Global Outlook on Financing for Sustainable Development 2021

A NEW WAY TO INVEST FOR PEOPLE AND PLANET

OECD

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Preface

The recession brought on by the COVID-19 pandemic is the worst human and financial crisis of the 21st century. Unlike previous financial crises, this recession impacts trade and investment chains in developed and developing countries alike. Global economic GDP could contract by up to 4.5% in 2020. Nearly two years of progress to eradicate poverty have been erased while hundreds of millions of jobs have been lost across the world.

Confronted with these unprecedented challenges, one question needs to be asked: does the ambition of our global response match the severity of the crisis? Certainly, the current economic, social and environmental threats will not be overcome with economic co-operation alone. We need all stakeholders to work together across all fronts: economic, social and development. Like climate change and migration, the pandemic and its impact know no borders. We are all in it together, and failure to support even one member of the international community risks global economic and development setbacks for all.

The *OECD Global Outlook on Financing for Sustainable Development 2021* provides a new holistic view on the state of finance in support of both people and the planet. It also highlights how we can enable better investments. Policy tools and recovery strategies must address the risk of collapse of financing for sustainable development. While providing a short-term emergency response, they must also seize the opportunities to rebuild a financial system that phases out wasteful incentives and prevents market failures over the long-term.

The *Global Outlook* makes a powerful argument to promote joint action by both public and private sector actors to change the way investments are made, and to align with – and support – the UN Sustainable Development Goals (SDGs). If we look at financing for sustainable development through the aid lens alone, we will miss the big picture. The policies and resources of OECD countries – such as taxation, investment and remittances – can have a tremendous impact on facilitating more sustainable and inclusive investment and finance. Indeed, over 80% of USD 379 trillion in financial assets, managed globally by banks, asset managers and institutional investors, are held in OECD countries. Yet, these resources are not effectively used and risk contributing to a misalignment of the SDGs.

The *Global Outlook* also makes a strong case for the alignment of financing to support the SDGs, to make sure no person, no country and no goal is left behind. It is no longer possible to sustain the long-term value of assets without integrating global non-financial risks like climate or health. Raising the bar with private sector actors can strengthen accountability and transparency, and can preserve the long-term value of assets. But for this to work, and for positive impacts to materialise, the global goals must be translated into a language suited for the finance and business community. Moreover, governments must ensure the policy coherence of domestic and international SDG financing strategies.

Achieving the 2030 Agenda is not only an ethical and political imperative, it is a risk mitigation strategy. The crisis has transformed opportunities into imperatives for action. This *Global Outlook* delivers the evidence, analysis and recommendations needed to strengthen collective and comprehensive action in support of financing for sustainable development.

Angel Gurría,

Secretary General

OECD

Foreword

The biennial *Global Outlook on Financing for Sustainable Development* presents new data, analysis and recommendations for members of the OECD and the international community to advance a more holistic approach to finance the 2030 Agenda for Sustainable Development and Sustainable Development Goals (SDGs) as called for in the Addis Ababa Action Agenda.

The *Global Outlook* is a unique publication that analyses the role of development finance in the broader mix of public, private, domestic and international sources of financing, building on expertise from tax, investment, environment and development communities across the OECD. This report was prepared by the OECD Development Co-operation Directorate (DCD), under the guidance of Director Jorge Moreira da Silva. It drew on the expertise from Greg Medcraft, Director of the Directorate for Financial and Enterprise Affairs (DAF), Mario Pezzini, Director of the Development Centre (DEV), Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration (CTPA) and their teams. It provides an examination of the quantity and quality of resources from different policy perspectives.

This second edition provides a major analytical contribution to international efforts to heighten understanding of the alignment and compatibility of all sources of financing to achieve the SDGs, particularly in the context of the outbreak of COVID-19 and increasing pressures in financing for sustainable development.

The report provides OECD members and other development actors with evidence, analysis and examples of how all sources of financing can avoid the collapse of resources as a result of the COVID-19 crisis in the short-term and rebuild better over the long-term. It further explores how resources can be better targeted to where the needs are greatest, to fix leakages in transmission channels, to make better use of the leveraging power of each resource, and to increase the quality and impact of investments. The report further identifies areas where OECD members and other development actors can align domestic policy to improve the sustainability and resilience of financing for sustainable development at its source.

The DCD team was led by Haje Schütte, Head of the Financing for Sustainable Development Division, Olivier Cattaneo, Head of the Policy Analysis and Strategy Unit, and Rachel Morris, Policy Analyst. Lead authors are: Martin Kessler (Chapter 1), Konstantin Poensgen (Chapter 2), Rachel Morris (Chapter 3) and Sam Mealy (Chapter 4). Cameron Bartlett, Drew D'Alelio and Thomas Rieger provided valuable drafting and research support throughout the publication.

Chapter 1 assesses the macroeconomic context of financing for sustainable development in the COVID-19 era and the implications for the gap between SDG needs and available financing. Chapter 2 analyses trends in the financing sustainable development landscape before and after the outbreak of COVID-19, with a focus on assessing the magnitude of impacts on all sources of development finance. Chapter 3 carries out an assessment of SDG alignment of the different sources of financing along equality and sustainability dimensions, integrating data and evidence on new actors' approaches to sustainability within the global financial system. Chapter 4 sets out two key building blocks for action to i. unleash the potential of the Addis Ababa Action Agenda, i.e. to better leverage public financing to increase the quantity and

quality of resources, and ii. promote an SDG alignment framework, i.e. policy options to improve market efficiency and integrity for transparency, accountability and the right incentives.

The Annex provides sustainable finance profiles of new actors including institutional investors, banks, asset managers, rating agencies, philanthropic organisations and stock markets with recommendations for shared public and private actions for alignment of financing in support of the SDGs.

Fundamental contributions were provided by a broader team of OECD specialists, in particular Ben Dickinson and Joseph Stead (CTPA), Barbara Bijelic, Maria Borga, Tihana Bule, Iris Mantovani, Catriona Marshall, Coralie Martin, Ana Novik, Robert Patalano Martin Wermelinger (DAF), Yasmin Ahmad, Catherine Anderson, Aussauma Bejaouri, Julia Benn, Thomas Böhler, Priscilla Boiardi, Faten Boukhchana, Matthew Bowie, Juan Casado, Cibele Cesca, Guillaume Delalande, Rebecca Engebretsen, Abdoulaye Fabregas, Paul Horrocks, Tomas Hos, Jieun Kim, Carolyn Neunuebel, Nadine Piefer-Söyler, Friederike Ruhmann, Cécile Sangaré, Jens Sedemund, Özlem Taskin (DCD), Federico Bonaglia, Jason Gagnon, Håvard Halland, Sebastien Markley, Arthur Minsat, Alexander Pick (DEV), Enes Sunel (ECO), Geraldine Ang, Alexander Dobrinevski, Catherine Gamper, Raphael Jachnik, Nicolina Lamhauge, Mireille Martini, Dirk Röttgers, Cecilia Tam, Robert Youngman (ENV), William Hynes (OSG). Stacey Bradbury, Sara Casadevall Bellés, Stephanie Coic, Erin Renner Cordell and Henri-Bernard Solignac-Lecomte supported the production process at the OECD. External editorial support was provided by Susan Sachs.

The report also benefitted from consultations and peer reviews of colleagues from various civil society and business organisations, and academia: Peter Uhlenbruch, Head of Investor Standards and Felix Nagrawala, Senior Research Analyst (ShareAction); Richard Hardyment, Research Director, World Benchmarking Alliance; Damien Barchiche, Director, Sustainable Development Governance programme and Maria-Alejandra Riano, Research Fellow, Sustainable Development Governance programme IDDRI; Prof. Daniel C. Esty, Hillhouse Professor of Environmental Law and Policy, Yale Law School; in addition to other colleagues at AFD, DFID, GIZ, USAID, members of the UN system and experts from the OECD-UNDP G7 Alignment Initiative.

Strategic guidance was provided by members of the Development Assistance Committee and the Investment Committee of the OECD.

The full report is published in English and French.

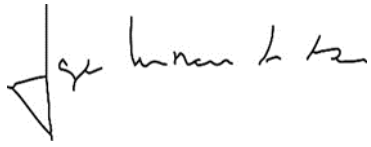
Editorial

Some have called the COVID-19 the great equaliser, because its impacts transcend borders. But this assumes an equal playing field, which doesn't exist. Even before the onset of the pandemic, progress to achieve the United Nations Sustainable Development Goals (SDGs) was starkly uneven across the targets and countries. The onset of the COVID-19 pandemic further eroded progress and is driving up costs to achieve the universal goals by 2030. One hundred million people have been pushed into extreme poverty and job losses have occurred across all sectors. Developing countries are still bracing for the worst, with growth prospects at their lowest level since World War II. While OECD countries are deploying trillions of dollars for recovery, fiscal space in developing countries is limited. The *Global Outlook on Financing for Sustainable Development 2021* finds that recovery spending in developing countries was USD 1 trillion less than the magnitude of spending carried out in OECD countries. Sub-Saharan Africa, as a whole, would need to increase its spending packages by about 6% of its GDP. In addition, there is a risk of external private finance collapsing; already we are facing a USD 700 billion drop, 60% greater than during the global financial crisis.

Business as usual will lead to a net negative. The current context requires real changes in how global finance is designed to support sustainable development. We are at a tipping point, where the paradoxes of financing for people and planet must be addressed. Mobilising greater quantities of resources will be counter-productive if the activity they support is unsustainable. The ambition for official development assistance must go beyond maintaining current levels, it must be better leveraged and targeted to where the needs are greatest, and redirected away from unsustainable activity. This includes increasing the share of development finance that supports climate objectives. Based on the most recent available data, only 20% of development finance provided each year includes a focus on climate change. Debt initiatives should be expanded, but care should be taken that these initiatives do not result in defaults or fossil fuel extraction increasing to service these debts - to the detriment of a more sustainable and resilient recovery. Taxation policies and co-operation should continue to raise more public revenues and tackle avoidance and evasion, but policy makers cannot continue to allow wasteful incentives such as lowering tax revenue without increasing investment. Remittance volumes were on the rise prior to the crisis, yet the cost of transfer, at 7% on average in 2017-19 or between USD 30.26 billion and USD 31.15 billion annually, is leaking crucial financing away from households to financial intermediaries. Global financial assets are at their highest value since before the global financial crisis (USD 379 trillion), yet 80% are held in the richest countries, and very little is known about their sustainable development impact.

