Figure 5.6 illustrates the broad range of potential benefits of policy support, guidance and coherence for the FSD market.

Figure 5.6. The role of policy in the financing for sustainable development market



Source: Author

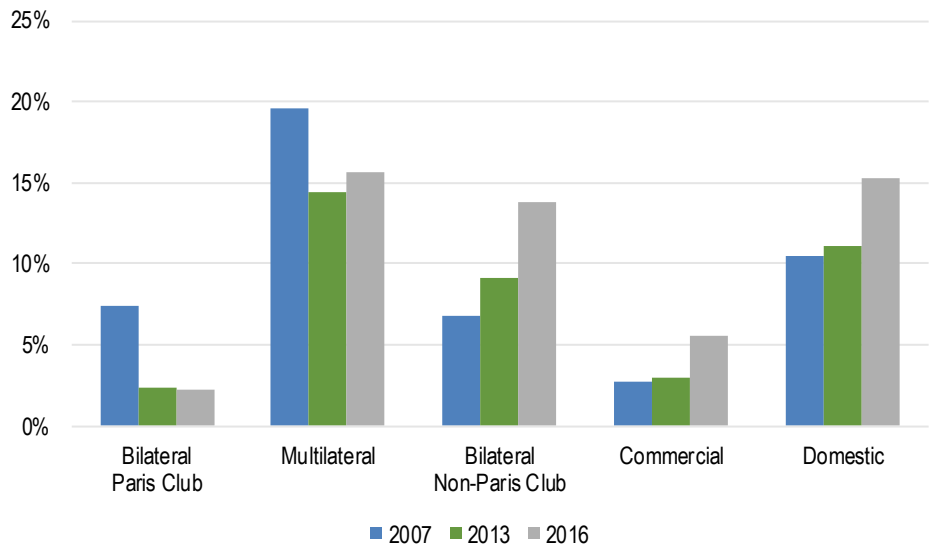
Better policy support is needed to inform decision making by beneficiaries of sustainable development finance

Continuing the market analogy, this "customer" protection part of regulation focuses on ensuring beneficiaries are best placed to make the most of available choices. As countries transition along their development continuum and access new financial resources and instruments (Chapter 3), financing must not come at the cost of sustainable and inclusive development.

Debt sustainability safeguards and transparency are needed to manage new sources of financing

Growing access to debt finance from a large array of actors is raising debt sustainability as an immediate challenge in transition economies. Since the financial crisis and the more recent collapse in commodity prices, there has been a sharp build-up of debt by low-income countries. A (2018[38]) IMF report finds 40% of low-income countries, or 24 out of 60, are now either in a debt crisis or highly vulnerable, twice as many as only five years ago. Moreover, as illustrated in Figure 5.7, commercial investors and bilateral non-Paris club lenders' share of debt in low-income countries has doubled over the 2007-16 period, reaching eight times the amount of debt held by Paris Club members (Ahmed, 2018[39]) (IMF, 2018[40]). The increased appetite of sovereign borrowers, particularly for infrastructure financing, has been facilitated mainly by commercial lenders and other bilateral lenders, particularly lenders beyond the Paris Club with lower levels of transparency. Box 5.8 presents the importance of debt sustainability to finance infrastructure.

Figure 5.7. Total public and publicly guaranteed debt by creditor in low-income developing countries, % GDP



Note: Data only available for 2007, 2013 and 2016.
Source: Author based on IMF (2018[41]), "Macroeconomic developments and prospects in low-income developing countries", https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/03/22/pp021518macroeconomic-developments-and-prospects-in-lidcs.

StatLink https://doi.org/10.1787/888933853262

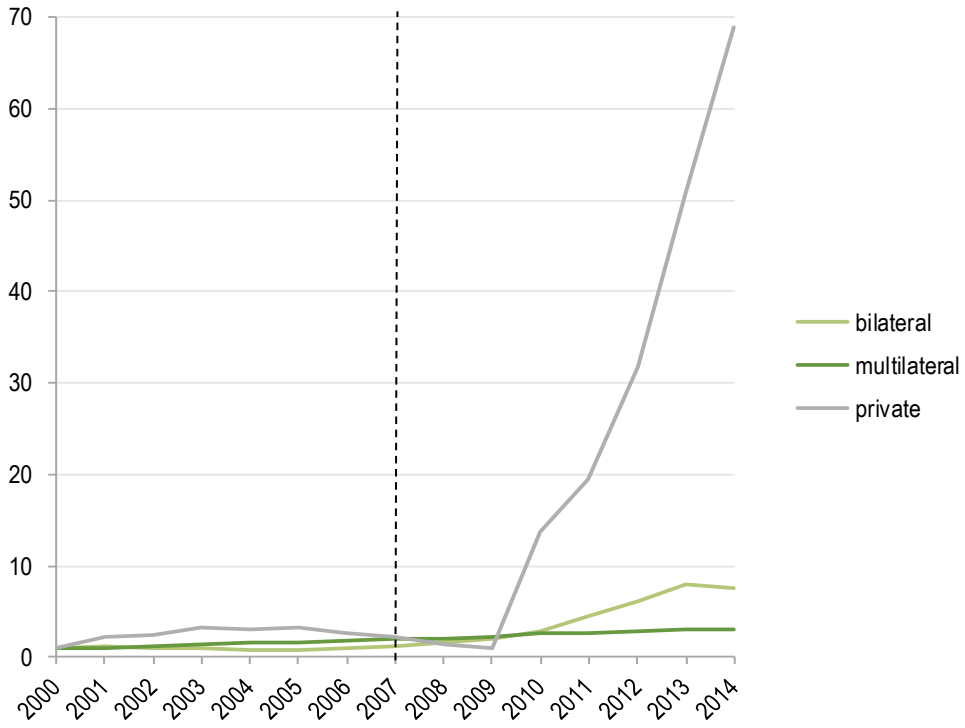
Box 5.8. One Belt, One Road initiative provides new sources of debt financing for infrastructure needs

The Chinese One Belt, One Road initiative – also called the Belt and Road Initiative (BRI) – includes USD 8 trillion in infrastructure investment targeting Asia, Africa and Europe that can help to fill the USD 26-trillion infrastructure gap in Asia alone. These levels are modest compared to total infrastructure financing needs and represent less than 1.5% of GDP per year in the 23 BRI countries. A 2018 study (Hurley, Morris and Portelance[42]) finds that the BRI is unlikely to set off a wide scale debt crisis but could significantly raise the risk of debt distress for at least eight developing countries, particularly those with rapidly increasing debt-to-GDP ratios beyond 50%-60%. These countries are Djibouti, Kyrgyzstan, Lao PDR People's Democratic Republic, Maldives, Mongolia, Montenegro, Pakistan and Tajikistan. Lack of data and information regarding many of the BRI transactions present a major challenge to securing the debt sustainability of these countries. As the initiative moves ahead, international mechanisms must work to further incentivise transparency and adherence to international frameworks for collaboration.

Source: (Hurley, Morris and Portelance, 2018[42]).

As countries gain access to new kinds of financing, it is crucial that debt levels are effectively managed to ensure sustainable economic growth. For example, Cabo Verde's graduation out of the least developed country category in 2007 fostered the perception internationally of a lower risk environment, resulting in increased multilateral debt stocks (up by 50%, or USD 682 million) and increased bilateral debt stocks (5 times , or USD 600 million, higher). This also resulted in soaring private debt (32 times, or USD 379 million, higher), Figure 5.8 shows. In the wake of this acceleration in debt financing, which exceeded by 13% the threshold set by the IMF, Cabo Verde's external debt was classified as high risk for the first time in 2016 (IMF, 2016[43])

Figure 5.8. External debt stock growth by origin of flows, Cabo Verde, Index, 2000=1



Note: In 2007, Cabo Verde graduated from the LDC category.
Source: World Bank (2017[44]), "World Bank international debt statistics". https://data.worldbank.org/products/ids.

StatLink https://doi.org/10.1787/888933853281

To address these concerns, recent international discussions emphasise the importance of ensuring renewed global co-operation and standards to safeguard debt sustainability, with some suggesting that a version 2.0 of the Heavily Indebted Poor Country (HIPC) Initiative is needed.[15] OECD members can play a role in renewing international co-operation to secure debt sustainability standards, for example by better informing beneficiaries of financing options and potential trade-offs. Rules on transparency and debt sustainability of development finance (e.g. Blended Finance Principles) and agreement of lending principles (e.g. OECD Working Party on Export) are evidence of this important role (Box 5.9). Members have since 2008 adhered to a set of principles and guidelines to promote sustainable lending practices in the provision of official export credits to lower income countries. Design of innovative financing solutions (e.g. non-debt based instruments) are an important first step.

Box 5.9. Strengthening principles to promote debt sustainability

At the 2017 High Level Meeting, OECD DAC members adopted the voluntary Principles for Unlocking Commercial Finance for the Sustainable Development Goals, thereby acknowledging the importance of transparency and adapting finance to the local context. However, principles to secure debt financing over the long term must adhere to internationally recognised frameworks to also secure debt sustainability, such as the IMF Debt Sustainability Framework for Low-Income Countries (LIC DSF). Further work must be carried out to ensure that the issue of debt sustainability is sufficiently integrated into Blended Finance Principles.[16]

Greater transparency is essential to reduce leakages and raise domestic resources

There is a growing risk that efforts by developing countries to attract investors to local markets could come at the cost of sustainable development progress. Developing countries compete to attract FDI, which often benefits the local economy through economic diversification gains, knowledge and technology spillovers, new management practices, job creation, and improved conditions in less-developed areas (Blomström and Kokko, 1998[45]).

Greater transparency of investment can prevent finance for sustainable development leakages and raise domestic value added. The recent policy toolkit released by the Platform for Collaboration on Tax recommends improving the governance and transparency of tax incentives to increase tax visibility and stability in developing countries and to avoid rent seeking and opportunistic behaviours (IMF-OECD-UN-World Bank, 2015[46]).

OECD countries can help to increase domestic value added in developing countries and improve local standards by promoting greater transparency of sustainability impact. For example, the Competitive Business Program, launched in 2016 by the Global Reporting Initiative (GRI) and the Swiss State Secretariat for Economic Affairs, aims to help small and medium-sized enterprises in developing countries to increase competitiveness through better transparency in sustainability reporting, which helps to avoid FSD leakages.[17]

Tailored policy guidance and tools for sustainable development finance providers

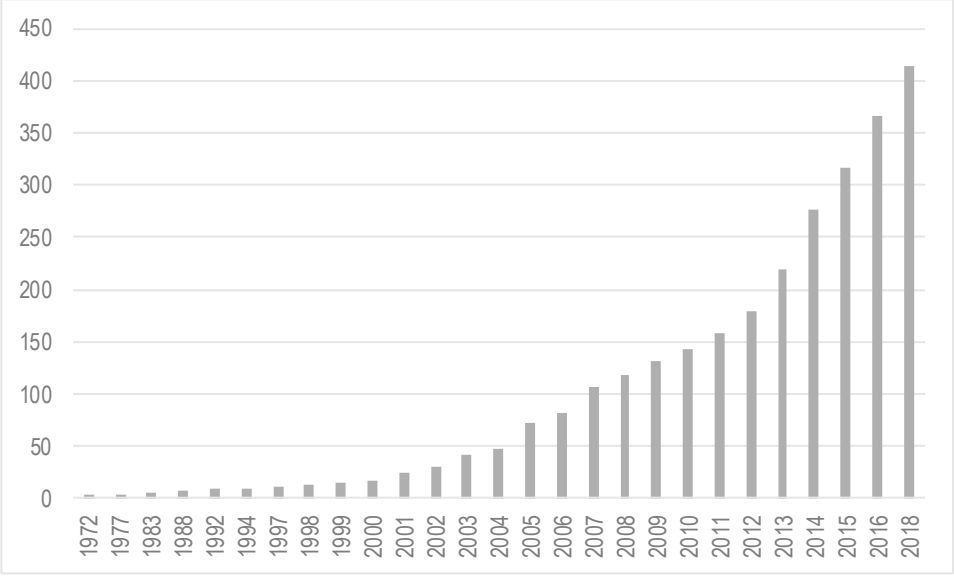
The evolution of the financing for sustainable development system is bringing a greater array of policy guidance and tools. The internationally agreed and legally binding frameworks of the AAAA, the 2030 Agenda and the Paris Agreement all aim to shift actors' behaviour. These frameworks provide rules to guide actors and so help to dissuade misconduct and raise compliance.

Setting rules is not as simple as choosing between carrot and stick. Often, policy guidance must involve a mix of regulatory and voluntary tools to succeed. Tools such as voluntary frameworks, guidelines, principles, standards, legal frameworks and regulations must be co-ordinated to effectively influence intermediary actors.

The proliferation of intermediary tools creates a more complex regulatory environment

The creation of intermediary tools such as policies, guidelines and regulations that help to guide actors toward sustainable investments is accelerating. Nearly 300 policy and regulatory measures targeting sustainability were in place in over 60 countries as of October 2017 (UNEP-World Bank, 2017[47]). Growth in such measures has averaged roughly 20% year on year since 2010, with an increase of roughly 30% just since July 2016 (Figure 5.9). Badré (2018[48]), for one, makes the case for the SDGs as the new economic development roadmap and also calls for intelligent regulation to help channel the power of finance in a positive direction.

Figure 5.9. Cumulative number of policy interventions targeting sustainability per year



Source: PRI (n.d.[49]), "Responsible investment regulation" (database), https://www.unpri.org/sustainable-markets/policy-and-regulation/regulation-map.

StatLink https://doi.org/10.1787/888933853300

Policies should promote long-term sustainable development objectives for business

The evidence base for investing in long-term sustainable development has grown. Chief executive officers of major institutional investors such as sovereign wealth and government pension funds recognise the need to shift business models, as do now some of the largest asset managers.[18] The integration of environmental and social factors in private sector enterprises is no longer seen as an inevitable drain on profits but as behaviour that can increase profit and gain the trust of investors and the public alike. According to recent estimates, investing in the SDGs could unlock economic opportunities worth at least USD 12 trillion a year by 2030 (more than 10% of global GDP) and generate up to 380 million jobs, mostly in developing countries. (Business and Sustainable Development Commission, 2017[2]) A 2018 study for McKinsey further demonstrates that social impact funds have similar profit returns as corporate entities[19] (Pandit and Tamhane, 2017[50]).

However, short-term considerations persist and can be detrimental to sustainable development. The AAAA describes private finance as often "short-term oriented", "concentrated in a few sectors" and "bypassing countries most in need" (paragraph 35). Long-term investment, such as FDI, is defined as investment funding that matures in a year or more. It provides greater stability of financing and better conditions for certain large-scale and cost-intensive projects capable of raising productivity, financing low-carbon infrastructure and improving living standards. Short-term financing, such as bonds and other securities, contribute to a higher degree of financial volatility.[20]

OECD members can help to redirect long-term investment into key SDG sectors. For instance, the 2013 High-level Principles of Long-term Investment Financing by Institutional Investors of the Group of Twenty (G20) and OECD "aim to help governments design a policy and regulatory framework [to overcome] impediments to long-term investment by institutional investors". These principles also "aim to avoid interventions that may distort the proper functioning of markets". As a response to the growing trend of short-termism, the OECD and the G20 also have taken steps to guide long-term investment decisions and better understand the barriers to investing in developing countries. In 2015, work was carried out to assess the risk and return characteristics of infrastructure financing in low-income countries and provide recommendations to help these countries unlock greater long-term finance (OECD-World Bank, 2015[51]).

Voluntary mechanisms are essential to involve private sector actors, yet these require better evaluation techniques

Voluntary mechanisms have played a crucial role in guiding private sector actions in support of sustainable development. They help to avoid the risks of negative externalities and increase the transparency of efforts to mobilise private finance. A wide range of private sector actors participate in a variety of voluntary frameworks in support of sustainable development, among them:

- **Multinational enterprises**. The UN Global Compact created in 2000 acts as a forum for policy dialogue in support of responsible business practices.[21] Adherence to the ten principles established by the Compact is voluntary, which may account for the large number – more than 12 000 – private sector signatories. To further guide actors, an SDG Compass (Chapter 4) developed by the Global Compact, GRI and the World Business Council for Sustainable Development provides a tool to promote reporting on development indicators and transparency of investments in an effort to guide companies to achieve the SDGs.
- **Philanthropic organisations.** The OECD Global Network of Foundations Working for Development (netFWD) led the development of the Philanthropy Guidelines, the first set of voluntary principles to promote mutual recognition and help governments and foundations connect at the country level (OECD netFWD, 2014[52]) The guidelines are voluntary, non-binding, and comprise the three pillars of dialogue, data and information sharing, and partnerships. Through these pillars, the guidelines can enable collaboration for development, poverty reduction and the creation of effective public policies.
- **Taxation.** The recent creation of the B Team Responsible Tax Principles demonstrates the importance for multinationals of raising public trust and addressing reputational risk related to taxation. These principles seek to address

relationships with tax authorities, use of tax incentives, public transparency and other matters related to tax.

Voluntary frameworks are an important first step to strengthening policy guidance. But on their own, they often lack adequate mechanisms for evaluation and accountability.[22] For example, in 2000, the UN General Assembly passed a resolution that led to the Kimberley Process Certification Scheme, which create a system of warranties to require all buyers and sellers of diamonds to certify compliance with human rights standards. Failure to comply results in expulsion from the industry market, a provision that has led some to question the efficiency of such a voluntary system that does not address an increasing number of transactions beyond the certification scheme.

Regulatory frameworks must provide policy guidance at the global, regional and national levels

Given the rapid evolution of regulatory frameworks in nearly all OECD countries, the OECD is well placed to lead the agenda on regulatory policy in support of the SDGs. Indeed, the OECD has developed 450 substantive legal instruments since its creation in 1961. Notably, the Due Diligence Guidance for Responsible Business Conduct (RBC), adopted at the 2018 OECD MCM, is the first government-backed guidance to companies for the implementation of the OECD Guidelines for Multinational Enterprises.[23]

In OECD countries, regulatory policy has contributed to sustainable economic growth and rule of law for stronger market functioning (OECD, 2010[53]). However, to be effective, existing laws must also be enforced. The following are examples of legally binding frameworks that enhance functioning of the financing sustainable development market:

- At the global level. Established in 1976, the OECD Guidelines for Multinational Enterprises entered into legal force in 2000 (OECD, 2011[54]). Their aim is to provide an open and transparent international investment environment and to encourage the positive contribution of multinational enterprises (MNEs) to economic and social progress. The OECD Guidelines are the most comprehensive set of government-backed recommendations on what constitutes responsible business conduct. They cover all major areas of responsible business conduct: disclosure, human rights, employment and industrial relations, environment, bribery and corruption, beneficiary interests, science and technology, competition, and taxation.
- At the regional level. The European Union (EU) has taken a proactive role in the design of European policy aimed at strengthening the legal framework for responsible business conduct. Recently, the European Commission announced its intention to mainstream the Sustainable Development Goals in its policy process, while recognising that only a subset of goals is actionable at the national level (Furness, 2012[55]). Efforts will be made under the EU Better Regulation Agenda to ensure that regulation is better linked with the SDGs. The Better Regulation Agenda also serves as an instrument for policy coherence for sustainable development in EU public policy by mainstreaming sustainable development into European domestic and external policies (European Commission, 2016[56]).
- At the national level. The German government adopted a National Action Plan for Business and Human Rights in 2016 that calls on German businesses to commit to human rights due diligence across supply chains (German Federal Foreign Office, 2016[57]). The Action Plan is based on the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. Germany aims

to have 50% of businesses with more than 500 employees implement this plan by 2020. An OECD peer review team provides recommendations on implementation of the action plan. Another example, France is the first country to introduce a legal requirement for institutional investors to disclose how they are contributing to national carbon targets, known as the Energy Transition Law. To date, 70% of the largest French institutional investors have published reports on sustainable financing.