Overcoming these paradoxes means invoking the Addis Ababa Action Agenda to align better all forms of financing in support of the 2030 Agenda. Business and finance communities are moving the dial on mitigating non-financial risks and ensuring that financing is sustainable. Why? Because achieving the twin goals of financial and non-financial returns preserves the long-term value of assets. However, a proliferation of sustainability measurements and standards is contributing to market asymmetry and the risk of "SDG washing." We have no idea how much financing is contributing to good and how much to greater inequalities and unsustainable ends. The private sector is calling on government to help strengthen the SDG financing market.

Governments have a singular role and opportunity to avoid the collapse in financing for sustainable development in developing countries and enable changes to the way global finance is invested. Overcoming the financing paradoxes through better incentives to correct market failures means removing obstacles to transparency and building greater accountability of different finance flows. Collective action across the different stakeholder communities is needed to translate the SDGs into their language and better assess impact. Misalignment starts at home: domestic policies in OECD and other countries, in addition to international regulations, guide where, in what and how investments are made. The *Global Outlook on Financing for Sustainable Development 2021* promotes an SDG alignment framework that brings together all relevant stakeholders, led by OECD members and broader actors to agree on concrete joint actions to change the way we invest for global good.



Jorge Moreira da Silva,

Director,

Development Co-operation Directorate, OECD

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Abbreviations and acronyms

AAAA	Addis Ababa Action Agenda
DAC	Development Assistance Committee (OECD)
DFI	Development finance institution
ESG	Environmental, social and governance
FDI	Foreign direct investment
FSD	Financing for sustainable development
GDP	Gross domestic product
GFCF	Gross fixed capital formation
HDP	Humanitarian-development-peace
INFF	Integrated national financing framework
LCD	Least developed country
MDB	Multilateral development bank
NGO	Non-governmental organisation
ODA	Official development assistance
ODF	Official development finance
OECD	Organisation for Economic Co-operation and Development
SDG	Sustainable Development Goal
SME	Small and medium-sized enterprise
SSI	Sustainable impact investing
TOSSD	Total official support for sustainable development
UN	United Nations
USD	United States dollar

Executive summary

The outbreak of coronavirus (COVID-19) has magnified the financing gap to achieve the Sustainable Development Goals (SDGs) in developing countries, with threats to SDG progress across all countries

The Decade of Action for the Sustainable Development Goals (SDGs) is mired by uncertainty. As COVID-19 unfolds, financing for sustainable development is at risk of collapse, with all resources available to developing countries under stress. The 'scissor effect' of SDG financing – increasing needs and declining resources already observed in previous years - has been magnified. Poverty levels are on the rise and livelihoods are at stake. The increased risk of climate-related disasters, future pandemics, and other shocks provides a stark reminder that one country's progress to achieve the SDGs will impact our collective efforts.

A step change is needed to shift the trillions in favour of sustainable and inclusive development along the investment chain

Investing in the SDGs and "leaving no one behind" go beyond an ethical imperative; they are also a risk mitigation strategy and a business opportunity. However, the trillions held in the financial system continue to fuel inequalities and unsustainable investments. On the one hand, a debt crisis looms in developing countries who lack financial reserves to implement a greener and more resilient recovery. On the other hand, a black box surrounds the actual environmental and social impact of investments. The fragmentation of the different measurements of the quality or sustainability of financing have led to challenges to assess SDG alignment across different sources of financing, increasing the risk of SDG washing and threatening the long-term value of assets.

The second edition of the *Global Outlook* calls to change the way we invest by lifting barriers to SDG alignment at their source

While providers of development finance must continue to leverage the billions in public finance, looking at SDG alignment through the lens of development co-operation alone misses the big picture. Misalignment starts at home, and domestic policies in OECD and other countries, as well as international regulations, guide private sector decisions to invest at their source. Trillions of dollars in recovery and stimulus packages as well as financial assets held by banks, institutional investors or asset managers are increasing their sustainability focus, i.e. the twin goals of financial and non-financial returns. With the right guidance and incentives these resources could make a tremendous contribution to a better world. The role of governments and regulators is not to force the shift but to increase the efficiency of markets and remedy their failures to leave no one and no goal behind.

The 2030 Agenda and Addis Ababa Action Agenda provide the blueprint for a collective financing framework bringing all actors behind the SDGs

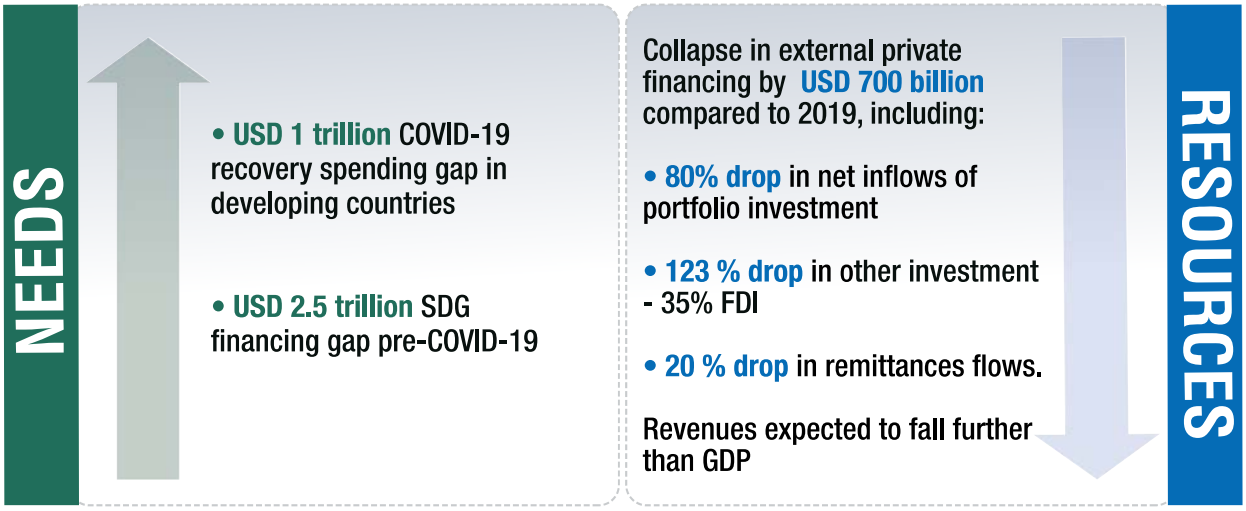
The next frontier to finance sustainable development means bringing all actors along the investment chain behind the SDGs to respond to the crisis in the short-term and rebuild over the long-term for a more resilient and sustainable future. Support for misalignment must be phased out. The COVID-19 crisis provides a singular opportunity for governments to develop a common SDG alignment framework translated into concrete actions for the different actors. All relevant stakeholders must be on board to securely place people and planet at the heart of the global financial system.

Infographic 1. Aligning global finance with the Sustainable Development Goals

Overview

The Decade of Action for the Sustainable Development Goals (SDGs) starts with a crisis: as the COVID-19 pandemic unfolds, progress toward the goals is in danger of slowing – and even reversing with poverty expected to rise for the first time in more than twenty years. The crisis has increased inequalities, and not all countries can raise the funds necessary on domestic or international markets to effectively respond and recover. Financing for the sustainable development of developing countries risks collapsing, with all resources available under stress, domestic and external, public and private. Even before COVID-19, financing for the SDGs was not enough. Now, external financing to developing countries could drop by an estimated USD 700 billion in 2020. Revenues will fall further than gross domestic product (GDP) (OECD, 2020[1]). The scissor effect of SDG financing – increasing needs and declining resources – has been magnified (Figure 1). The USD 2.5 trillion annual SDG financing gap in developing countries is predicted to increase due to global economic uncertainty and an estimated USD 1 trillion gap in COVID-19 emergency and response spending in developing countries compared to OECD countries. As a result, the annual SDG financing gap in developing countries could increase by USD 1.7 trillion, i.e. about +70% in 2020.[1]

Figure 1. The scissor effect demonstrates a widening SDG financing gap in developing countries



Source: Authors

The SDG alignment agenda

The impacts and risks presented by COVID-19 reinforce the case to align more global finance in support of a more sustainable and inclusive world and to achieve the 2030 Agenda. More than ever before, incentives governing the public and private sectors are aligning. Putting people and planet at the heart of our economic system is not only an ethical or political imperative but also an economic and risk management strategy.

The cost of inaction now exceeds the cost of action. The global threat of climate-related disasters, future pandemics, and other shocks have brought the development finance world to a tipping point. However, the adjustment of markets, policies and behaviours will require pro-active interventions by all actors along the investment chain. Already, in the period between the beginning of the pandemic in early 2020 and 15 July 2020, G20 countries committed at least USD 151 billion to fossil fuels but only USD 89 billion to clean energy in their stimulus and recovery packages (Gerasimchuk and Urazova, 2020[2]).

This is a central challenge. Trillions of dollars are in the system, but it will take political leadership to shift them to better serve people and planet, and OECD governments and other relevant stakeholder have an essential role to play to enable this shift. As trillions of dollars of debt are contracted to help current and future generations recover, will spending accelerate the trajectory of the past or will it put the policy makers, in partnership with the private and civil sectors, on a new path, towards more inclusive and sustainable development?

The COVID-19 crisis has shown that the depreciation of assets linked to global shocks, such as epidemics, climate change, or forced displacements of populations, is not a distant threat. Since the onset of the crisis, sustainable investment has surged, due in part to the anticipation by markets of stricter environmental and social rules – including the conditionality of stimulus packages, but also due to the possibility of higher financial returns, or least lower losses on sustainable investment than traditional investment. As a result, the twin goals of higher non-financial and financial return are mutually reinforcing. The economic case for making finance more sustainable – and more aligned with the SDGs – has never been stronger.

Shifting the trillions will only build resilience within the system and preserve the long-term value of assets if the two dimensions of SDG alignment are addressed: equality – to guide resources to where the needs are, leaving no one and no goal behind particularly in developing countries; and sustainability – to increase the sustainability of finance and avoid "SDG washing", i.e. the use of sustainability labelling or branding without reliable assessment of how financing impacts progress towards the global goals.