Beyond the OECD, other countries have also stepped up efforts to implement sustainability laws. The People's Republic of China introduced explicit responsible business conduct regulations in 2006 as part of its social harmony policy. The number of mining firms disclosing information in annual reports has increased dramatically, with 78.3% of these firms disclosing annual reports in 2007. Almost all mining firms, or 98.3%, disclosed responsible business information in annual reports in 2012 (Shidi Dong, 2016[58]).

Multilateral governance/international institutions can help to strengthen standards in support of the SDGs by integrating a wider array of actors. The development and promotion of international standards and regulatory convergence help to level the playing field if all actors are involved, particularly those driving international trade and investment. Differences in standards and governance can present a barrier to a common vision for sustainable development. Just as standardised accounting rules underpin investor confidence in stock markets, government must play a role to establish legal guidelines for standards to secure the financing sustainable development market. The "In My View" piece by Daniel C. Esty in Box 5.10 argues that the next major challenge will be to develop more inclusive standards and mandatory frameworks.

Box 5.10. In My View: Toward a next generation framework of corporate sustainability metrics* by Daniel C. Esty, Yale University

A broader interest in corporate sustainability has recently emerged among mainstream investors, fuelled in part by high-profile global policy commitments to climate change action (notably the 2015 Paris Agreement) and the Sustainable Development Goals (SDGs). Evidence of sustainability's move from the margins of the investment world to the mainstream can be seen in the groundswell of interest in the United Nations Principles for Responsible Investing (PRI), which now have nearly 1 800 signatories in more than 50 nations representing over USD 70 trillion in assets under management.

But the translation of this interest into sustainable investing has not reached its full potential. A number of factors related to the fragmentation, misalignment and methodological weakness of the existing environmental, social and governance (ESG) metrics present barriers to ramped-up sustainable investing. Investor confusion over the definition of sustainability and over exactly what the various ESG metrics actually measure is part of the problem. A recent survey of ESG metrics demonstrates that no two sustainability-minded investors have the same focus or priorities. Some want to emphasise climate change and thus seek to avoid investments in big greenhouse gas emitters. Others care about a broader set of environmental issues including water and air pollution, chemical exposures, and waste management.

Lack of confidence in the quality and integrity of ESG metrics has proved to be an even bigger problem. There are a number of ESG data providers competing aggressively in the marketplace (Table 5.1). Yet many investors worry that the available metrics are not reported in a manner that assures methodological consistency and substantive accuracy. Indeed, most of the data are self-reported and unverified.

Table 5.1. Sample of ESG and sustainability metrics offered by major data providers

Provider	Product	
MSCI	Sustainable impact metrics	Six social themes (nutrition, disease treatment, sanitation, affordable real estate, SME finance, education) and five environmental themes (alternate energy, energy efficiency, green building, sustainable water, pollution prevention).
MSCI	ESG fund	Including metrics across three dimensions: sustainable impact (to measure fund exposure to companies that address core environmental and social challenges); values alignment (to screen funds for investment that align with ethical, religious or political values); and risk (to understand fund exposure to ESG-related risks).
MSCI	ESG rating	Includes "80 Exposure Metrics (business segment and geographic risk exposure)" and "129 Management Metrics (based on policies, programme and performance data)."
MSCI	Carbon Solutions	Includes "a comprehensive range of data on fossil fuel reserves, carbon emissions and sector application".
Bloomberg	ESG Disclosure Scores	Over 120 environmental, social and governance indicators keyed to the Global Reporting Initiative list of performance indicators.
Thomas Reuters	ESG Data	Includes "over 70 Key Performance Indicators" in three categories: environmental (resources use, emissions, innovation); social (community, workforce, human rights, product responsibility); and governance (management, shareholders, CSR strategy).

Note: Not exhaustive

Achieving a next generation corporate sustainability metrics framework will rely on a revitalised partnership for data and standards among both public and private actors. While a number of established data providers are working to fill the gaps and address the problems outlined above, requisite investor trust would be most easily established if governments (perhaps working collaboratively across national boundaries) spelled out a mandatory set of core corporate sustainability metrics and clear methodological standards for reporting.

A consistent and reliable ESG metrics framework should be seen as a public good that governments provide as a foundation for decision making across the investment realm. A high-integrity next generation corporate sustainability metrics framework would promote the flow of capital to those companies that are helping to deliver a sustainable future and away from those whose business models contribute disproportionately to climate change, undermine social values or otherwise degrade efforts to deliver on the promise of sustainable development.

Sustainable development for all relies also on OECD policies at home

Both the AAAA and the 2030 Agenda call for enhanced support to address the policy coherence of domestic and external policies. The AAAA states, "We recognize the importance of policy coherence for sustainable development and we call upon countries to assess the impact of their policies on sustainable development" (paragraph 103). SDG target 17.14 calls for more broadly enhancing "policy coherence for sustainable development". The importance of policy coherence extends to areas both directly and indirectly related to sustainable development.

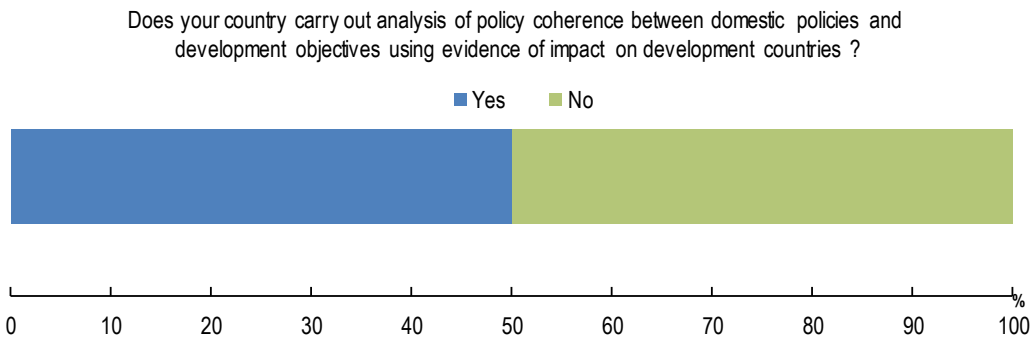
As Chapter 4 demonstrates, there are a number of recent initiatives aimed at assessing the policies and financing that contribute to accelerating or limiting progress towards the global goals. These nascent efforts represent an important first step to policy coherence that maximises sustainable development financing, including beyond the traditional remit of aid policies. New and emerging issues can shed light on the often complex dynamics.

These issues include adherence to the base erosion and profit shifting (BEPS) framework for multinational enterprises and laws promoting responsible business conduct and the need for a better understanding of the impact of the tax exemption status of ODA-funded goods and services on domestic resource mobilisation.

Institutional challenges impede efforts to strengthen policy coherence

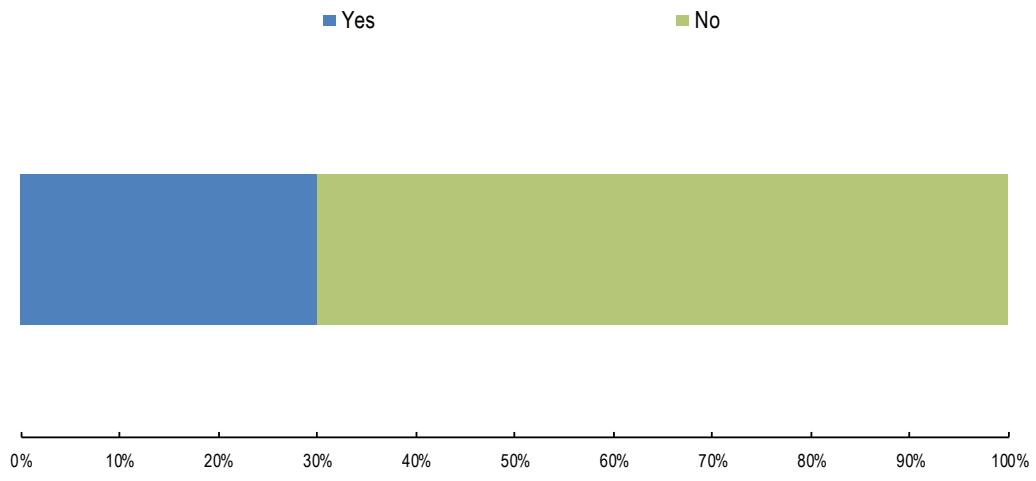
A lack of national institutional mechanisms can impede policy coherence across governments and institutions (Box 5.11). Responses to the "2018 Global Outlook on Financing Sustainable Development Survey" indicate that only 50% of countries surveyed carry out analysis of policy coherence between domestic policies and development objectives using evidence of impact on developing countries (Figure 5.10). Moreover, only 30% of countries responding to the survey have a timebound plan for implementing policy Figure 5.11. Most of these countries cite major institutional challenges such as a lack tools or forward-looking strategies (Figure 5.12).

Figure 5.10. Analysis of policy coherence by DAC member governments



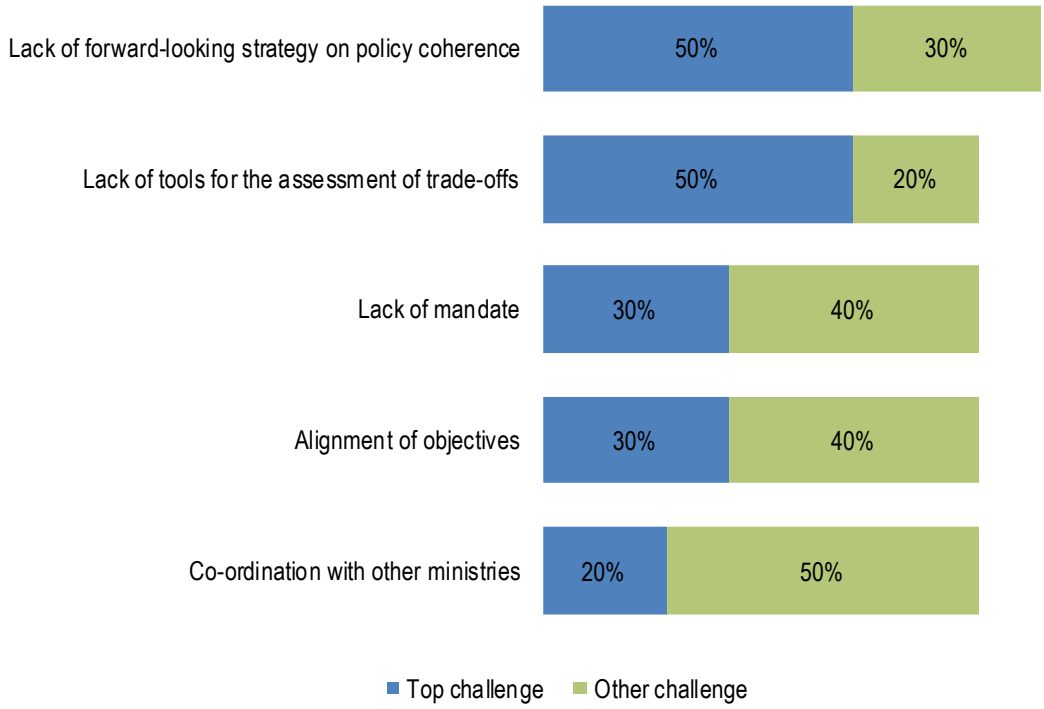
Source: OECD (2018[26]) "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm.

Figure 5.11. Time-bound plan for policy coherence



Source: OECD (2018[26]) "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm.

Figure 5.12 Top institutional challenges of policy coherence



Source: OECD (2018[26]), "Global Outlook Survey on Financing for Sustainable Development", http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/global-outlook-on-financing-for-development.htm.

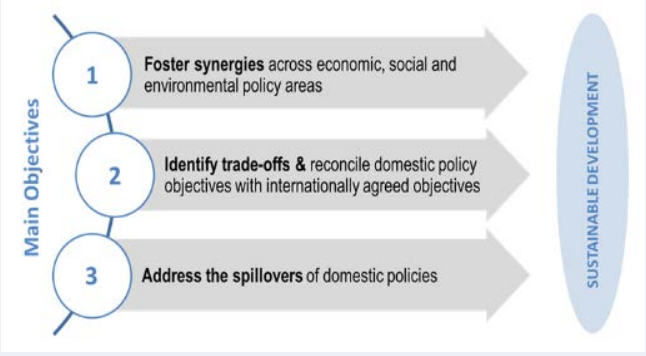
Box 5.11. Institutional mechanisms to strengthen policy coherence

Policy coherence for sustainable development (PCSD) – embodied in SDG target 17.14 – is an integral part of the means of implementation for all SDGs. The OECD defines PCSD as both an approach and a policy tool to systematically integrate the economic, social and environmental dimensions of sustainable development at all stages of domestic and international policy making.

Policy coherence does not happen automatically. It is a political choice by governments to establish supporting institutional structures and take specific initiatives. Enhancing PCSD as called for in target 17.14 will depend on reconciling short-term priorities with the long-term policy direction integral to attaining sustainable development objectives. It will also need mechanisms to anticipate, balance and reconcile divergent policy pressures such as conflicting domestic and international priorities; opposing economic, social and environmental concerns; and competing sectoral interests.

The experiences of OECD countries in promoting policy coherence for development over the past two decades and in implementing national sustainable development strategies have led to the Policy Coherence for Sustainable Development (PCSD) Partnership[24] and a number of guidance and tools for grappling with policy interactions and spillovers in the global economy (Figure 5.13).

Figure 5.13. Main objectives of the PCSD Partnership



Source: OECD (2018[59]), *Policy Coherence for Sustainable Development 2018: Towards Sustainable and Resilient Societies,* http://dx.doi.org/10.1787/9789264301061-5-en.

A policy coherence lens must be applied to areas both directly and indirectly related to aid policy

Policy directly related to traditional development finance such as ODA is not provided in a vacuum and can have spillover effects (Chapter 4). Domestic policies in OECD countries affect development in the rest of the world. Development finance programming has an impact on domestic revenue mobilisation, remittance facilitation, philanthropic giving, trade and investment, and illicit financial flows. Chapter 3 discusses this in relation to dynamic effects.

As providers increase support for domestic resource mobilisation to meet Addis Tax Initiative commitments, the practice of requiring tax exemptions for ODA-financed goods

and services is coming under heightened scrutiny. Such tax exemptions increasingly are seen as undermining efforts to improve mobilisation (Steel et al., 2018[60]). In recent years, some countries, as discussed in Box 5.12, have changed their policy and no longer seek such tax exemptions on ODA-funded goods and services. But this is not yet common practice. The Platform for Collaboration on Tax is planning to review the 2007 guidelines to assist countries in reviewing their policies in this area.

Box 5.12. Transparency of policy for official development assistance-funded goods and services

Efforts are underway to improve the transparency of taxation of ODA-funded goods and services. The 2018 Global Outlook on Financing for Sustainable Development Survey shows that more OECD countries are taking a stance against tax exemptions. The most recent to do so are Greece, Hungary and Portugal. Belgium, Denmark, Netherlands, Poland and Sweden already were calling for an end to tax exemptions. Other OECD members who require exemptions, notably Italy on VAT, recently undertook efforts to enhance the transparency of practices by providing additional details guiding exemption policy.

It is important to also recognise that policies not directly related to aid can play a central role to maximise finance for sustainable development. This is the case for selected tax issues as well as for laws promoting responsible business conduct and, as discussed elsewhere in this chapter, financial sector investment. Significant progress has already been made in tax through inclusion of developing countries in OECD decision-making structures on international tax standards.

A commitment to effective international tax co-operation is central to ensuring the policy coherence of financing, because the information that enables authorities to effectively tax cross-border activities is often held in another country. The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC) enables access to such information and allows the exchange of information among all 123 signatories. The MAC also provides a base to enable automatic exchange of information (AEOI). The potential impact of automatic exchange of information is significant, with over USD 93 billion in increased revenues raised from voluntary disclosure in advance of the first exchanges.

In addition the BEPS process, which starting in 2013 began to address the challenges of taxing multinational enterprises in the era of globalisation, has shown how developing countries can be integrated into standard setting structures. The Inclusive Framework on BEPS brings together over 120 countries and jurisdictions to collaborate on the implementation of the OECD/ G20 Base Erosion and Profit Shifting (BEPS) Package, integrating developing countries into the decision making structures on international tax standards, on an equal footing. The 15 BEPS Actions25 provide a range of tools to address some of the principal methods used by MNEs either to avoid activities becoming part of the tax base or to shift profit offshore. One of these tools is country by country reporting, which provides an overview of the key activities of MNEs in every country they operate in and thereby enables high-level risk analysis. In committing to tools like these, countries help to ensure the access to information on their MNEs and reduction of treaty abuse on a multilateral basis.

Forward look: Policies must target both inclusive and sustainable development

Achieving the SDGs will rely on integrating the sustainable development and inclusive growth agendas. All countries, in agreeing the 2030 Agenda, recognise the need to eradicate poverty and to maximise the effectiveness of development policies to leave no one behind.

The role of OECD countries is to support all three policy levers – policy support, policy guidance and policy coherence – to achieve inclusive growth and sustainable development. Both domestic and external policies create opportunities to distribute the dividends of growth across populations. For example, the 2015 Paris Agreement acknowledges that the negative impacts of climate change most severely affect the poor and that the success of international climate change action depends on action at the global level. OECD members thus have an important role, for example, to promote global action that closes the gap of widening inequalities.

Box 5.13. A new framework for inclusive growth

The OECD Framework for Policy Action on Inclusive Growth provides a blueprint to strengthen the foundations for sustainable growth and to better tackle inequalities that can impede progress. Moving beyond GDP metrics and statistical averages, the framework focuses on well-being outcomes and emphasises the distribution of outcomes across a population. Using 24 indicators, it provides guidance to complement national development strategies on a number of Sustainable Development Goals that are relevant from an inclusive growth perspective (OECD, 2018[61]).

Sustainable development finance actors must recognise that the development agenda is circular

Better policy coherence is needed to operationalise a circular approach to development and ensure that no dollar of financing is lost. This is especially true regarding remittances, as financing is channelled at the levels of origin, transit and destination from the perspective of migrants. This section examines the case of remittances transferred cross-border by migrants. In recent years, a number of international fora and organisations including the AAAA (paragraph 111) and the 2030 Agenda (paragraph 29) recognise the importance of policy coherence related to international migration and the need to account for what is widely termed the multidimensional reality of remittance transfers and migration.

Host countries must deliver better policies to maximise remittances for sustainable and inclusive development

As more developing country migrants work in OECD countries, there are emerging opportunities to create a virtuous circle of inclusive growth and sustainable development to maximise available finance. In this context, crucial remittance flows to developing countries will depend largely on the domestic policy of OECD countries.

OECD members can promote policies to better integrate migrants into the labour market and to promote financial inclusion. Domestic policies that promote education, skills, financial inclusion and social safety nets for migrants in turn increase the contribution of

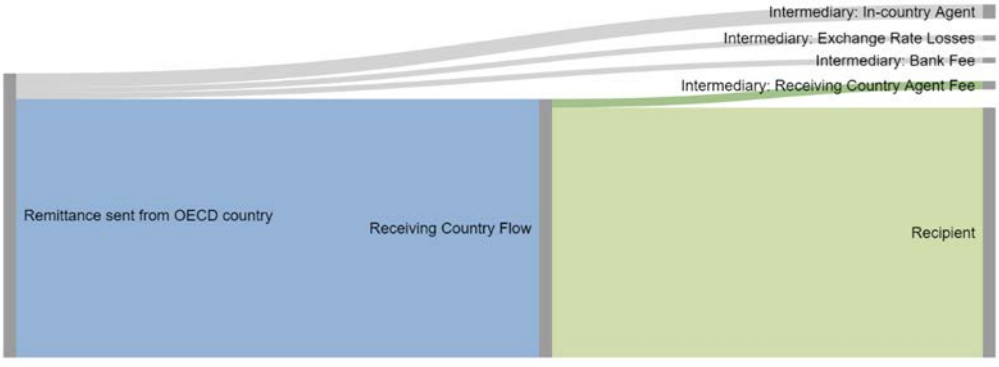
migrants to OECD economies (i.e. inclusive growth) by boosting the labour force and in some cases contributing more in taxes and social insurance payments (OECD, 2013[62]). Responses to the 2018 Global Outlook on Financing Sustainable Development Survey reveal that several OECD countries, among them Australia and Korea, are adopting domestic policies to facilitate remittance transfer to developing countries, notably by increasing earning opportunities for remittance senders.

Policies that increase competition among financial intermediaries can drive down transfer fees

To ensure that developing countries get the most out of remittances sent by migrants, it is essential to address the leakages that can occur when funds are transferred. A 5% decline in remittance costs could potentially generate USD 15 billion in savings (Rillo and Levine, 2018[63]). Although transfer costs are declining broadly, the cost of sending remittances still stands at 14-20% for all developing regions – far above the target established under the SDGs to reduce transfer costs to 3% by 2030.

As remittances transit from the OECD host country through financial intermediaries to beneficiary households, there are opportunities to maximise the volume of available financing. Promoting greater competition among service providers can help to drive down fees charged by financial intermediaries. The World Bank Payment Systems Group examined the cost of remittances sent across 119 country corridors used for 60% of total remittances to developing countries. The study shows that increased competition helps to decrease remittance costs, except in the case of Western Union (Beck and Peria, 2009[64]). Figure 5.14 shows key points where intermediaries have an impact on the transfer cost of remittances.

Figure 5.14. Leakages in remittance transfer due to intermediary actors



Source: Author based on (ODI, 2014[66]) "Lost in intermediation: How excessive charges undermine remittances in Africa", https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8901.pdf

One important, emerging factor is the need to change the perception among banks that the remittance sector is high risk (World Bank Group, 2017[65]). Delivery of innovative financial technologies can help banks to strengthen anti-money laundering measures without sacrificing financial inclusion of remittance senders, as is reflected in the 2017 Financial Stability Board recommendation to governments. As banks seek to reduce illicit financial flows and terrorist financing, money transfer operators often respond by shutting down bank accounts. The shutdown of bank accounts acts as a risk management

strategy but it also creates barriers for migrants seeking to transfer remittances (Ratha et al., 2016[66]). Some countries are addressing this. An example that emerges from the Global Outlook on Financing Sustainable Development Survey is Korea, where the Korea Financial Supervisory Service and the Korea Federation of Banks are leading efforts to lower remittance fees to developing countries through improved co-ordination with banks.

Policies of countries of origin can strengthen the sustainable development impact of remittance flows

In addition to cutting costs and making it easier to send and receive remittances, policy makers can create an enabling environment for remittance use. Remittances are most often received as cash transfers. This presents a number of challenges for developing countries, particularly when robust, financial intermediary services are lacking. One of the most successful matching grants schemes, Mexico's *Tres por Uno* (Three for One) programme, designed an innovative solution whereby the federal, state and municipal governments contribute by tripling the amount of money sent by the migrants to support local development projects.

Other measures that have been taken to overcome these challenges include:

- **Tax exemptions for remittance income.** Most developing countries offer some form of tax incentives to attract remittances, although sometimes these bring unwanted side effects such as tax evasion (Ratha, 2007[67]).
- **Incentives to attract diaspora investments.** Countries such as Ethiopia, Ghana, Kenya, Nepal, the Philippines and Sri Lanka, among others, have issued diaspora bonds to attract savings from migrants abroad (Ratha et al., 2015[68]).
- **Matching grants schemes.** These government schemes channel collective remittances received through hometown associations set up by diaspora groups to support local development in the countries of origin.

Conclusion and recommendations

Sustainable development finance policy design requires a more holistic approach that utilises all policy levers of the AAAA. Efforts to mobilise additional resources for development and go from billions to trillions should be sustained. But they should be supplemented by efforts to shift the trillions, i.e. re-direct existing and future flows towards the SDGs. Beyond the efforts to better understand and use interactions described in Chapter 3, actions to achieve this objective include:

- set new targets for innovative instruments, such as blended finance; develop new tools to facilitate the attainment of these targets (e.g. blended finance toolkit developed on the basis of the Principles) and the evaluation of their use (e.g. monitoring and evaluation of blended finance projects and impact/diaspora/green bonds, etc.).
- encourage international co-operation and/or adoption of a legal/regulatory framework for shifting the trillions; put long-term saving and financing to work for the SDGs (e.g. guides for pension funds, a new rating system for investment or company performance, rules on responsible business conduct activity reporting, fight against fiscal evasion and tax co-operation, etc.).

Given the importance of domestic resources in the promotion of the 2030 Agenda, it is important to put in place the right framework and/or environment for self-sustained sustainable and inclusive growth in developing countries. Development assistance should further invest in enablers through the following actions, for instance:

- Continue and increase support to technical assistance and capacity building programmes pertaining to domestic resources mobilisation in line with the Addis Tax Initiative target of USD 447 million in the next four years; complement this these with an increased focus on improving the effectiveness of the assistance and broadening the scope to all actors in the tax system
- Continue and increase support to other enablers, such as aid for trade or private sector development.

In the spirit of the AAAA and its holistic approach, the different financing sustainable development actors, and in particular the private sector, should jointly undertake these efforts. Beyond commingling resources, synergies and new forms of partnerships and, platforms for matching actors and remedying market failures should be put in place:

- Create a private sector engagement platform for collecting evidence, sharing experience, identifying best/worst practices, matchmaking actors (e.g. public and private and investors), and replicating/scaling-up innovative sustainable development finance solutions as part of an effort to increase transparency.
- Identify champions and launch next generation partnerships at country or regional level and/or along specific value chains, as was done for agriculture or mobile phone (batteries) value chains.
- Promote effective co-operation with other private sector actors (e.g. OECD netFWD Guidelines for Effective Philanthropic Engagement).

Chapter 6 explores how the holistic approach can be operationalised so that financing is more effectively targeted to meet demand. From the global to the local level, better co-ordination among the different actors is needed to bridge divides and deliver a new vision for development.

Notes

[1] One year earlier, a World Bank (2016[75]) report introduced the cascade approach as a means of conceptualising strategies to maximise financing for development by leveraging the private sector and optimising the use of scarce public resources.

[2] The World Bank defines the development footprint of the private sector as the investments and operations in developing countries that transfer capital, technology, knowledge and know-how. The operations of global firms, the standards they expect their suppliers and partners to meet, the societal values and norms they promote through their operations – all can profoundly affect the future of developing economies. These transfers of all kinds, whether tangible or not, and their direct and indirect effects represent the development footprint of global business and value chains.

[3] The OECD DAC defines mutual accountability as "a process by which two (or multiple) partners agree to be held responsible for the commitments that they have voluntarily made to each other. It relies on trust and partnership around shared agendas, rather than on 'hard' sanctions for non-compliance, to encourage the behaviour change needed to meet commitments". See https://www.oecd.org/dac/effectiveness/49656340.pdf.

[4]An evaluation of the programme can be found at https://www.kfw-entwicklungsbank.de/PDF/Evaluierung/Ergebnisse-und-Publikationen/PDF-Dokumente-E-K_EN/Indien_TNUDF_2017_E.pdf.

[5] Further information about the Microfinance Initiative for Asia debt fund is at http://www.blueorchard.com/wp-content/uploads/MIFA_InvestorUpdate.pdf.

[6] A global monitoring exercise was carried out. It looked at progress in implementing the four principles for effective development co-operation: focus on results, country ownership, inclusive partnerships, and transparency and accountability. See http://www.oecd.org/dac/effectiveness/Making-Development-Co-operation-More-Effective-2016-monitoring-findings-at-a-glance.pdf.

[7] The Shared Value Initiative was launched in 2012 as a Clinton Global Initiative Commitment to Action. See https://summit.sharedvalue.org/.

[8] At the 2017 OECD DAC Senior Level Meeting, Jean-Christophe Laugée, Vice President for Sustainability and General Manager of the Danone Ecosystem Fund, stressed the need to shift the development finance system framework to co-develop models and co-create ecosystem change.

[9] The United States and G7 have been active in initiatives in the agricultural sector. Among other such initiatives are the New Vision for Agriculture and the Grow Africa and Grow Asia initiatives that have jointly fostered public and private investment with local government and civil society support.

[10] The co-chairs' statement of the G7 Development and Finance Ministers Summit is available at https://g7.gc.ca/en/g7-presidency/themes/investing-growth-works-everyone/g7-ministerial-meeting/co-chairs-summary-g7-joint-development-finance-ministers-meeting/.

[11] An example is the recent debate around a 2016 paper (Collier and Venables, 2016[68]), available at https://urbanisation.econ.ox.ac.uk/materials/papers/110/oxf-rev-econ-policy-2016-collier-391-409.pdf.

[12] For more on USAID recent statements, see https://www.usaid.gov/news-information/press-releases/jan-31-2018-usaid-administrator-mark-greens-opening-remarks-usaid-town-hall.

[13] The enabling environment for domestic resource mobilisation is defined as "a set of interrelated conditions – such as legal, bureaucratic, fiscal, informational, political, and cultural – that impact on the capacity of […] development actors to engage in development processes in a sustained and effective manner". See http://web.worldbank.org/archive/website01029/WEB/IMAGES/_ENGL-60.PDF.

[14] The EITI value chain is described at https://eiti.org/eiti-value-chain.

[15] An example of such discussions is the Paris Club meeting of 20 April 2017, available at http://www.clubdeparis.org/en/communications/article/paris-forum-workshop-spring-meetings-20-04-2017.

[16] The principles are at www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf.

[17] Better reporting, in turn, helps to reduce indirect costs resulting from rent seeking and corruption, ultimately resulting in more jobs and income opportunities. See https://www.globalreporting.org/information/about-gri/strategic-partnerships/Pages/CSRCB-Program.aspx.

[18] For example, in 2018, the Chief Executive Officer (CEO) of BlackRock, the world's largest institutional investor, urged other CEOs to adopt a social purpose and to pursue a strategy for

achieving long-term growth. See https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[19] For example, 50 investors representing more than USD 5.2 billion achieved a median internal rate of return of 10%. Holding period returns were similar to normal venture capital or private equity projects, with average exit around five years.

[20] FDI to developing countries amounted to USD 193.3 billion in 2016, while bonds and other securities amounted to USD 57.6 billion.

[21] Information about the Global Compact is at www.unglobalcompact.org/about.

[22] The broad question of whether regulations and principles for responsible business conduct should be voluntary or binding is discussed at https://www.hrw.org/news/2017/09/18/should-corporate-social-responsibility-be-voluntary-or-binding.

[23] The sector-specific Due Diligence Guidance and good practice papers focus on strengthening business operations and supply chains, including in areas related to human rights, labour, the environment and corruption. Although the Due Diligence Guidance is not mandatory, it holds particular weight as a tool designed to support other legal instruments. See http://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm.

[24]For more information on the PCSD partnership, see http://www.oecd.org/pcd/thepcsdpartnership.htm.

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Chapter 6. Implementation: Co-ordinating actors, tailoring solutions

The 2030 Agenda requires a significant change in how development actors operate so that they deliver on the promise of a holistic approach. Indeed, the impact of the Addis Ababa Action Agenda should be most visible at the level of implementation and operations.

This chapter outlines challenges encountered at the country level in integrating diverse sources of financing. It surveys some of the tools being tested to overcome these challenges and recommends ways forward. In short, existing tools must be strengthened, new tools developed and a significant implementation gap filled in order to realise the promise of the Addis Ababa Action Agenda.

While recognising that country-led development remains the central pillar of financing for sustainable development, the chapter also encourages the integration of sustainable development at local, regional and global levels. Financing solutions must also be tailored across sectors, including for cross-cutting policy goals such as gender equality and the climate transition.

In brief

To ensure that financing will support the Sustainable Development Goals (SDGs), it is not enough simply to enhance measurement of efforts and impact (Chapter 4) or improve policies, partnerships and capacity building (Chapter 5). Full implementation of the Addis Ababa Action Agenda (AAAA) requires collective action at the final mile – that is, at the level of operations.

But a collective approach to financing is a challenge to current operational practice, whereby financing actors tend to act independently, driven by their own assessment of priorities. While partnerships between public and private actors are increasing, true integration of financing behind the SDGs remains elusive.

This chapter surveys tools that are emerging to support financing actors, and particularly bilateral and multilateral providers, as they seek to overcome this challenge of fragmentation. It looks at the benefits of integrated financing approaches to sustainable development challenges through the examples of gender equality and the climate transition.

At country level, tools are emerging to support the alignment of national development strategies to the SDGs and development of the integrated national financing frameworks called for by the AAAA (paragraph 9). Such frameworks are still at an early stage. Actors are also using new tools to better identify their comparative advantages, co-operate with other actors and prioritise transformative investments.

Despite these positive steps, however, implementation is lagging behind ambition. A three-pronged approach is needed to turn opportunities for financing for sustainable development (FSD) into realities:

- **Co-ordination at the diagnostic phase can help align country and financing strategies.** A more coherent FSD toolkit is needed and gaps in implementing the tools need to be addressed. Even where diagnostic tools exist, they are fragmented. Actors need to expand country coverage, collectively implement findings, and support countries' capacity to manage diverse sources of financing. Mechanisms such as inclusive dialogue should be expanded to bring actors together and enhance country ownership. Actors at the subnational, regional or global level need to be more actively integrated, since many development challenges are best handled outside of the national level.
- **New tools are needed to tailor financing solutions to sectoral and country contexts and integrate multi-layered governance**. Opportunities also exist for integrated financing across levels of governance, sectors and specific country challenges. Such financing opportunities, such as the contribution of global replenishments to global public goods, must also be better mapped and once they are found, FSD opportunities need to be better implemented – for example, by ensuring compatibility of financing for sustainable development with the Paris Agreement.
- **Much remains to be learned about FSD needs and their complexity**. The AAAA addresses a wide range of action areas, investments and tools, but operational links remain relatively unexplored. Further work is needed on how to articulate roles. Some examples include how to leverage private and blended finance in country strategies, how to integrate remittances into financing strategies, and how to improve diagnostics to fill financing gaps. Particular financing contexts need to be further explored, for example the sectoral dynamics as countries transition.

Integrated national financing frameworks are key to achieving the Sustainable Development Goals

The Addis Ababa Action Agenda promotes "cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks" (paragraph 9). Yet three years after the AAAA, there is no agreed definition of these frameworks or what steps need to be taken to implement them.

Actors must identify their comparative advantages, co-operate with other actors and prioritise transformation investments within a coherent overarching framework. Tools have been developed to support this, among them the UNDP development finance assessments, the World Bank's Country Private Sector Diagnostics (CPSD) and the OECD's multi-dimensional country reviews. Nevertheless gaps in coverage, implementation and substance remain.

Actors, including donors, need to do more to support integrated national financing frameworks (INFFs). Greater knowledge must be amassed about how best to leverage diverse financing sources and improve data and diagnostics to find and fill financing gaps.

A coherent and co-ordinated financing sustainable development toolkit is needed

As explored in Chapters 2 and 3, the complexity of the financing for sustainable development system presents a triple operational challenge. Actors need to:

- *co-ordinate* based on each actor's comparative advantages
- *prioritise* among enablers to increase development footprint (see Chapter 5)
- *navigate and manage this complexity* while also assessing financing gaps and supporting partner countries.

The tools to meet these needs remain fragmented: making them part of a coherent toolkit to support INFFs will help all actors achieve the ambitions of the AAAA.

Financing actors need to co-ordinate comparative advantages

Different actors have expertise in specific countries, sectors and instruments, and can contribute this expertise to integrated financing approaches. Most bilateral providers, UN agencies and vertical funds focus on social sectors through concessional finance. Multilateral development banks and some large bilateral donors focus on private sector development and infrastructure (OECD, forthcoming[1]), while philanthropic finance invests heavily in the health sector (OECD, 2018[2]).

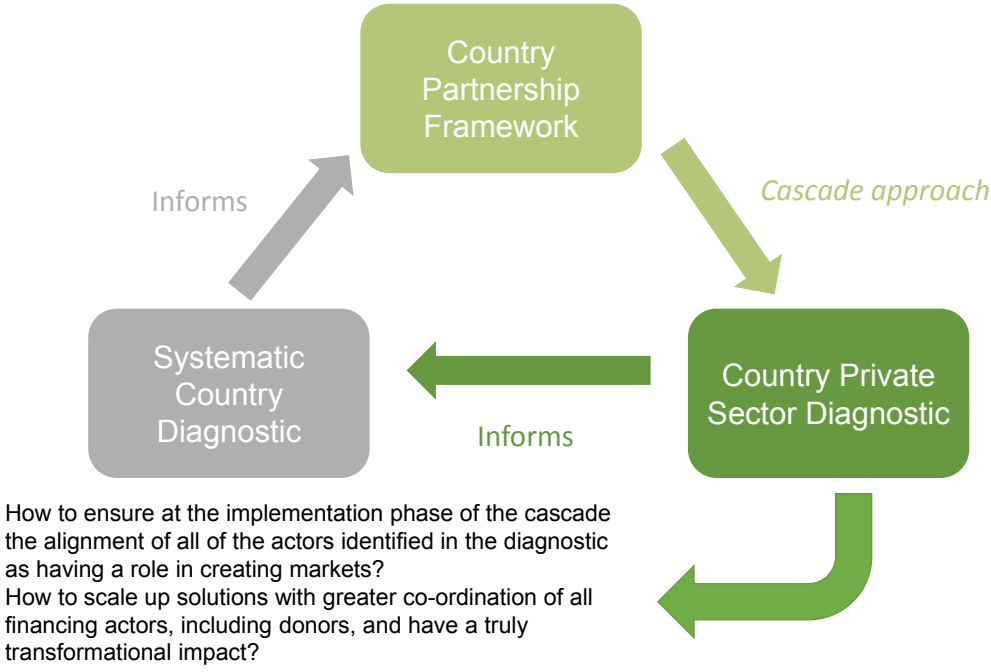
Further work is needed to ensure complementarity and to minimise financing gaps. For example, there is not yet agreement on which development challenges the private sector is best placed to solve and at what price. Nor is it clear whether the tendency of private sector engagement to focus on economic sectors (OECD, forthcoming[3]); (OECD, 2018[4]) represents a division of labour or a missed opportunity.

The World Bank Group aims to address these co-ordination issues using the Country Private Sector Diagnostic (CPSD) tool. The CPSD operationalises the cascade approach to first use private finance and reserve scarce concessional finance for situations where no

market-based solution is possible (Chapter 5). The CPSD identifies the most feasible short- to medium-term opportunities for market creation and development impact.

Over time, the World Bank Group will need to integrate the CPSD into its planning process with systematic country diagnostic (SCD) reports and country partnership frameworks (CPFs) so that the cascade approach is embedded throughout operations.