SDG alignment is needed across two dimensions

"SDG alignment" seeks to raise the accountability of different sources of financing by carrying out an assessment of how financing is targeted across two dimensions:

1. **equality**: resources should be mobilised to leave no one behind and fill the SDG financing gaps, and
2. **sustainability**: resources should accelerate progress across the SDGs, while doing no significant harm to any single objective.

This shift will require governments to accompany market forces, and adopt better policies for a better financial system, e.g. to harmonise rules pertaining to reporting or assessing non-financial performance, as well as remedy market failures, e.g. to address the equality dimensions of SDG alignment and protect investors and consumers against deceitful practices.

Financing for sustainable development is at risk of collapse

The COVID-19 crisis struck on the eve of the Decade of Action for the SDGs (2020-2030). The health crisis quickly turned into an economic crisis of large magnitude with potential long-lasting effects on inequalities and development. The dual demand and supply shock spared no country, but hit harder those without the financial and technological means to handle the health crisis and lockdowns. More developing countries (90 of 122 low and middle-income) have entered into economic recession than at any time since the Second World War. This is in contrast to the global financial crisis, which resulted in negative growth, mostly in developed countries. As a result, inequalities have increased, and populations at risk, including youth and women who lost access to basic services such as education or health, have suffered most.

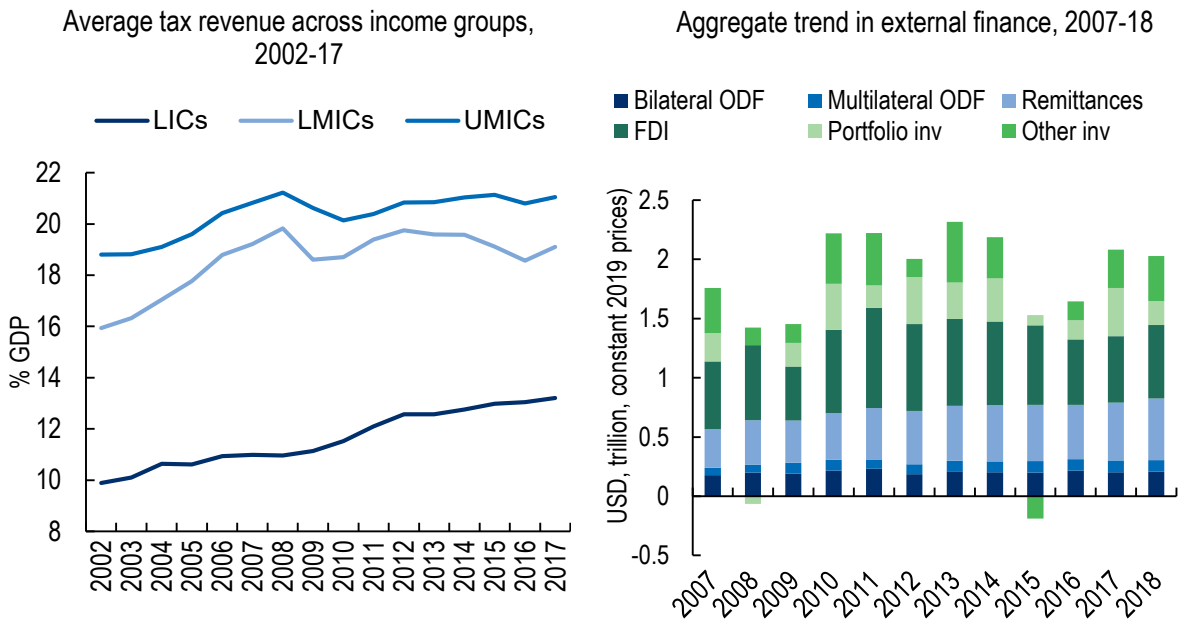
Prior to the COVID-19 crisis, countries were already facing difficulties to finance and fulfil the ambitions of the 2030 Agenda

Prior to the COVID-19 crisis, progress made on the SDGs and their financing was a mixed picture. Despite stark improvements, tax revenue, the largest source to fund public expenditure – and the only viable one in the long term - fell short of needs in many countries. In 2017, countries eligible to receive ODA had collected USD 5.3 trillion in tax revenue, more than double the sum of external inflows that year. Since the early 2000s, tax revenue had substantially increased across country income levels (Figure 2, left panel). The overall increase could be attributed to a combination of macroeconomic conditions, among them high average GDP growth, rising commodity prices, tax policy reforms to broaden tax bases, and tax administration reforms to increase collection efficiency and compliance. However, tax revenue in about one-third of developing countries (46) was below 15% of GDP and below 20% of GDP in about two-thirds (79) of ODA-eligible countries – that is, below the thresholds commonly considered to be necessary for effective state functioning.

Although the total level of external finance had recovered from a sharp drop in 2015, at around USD 2 trillion in 2018, it remained well below the peak of 2013 (Figure 2, right panel) that was driven by private investment inflows. Remittance inflows had steadily increased due to rising international migration and improvements in measuring the flow. Excluding the People's Republic of China (hereinafter China), remittances surpassed foreign direct investment (FDI) as the largest individual source of external finance since 2016. Official development finance remained stable over time with a small increase in 2019.

Rising public debt and debt servicing costs, particularly in the poorest countries, were putting SDG financing levels under increasing pressure. Government debt had soared on expectations of high growth, including in low-income economies where it rose by 20 percentage points on average after large declines in the 2000s. Non-financial corporate debt also ballooned in emerging markets, from USD 1.6 to USD 3.8 trillion between 2009 and 2019, leading to vulnerabilities and to "sudden stops" in international credit (Avdjiev, McGuire and von Peter, 2020[3]). However, of the 69 countries applying the low-income countries debt sustainability analysis in 2019, half were either already "in debt distress" or "at high risk of debt distress", compared to 23% in 2013 (IMF, 2020[4]).

Figure 2. Tax revenue and external financing of ODA-eligible countries prior to the coronavirus (COVID-19)



Note: The left panel shows unweighted average tax-to-GDP ratios for 113 countries and uses the World Bank classifications for income groups is used. In the right panel, the largest sample possible for ODA-eligible countries was used for each year.
Source: Tax revenue are based on OECD (2020[5]), Global Revenue Statistics Database, http://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm; IMF (2020[6]), World Revenue Longitudinal Data (WoRLD) (database), https://data.imf.org/?sk=77413F1D-1525-450A-A23A-47AEED40FE78; and UNU-WIDER (2020[7]), Government Revenue Dataset (database), https://www.wider.unu.edu/project/government-revenue-dataset. Official development finance is based on OECD DAC Tables 2a and 2b. Remittances based on KNOMAD (2020[8]), Remittances inflows (database), https://www.knomad.org/data/remittances. FDI, portfolio investment and other investment data refer to net incurrence of liabilities and are from IMF (2020[9]), Balance of payments (database), http://data.imf.org/bop. Missing data on FDI are imputed using World Bank (2020[10]), World Development Indicators (database), https://datacatalog.worldbank.org/dataset/world-development-indicators.

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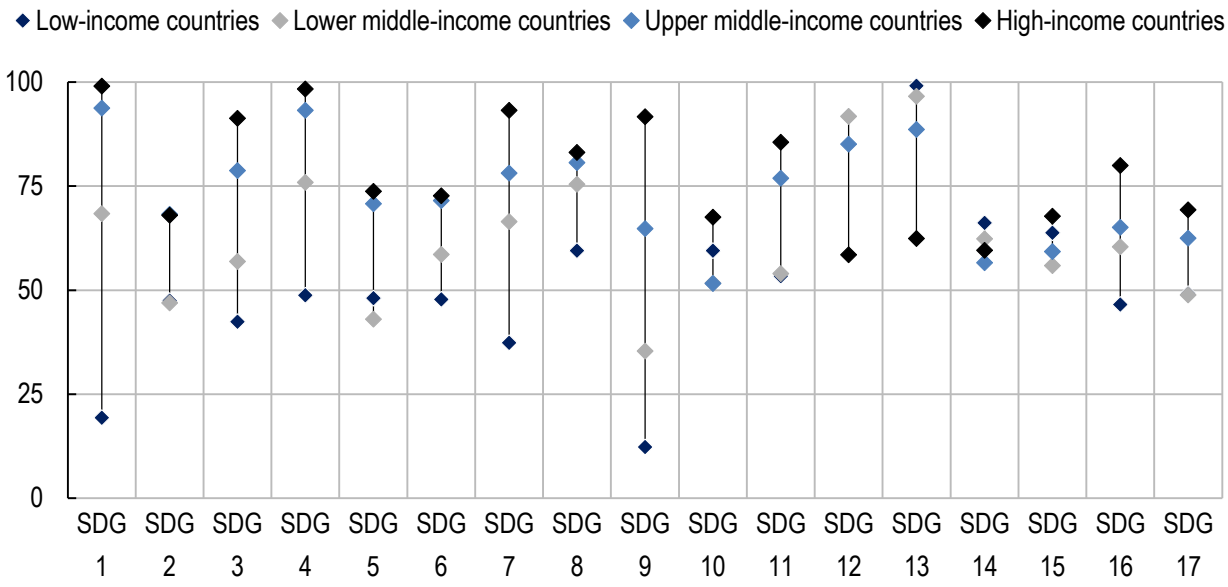
Still, financing was not increasing fast enough to fulfil the ambitions of the 2030 Agenda. The pre-COVID-19 USD 2.5 trillion annual SDG financing gap corresponds to about USD 500 billion for low-income countries and USD 2 trillion for other developing countries, or respectively 15% and 4% of GDP of additional spending per year (Gaspar et al., 2019[11]).

On one hand, between 2015 and 2019, the world made significant progress to eliminate poverty (SDG 1): extreme poverty, while not eradicated, was trending downward, reaching 8.2% in 2019 due to rapid economic growth, especially in East and South Asia. On the other hand, progress towards several other SDGs had stagnated or reversed. Food insecurity (SDG 2) rose between 2015 and 2018. Inequalities (SDG 10) have risen globally, as extreme wealth and incomes have grown and protection of the most vulnerable has weakened. While high income countries aggregate index, as computed by Sachs et al. (2020[12]) for the *2020 Sustainable Development Report*, have more than halfway met (above 50) all of the 17 goals, low income-countries' aggregate index is less than halfway met for 10 of 17 goals. For lower middle income-countries, 13 were below 75 (Figure 3. The SDGs in 2020: Mixed success).