Figure 6.1. World Bank Group diagnostic and strategy process



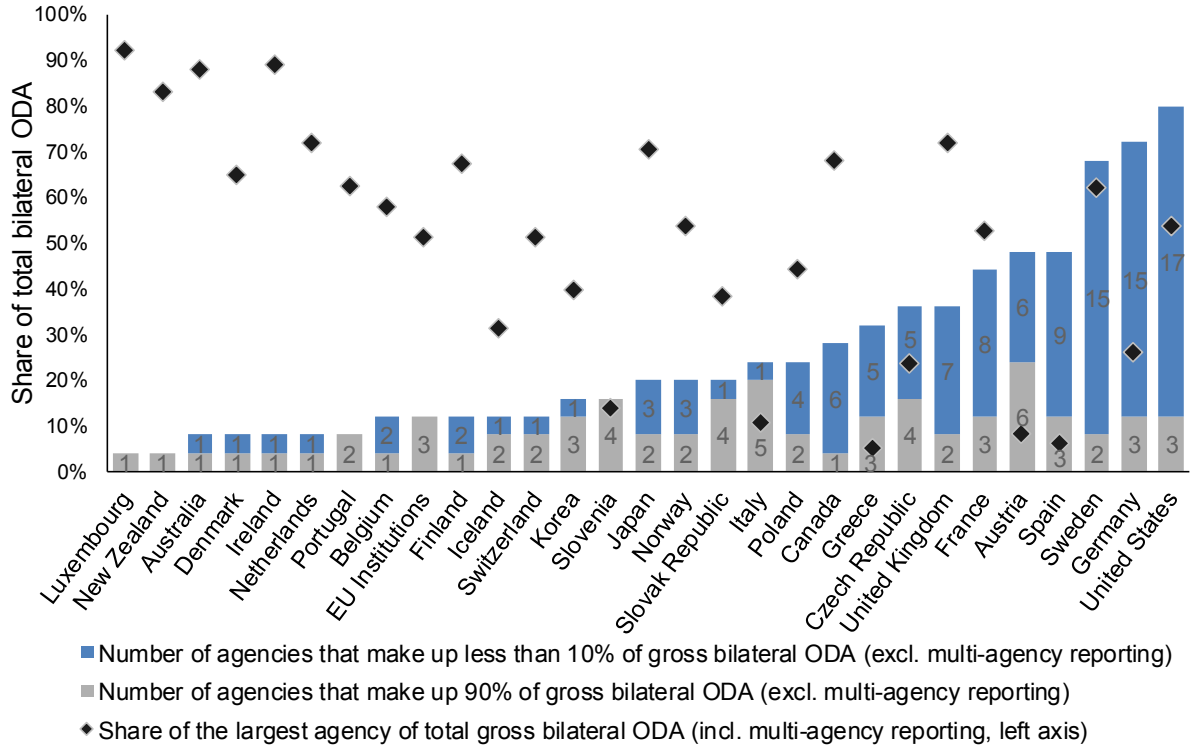
Source: Author based on World Bank Group (2018[5]) *World Bank Group Directive: Country Engagement,* https://policies.worldbank.org/sites/ppf3/PPFDocuments/1cb5ccd7e58e479096378f9d5f23b57d.pdf; World Bank-IMF (2018[6]), *Forward Look - A Vision for the World Bank Group in 2030: Implementation Update,* http://siteresources.worldbank.org/DEVCOMMINT/Documentation/23775499/DC2018_0005ForwardLookupdate_329.pdf.

The intent of the cascade approach is to identify comparative advantages, find shared value and work in partnership rather than having the WBG try to do everything itself (World Bank Group, 2014[7]). But this is challenging. Early evaluations of SCDs and CPFs find that they have struggled to achieve selectivity, are spread thinly across multiple fronts and need to better articulate not just what the WBG does but what it does not do (IEG/World Bank Group, 2017[8]).

As actors establish their comparative advantages and as the number of actors increases, co-ordination will become even more critical. This is true for OECD member states as well. As Figure 6.2 shows, at least 15 OECD Development Assistance Committee (DAC) members have more than 5 agencies active in development, with the United States alone having has 20 government agencies delivering official development assistance (ODA).

Figure 6.2. Number of government agencies delivering DAC members' official development assistance

Aid distribution across DAC members' aid extending agencies



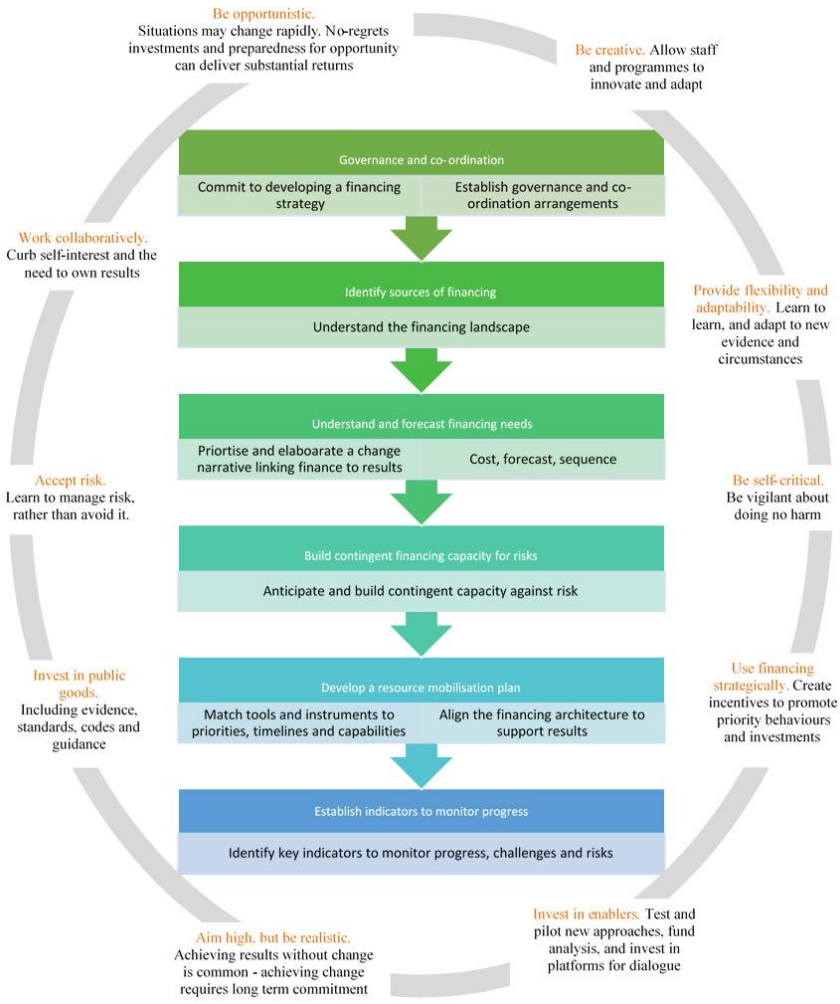
Source: Author's calculations based on OECD (2018[9]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1.

StatLink http://dx.doi.org/10.1787/888933853376

The roles and comparative advantages of actors, be they public or private, will vary according to context. For instance, contexts as different as small island developing states, least developed countries and landlocked developing countries each have their individual challenges. As Stiglitz (1998[10]) noted in a lecture 20 years ago, "[t]he issue is one of balance, and where that balance is may depend on the country, the capacity of its [g]overnment, and the institutional development of its markets."

For example, integrated approaches to financing can play a constructive role in fragile contexts (see Box 6.3). The OECD's Financing for Stability framework illustrates the diversity of possibilities that need to be taken into account. The framework is designed to integrate financing across a range of actors in a way that is tailored to fragile contexts, an approach that particularly emphasises risk management and flexibility (Figure 6.3).

Figure 6.3. The Financing for Stability framework emphasises risk management



Source: Poole (2018[11]), *Financing for stability in the post-2015 era*, https://www.oecd-ilibrary.org/development/financing-for-stability-in-the-post-2015-era_c4193fef-en.

Box 6.1. In My View: How can private sector operations help in fragile contexts?
By Ben Miller, Associate Director, CDA Collaborative Learning

What are the opportunities?

Partners CDA, the Peace Research Institute Oslo and the University of Stellenbosch's Africa Centre for Dispute Settlement recently concluded a case study-based inquiry to identify constructive approaches by private sector actors in fragile contexts.

We found that private sector actors are most effective when they act purposefully as:

- a catalyst for positive change in the relationships between other actors
- a facilitator of constructive activities by other actors that have an interest in peace
- an influencer of actors who, by virtue of their official position or informal authority and legitimacy, have the power to say "yes" or "no" to peace and conflict.

Where companies' efforts are focused on conflicts and tensions as they exist in the immediate vicinity of their operations, their relationships with local stakeholders and communities are therefore critical to success. Effective companies pay particular attention to their "social license to operate", for example by slowing the pace of operations to build trust.

Actors outside of the private sector (nongovernmental organisations and bilateral and multilateral actors) played critical roles in all of our case studies. The best outcomes were achieved when actors from a range of sectors identify a set of common interests and work towards those goals, which can require a significant investment on the part of all actors in analysis, dialogue and relationship-building.

What are the risks?

Fragility – the inability of formal institutions to fulfil adequately their mandates, contain or resolve conflicts, and meet the needs of citizens – shapes the impacts of investments and business activities. Unless well managed, new investments may intensify conflict and fragility rather than diminish them. In a fragile context, we should consider ways to improve the quality of investment and not just the quantity – encouraging and supporting companies to enhance social performance and stakeholder engagement and to develop capacities for conflict and risk analysis and improving the accountability and performance of governance institutions.

Non-business risk is an important driver of corporate social performance and influences decisions about where to invest and how to operate. The reputational risks of being inappropriately entangled with a government that is perceived to be corrupt or indifferent to citizens' human rights, for instance can drive good practice in this area. This means that eliminating companies' losses that are incurred through the realisation of non-business risks removes an important incentive for companies to get it right with their stakeholders. A better way to "de-risk" private investment is to mitigate conditions of fragility and conflict. There also needs to be greater consideration of the absorptive capacity of fragile environments to manage contested inflows of new resources.

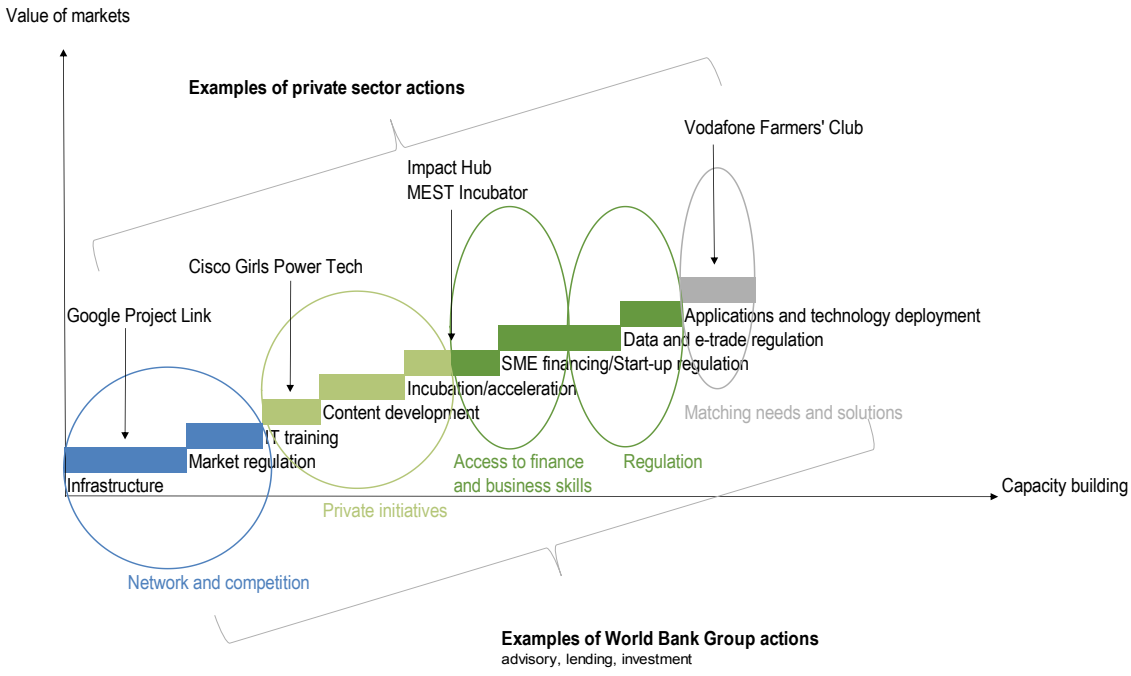
Further information can be found at: https://www.cdacollaborative.org/cdaproject/business-and-peace/.

Financing actors need to prioritise investments

The co-ordination and repartition of roles among actors according to their comparative advantage can also help prioritise the use of finite resources and sequence investment. Prioritising could increase social returns. For example, in a report for the Copenhagen Consensus Center,[1] Kydland et al. (2015[12]) argue that some development targets present the best "value-for-money", and that globally, every dollar spent on just 19 targets by 2030 would generate more than USD 15 of social good (Kydland, Stokey and Schelling, 2015[12]).

Country context will determine prioritisation of investments. Figure 6.4 shows, for the information and communication technology (ICT) sector in Ghana, the respective contributions to the creation of markets and capacity building of public and private actors, identifying bottlenecks and priorities for future actions and partnerships to have a transformational impact.

Figure 6.4. Investing in the building blocks of ICT markets



Source: Based on World Bank Group (2017[13]), *Creating Markets in Ghana: Country Private Sector Diagnostic,* *https*://www.ifc.org/wps/wcm/connect/ac42c20a-c82c-48b7-8432-221c0e066e2a/CPSD-Creating-Markets-in-Ghana-Nov-2017_v1.pdf?MOD=AJPERES.

Prioritisation tools such as growth diagnostics are well established to identify constraints to growth as well as actions that overcome constraints (Rodrik, Hausmann and Velasco, 2005[14]). Financing actors including the Bill & Melinda Gates Foundation use economic valuation to prioritise across health investments (NICE International, 2014[15]). In the SDG era, prioritisation also must factor in the multi-dimensionality of development goals, linkages among SDGs, and the urgency of individual SDGs (Chapter 5) (Le Blanc, 2015[16]).

The OECD Development Centre's multi-dimensional country review (MDCR) is one tool used to prioritise financing in the context of multi-dimensional development and with strong links to the SDGs. An MDCR assesses a country's economic growth, social inclusion and environmental outcomes against benchmark OECD and regional economies.[2] Panama is one of the assessed countries that have chosen to include a focus on the financing and policies needed to achieve multi-dimensional development outcomes (OECD, 2017[17]). These include, for example:

- tax mobilisation;
- fostering private investment, domestically and internationally;
- the role of remittance flows in consumption.

Integrated national financing frameworks offer much-needed potential to map financing to development strategy

To effectively finance the SDGs, financing actors need to co-ordinate their comparative advantages and prioritise their diverse investments. They also need to co-ordinate and prioritise in a way that reinforces country ownership, links to policy and supports the country's development strategy. INFFs, although at an early stage, are a promising mechanism in this regard.

National development strategies are an important building block. They must be inclusive and tailored; no single approach will work for all contexts. The report, *Perspectives on Global Development 2019* (OECD Development Centre, forthcoming[18]), underscores that strategies must be multi-sectoral, place-based, participatory and implemented within the context of multilateralism.

National development strategies are already widely used.[3] But on their own, such strategies may not be sufficiently integrated into financing and policy choices or linked to SDGs. A number of new tools aim to address these gaps. Among them is the UNDP Rapid Integrated Assessment (RIA) tool (UNDP, 2017[19]). Another is the United Nations' Mainstreaming, Accelerating and Policy Support (MAPS) approach, which aims to embed the SDGs in domestic planning and budgets (UN Development Group, 2015[20]).

The AAAA offers an opportunity – in the form of INFFs – to link national development strategies with financing and partnerships from a broad range of actors, domestically and internationally. While there is no agreed design for an INFF, to fulfil this role, INFFs could provide prioritised and integrated investment plans, mapping across needs and sources of financing, a resource mobilisation plan, and governance arrangements to monitor implementation.

Such frameworks for SDG financing would help to equip countries to better negotiate and make the most of diverse financing sources in the complex FSD market, or what Prizzon, Greenhill and Mustapha (2016[21]) called "the age of choice". These frameworks also could build on existing mechanisms such as aid management platforms[4] that governments use to better understand which partner is doing what and where (Weaver et al., 2014[22]).

The UNDP's Development Finance Assessment (DFA) is the most prominent example of the tools being used to link financing to policy and to implement INFFs. A DFA provides planning and finance ministries with data, analysis and recommendations on trends in development finance and the alignment of these with national priorities, synthesising analysis across resource flows and institutions (UNDP, 2016[23]). An important feature of a DFA is an inclusive and consultative process to engage with the country's government, media, parliamentarians, civil society organisations (CSOs) and other stakeholders. The "In My View" piece below describes lessons learned from the DFA process.

Box 6.2. In My View: Lessons learned from UNDP Development Finance Assessments, by Margaret Thomas, Chief, Development Impact Group, UNDP

Countries face a number of challenges in mobilising and strengthening the effective use of a diverse range of public and private resources for the Sustainable Development Goals (SDGs). These challenges are rooted in, or made more difficult by, misalignment between planning and finance systems and by the participation of only a narrow group of stakeholders in dialogue and decisions on financing.

In response to these challenges, UNDP has developed the Development Finance Assessment (DFA). The DFA makes financing issues accessible to policy and decision makers and follows a process of multi-stakeholder consultation. It builds an agreed roadmap that can support progress, including:

- strengthening the link between planning and financing
- strengthening multi-stakeholder participation in financing dialogue
- mobilising financing
- managing finance to maximise sustainable development impact

The DFA aims to both build a broader base of support for reform agendas and identify innovative solutions to the challenges of integrated financing of the SDGs. The DFA looks at opportunities for deeper collaboration with the private sector beyond growth in private investment. It considers how monitoring frameworks, transparency and collective accountability can strengthen the role of private finance in realising sustainable development objectives.

To date, 25 countries have undertaken or are undertaking a DFA. Lessons learned from countries' experiences continue to strengthen the DFA methodology.

- Given that the scale and diversity of finance available vary widely across countries, the tailored, context-driven nature of the methodology and government-led approach of the DFA is unique in its aims and process.
- The specific value added of the DFA lies in broad-based engagement. The government-led oversight committee brings together ministries and private sector and other partners, and it plays a crucial role in the DFA roadmap.
- Evidence-based dialogue is strengthened by a solid analytical basis that aggregates data from a range of sources and takes stock of the policy and institutional landscape across financing flows. This analysis benefits from collaboration with key partners such as international finance institutions, development partners, academia and think-tanks, among others.
- The DFA Roadmap as the outcome of the process needs to be concrete, focused and actionable and built on consensus by actors across financing partners committed to a set of prioritised and agreed actions.

The methodology has been revised to better respond to challenges such as the availability of data across ministries, effective engagement with the private sector and garnering buy-in across partners for long-term implementation of the DFA Roadmap.

DFAs undertaken have led to countries taking a more integrated approach to financing the SDGs with reforms and follow-up including designing financing strategies for the SDGs; reforms to integrate SDGs in planning, budgeting, monitoring, reporting and administrative frameworks; initiatives for private sector to report against the SDGs; and capacity building of civil service on effective financing for development.

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Important gaps in implementation and knowledge need to be filled

Despite positive steps, integrated financing has yet to fully be implemented. To address this, donors have an important role. This section outlines immediate implementation gaps that should be filled and areas for further research and policy guidance.