Figure 3. The SDGs in 2020: Mixed success



Note: SDG 1 "No Poverty", SDG 2 "Zero Hunger", SDG 3 "Good Health and Well-being", SDG 4 "Quality Education", SDG 5 "Gender Equality", SDG 6 "Clean Water and Sanitation", SDG 7 "Affordable and Clean Energy", SDG 8 "Decent Work and Economic Growth", SDG 9 "Industry, Innovation and Infrastructure", SDG 10 "Reduced Inequality", SDG 11 "Sustainable Cities and Communities", SDG 12 "Responsible Consumption and Production", SDG 13 "Climate Action", SDG 14 "Life Below Water", SDG 15 "Life on Land", SDG 16 "Peace and Justice Strong Institutions" and SDG 17 "Partnerships to Achieve the Goal".
Source: Author's based on (Sachs et al., 2020[12]), *The Sustainable Development Goals and COVID-19. Sustainable Development Report 2020*, https://s3.amazonaws.com/sustainabledevelopment.report/2020/2020_sustainable_development_report.pdf.

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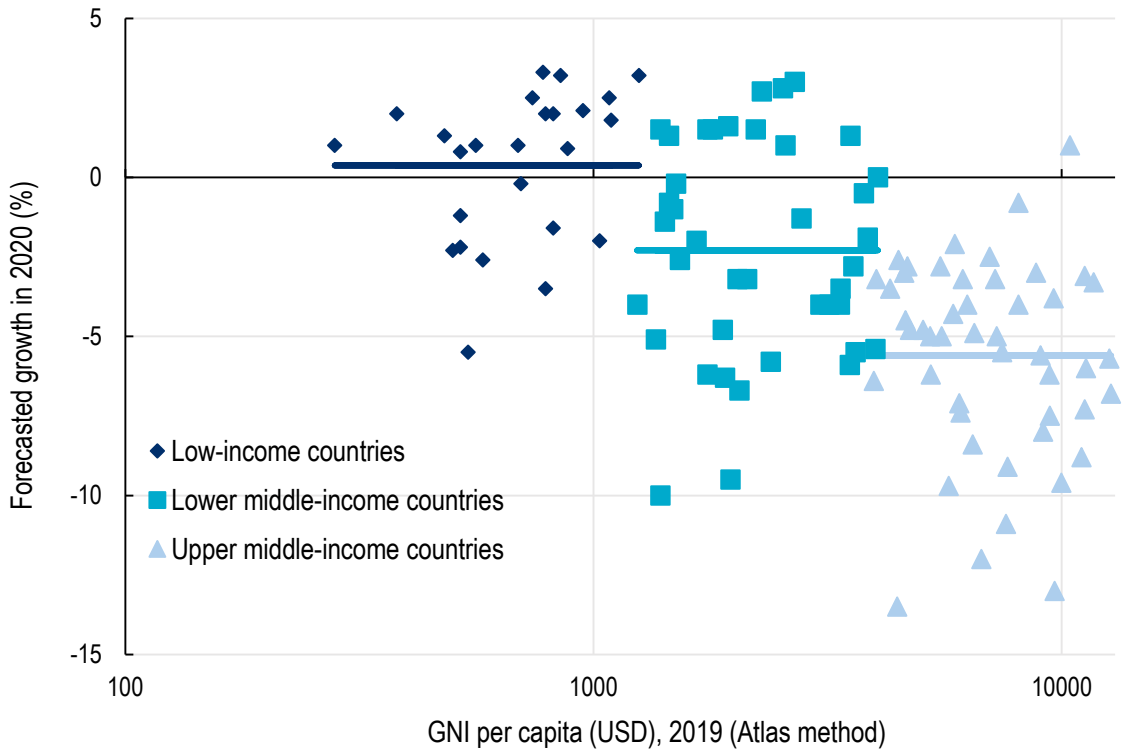
With COVID-19, developing countries face an economic shock of unprecedented magnitude in recent history

The COVID-19 crisis magnified those difficulties to fulfil and finance the ambitions of the 2030 Agenda. The crisis is expected to result in an historic contraction in global gross domestic product (GDP) – estimated at about 5%, compared to 2% during the global financial crisis and 1% during the four previous global recessions (World Bank, 2020[13]). It will also prompt recessions in many developing countries that had managed to maintain positive growth rates in previous crises. GDP of developing countries is expected to drop by an average 3%, among them almost all upper middle-income countries and 31 of 44 lower middle-income countries. Low-income countries are projected to have better prospects due to better containment of the disease (with a less vulnerable demography and experience with past epidemics), less restrictive lockdowns, higher mobility and less integration in the global economy (World Bank, 2020[13]). However, the progression of the disease is a source of considerable uncertainty; and effects of the crisis are magnified in countries with large segments of the population just above the poverty line and already subject to vulnerabilities.

Figure 4. Growth forecasts amid the COVID-19 recession in 2020 by income group

Direct impact worsens with income



Source: Author's based on (World Bank, 2020[13]), *Global Economic Prospects, June 2020*, 10.1596/978-1-4648-1553-9; (World Bank, 2020[14]), *World Development Indicators* (database), http://datatopics.worldbank.org/world-development-indicators/.

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With regard to sectors, tourism, commodities and manufacturing in developing countries suffered the greatest immediate income and job losses.

- Tourism: Tourism overall accounted for 10% of global GDP in 2019 and could decline by 60% to 80% in 2020. The sector is particularly labour intensive, which means that the impact on jobs will be even larger, and affect women in particular. In small island developing states (SIDS) and other countries such as Thailand, unskilled employment could fall by more than 20% due to direct and indirect effects of the pandemic.
- Commodity exports: The price of commodities fell sharply in the early months of 2020, especially for energy. As a result, commodity exporting countries – most notably Botswana, Equatorial Guinea, Iraq, Peru and Zimbabwe – are projected to experience growth decline of more than 8% (World Bank, 2020[13]).
- Manufacturing: As China had moved to the centre of many global value chains, the impact of its slowdown spread faster through developing countries. On the trade side, the World Trade Organization (2020[15]) estimated a slowdown in trade of 18.5% for Q2 2020. The pandemic severely affected countries such as Bangladesh and Cambodia, which rely on garment manufacturing and saw an 80% decline in exports in April 2020 over April 2019. These impacts also have strong gender dimensions, as most employees in the garment-producing sector are women from rural areas. Ethiopia and Kenya also experienced an initial reduction in demand during

spring 2020, but have rebounded in the summer (Mold and Antony, 2020[16]). Unemployment risks are particularly high for self-employed workers, of whom close to 100 million work in the manufacturing sector worldwide.

The consequences of unemployment in developing countries are magnified by the lack of unemployment insurance (Gerard, Imbert and Orkin, 2020[17]). Other social protection systems are also limited. In South Asia, the region with the largest existing safety nets, social protection tends to be based on public works programmes, which are harder to maintain in times of physical distancing.

Progress towards the SDGs has stopped, or even reversed, as financing needs increase

This economic downturn could have major impacts on development prospects. Hard fought development gains are facing short, medium and long-term setbacks (Infographic 2 below). In just a few months, several years of progress on poverty reduction were erased. Poverty will rise for the first time since 1998 with an additional 100 million people expected to be pushed into extreme poverty and job losses up to 200 million. Uncertainty regarding the interrelated health and economic shocks are increasing tensions within the multilateral system, compounding pressure on available resources for sustainable development. Inequalities are likely to rise significantly over the short term, with Gini coefficients increasing on average by 1.5% over five years, based on the experience of the previous five major pandemic events (Furceri, Loungani and Ostry, 2020[18]). Inequality is not only linked to income. The digital divide makes it harder to perform tasks from home, whether they are for work or schooling or simply to access information. Over the long term, global uncertainty on the future path of growth is likely to slow investment in sectors such as infrastructure and innovation, further increasing the overall long-term financing needs.

Beyond the direct health effects of COVID-19, lockdowns have significantly affected access to basic services. While some education and health investments can be postponed and will translate into larger needs in the future, others cannot be delayed and will translate instead into deaths or permanently lower quality of life. A dramatic example is that of maternal health. As described by Robertson et al. (2020[19]), a 10% to 19% reduction in access to maternal care – their best-case scenario of the impact of the pandemic – would translate into 253 500 additional child deaths and 12 200 additional maternal deaths in 119 lower income countries.

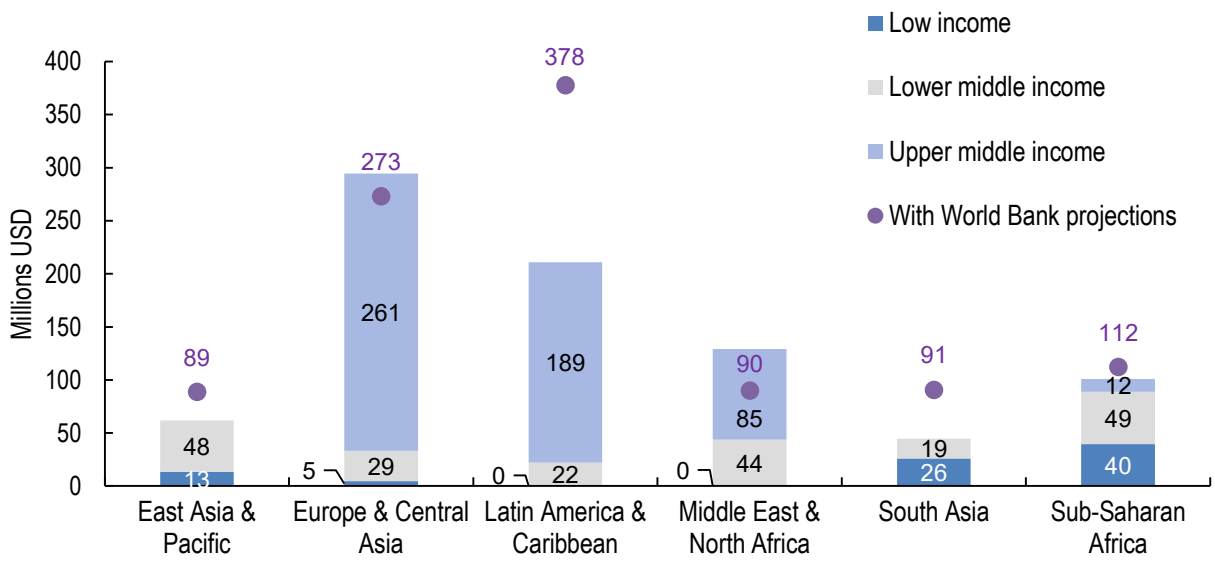
Infographic 2. The COVID-19 economic and social shock and its consequences for the SDGs

	SHORT-TERM IMMEDIATE FIRE-FIGHTING	MEDIUM-TERM SUPPORTING DEMAND DURING REOPENING PHASE	LONG-TERM INVESTING IN "BUILDING BACK BETTER"
ECONOMIC AND SOCIAL IMPACT	Finance and demand shocks threaten firms and job losses, incomes fall, public and private services reduce activity	Firm bankruptcies, incomes lagging from reduced economic activity, risk to most vulnerable	High debt levels prevent new investment. Depressed demand leads to permanently lower growth in all sectors
SDG IMPACTED	INDUSTRY HEALTH HUNGER GENDER EQUALITY	POVERTY EDUCATION JOBS INEQUALITIES RESPONSIBLE CONSUMPTION	INFRA-STRUCTURE ENERGY WATER CLIMATE SUSTAINABLE CITIES BIODIVERSITY GOVERNANCE

Source: Authors

Advanced economies have managed to implement large monetary and fiscal stimulus packages, allowing debt to gross domestic product (GDP) ratios to rise by 20 to 30 percentage points of GDP in OECD countries. Based on the recession as forecasted in Figure 4 it is estimated that developing countries would have required an additional USD 800 billion to USD 1 trillion to respond to the crisis at a comparable magnitude of spending. This includes USD 100 billion in low-income countries, or 5% to 6% of the GDP of these countries; low-income economies represent about USD 85 billion of this gap, or 6% of their GDP. Sub-Saharan Africa, as a whole, would need to increase its packages – of about 1% of GDP – by about 6% of its GDP, or USD 100 billion, in line with the magnitudes found by the United Nations Economic Commission for Africa[2] and others.

Figure 5. Stimulus packages: Comparing the financing needs



Note: Stacked columns display stimulus financing needs using International Monetary Fund (2020[20]) projections for 2020 by region and income level. Diamonds display aggregate regional needs using the World Bank (2020[13]) *Global Economic Projections, June 2020*. The difference stems from large differences in growth prospects.

Sources: Author's based on Center for Strategic and International Studies (2020[21]), *CSIS G20 COVID-19 Fiscal Relief Tracker Dataset*, https://datastudio.google.com/embed/reporting/92894631-b883-4140-a294-5d0ab65974fa/page/v7WYB; International Monetary Fund (2020[20]), *World Economic Outlook: A Crisis Like No Other, An Uncertain Recovery*, https://www.imf.org/en/Publications/WEO//; World Bank (2020[13]), *Global Economic Projections, June 2020, https://openknowledge.worldbank.org/handle/10986/33748*; Hale et al. (2020[22]), *Oxford COVID-19 Government Response Tracker*, https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker.

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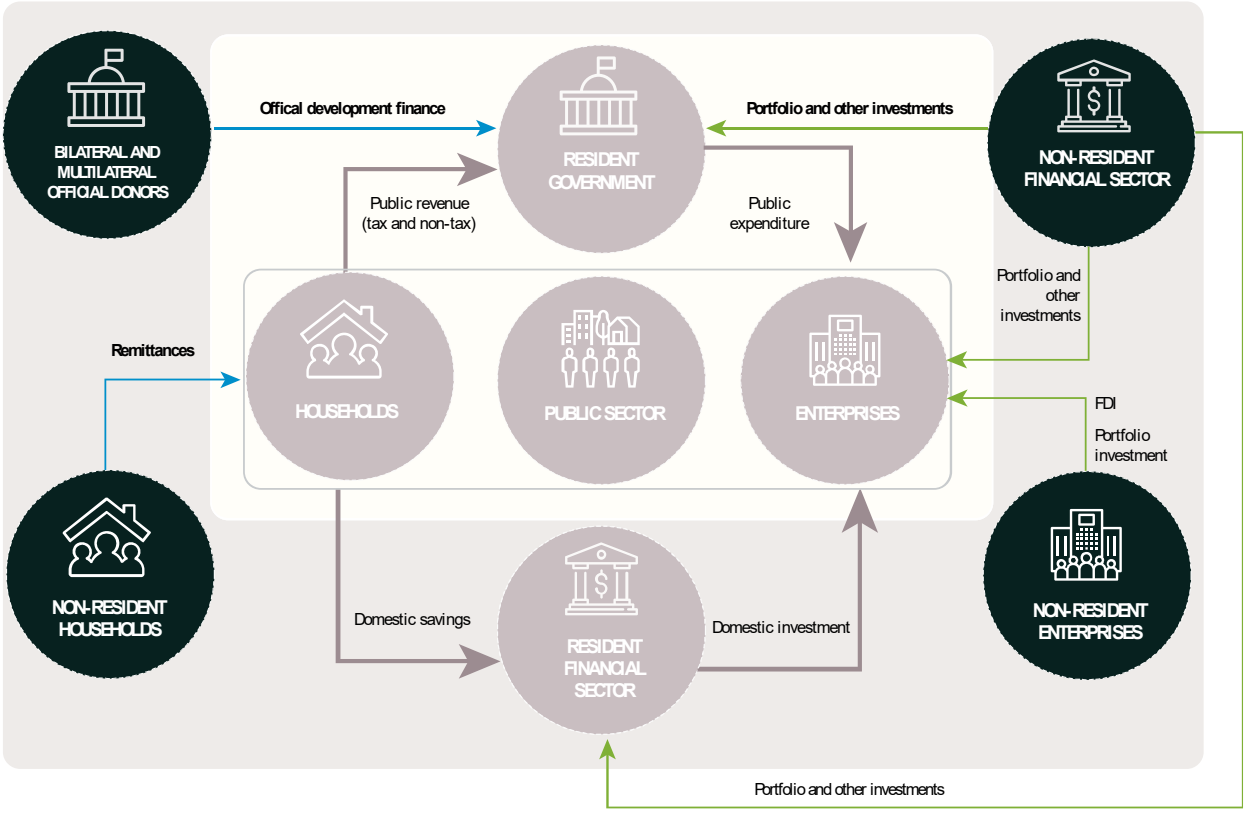
All sources of financing are now under stress and external private finance to developing countries could collapse

The growth of financing needs starkly contrasts with the decline of available development finance. The risks of COVID-19 are causing major, long-lasting setbacks to all sources within the financing for sustainable development landscape (see Infographic 2 below). The contraction of economies, affecting all major sources of tax revenue, will depress domestic resources. Non-tax revenue in resource-rich countries will drop as commodity prices sink. Tax revenue could also decline as economies contract and governments introduce tax relief measures in the short and medium term. Remitters facing job losses and drops in income will send less money home. Finally, while levels of official development assistance (ODA) have shown resilience in past crises, they may also come under strain.

Infographic 3. The relationship between different actors in the financing for sustainable development landscape

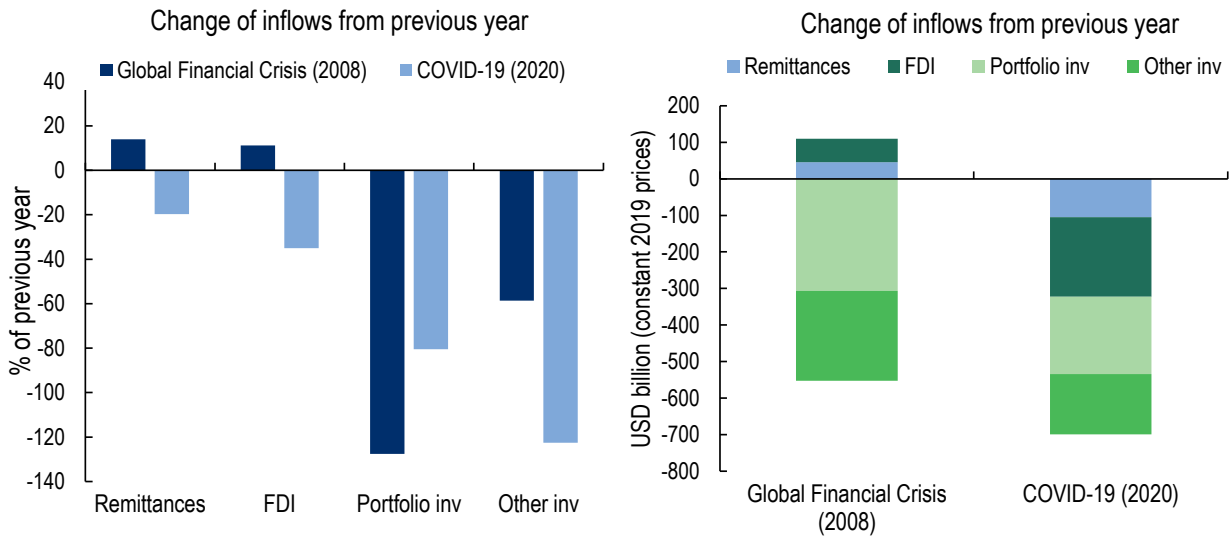


Note: The infographic focuses on the financial flows considered in this report
Source: Authors

In total, this report projects an estimated USD 700 billion reduction of private capital inflows in 2020 compared to 2019 levels in ODA-eligible countries – a drop 60% larger than the drop after the global financial crisis. In March 2020, emerging markets experienced portfolio outflows of USD 83 billion, an impact that was faster and more sizeable than in previous sudden stops (OECD, 2020[23]; Institute of International Finance, 2020[24]). The Institute of International Finance (2020[25]) projects that net inflows of portfolio investment and other investment to emerging markets in 2020 could drop by 80% and 123%, respectively, compared to 2019 levels. Inflows to low- and middle-income countries could decrease by 35% for FDI and by 20% for remittances compared to 2019 levels (World Bank, 2020[26]).