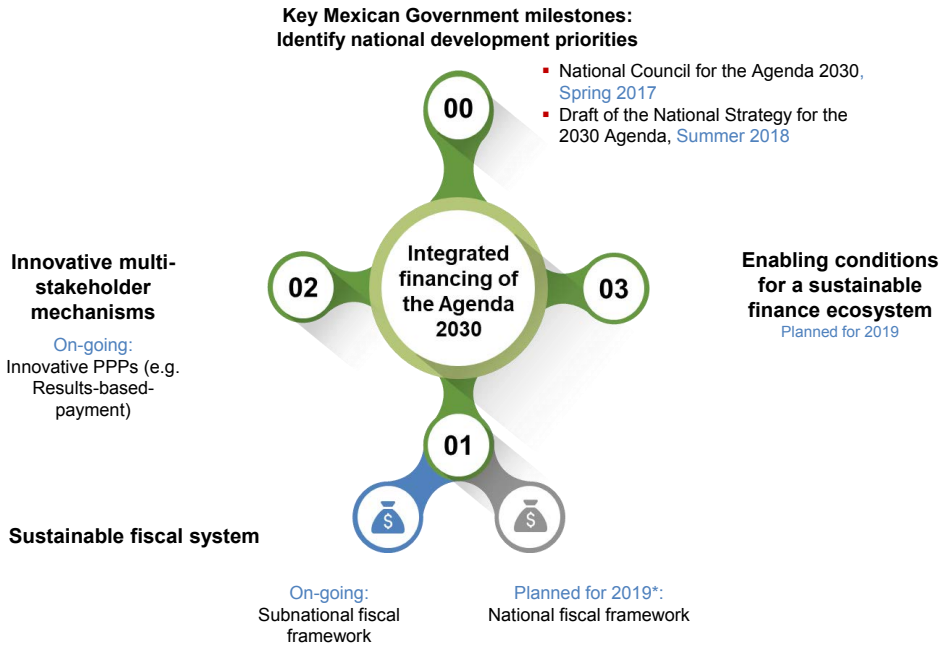
Financing actors should actively support integrated national financing frameworks

Despite progress in developing the tools to support integrated national financing frameworks, substantial gaps remain:

- *Tools for integrated FSD need to reach critical mass*. So far, 25 Development Finance Assessments have been completed and the Financing for Stability methodology has been applied in six countries. A pipeline of Country Private Sector Diagnostics is underway, but the process now needs to be fully integrated into World Bank Group systems and partnerships.
- *Better co-ordination at the diagnostic phase is needed to align financing*. All DAC member countries who responded to the Global Outlook Survey on Financing for Sustainable Development noted that they rely on their own diagnostic tools, with other actors' tools used in a fragmented way in programming and implementation.[5]
- *Actors need to support and implement the findings*. Donor countries support the DFA analysis. Yet none of the DAC members who responded to the "Global Outlook Survey on Financing for Sustainable Development" use this analysis in their development activities (OECD, 2018[24]). As Box 6.3 suggests, it is not clear whether private sector or other actors are sufficiently engaged.
- Development actors can play a collaborative role in supporting countries' integrated national financing frameworks. In Mexico, for example, the German Federal Ministry for International Cooperation (GIZ) supports the Mexican federal government in developing a comprehensive architecture for the implementation of the 2030 Agenda that has already contributed to identifying national development priorities (Figure 6.5). The financing component comprises ongoing and planned initiatives: pilot recommendations for a sustainable fiscal framework at the subnational level; promotion of innovative multi-stakeholder financing mechanisms (e.g. results-based payments to finance the SDGs); from 2019 onwards,[6] and a planned collaboration to jointly foster enabling conditions for a financing sustainable development system.

Similar capacity development approaches and the sharing of South-South experiences may be particularly important in connection with the use of sophisticated financing modalities such as green bonds, diaspora bonds or public-private partnerships.

Figure 6.5. How international co-operation can support integrated financing of the 2030 Agenda: GIZ and the Mexican government

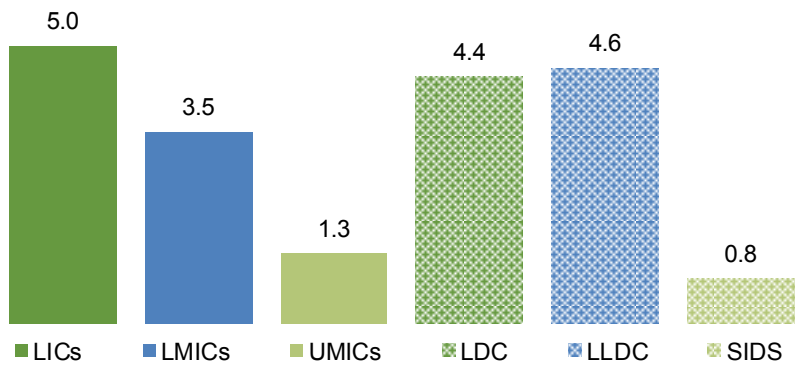


Source: Adapted from an illustration supplied by the German Corporation for International Cooperation (GIZ), Mexico.

Donor partnerships can be an important part of INFFs. But there are big gaps, as Figure 6.6 shows. The OECD's 2017 Survey on Donors' Forward Spending Plans highlights the drop-off in priority development partnerships as countries move towards graduation, and the low level of priority partnerships for small island developing states. Three least developed countries – Eritrea, Gambia and Lesotho – have no priority partnerships at all, while Ethiopia has 16 (OECD, 2017[25]).

Figure 6.6. DAC members' priority development partnerships

Average number of priority partnerships



Source: Author's calculations, based on OECD (2017[25]), "Survey on Donors' Forward Spending Plans", (unpublished).

StatLink http://dx.doi.org/10.1787/888933853395

Mechanisms are needed to create shared value and support country ownership

As they increase in diversity, new sources of finance need to support SDGs and country ownership. The Busan Partnership for Effective Development Co-operation specifies that countries' own and define the development priorities to be implemented. The investments of other actors should align with national strategic priorities and plans and use country systems as far as possible (OECD-UNDP, 2016[26]).

Country ownership is a pre-condition of successful implementation, but it can be challenging to achieve. Actors other than the developing country itself may finance different goals or work outside of the country system. For example, only 19 of 81 territories that participated in the Global Partnership for Effective Development Co-operation (GPEDC) monitoring had 60% or more of development co-operation in the government sector passing through country systems (OECD/UNDP, 2016[27]).[7]

In a complex financing environment, this challenge is amplified. But so too is opportunity. The GPEDC, in a forthcoming report, notes that evidence from Bangladesh, Egypt, El Salvador and Uganda suggests that the private sector wants to be a genuine partner to governments – and not simply a provider of FSD – to enhance country ownership of development priorities (Box 6.3).

Inclusive policy dialogue thus can be a crucial mechanism to engage diverse actors such as the private sector as partners, building buy-in while retaining the government's special role.

An additional benefit of policy dialogue is that it can engage actors in the planning and implementation of specific investments from an early stage. Effective follow-up processes and mutual accountability frameworks are needed to ensure all principles of development effectiveness – ownership, results, inclusive partnerships, transparency and accountability – are met (OECD, forthcoming[3]); (UN DESA, 2018[28]); (UNDP, 2017[29]).

Box 6.3. Inclusive dialogue is a key mechanism for effective private sector engagement

The Global Partnership for Effective Development Co-operation assesses the effectiveness of private sector engagement through development co-operation at country level. Case studies in Bangladesh, Egypt, El Salvador and Uganda identified several challenges in partnership arrangements between the private sector and the development co-operation actors. Findings of these case studies included the following:

- The creation of shared value is often lacking. Bangladesh and Uganda case studies revealed that development partners do not always sufficiently consider the business case when establishing partnerships.
- The private sector does not yet see alignment between business interest and social, environmental and economic sustainability. In Egypt and Bangladesh, private sector representatives sought a structured approach to inform the local private sector about the Sustainable Development Goals and how to address them.
- Private sector stakeholders across all four countries noted the need for development partners to simplify their procedures (e.g. application processes) to make partnerships more attractive.
- The explicit focus of private sector projects on target groups of development co-operation is limited. Only 11% of reviewed private sector projects target rural communities and only 4% target the poor.
- Private sector projects rarely include an explicit reference to their added social or developmental value, or what is called "development additionality". Only 12% of private sector projects reviewed had a results framework overall – a sign of a lack in agreed expected development outcomes.
- Only 16% of private sector projects reviewed report actual results and 38% have expected results available. Results are rarely communicated widely. The understanding of how individual private sector projects contribute to expected results is also lacking.

Inclusive policy dialogue, as one of the modalities of private sector engagement, appears to be a key instrument to help achieve the buy-in and ownership of both the private sector and development co-operation actors. It can foster effective partnerships and align interests, creating a shared understanding of sustainability from both the business and the development perspective. Inclusive policy dialogue is still an under-appreciated modality. Among 919 private sector projects, only 18 were supported by inclusive policy dialogue. To bridge this gap, the GPEDC aims to launch guidelines on effective private sector engagement in 2019.

Contributed by the Secretariat of the Global Partnership for Effective Development Co-operation

Blind spots remain in the links between actors and financing types

Specialist and diagnostic tools and strategies are available to support the AAAA action areas, from tax mobilisation to reform of investment enabling environments and financial market development[8]. Together, they form a patchwork with significant blind spots where further policy work is required to integrate financing and map it to financing needs (Figure 6.7).

Tools are still lacking to identify and leverage the links between financing sources. For example, data on amounts of private finance mobilised in support of development goals are improving but that is not the case for data on the amount of public finance used to achieve this mobilization. It is not yet evident how to ensure the effectiveness of blended finance actors or how best to engage the local private sector and support the investment enabling environment (OECD, 2017[30]). Nor is there consensus on how to ensure additionality – or even what type of additionality should be sought – when public funds play the role of leveraging private finance.[9]

The relationship between tax revenue and investment reveals another important blind spot where better knowledge could help release greater financing. Evidence is growing that it is not necessary to trade off rates of tax and investment, as uncertainty about the level of tax on profits may be a more important driver of investment decisions (OECD/IMF, 2018[31]).

As noted in Chapter 3, efforts are increasing to connect private sources of financing such as remittances to financing strategies but more must be done. In 2018, the DAC began collecting data on "remittance facilitation, promotion and optimisation". The funded activities included reducing the costs of remittances transfer (most common); increasing earning opportunities within each DAC member' own country; increasing data about remittance flows; supporting international co-operation; developing banking solutions; and increasing the proportion of low-income households with opportunities to earn and remit (OECD, 2018[24]).

Figure 6.7. Diagnostic tools need to be integrated into a coherent whole

Source: Author based on UN (2015[32]), *Addis Ababa Action Agenda of the Third International Conference on Financing for Development*, http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

In addition to better integration of diagnostic tools, sometimes, individual diagnostics could be improved to support holistic approaches and help understand, prioritise and fill financing gaps (Box 6.4).

Box 6.4. Better tools can increase tax revenue mobilisation

There are a range of tools and approaches that are helping developing countries address challenges in international taxation. For countries that have joined the Inclusive Framework on BEPS and the Global Forum on Transparency and Exchange of Information for Tax Purposes, induction programmes offer high-level dialogue as well as the development of detailed roadmaps on the steps needed to implement these international standards. More specialist tools are being developed, including a transfer pricing needs assessment tool that helps countries to identify their transfer pricing priorities. The Platform for Collaboration on Tax is developing a series of eight toolkits on high-priority international taxation issues in developing countries.

Such tools help countries to increase their tax revenue. For example, Uganda has received technical assistance for several years from the African Tax Administration Forum, OECD, World Bank and Global Forum. Uganda also received direct support on tax audits from Tax Inspector Without Borders. Significant increases in revenue and improved taxpayer voluntary compliance are expected from better control of the cross-border transactions of multinational enterprises. Improved information exchange netted over USD 9 million in 2015/16.

There are also new and emerging tools supporting the tax system overall. The Platform for Collaboration on Tax is supporting the development and implementation of medium-term revenue strategies (MTRS). Such strategies help to move from high-level diagnostics of financing needs to an articulation of the contribution from revenue. Development partners can then support a five- to seven-year MTRS year plan for the development of a country's revenue systems. The first MTRSs are currently being developed in several countries. At the tax administration level the Tax Administration Diagnostic Assessment Tool (TADAT), which uses 28 high-level indicators, is the most established tool for assessing a country's tax administration system. A total of 34 countries have had TADAT diagnostics under the final version of the TADAT guide.

Contributed by the Centre for Tax Policy and Administration, OECD.

Financing for sustainable development solutions need to be tailored across different levels of governance

Critical implementation gaps include partnerships beyond the country level. There is no one size fits all, holistic approach; approaches must be tailored to integrate actors at the local, regional and global levels. These levels of governance are increasingly important for FSD.

Local and regional actors represent untapped opportunities

Ultimately, development is local. Subnational actors bring specific and under-explored comparative advantages in FSD. More must be done to support subnational actors to increase their development footprint. At the same time, globalisation has meant that supranational regional groupings[10] have an increased role. Both sets of actors should be integrated into financing for sustainable development approaches.

Local and regional actors are increasingly important financiers and implementers

Some development challenges are best handled below and above the country level. In some countries, half the national budget is now devoted to lower levels of government through education, general public services and social protection, among other government services. Subnational governments not only receive grants and revenue from higher levels of government, donors, and international organisations. They also are responsible for mobilising domestic resources; in Argentina and India, subnational governments receive over 50% of public tax revenues (OECD-UCLG, 2016[33]).

Above the country level, neighbouring countries are becoming more closely connected economically, socially, and financially than ever before, as recognised in paragraph 21 of the AAAA. This makes the regional level particularly important in the management of public goods, regional assets, trade and investment and regional responses to shocks. The following are some examples:

- Regional networks can provide economies of scale and support integration, as for example through investments in ICT and transportation corridors and the five regional power pools in Africa[11] (Karekaho, 2017[34]).
- Regional approaches can be deployed to more effectively manage common natural resources such as highly migratory fish stocks in the South Pacific (UNDP-GEF, 2016[35]).
- Regional financing approaches can overcome capacity constraints to allow greater access to finance by more countries, as shown by the World Bank's aviation safety project involving Tonga, Tuvalu and the World Bank (World Bank, 2011[36]).
- Trade and investment corridors help local suppliers to access markets and require co-ordinated investments and institutional links to decrease costs throughout the corridor (Arvis et al., 2011[38]).

Realising this potential, and aligning to country priorities and SDGs, does not happen automatically. For example, without the accompanying skills, technical capacities, financial resources and oversight, decentralisation can result in negative impacts on local development (Vujanovic, 2017[37]).

To tap this potential, then, capacity building, support to engage the private sector, as well as better mechanisms for dialogue and co-ordination with the donor community at the local and regional level are all needed.

Box 6.5. In My View: The local challenges of financing sustainable development by Anuradha Thakur, Ministry of Finance, India

Translating the global Sustainable Development Goals (SDGs) into local commitments takes a multi-pronged, multi-stakeholder approach. India has been a strong supporter of the Millennium Development Goals (MDGs) and the SDGs, and a convincing advocate and promoter at the UN. Starting at that global level, the SDGs come down to us in Himachal Pradesh, a small hill state in India.

First, interdepartmental working groups were constituted to develop a seven-year strategy and a three-year action plan, all neatly dovetailing into the state vision document for the SDGs. The UN offered technical and financial support. The 169 targets had already been broken down to around 300 indicators by the central ministry but the working groups were given the flexibility to modify them.

For SDG 6, we undertook a detailed situation analysis, gap analysis and resourcing assessment. Taking the example of Goal 6.1 – to achieve 100% access to all for safe and affordable drinking water – it was assessed that a total of about USD 1.3 billion would be needed over the next three years to complete and augment existing schemes and to implement new ones. Of this, the state budget would provide about USD 800 million, and projects had been already posed for funding by the BRICS Bank and Japan International Cooperation Agency (JICA). The BRICS Bank agreed to take up one of the projects for about USD 100 million. Other sub-goals needed even greater resources for sewage management, improving quality, operation and maintenance, and sustaining water sources.

The lessons learned are critical:

- Pro-active leadership at the state level is important – to set indicators, link the state budget with the SDGs, judge relative priorities and ensure that SDGs are mainstreamed into regular government functioning.
- Capacity and network building at the state and below is a crucial piece of the puzzle to ensure that lower levels of government have the ability to see the whole picture, learn what resources there are to access and how, develop expertise to draw in the private sector for those aspects where there could be revenue sharing and to draw in the community as well for maintenance and upkeep. Without these skills, there is overdependence on already stretched state budgets and under-achievement of targets.
- The private sector and innovative financing mechanisms are not available for all sectors or levels of governance and may require too much upstream work given the pressing need to deliver on

sectors such as water.

- The donor community needs to see the enormity of funding and policy work required beyond country strategies. Something deeper needs to be achieved by engaging with the donor community in terms of institutional change and good practice. The Ministry of Finance of the government of India has devised a "Finance Plus" filter to ensure this. The achievement of the SDGs will need a fair amount of financial support and a fair amount of added benefits. The donor community has to respond to this.
- There is a need to work better together as associates and not as competitors at country and regional level, harmonising donor priorities with country priorities.
- Monitoring of SDG achievement needs to be embedded in the national and local system.

Anuradha Thakur is a member of the premier civil service of India, the IAS (Indian Administrative Service). This essay reflects her personal opinion gained from her experience as Principal Secretary of the Irrigation and Public Health Department and as Principal Secretary, Social Justice and Empowerment Department of the government of Himachal Pradesh, while working out the Action Plan for accomplishment of SDG 5 and SDG 6 in the State of Himachal Pradesh.

New tools can boost the local and regional contribution to financing sustainable development

Innovative instruments, partnerships and policies at the subnational and regional level present new opportunities. Some examples include:

- Sub-national pooled financing mechanisms (SPFMs) allow local governments to jointly access public sector funding, private capital markets and bank finance. This can help to overcome limitations of scale, expertise and credit history and thus reduce the costs of finance and increase efficiency. SPFMs can also develop local markets and increase standards of transparency, reporting and results (FMDV, 2017[38]).
- The European Union's Trade for All Strategy commits the European Union to a responsible trade and investment policy as an instrument of SDG implementation (European Commission, 2017[39]). Regulatory coherence mechanisms – particularly important for investment into regional infrastructure such as ICT – were explored through the Trans-Pacific Partnership negotiations (Bollyky, 2012[40]).

Multi-stakeholder partnerships can support subnational and supranational levels of governance to play an important role in financing sustainable development. For example, the R20 (subnational) Regions of Climate Action is a global partnership that aims to ensure cities and regions are leaders in reducing global carbon emissions (Box 6.6).

Box 6.6. R20 Regions of climate action

Founded in 2011 by Arnold Schwarzenegger, a former governor of the state of California, R20 is a coalition of subnational governments, private companies, international organisations, NGOs, and academic and financial institutions. It supports subnational governments in reducing carbon emissions and works towards a green economy through renewable energy, waste management and energy efficiency projects, in line with the Paris Climate Agreement, SDG 7 promoting affordable and clean energy and SDG 12 for responsible consumption and production. R20 aims to implement 100 infrastructure projects with USD 3 billion worthy capital expenditure by 2020. Since October 2014, R20 works with the State of Rio de Janeiro, 40 cities, technical partners and investors to retrofit street lights to energy-saving LEDs, with investor returns linked to energy and maintenance savings.

Local governments have a critical role to play in building climate-resilient societies. For instance, research by Yale University finds that sub-national programmes in eight countries alone could reduce 2020 emissions by 1 gigaton (Hsu et al., 2015[41]), – global carbon emissions were 32.5 gigatons in 2017 (IEA, 2018[42]). Municipalities are where such actions could matter most, as cities account for 60 to 80% of global CO^2 emissions (UNEP, 2017[43]).

Note: Additional information can be found at http://www.climate-kic.org/news/certification-standards-matter-city-level-climate-interventions/#_ftn1 and at: https://regions20.org/about-us-2/.