Considering the increase in needs and drop in resources, the scissors effect of the COVID-19 crisis could be estimated to about USD 1.7 trillion, i.e. a 70% increase in the pre-COVID SDG financing gap.

Figure 6. COVID-19 will set external private finance back by USD 700 billion, a 60% greater drop than after the 2008-09 financial crisis



Note: All data refer to ODA-eligible countries. The sudden stop of capital flows in 2015 is not shown here, as it would have included a USD 556-billion drop relating only to China. Other investment excludes IMF lending and Special Drawing Rights allocations.
Source: Author's based on KNOMAD (2020[8]), *Remittances inflows (database)*, https://www.knomad.org/data/remittances. Historical FDI, portfolio investment and other investment data refer to net incurrence of liabilities and are from IMF (2020[9]), *Balance of payments (database)*, http://data.imf.org/bop, and national central bank data. COVID-19 projections are based on combining historical data with projections on remittances and FDI by the World Bank (2020[26]), "COVID-19 Crisis through a migration lens", https://openknowledge.worldbank.org/handle/10986/33634, with portfolio and other investment data by the Institute of International Finance (2020[25]), *IF Capital Flows Report: Sudden Stop in Emerging Markets*, https://www.iif.com/Portals/0/Files/content/2_IIF2020_April_CFR.pdf.

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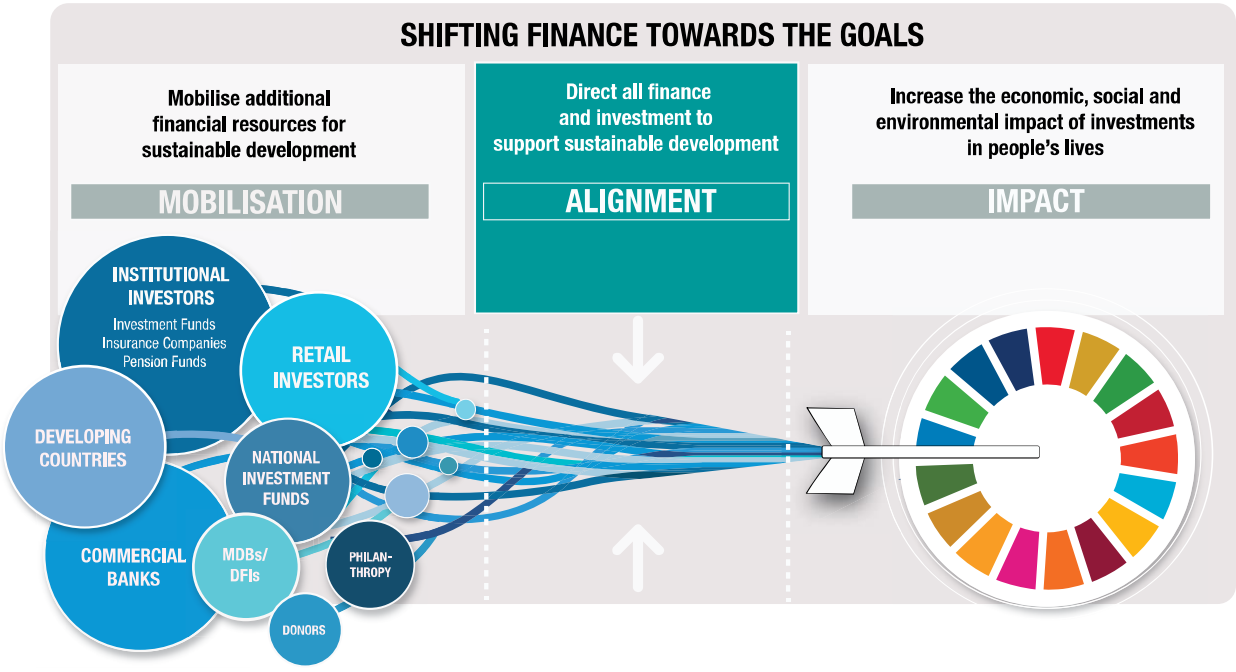
SDG alignment can help avoid the collapse and build back better

The SDG alignment agenda has the potential to both address the urgency of the response to the COVID-19 crisis, i.e. avoid the collapse of financing for development that would have dramatic effects on the global economy and political stability, and the medium-to-long-term objective to recover better for sustainability, i.e. build the resilience of the system. It has the potential to respond to the need to mobilise resources for development by making better use of each resource's leveraging power, fixing leakages in transmission channels, and increasing the quality of existing flows to achieve greater SDG impact (Figure 7).

Figure 7. A three-step approach to shifting finance towards the SDGs



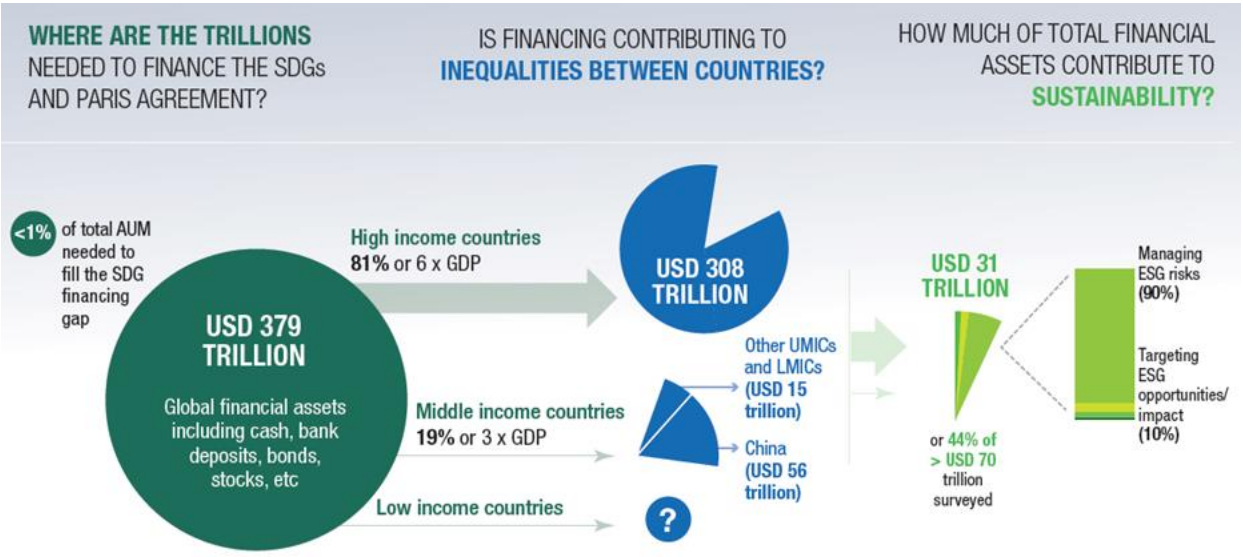
Note: Multilateral development bank (MDB) and development finance institutions (DFIs)
Source: (OECD, 2018[27]), *Global Outlook on Financing for Sustainable Development 2019: Time to Face the Challenge*, https://www.oecd.org/development/global-outlook-on-financing-for-sustainable-development-2019-9789264307995-en.htm.

Shifting only 1% of the trillions could fill the growing gap

This report finds that shifting 1.1% of the total financial assets held by banks, institutional investors or asset managers (USD 4.2 trillion) would be enough to fill the growing financing for sustainable development gap. These new actors hold financial assets valued at more than USD 378.9 trillion that have grown at 5.9% year on year since 2012, due to increased financial intermediation (International Development Finance Club, 2020[28]).

How much of the universe of finance is (mis)aligned with the SDGs? What are the real margins of manoeuvre to tap into global financial assets to build back better and fill in the developing countries' SDG financing gap? Infographic 4 shows that financial assets are largely held in higher income countries (more than 81% or USD 308 trillion). In addition, out of USD 77 trillion surveyed, USD 31 trillion of assets managed are labelled as having some sustainability consideration. Roughly 10% (USD 3.1 trillion) of these resources seek sustainable development impact. Based on these findings, OECD members have significant opportunities to engage with the new actor to improve progress to improve both the equality and sustainability pillars of alignment.

Infographic 4. How much of the trillions in the system are contributing to equity and sustainability?

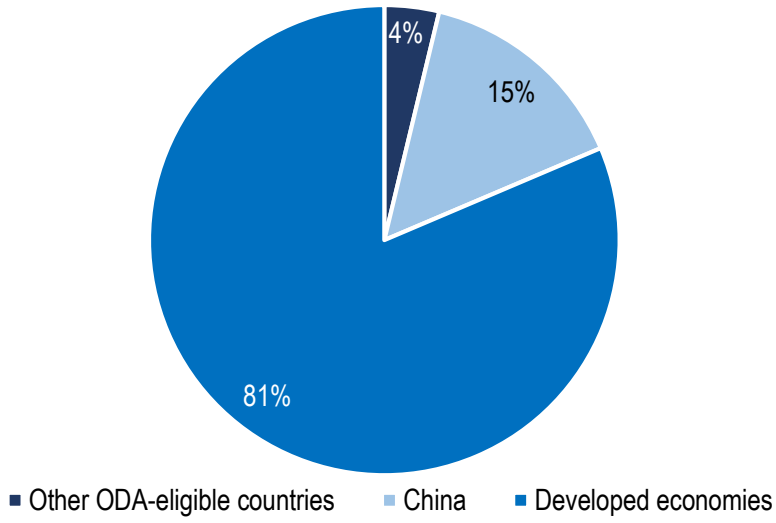


Source: Author's based on Financial Stability Board (2020[28]), *Global Monitoring Report on Non-Bank Financial Intermediation 2019*, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/ and Global Sustainable Investment Alliance (2018[29]), *Global Sustainable Investment Review 2018*, http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf.

Financing is not reaching countries and people most in need

Following the COVID-19 crisis, financial markets rebounded relatively quickly. However, the poorest developing countries lack domestic financial systems to provide reserves, which may accelerate global financial inequalities. Without strong local capital markets, developing countries are faced with increasing competition to seek international financing to respond to the crisis and build back better which exacerbates existing inequalities. Developing countries hold less than 20% of global financial assets, yet represent 84% of the world's population (Figure 8). Only 5.6% of ODA-eligible countries (8 out of 142) are included in reporting by the Financial Stability Board on financial assets, suggesting a lower level of integration than developed countries in the global financial system and likely negligible size of financial assets. An indicator of local capital market development, the value of stock markets recovered in high-income countries (HICs) after the global financial crisis and are now nearing levels of over 110% of GDP. In upper middle-income countries (UMICs), excluding China, stock market size has remained stagnant at around 60% of GDP. In lower middle-income countries (LMICs), stock market size has remained below 40% of GDP. Notably, data are unavailable for low-income countries (LICs), again suggesting negligible local capital markets.

Figure 8. Shares of global financial assets are unevenly distributed across countries



Source: Author's based on Financial Stability Board (2020[28]), *Global Monitoring Report on Non-Bank Financial Intermediation 2019*, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/.

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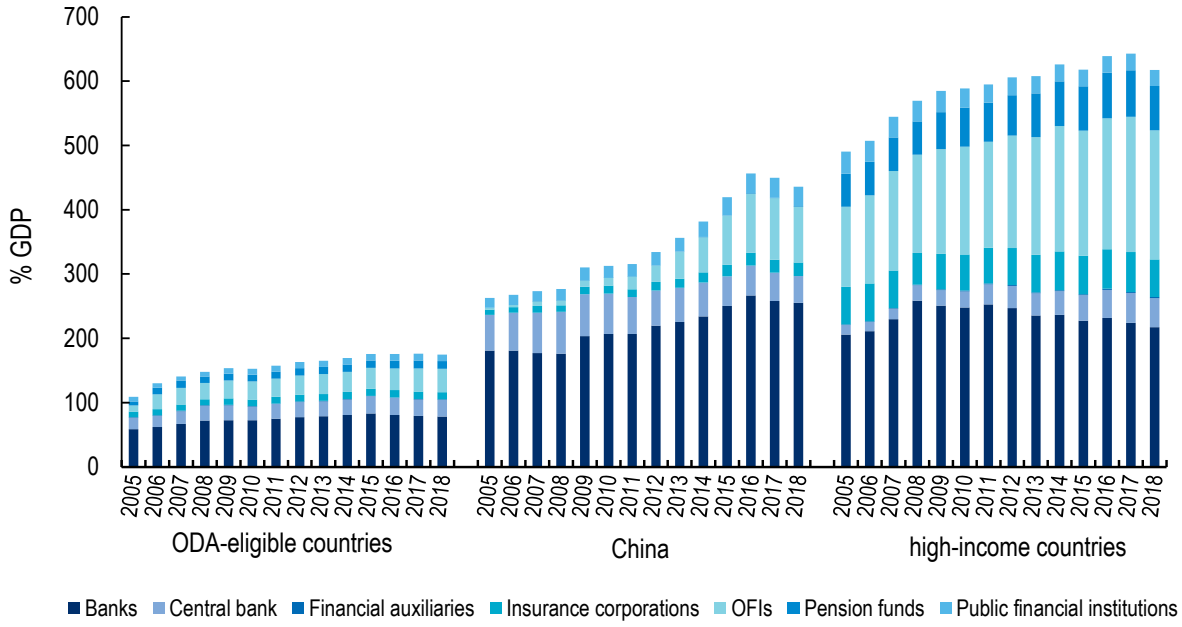
Developing countries lack financial reserves from central banks and face challenges to attract institutional investors such as insurance providers and pensions to provide social protection. Figure 9 shows that in high-income economies, financial assets increased by 20% due to a three-fold increase in central bank assets following implementation of quantitative easing. Yet, developing countries lacked greater margin to increase central bank reserves following the global financial crisis. In 2017, pension funds represented less than 20% of GDP in developing countries and insurance companies less than 15%, compared to nearly 45% and 40% respectively in high-income countries. In 2017, only one-third to one-half of the global population were covered by essential health services. Large informal sectors prevent the development of financial systems that provide social protection**.** Informal employment represents 90% of total employment in low-income countries, 67% in middle-income countries and 18% in high-income countries (ILO, 2020[30]). A lack of access to social protection increases the vulnerabilities of informal economy workers and their families, particularly during COVID-19 lockdowns (OECD/ILO, 2019[31]).

Figure 9. Financial assets held by new actors as a percent of GDP across country groups, 2005-18

Total financial assets by year and country group



Source: Authors based on Financial Stability Board (2020[28]), Global Monitoring Report on Non-Bank Financial Intermediation 2019, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/.

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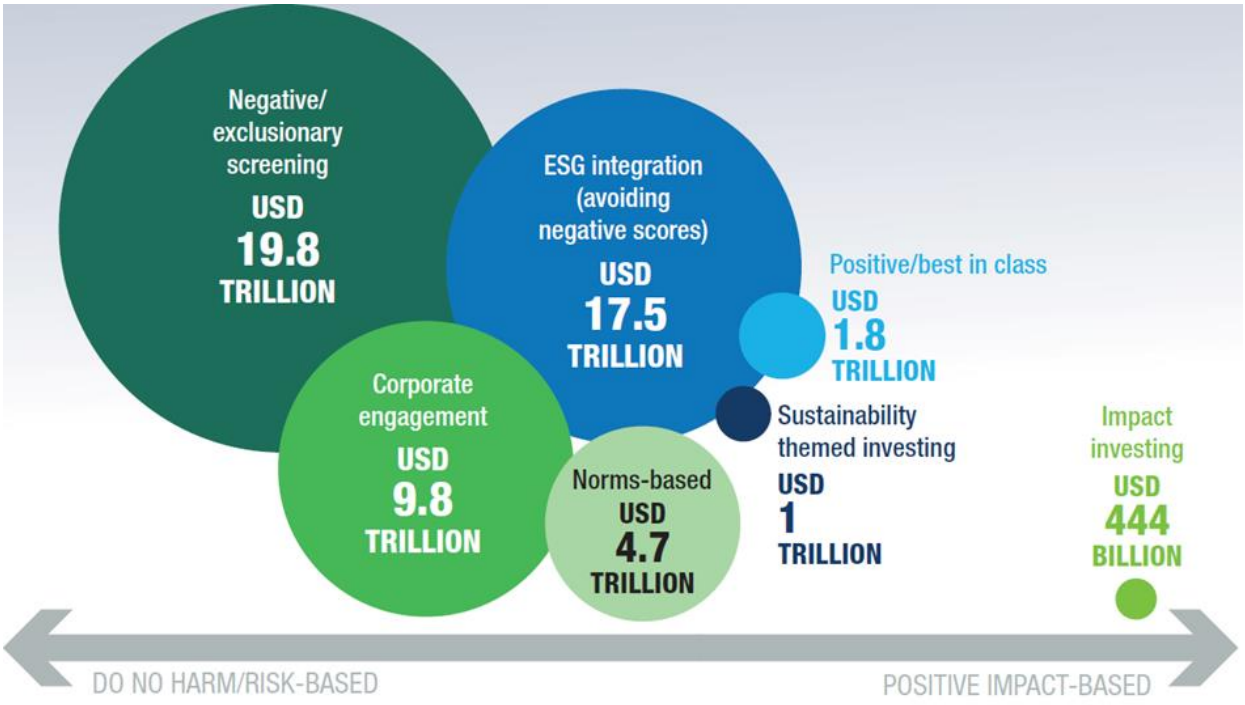
The unequal geographic distribution of financial assets also is linked to inefficiencies in domestic and international financial and taxation systems. Domestic resources keep leaking through tax evasion and avoidance, inefficient tax incentives, other illicit financial flows or high remittance transfer fees. These inefficiencies facilitate the outflow of assets and profits from lower-income countries. Aggressive tax avoidance by businesses and wasteful tax incentives by governments can further limit the ability of low-income country governments to align spending and economic activity to the SDGs.

- While some financial assets held off-shore are legitimate, a significant proportion are thought to be illicit and/or undeclared for tax purposes. Evidence suggests that at least 44% of African financial wealth is held offshore in tax havens, with tax losses estimated at EUR 17 billion annually (Zucman, 2015[32]).
- Aggressive tax avoidance by multinational enterprises is estimated to cost countries as much as USD 240 billion annually, and developing countries are disproportionately affected because they rely more on corporate tax revenues than do developed countries.
- According to surveys of investors, tax incentives are a low priority in investment decisions, with redundancy rates exceeding 70% in 10 of 14 surveys analysed by the International Monetary Fund (IMF et al., 2015[33]). Such redundant or wasteful tax incentives are essentially a transfer from a government to the companies.
- The cost of sending remittances to ODA-eligible countries remains high – between 6.8% and 7% on average in 2017-19 or between USD 30.26 billion and USD 31.15 billion annually.

While private investment for sustainable activity is on the rise, so is a risk of "SDG washing"

The private sector is shifting gears to include sustainability in its business models. A survey of the 75 largest asset managers found that 48% of investors are developing an approach to the SDGs (ShareAction, 2020[34]). Already, several funds that use non-financial environmental, social and governance (ESG) indicators have outperformed and registered lower losses than for-profit only funds during the pandemic. During the COVID-19 period, all three emerging market sustainable index funds outperformed the iShares Core MSCI Emerging Markets ETF by 1.58 percentage points (Freyman, 2020[35]). As this activity increases, a wide array of financing activities and strategies comprise the spectrum of what is labelled "sustainable" finance. The proliferation of hundreds of different ESG rating agencies has led to different measurement standards. Many overlap, ranging from funds that seek to do no harm (i.e. mitigate risks) to those that seek positive impacts based on thematic or geographic focus. In the broadest sense, sustainable finance includes both a do no harm objective and impact-based financing (Figure 10). Roughly 10% of sustainable finance, or USD 3 trillion, is defined as seeking to achieve positive impacts.

Figure 10. Few types of sustainable investment are based on non-financial impacts



Note: The amounts in the figure do not add up to the estimated USD 30-trillion estimate sustainable investments due to double-counting across several categories.
Source: Author's based on Global Sustainable Investment Alliance (2018[29]), Global Sustainable Investment Review 2018, http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf; European Sustainable Investment Forum (2018[36]), European SRI Study 2018, http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf; Responsible Investment Association Australasia (2019[37]), Responsible Investment Benchmark Report: Australia 2019, https://responsibleinvestment.org/wp-content/uploads/2019/07/RIAA-RI-Benchmark-Report-Australia-2019-2.pdf.