Global platforms and partnerships can bring systemic change

Financing for sustainable development actors must co-ordinate action across communities

Countries and partners, including the OECD, must prioritise the FSD agenda in order to achieve the promise of the Addis Ababa Action Agenda. This means working to strengthen international mechanisms, among them the UN-led Forum on Financing for Sustainable Development process (Chapter 1), and using global platforms to build bridges between policy communities - such as the e.g. Group of Twenty (G20), Group of 77 (G77) and Group of 7 (G7). The Charlevoix G7 meeting, which brought together finance and development ministers in pursuit of innovative finance, is one example of a global initiative designed to have concrete local effects. Efforts will continue under the Argentine and Japanese G20 presidencies, which will focus on infrastructure for development and quality standards respectively.

Global platforms can play a concrete role in building political will and co-ordinating the efforts of diverse communities. The G20 Compact With Africa demonstrates how political leadership can bring together multiple actors to achieve concrete, measurable results for local communities (Box 6.7).

Box 6.7. Compact with Africa

Initiated under the German G20 presidency, the Compact With Africa (CWA) was situated in the context of Agenda 2030 and the African Union's 2063 Agenda. The 2017 Hamburg summit launched the CWA as real GDP growth on the African continent declined and sovereign debt grew. The overarching goal of the CWA is to mobilise African and international governments and other partners to take concrete steps to increase private investment and particularly to fill the infrastructure gap. Under the overall CWA banner, each participant country selects its priorities. The actions to achieve those priorities are agreed under three pillars: a macroeconomic framework (including public expenditure, debt, tax, etc.); a business framework (improving the regulatory and enabling environment), and a financing framework (reducing costs and risks through de-risking instruments, reducing restrictions and developing domestic investment) (African Development Bank-IMF-World Bank Group, 2017[44]).

Compacts were agreed with the initial set of countries of Côte d'Ivoire, Ethiopia, Ghana, Morocco, Rwanda, Senegal and Tunisia and other countries are to be invited to join on a demand basis. A policy matrix was agreed under each of the three pillars, with G20 partners and institutions (IMF, World Bank Group and African Development Bank) assigned specific roles to support for implementation. The G20 private sector was encouraged to join as "pioneering investors". The CWA was complemented by the Marshall Plan with Africa that expands the agenda to include political governance, peace and security (German BMZ, 2017[45]).

Global mechanisms must be strengthened to maximise resources, especially for global public goods

Specialist and global funds are a major source of financing particularly for global public goods. They present a growing challenge in terms of prioritising and identifying gaps in tandem with the increasing the number of funds and volume of financing that is being sought. The International Development Association (IDA) is the world's largest trust fund, for example, and it attracted USD 75 billion at its IDA18 replenishment round (World Bank, 2016[46]). Currently, it is not clear how donors are prioritising and should prioritise across funds targeting climate, health, emergency relief and other aims. Maximising impact requires a better understanding of where and how much to allocate.

Global-level partnerships and instruments must be strengthened as they provide the opportunity to invest in deep systems change and cross-fertilise lessons from one region to another. A promising example from the philanthropic community is the Co-Impact platform, a new global philanthropists' collective that is partnering with social leaders, governments, non-profits and the private sector. With a target USD 500 million in initial funding, Co-Impact provides multi-year grants to:

- groups of partners from across sectors undertaking systems change plans to achieve change at scale, at the national or regional level

- groups taking what it terms a societal platforms approach to scaling, building a shared, universal infrastructure that allows a group's approach to translate geographies and contexts and grow networks of new partners

Global-level platforms are also critical for identifying opportunities for shared value and innovation that can be difficult to scale down. Smaller companies, for example, are less likely to be able to engage in development partnerships (OECD, forthcoming[3]) while the administrative costs of financial innovations such as green bond issuances or an advanced market commitment mean such financial instruments are often best handled at global scale.[12]

Global mechanisms are also critical to manage risk, with the oldest example being the IMF. Finance for sustainable development should be increasingly reflected in economic monitoring such as the IMF's Article IV consultations and OECD economic surveys. As discussed in Chapter 5, the impact of global policies and regulation from the perspective of financing for sustainable development must also be taken in consideration; for example, the impact of Basel III and other financial regulation must be considered (Domanski, 2018[47]).

Funding gaps remain across sectors and policy goals

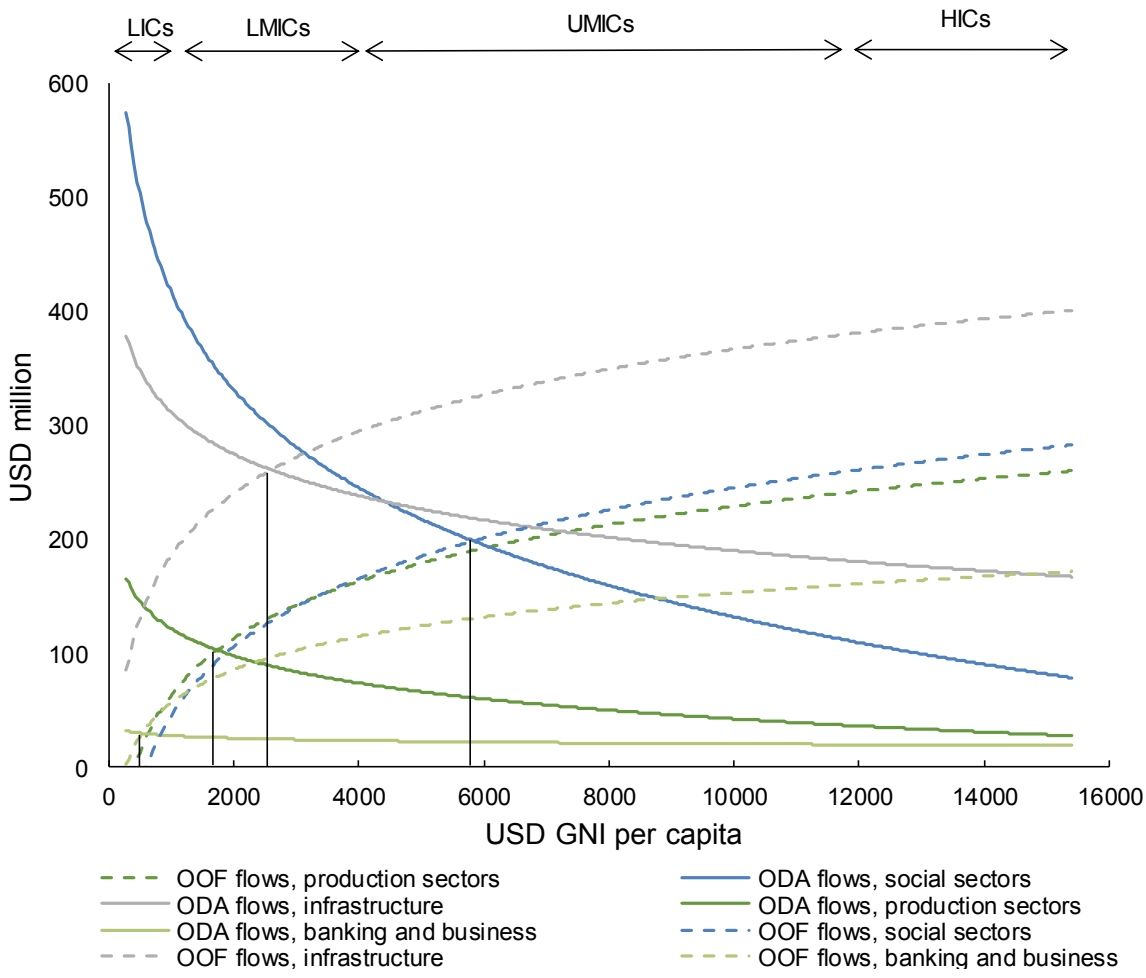
The implementation of holistic approaches should be tailored not only to country contexts, but also to sector and policy specificities, such as gender or climate.

Understanding the dynamic effects across sectors is crucial to avoid funding gaps as countries transition

New OECD work on transition finance shows that the dynamics affecting countries as they transition vary greatly by sector, as shown in Figure 6.8[13] DAC donors, for example, provide concessional (ODA) and non-concessional (other financial flows, or OOF) in different ways and according to the income level and the sector in question.

Figure 6.8. Monitoring the sectors at risk: Official development assistance and other official flows to developing countries 2012-16

From DAC members and multilaterals, 2015 prices, absolute terms



Note: This graph presents logarithmic trend lines.
Source: Author's calculations based on the OECD (2018[9]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for ODA and OOF flows; and the World Bank (2017[48]) "World Development Indicators" (database), https://datacatalog.worldbank.org/dataset/world-development-indicators for GNI per capita.

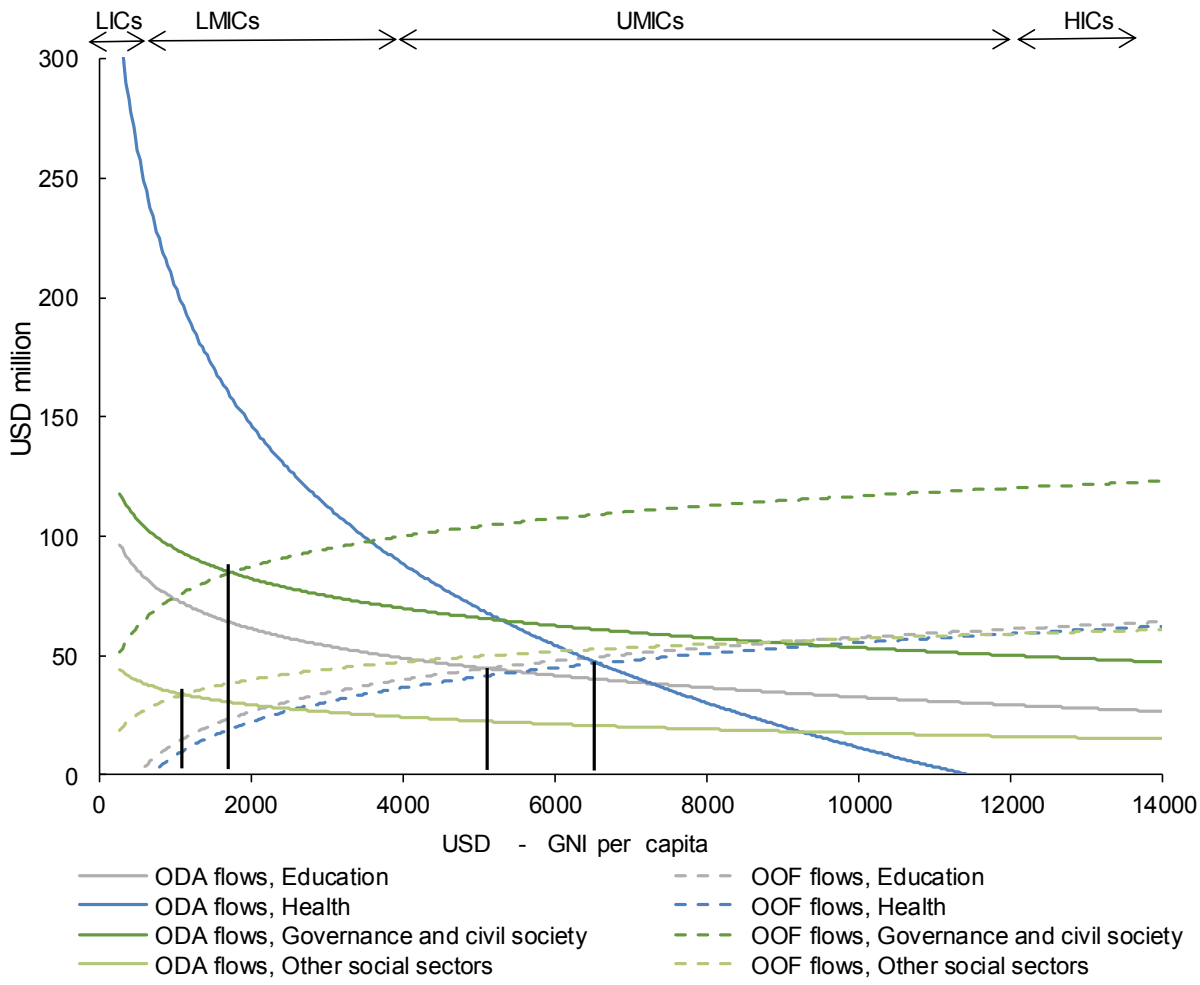
StatLink http://dx.doi.org/10.1787/888933853414

For some sectors such as banking and business, ODA appears to remain stable across income levels even as OOF increases. For productive sectors and infrastructure, the phasing out of ODA appears relatively evenly matched with the phasing in of OOF, although this may mask gaps for individual countries or sub-sectors.[14]

However, as income increases and concessional finance reduces, non-concessional finance may not increase correspondingly. This suggests potential transition gaps, particularly in the health sector. Figure 6.9 provides a disaggregated view of transition in social sectors. Health shows a high starting point and a sharp decline that is not observed in education, governance and other sectors.

Figure 6.9. Identifying transition gaps: Official development assistance and other official flows to social sectors 2012-16

From DAC members and multilaterals, 2015 prices, absolute terms



Note: This graph presents logarithmic trend lines.
Source: Author's calculations based on OECD (2018[9]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1 for ODA and OOF flows; and the World Bank (2017[48]) "World Development Indicators" (database), https://datacatalog.worldbank.org/dataset/world-development-indicators for GNI per capita.

StatLink http://dx.doi.org/10.1787/888933853433

A transition gap, as it could be called, may thus emerge unless social sector investment needs are lower or other financing – be it private, philanthropic or domestic public expenditure – is stepping in.

Development communities have started to respond to such gaps at the country level. The UN Conference on Trade and Development (UNCTAD), for example, provides special transitional support to countries as they graduate from LDC status. In a similar vein, the Economic Commission for Latin America and the Caribbean (ECLAC) has developed the Structural Gap Analysis approach to identify new ways to secure finance for middle-income countries in the region (UN, 2012[49]). Within IDA, special transition

arrangements were established for the Plurinational State of Bolivia, India, Sri Lanka and Viet Nam as they transitioned out of IDA eligibility and faced a substantial drop-off in development finance.

Nonetheless, further work is needed to respond to questions raised by these transitions across sectors. In the health sector, for example, what role are non-donor actors playing as concessional finance reduces? Is tax revenue-funded expenditure or private investment increasing, and if not, what can be done to support this transition? How are governments managing any transition gap and what are benchmark countries doing? Finally, how can donors best support a sustainable transition?

Further work also is needed to advise donors on options for ensuring sustainable transitions, for example by change allocation patterns, leveraging additional resources, and working with countries and sectors upstream to lay the groundwork for new forms of financing. Such work should complement and integrate existing needs and reform assessments. These assessments include World Health Organization work on health systems financing (McIntyre and Kutzin, 2016[50]) and OECD production transformation policy reviews of economic sectors (OECD Development Centre, 2018[51]).

Accelerating gender equality requires co-ordination across financing and policy

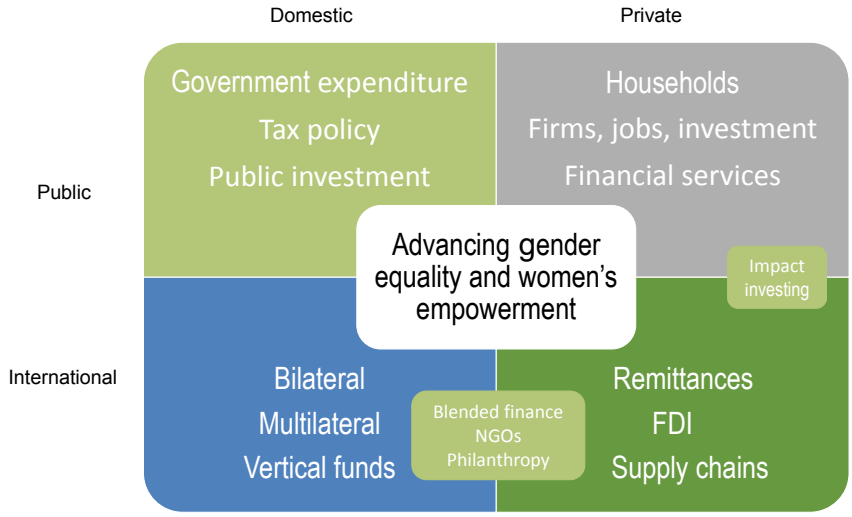
The 2030 Agenda commits to a significant increase in investments to close the gender gap and achieve SDG 5 (gender equality) (UN, 2015[52]). Gender equality is essential to ensure women's rights and could add trillions to global GDP (Woetzel and et al., 2015[53]).

Recently, the focus has been on gender-responsive budgeting to achieve gender equality; more than 80 governments have committed to some form of gender-responsive budgeting (Stotsky, 2016[54]) and donors are providing financial support for implementation (OECD, 2018[24]). Yet significant gaps remain in investment and impact (Downes, Trapp and Nicol, 2017[55]); (UN Women, 2015[56]).

To accelerate progress on gender equality, better mapping and co-ordination of actors are needed so financing is linked to policy. Recent work, notably by the IMF, suggests which spending and policies can jointly have the biggest impacts (Jain-Chandra et al., 2018[57]), but more gender-disaggregated data, experimentation and evaluation will be needed (World Bank, 2012[58]).

Accelerating gender equality furthermore requires co-ordinated action across countries, companies, foundations and other providers of finance. Figure 6.10 provides a non-exhaustive typology of the different financing sources required.

Figure 6.10. Towards a typology of financing sources for gender equality



Source: Author's illustration based on UN (2015[32]), *Addis Ababa Action Agenda of the Third International Conference on Financing for Development,* http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

Diverse financing sources can be harnessed by countries and individuals to support gender equality:

- Domestic resource mobilisation can increase or constrain gender equality. Personal income taxes can be structured in ways that encourage or discourage women from paid work through choices such as progressive tax credits, individual versus family taxation and taxation of the informal economy.
- Women directly receive a substantial proportion of remittances in some countries, for example 63% in Guatemala and 70% in Colombia (IOM/UN INSTRAW, 2007[59]), (IOM/UN INSTRAW, 2007[60]). Further work should be carried out to determine how policy can support an enabling environment for remittances (Chapter 3) and increase their impact on gender equality, for example through opportunities for productive investments.

Companies, foundations and other private providers of finance can have substantial impact by applying a gender lens. Policy efforts such as those outlined in Chapter 5 are increasing to ensure high standards by foreign direct investors, including in female-dominated sectors such as the garment industry. For multinational enterprises, as well as international, responsible supply chain standards, can influence policies and practices. Policies on recruitment, conditions, advancement and procurement choices all can affect women's empowerment.

The volume of foundation financing of women's empowerment initiatives was estimated at around USD 3.7 billion over 2013-15. The Bill & Melinda Gates Foundation (43%) and the Susan Thompson Buffett Foundation (19%) dominated the field of foundations financing such initiatives (OECD, 2018[2]).[15] The OECD Network of Foundations Working for Development (netFWD) has launched a working group on gender to examine funding trends in greater depth.

Private actors are also engaging in innovative partnerships for gender equality (Box 6.8).

Box 6.8. Innovative partnerships can drive gender equality

Innovative partnerships for gender equality are blossoming

The G7's **2X Challenge**, launched under Canada's leadership at the Charlevoix summit, calls for the mobilisation of USD 3 billion to provide women in developing countries with improved access to leadership opportunities, quality employment, finance, enterprise support, and products and services that enhance economic participation and access.

The **Women's World Banking Capital Partners Fund II** (WWBCP II) aims to improve women's financial inclusion by leveraging concessional equity to attract investors to women-focused financial services providers in emerging markets, low-income countries and fragile contexts. The USD 100-million fund will invest in services such as financing for small and medium-sized enterprises, smallholder finance, affordable housing, education, and insurance. The largest allocations will be in sub-Saharan Africa, the Middle East and North Africa, and South Asia.

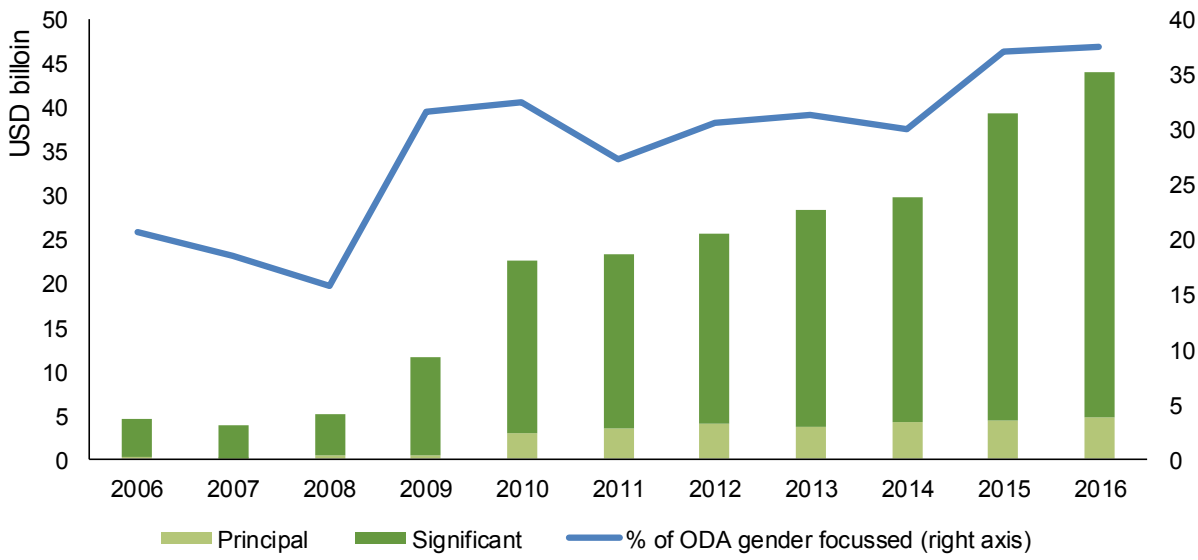
Entrepreneurship programmes also are focusing on women's empowerment, including the Goldman Sachs **10,000 Women** programme that is active in 43 countries and the Coca-Cola **5x20** programme, which aims to help 5 million women entrepreneurs by 2020 and is active in more than 12 countries.

The **Global Impact Investing Network** looks for investment strategies that seek to intentionally and measurably address gender disparities and/or examine gender dynamics to better inform investment decisions.[16]

Although bilateral ODA that integrates gender equality as a significant (albeit secondary) objective has increased over time, more must be done at the level of providers:

- ODA with gender equality as a principal objective lags behind what is needed to achieve commitments in the 2030 Agenda.[17] Figure 6.11 illustrates the proportion of ODA aimed at gender equality. The OECD DAC Network on Gender Equality has called on DAC members to strengthen their gender equality programming in the economic and productive sectors, particularly in areas where the private sector is unlikely to invest (OECD DAC, 2018[61]); (OECD DAC, 2016[62]).
- While funds such as the Global Fund for Women are dedicated to gender equality and women's empowerment, most vertical funds and instruments (Chapter 2) do not yet incorporate a gender equality perspective. Within green finance, for example, only the Green Climate Fund has explicitly mainstreamed gender considerations (Green Climate Fund, 2014[63]). The potential gender equality impact of new instruments such as taxes on international financial transactions and air travel should be included in their design.

Figure 6.11. The proportion of official development assistance that aims to achieve gender equality



Source: OECD DAC (2018[61]), "Aid to Gender Equality and Women's Empowerment: An Overview". https://www.oecd.org/dac/gender-development/Aid-to-gender-overview-2018.pdf.

StatLink http://dx.doi.org/10.1787/888933853452

The urgent need to achieve the climate transition requires all financing to move towards compatibility with the Paris Agreement

The Paris Agreement on Climate Change and the 2030 Agenda are inextricably linked and neither will succeed if one fails. With just 12 years left to cut fossil fuels, the climate agenda has never been more urgent (Intergovernmental Panel on Climate Change, 2018[64]).

The recent OECD (2017[65]) report, *Investing in Climate, Investing in Growth*, argues that a low emissions future is necessary for economic growth, increased productivity and reduced inequalities and notes that in the long run, GDP growth could increase by up to 2.8% on average in 2050 if a coherent package of financing and policy across the G20 is achieved.

For example, deep changes in how energy is used and produced are required, which governments can only achieve in partnership with others (Box 6.9). To keep within the International Energy Agency's (IEA) 2-degree scenario, by 2050, 95% of electricity needs to be low carbon; 70% of new cars need to be electric; and the CO2 intensity of industry needs to be 80% lower than it is today (OECD, 2017[65]).[18]

Box 6.9. Innovative partnerships can accelerate the climate transition

At the architecture level, the NDC Partnership is a coalition of countries and development co-operation providers that promotes the strengthening and implementation of nationally determined contributions (NDCs) in developing countries through technical assistance.

Emerging economies are driving new coalitions to promote low-carbon infrastructure such as the International Solar Alliance, a large-scale initiative that is driven by India and aims to scale up deployment of solar energy, with a target of mobilising USD 1 trillion by 2030.

Public-private coalitions are emerging. One is the Global Innovation Lab for Climate Finance, which disseminates small- and large-scale innovative solutions and instruments to build new markets, attract new investors and increase climate-friendly investment in developing countries. Similarly, investors, development banks, financial sector associations and NGOs launched the Green Infrastructure Investment Coalition launched by at COP21 as a platform to spur commercial investment in environmentally sustainable infrastructure projects.[19]

To achieve these needed climate goals, diverse financing sources can be harnessed by countries and domestic actors:

- Domestic resource mobilisation must be reviewed to be compatible with the Paris Agreement. The mix and structure of taxation and expenditure are critical to align incentives towards inclusive, low-emission and resilient development. These not only have a direct effect but also can catalyse industrial and business model innovation. Further, green fiscal policies such as carbon taxes can bring broader development finance wins such as substantial reductions in public debt-to-GDP (OECD, 2017[65]).
- Mobilising the required financing requires a positive enabling environment for green investments, reform of energy state-owned enterprises (SoEs), etc. Beyond the energy sector, reform of land use sectors such as agriculture and forestry can help to scale up the transformation; ecosystems need to be enhanced as carbon sinks. Research and development also need to be strengthened and incentivised to tackle emissions from energy, industry and transport and to improve agricultural yields and resilience (OECD, 2017[65]).
- Diagnostic tools such as the mobilising private finance tool developed by the Overseas Development Institute (Whitley, Canales Trujillo and Norman, 2016[66]) and the OECD's Policy Framework for Investment can help map needs, incentives and guide green investments.
- National development banks contributed 21% of primary financing for privately financed infrastructure projects in developing economies and could be key domestic partners in increasing finance (Box 6.10).

Box 6.10. National development banks can be key innovators and intermediaries in green infrastructure finance

Low-carbon, climate-resilient infrastructure is a foundation of the climate transition, which requires policies to align and differing financing actors to work together. National development banks (NDBs) can be key connectors, partners and innovators. In South Africa, for example, the Development Bank of Southern Africa is financing the development of renewable energy projects.

NDBs banks are in a privileged position to understand country-specific bottlenecks to low-carbon infrastructure investments due to their closeness to market and long-standing relationships with local actors, both public and private. NDBs can mobilise local private finance based on their special status within their countries (Smallridge et al., 2013[67]). In India, NDBs have access to soft funds from the Reserve Bank of India and can issue securities that qualify as reserves (Kumar, 2016[68]). NDBs are also important intermediaries to channel international development finance, for example from the Green Climate Fund. Figure 6.12 illustrates some of their main features.

Figure 6.12. Key features of national development banks

Source: Smallridge et al (2013[67]), *The Role of National Development Banks in Catalyzing International Climate Finance*, https://publications.iadb.org/bitstream/handle/11319/3478/Role%20of%20NDB%203-12-13final%20web.pdf?sequence=2.

Companies, foundations and other private financiers have a major role to play. Businesses can benefit from the opportunities that green growth presents and also need to manage risks from climate change (Crishna Morgado and Lasfargues, 2017[69]). For example:

- Institutional investors are convening around groups such as the Institutional Investors Group on Climate Change (IIGCC). With a membership comprising of nine of the ten largest institutional investors in Europe and over EUR 13 trillion in funds under management, IIGCC aims to minimise losses from stranded assets and other climate risks by lobbying for climate-friendly policy and investment behaviour.
- The financial system itself needs to better value and incorporate climate-related risks, for example by mainstreaming climate risk into the financial disclosures required for publicly listed companies. This is especially important for large asset owners and managers, many of whom are based in OECD countries (Task Force on Climate-related Financial Disclosures, 2017[70]).
- Philanthropy represents a growing financing source for climate transition in developing countries. The Philanthropy Task Force for the implementation of the Paris Agreement was launched during the One Planet Summit in Paris in December 2017 to identify priorities for further philanthropic investment, models for innovative partnerships and innovative solutions to raise climate finance.

Internationally, official actors have made – and now must implement – substantial commitments. In France, the AFD has set two targets. One was to channel 50% of its annual funding to projects with climate co-benefits, which it achieved in 2017. The second is a target of EUR 5 billion of climate finance by 2020, EUR 1.5 billion of which is for adaptation (OECD, 2017[65]).

- Bilateral climate-related development finance is on an upward trend, exceeding USD 30 billion in 2016, with mitigation finance dominating.[20] This must be matched by policy coherence. As high-income and G20 countries are responsible for the bulk of global emissions, bilateral actors must play a leadership role to ensure policy and financing coherence in support of the low-carbon transition.
- Bilateral development banks are also increasing their focus on climate finance and low-carbon infrastructure. On average between 2013 and 2015, 68% of AFD financing for infrastructure, 58% of such financing from KfW Development Bank and 40% of JICA's financing for infrastructure targeted climate change directly (OECD, 2017[65]).
- Multinational development banks (MDBs) have made significant commitments towards green finance, supporting more than one-third of estimated flows of public climate finance in 2013-14 under the USD 100 billion-commitment (OECD, 2015[71]). Between 2006 and 2016, the share of MDB support for renewable energy technologies (excluding hydropower) grew significantly (13% annually) but was still outstripped by the share of support for fossil fuels (15.7% annually), a trend that must be changed (OECD, 2017[65]).

The universe of financing actors is diverse and each brings its own comparative advantages to financing the climate transition. However, all must work in concert if the urgent change required is to be achieved. The world's ambitious and necessary climate aims require that financing for sustainable development from all sources be reviewed to move towards compatibility with the Paris Agreement.

Conclusion and recommendations

To reach full potential, the FSD system must put in place the key final element of its challenges – operations, where demand for financing for sustainable development meets supply. As described in this chapter, a number of tools are evolving to help financing actors to co-ordinate while fulfilling their niche roles. A core component is the integrated national financing frameworks (INFFs) that are called for in the Addis Ababa Action Agenda (paragraph 9). Yet the design of INFFs and mapping of opportunities remain incomplete, and important levels of governance, country and sector specificities are yet to be fully integrated.

While it is too soon to fully assess the efficacy of all FSD tools, **it is already clear that a more coherent FSD toolkit is needed and that gaps in its implementation need to be addressed** in line with SDG 17 (partnerships for the goals) and principles of effective development co-operation. Therefore, the following are necessary steps:

- Fill the INFF implementation gap by promoting a coherent FSD toolkit and moving from a plethora of diagnostics to co-ordinated implementation of recommendations.
- Promote multi-stakeholder partnerships and mechanisms such as inclusive policy dialogue to and ensure alignment of financing with country ownership.
- Build capacity in developing countries to manage the complexity of the FSD market, both in driving priorities (ownership) and co-ordinating actors, and to fill capacity gaps such as managing specific instruments.

Solutions need to be tailored to sectors and integrate different levels of governance.

- Develop FSD strategies adapted to country specificities such as those pertaining to small island states, landlocked states and least developed countries, building on the example of Financing for Stability.
- Explore opportunities for partnerships and new financing mechanisms at the subnational, regional and global levels. Actors could explore the inclusion of the SDGs in regional trade and investment agreements; support partnerships and capacity development among subnational governments; and map global funds and explore how to mobilise additional financing for global public goods.
- Further map specific sectors and policy goals for FSD opportunities, for example moving towards development finance that is compatible with the Paris Agreement on Climate Change.

Expand the state-of-the-art knowledge about FSD. Further research and policy guidance are needed to fill knowledge gaps and deliver more effective financing.

- As INFFs are implemented, evaluate their effectiveness and develop guidelines on what works.
- Further explore the role of different FSD actors and sources in sectors and policies as countries transition in order to avoid setbacks as countries lose access to concessional finance.
- Further explore how to articulate roles among financing actors. Examples include making best use of private and blended finance, integrating remittances into

financing strategies, and improving diagnostics to find and fill SDG financing gaps.

Along with efforts to achieve transparency (Chapter 5) and better regulation (Chapter 6), transforming operations in this way will help actors to assess financing and policy needs, map resources, and deliver the partnerships, innovation and capacity development required to achieve the SDGs.

Notes

[1] The Copenhagen Consensus Center advises governments on prioritising the SDGs, making use of methodologies based in welfare economics and cost-benefit analysis https://www.copenhagenconsensus.com/.

[2] The MDCR methodology makes use of Vulnerability-Adjusted Tax Effort Index developed by the Foundation for Studies and Research on International Development (FERDI). For further information on the index, see (Yohou and Goujon, 2017[96]) http://www.ferdi.fr/sites/www.ferdi.fr/files/publication/fichiers/p186-ferdi_hyohou-mgoujon_0.pdf.

[3] Of 81 low-income and middle-income countries and territories that participated in the 2016 Global Partnership for Effective Development Co-operation monitoring, 80 had a national development strategy at the country and sector level. See (OECD-UNDP, 2016[26]) for further details.

[4] Many governments use aid management platforms among them Côte d'Ivoire, Jordan, Kyrgyzstan, Lao People's Democratic Republic, Malawi, Madagascar and Nepal.

[5] The source is the Global Outlook on Financing for Sustainable Development Survey.

[6] Following 2018 federal elections, these proposals are subject to discussions with the incoming federal government of Mexico.

[7] GPEDC monitoring indicator nine emphasises the quality and use of country public financial management and procurement systems. Where development partners do not use country systems, a lack of confidence in the quality of PFM systems is often cited as the reason why.

[8] The seven Addis Ababa Action Agenda action areas are domestic public resources; domestic and international private business and finance; international development co-operation; international trade as an engine for development; debt and debt sustainability; addressing systemic issues; and science, technology, innovation and capacity building. A myriad of sectoral and thematic implementation actions are included within these broad action areas.

[9] Respondents to the "Global Outlook on Financing for Sustainable Development Survey of DAC Members" gave varying criteria for additionality including economically and socially responsible business conduct and increasing human capital to increasing the proportion of micro and small and medium-size enterprises in the economy (OECD, 2018[24]). Several countries report they are developing criteria for additionality.

[10] Here, regional refers to the supranational rather than the subnational level of governance.

[11] The five are the Power Pools of East Africa, Western Africa, Southern Africa, Central Africa and the Maghreb.

[12] The original advanced market commitment was for USD 1.5 billion for the pneumococcal vaccine.

[13] A country in transition should be considered a success story, but such countries also face special challenges. For example, the transition out of least developed country status brings the loss of concessions and preferences such as tariff and quota-free trade access. Additionally, changes in income group classification can decrease the volume and increase the price of development finance, which may not be mirrored by increases in volume and decreases in price of market-based instruments. Moreover, once countries are in the high-income classification for three consecutive years, they transition out of ODA-eligibility.

[14] Graphs 6.8 and 6.9 provide an illustration of trends in ODA and OOF as they relate to growth in GNI per capita. Actual financing gaps are context-specific and depend on other variable as well.

[15] This is estimated differently than the gender markers referred to above, and includes activities recorded under the OECD (2018[9]) Creditor Reporting System database purpose codes related to support to women's equality organisations, ending violence against women and girls, reproductive health care, family planning and other activities supporting women and girls as suggested by qualitative information in descriptive fields of individual activities.

[16] For more information, see https://thegiin.org/gender-lens-investing-initiative.

[17] In 2015-16, dedicated programming focussed on gender equality as a principal objective amounted to USD 4.6 billion per year, corresponding to 4% of DAC members' total bilateral allocable aid. Out of the USD 4.6 billion of aid for dedicated programmes targeting gender equality and women's empowerment as a principal objective, the largest amount is allocated in the government and civil society sector, followed by population and reproductive health and health. On the other hand, very little aid dedicated to gender equality as a principal objective is committed in the sectors of economic infrastructure and services, business, and banking and financial services. See also (OECD DAC, 2018[61]), https://www.oecd.org/dac/gender-development/Aid-to-gender-overview-2018.pdf and (OECD DAC, 2016[62]), https://www.oecd.org/dac/gender-development/Tracking-the-money-for-womens-economic-empowerment.pdf.

[18] Since investment gap for infrastructure is highest for middle-income countries, ensuring the climate compatibility of the infrastructure that is built in these countries will help determine whether the Paris Agreement goals are met or not (OECD, 2017[65]).

[19] Further information is at https://ndcpartnership.org/, http://isolaralliance.org/ and https://www.climatefinancelab.org/the-labs/global/.

[20] Adaptation-related development finance was committed primarily to LMICs (32%) and LICs, including LDCs. At just 8%, LICs had the highest share of adaptation-related development finance over total development finance.

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Glossary

Addis Ababa Action Agenda (AAAA)

Negotiated at the Third Financing for Development Conference in Addis Ababa, Ethiopia, in July 2015, the AAAA sets out a strategy for implementing the global sustainable development agenda adopted in September 2015. It includes more than 100 measures covering all sources of finance and includes co-operation on a range of issues including technology, science, innovation, trade and capacity building.

Advanced market commitment

An advanced market commitment is one whereby donors provide a demand guarantee in exchange for commitments by pharmaceutical firms to research medicines or vaccines for diseases that are prevalent mainly in lower-income countries.

Agenda 2030 or the 2030 Agenda for Sustainable Development

The 2030 Agenda for Sustainable Development is centred on the 17 Sustainable Development Goals agreed in September 2015. It is also conceived as a broad agenda that includes the AAAA as a framework for implementation and the Paris Agreement on Climate Change, and that builds on a history of multilateral agreements such as the Universal Declaration of Human Rights.

Aid effectiveness

Aid effectiveness refers to how DAC members measure the degree to which their delivery of aid will increase its effect, notably by harmonising their funding and by using and strengthening a partner country's own systems.

Aid for trade

Aid for trade is official development assistance (ODA), including grants and concessional loans, which targets support to developing countries so they can build the trade capacity and infrastructure they need to benefit from trade opening.

Bilateral flow

Bilateral transactions are those undertaken by a development assistance provider directly with a developing country. They also are transactions channeled through multilateral agencies ("multi-bi" or "earmarked" contributions), transactions with non-governmental organisations active in development, and other internal development-related transactions.

Bonds

Bonds are fixed-interest debt instruments that are issued by governments, public utilities, banks or companies and are tradable in financial markets.

Blended finance

Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries.

Capacity building

Capacity building is the development and strengthening of human and institutional resources. The United Nations Development Programme (UNDP) states that capacity lies in the ability to perform functions, solve problems, and achieve objects at the individual, institutional and societal levels.

Cascade approach

The World Bank Group introduced the cascade approach in 2016 as a means of conceptualising strategies to maximise financing for development by leveraging the private sector and optimising the use of scarce public resources.

Catalytic effect

Official development finance, which is the only form of financing for sustainable development with an explicitly development-oriented mandate, is said to be catalytic to the degree it speeds up positive change, unlocks other forms of financing for development and/or increases the development footprint of financing.

Civil society organisations (CSOs)

CSOs can be defined as including all non-market and non-state groupings of people outside of the household and by which people organise themselves to pursue shared interests in the public domain. Examples include community-based organisations and village associations, environmental groups, women's rights groups, farmers' associations, faith-based organisations, labour unions, co-operatives, professional associations, chambers of commerce, independent research institutes and the not-for-profit media.

Collective investment vehicle (CIV)

A CIV is a legal entity in which different actors pool their resources to make collective investments in specific segments.

Commitment

A commitment is a firm, written obligation by a government or official agency that is backed by the appropriation or availability of necessary funds, provides a specified amount of resources under specified financial terms and conditions, and provides these for specified purposes for the benefit of a recipient country or a multilateral agency.

Concessional loans

These are loans that are extended on terms substantially more generous than market loans. The concessionality is achieved through interest rates below those available on the market, by grace periods or a combination of these. Concessional loans typically have long grace periods.

Countercyclical

A policy move in the opposite direction to the current business cycle. For example, countercyclical fiscal policy involves reducing spending and raising taxes during a period of high growth, and increasing spending and cutting taxes during a recession.

Country programmable aid (CPA)

The portion of aid that providers can programme for individual countries or regions, and over which partner countries could have a significant say, is country programmable aid. Developed in 2007, CPA is a closer proxy of aid that goes to partner countries than official development assistance (ODA).

Country ownership

One of the four principles of the Busan Partnership for Effective Development Co-operation, country ownership signifies that a country defines the development priorities and model it wants to implement. The investments of other actors should align with national strategic priorities and plans and use country systems as far as possible.

Creditor Reporting System (CRS)

CRS is the central statistical reporting system of the OECD Development Assistance Committee (DAC). Bilateral and multilateral providers of development co-operation report to CRS at item level on all flows of resources to developing countries. CRS is governed by reporting rules and agreed classifications and used to produce various aggregates, making DAC statistics the internationally recognised source of comparable and transparent data on official development assistance (ODA) and other resource flows to developing countries.

Decentralised development co-operation

Decentralised development co-operation is a method of development co-operation carried out by subnational actors, who can include economic actors, civil society organisations, deconcentrated state services, autonomous public institutions (universities), and/or decentralised public authorities and agencies. It can include twinning arrangements, partnerships, cultural, educational, business, professional and technical exchanges and projects, as well as financial arrangements.

Development Assistance Committee

The Development Assistance Committee (DAC) is the committee of the Organisation for Economic Co-operation and Development (OECD) that deals with development co-operation matters. A description of its aims and a list of its members are available at: www.oecd.org/dac.

Development finance institution (DFI)

A development finance institutions is a government-backed or quasi-government-backed institutions that provides financial support for private sector projects in developing countries.

Development footprint

The World Bank defines the development footprint of the private sector as the investments and operations in developing countries that transfer capital, technology, knowledge and know-how. The operations of global firms, the standards they expect their suppliers and partners to meet, the societal values and norms they promote through their operations – all can profoundly affect the future of developing economies. The direct and indirect effects of transfers of all kinds, whether tangible or not, represent the development footprint of global business and value chains.

Diaspora bond

A diaspora bond is a bond issued by a country of origin in order to access a portion of the savings of the communities of its emigrants, or diaspora communities, outside the country. Diaspora bonds that offer interest rates above the often-negligible bank rate in OECD countries can be attractive to members of the diaspora, while also allowing the issuing country to access financing at an attractive rate. A number of countries are considering these, and Israel has been issuing diaspora bonds since 1951.

Disbursement

A disbursement is the release of funds to or the purchase of goods or services for a recipient and, by extension, the amount thus spent. A disbursements records the actual international transfer of financial resources or of goods or services valued at the cost to the provider.

Domestic resource mobilisation (DRM)

Domestic resource mobilisation is the process through which countries raise and spend their own funds to provide for their people. Such resource allocation can come from both the public and private sectors. The public sector does this through taxation and other forms of public revenue generation

Aid for domestic resource mobilisation supports tax policy, analysis, administration and non-tax public revenue. Such support is carried out in close collaboration with ministries of finance, line ministries, revenue authorities, or other local, regional or national public bodies in the recipient country.

Economic infrastructure and services

In the DAC sectoral classification, economic infrastructure and services relate to assistance for networks, utilities and services that facilitate economic activity, notably transport and storage, communications, energy generation, distribution and efficiency, banking and financial services, and business and other services. For more information see www.oecd.org/dac/stats/purposecodessectorclassification.htm.

Effective development co-operation

The Busan Partnership for Effective Development Co-operation sets out principles that are reinforced in the Nairobi Outcome Document and include country ownership, results, inclusive partnerships, transparency and accountability. The Global Partnership for Effective Development Co-operation is supported by an indicator framework and global monitoring.

Enablers

In the context of development, enabler refers to something that enables other positive change to take place. For example, education can be seen as an enabler of positive employment outcomes and economic growth. Enablers are often context-dependent.

Equity

Equity is a share in the ownership of a corporation that gives the owner claims on the residual value of the corporation after creditors' claim have been met.

Export credit

Export credits are an insurance, guarantee, or financing arrangement for the purpose of trade that are not represented by a negotiable instrument. Export credits may be extended by the official or the private sector. If extended by the private sector, they may be supported by official guarantees.

Extreme poverty

Since 2015, extreme poverty is defined using an updated international poverty line of USD 1.90 a day. It was revised upwards from USD 1.25 a day and incorporates new information on differences in the cost of living across countries (purchasing power parity exchange rates). Under this definition, the proportion of people living in extreme poverty was projected to drop below 10% of the world's population in 2015.

Financing gap

The Sustainable Development Goal (SDG) financing gap refers to the additional quantity of funds to be leveraged in order to achieve the SDGs by 2030.

Foreign direct investment (FDI)

Foreign direct investment is a category of cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor.

Gini coefficient

The Gini coefficient is a measure of statistical dispersion intended to represent the income or wealth distribution of a nation's residents. It is the most commonly used measurement of inequality. A Gini coefficient of 0 represents perfect equality; a Gini coefficient of 1 represents the maximal inequality.

Global value chain (GVC)

The term global value chains refers to international production, trade and investments whose different stages of the production process are located across different countries.

Grants

Grants are transfers made in cash, goods or services for which no repayment is required.

Greenfield investment

A greenfield investment is one in which a new venture is set up by constructing new facilities. Its opposite is a brownfield investment, where an entity purchases an existing facility to begin new production.

Guarantee

A guarantee is an agreement where the guarantor (often a government) agrees to fulfil certain conditions of a financial agreement in the event that they are not otherwise met. For example, the government may guarantee to repay the amount outstanding on a loan in the event of default. Governments may also provide guarantees covering risks such as the risk that revenue or demand may be lower than anticipated by investors, or risks from changes in exchange rate or price.

Holistic approach

The 2002 Monterrey Consensus (paragraph 8) said a holistic approach is essential to address the interconnected challenges of financing for –"sustainable, gender-sensitive, people-centred development". A holistic approach is one that recognises that economic, social and environmental areas of the development agenda are interrelated, and that seeks to ensure actions are collective, coherent and involve all stakeholders in active partnerships.

Impact bond

A social impact bond is an innovative financing mechanism by which governments or enter into agreements with service providers such as social enterprises, non-profit organisations, and investors, to achieve specified social outcomes. The investors receive return subject to the achievement of these pre-defined social outcomes, usually based on expenditure savings realised by the government.

Inclusive growth

Inclusive growth is growth that is held to be fairly distributed across society, creating economic opportunities for all.

Instrument

Instruments refers to financial instruments, which are the financial mechanisms and structures through financing occurs. Instruments are monetary contracts between parties that can include a transfer of cash (e.g. currency), evidence of an ownership interest in an entity (e.g. share), or a contractual right to receive or deliver cash (e.g. bond). The instruments covered by this report are defined in Chapter 2.

Interlinkages

Interlinkages between resource flows, actors, and policies refer to links whereby one flow, actor or policy area affects another. These can involve positive or negative spill-overs as well as interactions in decision-making processes and actions.

Key performance indicator (KPI)

A key performance indicator is one of a set of quantifiable measures that a company or industry uses to gauge or compare performance in terms of meeting their strategic and operational goals. See www.investopedia.com.

Least developed country (LDC)

The United Nations defines a least developed country as one with low income that is also confronting severe structural impediments to sustainable development. LDCs are highly vulnerable to economic and environmental shocks and have low levels of human assets. Currently, 47 countries figure on the list of LDCs, which the Committee for Development (CDP) reviews every three years. LDCs have exclusive access to certain international support measures, in particular in the areas of development assistance and trade.

Merger and acquisition (M&A)

M&A is oone of the primary forms of investment in foreign markets and a major component of foreign direct investment. Data on M&A cover a variety of financial transactions that can range from the full merger of two previously independent firms to the acquisition of a minority stake in a strategic partner.

Mezzanine finance

Mezzanine finance is a hybrid instrument that combines features of debt and equity. In the event of bankruptcy, mezzanine investors have lower rankings than other creditors but higher rankings than equity investors.

Millennium Development Goal (MDG)

The Millennium Development Goals predate the Sustainable Development Goals. Signed in September 2000, the MDGs committed world leaders to combat poverty, hunger, disease, illiteracy, environmental degradation and discrimination against women. At the end of the MDG era, in 2015, the MDGs were only partially achieved.

Monterrey Consensus

The Monterrey Consensus was the outcome document of the First International Conference on Financing for Development that took place in Monterrey, Mexico, in March 2002. It was the first United Nations-sponsored, summit-level meeting to address key financial and related issues pertaining to global development. It also marked the first time governments, civil society, the business community and the institutional stakeholders shared views on global economic issues at this level.

Multilateral flow

Aid activities financed from the multilateral institutions' regular budgets are referred to as multilateral flows. Activities reported in the Creditor Reporting System database under multilateral flows include those of the World Bank, the regional development banks, some UN agencies and other multilateral agencies. Aid activities from the Bill & Melinda Gates Foundation are also included.

Mutual accountability

The OECD DAC defines mutual accountability as "a process by which two (or multiple) partners agree to be held responsible for the commitments that they have voluntarily made to each other. It relies on trust and partnership around shared agendas, rather than on 'hard' sanctions for non-compliance, to encourage the behaviour change needed to meet commitments." See https://www.oecd.org/dac/effectiveness/49656340.pdf.

Non-governmental organisation (NGO)

A non-governmental organisation is any non-profit entity in which people organise themselves on a local, national or international level to pursue shared objectives and ideals, without significant government-controlled participation or representation. NGOs include co-operative societies, trade unions and ad-hoc entities set up to collect funds for a specific purpose.

Official development assistance (ODA)

The DAC defines ODA as those flows to countries and territories on the DAC List of ODA Recipients which are:

1. provided by official agencies, including state and local governments, or by their executive agencies; and
2. each transaction of which:
    a. is administered with the promotion of the economic development and welfare of developing countries as its main objective; and

b. is concessional in character and conveys a grant element of at least 25% (calculated at a rate of discount of 10%).”

ODA is the basic financial support used to develop the building blocks of nations such as healthcare, education services and infrastructure. Once the building blocks are firmly in place, countries can typically start to attract or develop other sources of development finance as they move up the income scale. ODA can flow directly from a donor to a recipient country (bilateral ODA) or be provided via a multilateral agency (multilateral ODA). (Source: OECD DAC).

Official development finance (ODF)

Official development finance is used in measuring the inflow of resources to recipient countries. It includes bilateral ODA; grants and concessional and non-concessional development lending by multilateral financial institutions; and other official flows (OOF) for development purposes (including refinancing loans) which have too low a grant element to qualify as ODA.

Other official flows (OOF)

Other official flows are transactions by the official sector which do not meet the conditions for eligibility as official development assistance (ODA), either because they are not primarily aimed at development or because they have a grant element of less than 25%.

Paris Club

The Paris Club is an informal group of official creditors who aim to find co-ordinated and sustainable solutions to payment difficulties experienced by debtor countries. The Paris Club has 22 permanent members, including most of the western European and Scandinavian nations, the United States, the United Kingdom and Japan. It also invites ad hoc participants and observers. The first meeting of the Paris Club with a debtor nation was in 1956, with Argentina, and since then, USD 583 billion of debt has been treated in the framework of Paris Club agreements.

Philanthropic foundation

A philanthropic foundation is a nongovernmental, non-profit organisation whose funds derive usually from a single source such as an individual, family or corporation and whose programme managed by its own trustees or directors. Such foundations usually are established to maintain or aid social, educational, religious or other charitable activities serving the common welfare, primarily through grant making. The only philanthropic flows referred to in this report are those provided in support to sustainable development.

Policy coherence

Policy coherence refers to the design, implementation and monitoring of coherent and integrated policies for sustainable development. This entails fostering synergies across economic, social and environmental policy areas; identifying trade-offs and reconciling domestic and international objectives; and addressing the spillovers of domestic policies on other countries and on future generations.

Portfolio investment

Portfolio investments are investments in the form of a group (portfolio) of assets, including transactions in equity and debt securities. Unlike direct investments, which

involve taking a sizable stake in a target company, portfolio investments do not acquire more than 10% of ownership.

Production sectors

In the DAC sectoral classification, production sectors include activities in support of agriculture, forestry, fishing, industry/manufacturing, mineral resources and mining, construction, tourism and trade policy and regulations and trade-related adjustments. For more information see www.oecd.org/dac/stats/purposecodessectorclassification.htm.

Project finance

Project finance is a form of investment that uses a non-recourse or limited recourse financial structure. In this structure, the debt and equity used to finance the project are paid back from the cash flow generated by the project rather than from the balance sheets of the project's sponsors. Project finance is used for the financing of long-term infrastructure, industrial projects and public services.

Public-private partnerships (PPPs) and networks

Public-private partnerships and networks are collaborative arrangements among private actors and bilateral/multilateral agencies or governments. A PPP is an operational partnership whose board or other governance structure includes both public officials and private individuals; a network is a global or regional organisation that supports and brings together public sector, private sector and civil society organisations with similar goals to facilitate knowledge sharing.

The term PPP is often used in infrastructure development, where it refers to a range of contractual forms used in project finance. Such contracts share risk between the public and private sector. For example, a build-operate-transfer (BOT) contract is a type of PPP that grants a concession from the government to a private company to finance, build and operate an asset for a set period. The company receives revenue from user charges or the government to recoup its investment. At the end of the period, control of the asset is transferred back to the government.

Remittances

Remittances are funds sent by individuals living and working abroad to their home countries.

Safeguards

Social safeguard policies or safeguards are policies and redress mechanisms to prevent and mitigate undue harm to people during the development process.

SDG washing

SDG washing is a recent term that signifies the use of Sustainable Development Goals (SDGs) as a marketing or branding strategy and without evaluation or actual impacts, particularly negative impacts. For example, electric car companies may wish to emphasise their contribution to renewable energy and climate change action (SDGs 7 and 13) without acknowledging that labour rights (SDG 8) may have been violated in the mining of the cobalt used in their cars' batteries (SDG 8).

Shared value

Shared value derives from the concept of private sector actors working towards social outcomes as a basis for their own future profitability. Shared value recognises that

business takes place in a social ecosystem that must function well in order for business to thrive. The Social Value Initiative was launched in 2012 as a Clinton Global Initiative Commitment to Action. For more information, see https://summit.sharedvalue.org/.

Shifting the trillions

The term shifting the trillions is borrowed from climate finance. Shifting the trillions acknowledges that instead of focusing solely on mobilising additional finance, development actors need to also ensure that the trillions of dollars in existing finance throughout the financial system are better targeted to sustainable and inclusive growth.

Social impact investment (SII)

Social impact investment is the provision of finance to organisations that are addressing social needs and with the explicit expectation of a measurable social, environmental and/or financial return.

Social infrastructure and services

In the DAC sectoral classification, social infrastructure and services refer to efforts to develop the human resource potential of developing countries in the sectors of education, health, population policies/programmes and reproductive health (further health and reproductive health), water supply and sanitation, government and civil society and other social infrastructure and services. For more information see http://www.oecd.org/dac/stats/purposecodessectorclassification.htm.

South-South co-operation

There are numerous descriptions of South-South co-operation. The UN General Assembly describes it as "… a manifestation of solidarity among peoples and countries of the South that contributes to their national well-being, their national and collective self-reliance and the attainment of internationally agreed development goals, including the Millennium Development Goals" (UN General Assembly Resolution 64/222).

The United Nations Office for South-South Cooperation further describes it developing countries working together to find solutions to common development challenges. Linked by similarities in their development contexts and challenges, the countries of the South have been increasingly active in sharing knowledge, exchanging technologies, and forming common agendas and collective actions. See www.arab-ecis.unsouthsouth.org/about/what-is-south-south-cooperation/.

Sustainable development

Sustainable development is defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

Total official support for sustainable development (TOSSD)

Total official support for sustainable development is measure of official development finance designed to complement official development assistance (ODA). It measures flows included in ODA as well as the leveraging/catalytic effect of ODA, the use of blended finance packages and the use of innovative risk mitigation instruments in development co-operation.

Transition

A country in transition is a country facing a structuring change in its access to finance, for example due to increased income per capita above graduation thresholds. In some contexts, transitioning refers to a country's transition out of fragility.

Transitioning countries should be considered a success story although they also experience special challenges. For example, the transition out of least developed country status brings the loss of concessions and preferences such as tariff and quota-free trade access. Changes in income group classification also can decrease the volume and increase the price of development finance, while these s may not be mirrored by increases in volume and decreases in price of market-based instruments. Once in the high-income classification for three consecutive years, countries transition out of ODA-eligibility.

Triangular co-operation

Development co-operation partnerships between and among two or more developing countries, with the support from a developed country or multilateral organisation

Value for money

No standard definition exists for value for money. The term is often used to characterise economy (the cost), efficiency (achieving outputs for inputs) and effectiveness (achieving programme outcomes) while simultaneously taking into account quality and equity.

Vertical funds

Vertical funds involve earmarking non-core financing, usually in large volumes, for specific uses. Vertical funds are often created in response to high-visibility advocacy campaigns to tackle specific development issues. They are frequently administered by the World Bank or other multilateral institutions.

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Global Outlook on Financing for Sustainable Development 2019

TIME TO FACE THE CHALLENGE

The financing for sustainable development agenda promises to bring together more actors than ever before – from businesses, governments, philanthropists, and remitting households – to address the world's most pressing problems and achieve the Sustainable Development Goals.

Yet, in spite of this promise, the financing for sustainable development gap is growing. While needs continue to increase, resources available to developing countries have been constrained and in some cases even declining, as illustrated by the recent drop in foreign direct investments. New financial instruments and interactions have yet to mobilise much-needed new resources in sufficient volumes. And despite significant advances, we do not yet fully understand the opportunities and risks faced by the various actors in this complex new global financing system.

This report sounds a wake-up call. To fulfil the commitments of the 2030 Agenda, and lift hundreds of millions of people out of extreme poverty, the international community needs to maximise the development footprint of existing and future resources, thereby "shifting the trillions" towards the SDGs. The first in a series, this report charts a forward path for the changes required in measurement, policies, and operations to achieve these ambitious objectives.

Consult this publication on line at ***https://doi.org/10.1787/9789264307995-en***.

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