While USD 30 trillion out of USD 70 trillion assets under management (AUM) surveyed meet some sustainability criteria, the sustainable finance market remains immature and there are many inefficiencies. Standards, instruments and initiatives proliferate: estimated at 115 multi-stakeholder initiatives, growing at a rate of eight per year, involving 5 181 constituent members. Without better accountability, transparency

and incentives, impediments remain to improve the allocation of resources and enable the use of sustainability labelling or branding without reliable assessment of how financing impacts progress toward the global goals (i.e. green or SDG washing). Lack of transparency and accountability present challenges for investors, clients, and citizens to assess how their investments affect people, planet and prosperity.

Implementing a common framework for SDG alignment

With hundreds of trillions of dollars in the system, and a significant margin to correct misalignment of finance, what could be done to foster change? Recovery for greater resilience and sustainability in response to the COVID-19 crisis relies on the collective capacity to better manage risks associated with recurrent shocks linked to growing inequalities and uneven or insufficient progress towards the SDGs. The equality and sustainability dimensions of SDG alignment are interlinked: one cannot be achieved without the other. According to a recent study, the cumulative economic losses due to natural disasters in 2019 were nearly equivalent to total ODA volumes in the same year (USD 150 billion) (Löw, 2020[38]).The capacity of each individual country to reduce the distance to the SDGs will depend on the performance of other countries to avoid negative spillovers.

Five years after their adoption, the 2030 Agenda remains the best blueprint to successfully build better after the crisis, and the Addis Agenda the best framework to finance the goals. However, a step change is needed to accelerate progress. Sustainable finance cannot remain a niche; it should be mainstreamed in order to build resilience in the system. In particular, the Addis Agenda could be leveraged to help shift the trillions in favour of the SDGs while leaving no one and no goal behind. Two key challenges must be addressed by policy makers:

- First, engagement with the private sector on the 2030 Agenda remains a challenge. The United Nations Secretary General (UNSG) has made it a priority in its SDG Financing Strategy and Roadmap, including with the creation of the Global Investment for Sustainable Development (GISD) Alliance. Perception of risk in many developing countries still impedes sustainable investment opportunities, and market failures need to be addressed. Better leveraging official development finance to mobilise more SDG-aligned finance will be key to success.
- Second, incentives and policies that could align the trillions along the investment chain need to be updated. Domestic and international SDG financing strategies need to be better connected. Unless the incentives within OECD countries are corrected, resources will not flow to where the needs are greatest. Without clear rules, the sustainable finance market will continue to lack integrity and efficiency, and allow investors to be misled by deceitful practices. Without transparency and harmonisation of definitions and standards, the growing number of public and private initiatives could lead to further fragmentation and segmentation of markets.

This is a shareholders' agenda: people's savings, pensions, investment should serve their interests. All actors along the investment chain should be involved to put people and planet at the heart of the system, and reach the twin goals of higher non-financial and financial results. Of the trillions of dollars invested in stimulus packages, a portion of resources should be allocated to development co-operation and building resilience within the system in order to prevent future crises. The United Nations and other forums, such as the G7 or G20, have raised concrete recommendations. Now it is time to translate them into concrete actions for all stakeholders.

Building Block 1 – Unleash the potential of the Addis Ababa Action Agenda

The SDG alignment agenda starts with a two-pronged crisis management strategy that must address the equality and sustainability dimensions: in the short term, to stop the bleeding of available resources, i.e. avoid the collapse of financing for sustainable development; in the medium-long term, to build back better,

i.e. increase the sustainability or qualities of the financing. Figure 11 outlines the central challenges and corresponding actions to be taken.

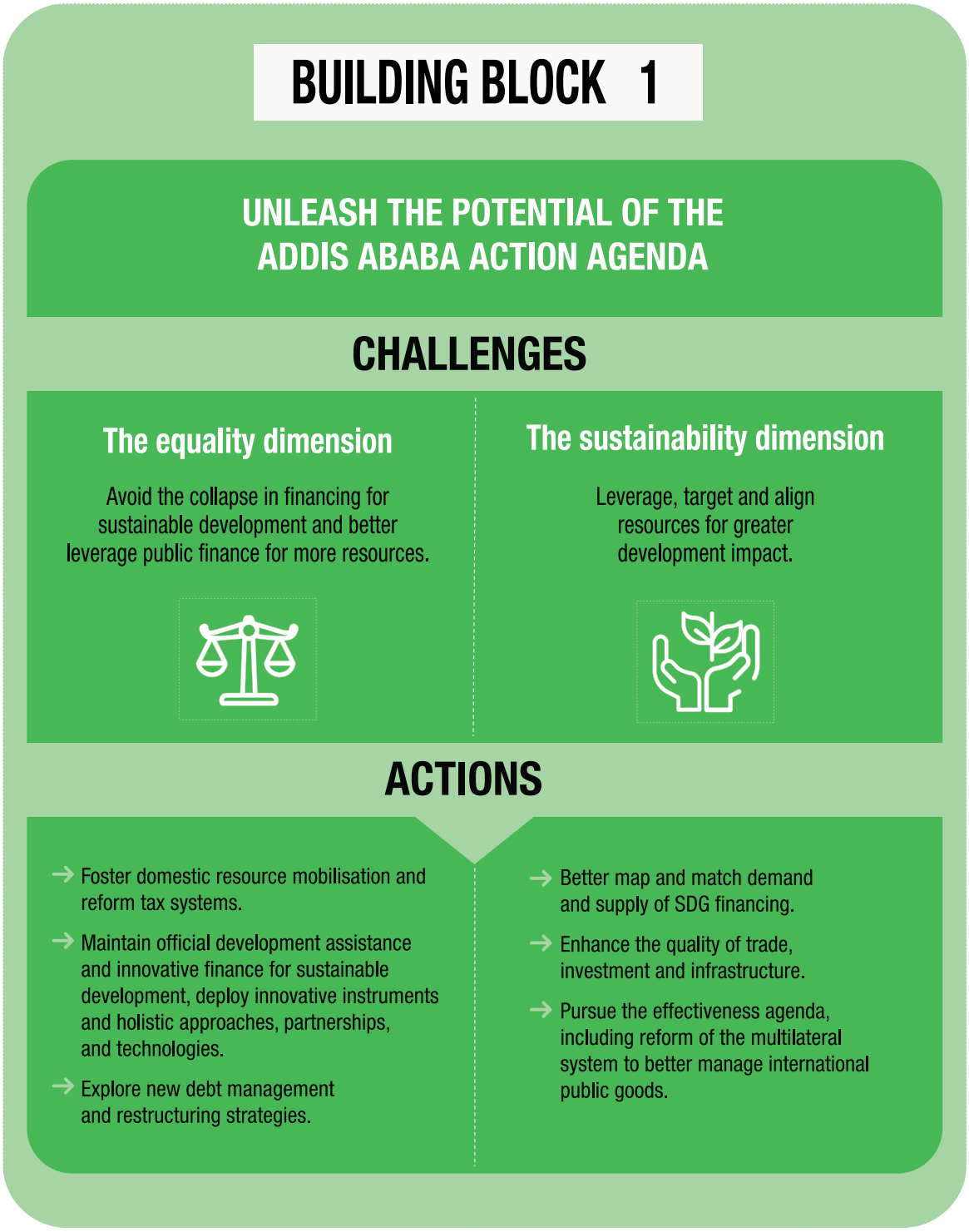
First, the traditional actors in the financing for sustainable development landscape should better mobilise and leverage resources in support of SDG financing in developing countries:

- Domestic resources remain the most sustainable long-term source of financing for sustainable development. Realising this potential requires actions at both the domestic and international level, and on both policy and administration. Improving international co-operation and exchange of information on tax is vital to enable action against tax avoidance and evasion, while ensuring effective taxation with a digitalised global economy will require new international standards that work for, and can be implemented by, all countries. The challenge of designing tax systems in the wake of the COVID-19 crisis will require new approaches, and more support, for developing countries in identifying and implementing policy and administration reforms to not just generate revenues, but also influence growth and equity, and shape behaviours. Increasing the supply of tax expertise remains a high priority, and can deliver significant impacts, on average, USD 70 in additional tax revenues have been recovered by Host Administrations for every dollar spent on TIWB operating costs between 2012 and 30 June 2020 (OECD/UNDP, 2020[39]).
- Development finance providers should play a larger role to increase efforts to maintain official development assistance budgets and keep external financing flowing, including private investment and remittances. This requires scaling up innovative finance approaches and tools, such as blended finance and COVID-19 and SDG bonds, and doing more to promote digital financial services. It is also important to promote innovative finance for sustainable development to identify potential new sources of funding for official development finance. Following the pandemic, governments and the private sector globally raised USD 150 billion in four months using COVID-19 bonds (Hirtenstein, 2020[40]).
- In 2019, half of low income countries were either already “in debt distress” or “at high risk of debt distress”, compared to 23% in 2013 (IMF, 2020[41]). With a debt crisis looming, all development finance providers must do more to ensure the positive development impact of all resources over the long term. Debt suspension, restructuring and relief should be used as levers to promote greener and more resilient growth in developing countries. New instruments should be deployed to repurpose debt in support of the environment and social protection, among others.

Second, official development finance providers and other relevant stakeholders should increase the quality of financing for greater SDG impact:

- At the global level, the international community must build on and accelerate its work to develop a framework for assessing national SDG financing needs. At the national level, demand for and supply of SDG financing needs to be better matched. Development finance providers should assist partner countries to create a pipeline of sustainable projects and match sustainable finance opportunities, as well as mainstream SDGs into tax reform, budget planning and performance review.
- Development finance providers should strive to enhance the qualities of trade, investment and infrastructure that are essential elements of a sustainable recovery. For example, climate-resilient infrastructure translates into a USD 4 benefit for each dollar invested in resilience (Hallegatte, Rentschler and Rozenberg, 2019[42]).
- The channels of distribution of development finance also need to improve as part of the effort to build back better, e.g. by pursuing the effectiveness agenda, including for multilateral development finance that has played and will continue to play a key role in the management of global crises. For example, multilateral organisations channelled USD 250 billion to developing countries following the pandemic in developing countries (OECD, 2020[43]). DAC members are the major shareholders of the multilateral system and must ensure greater efficiency to address global challenges.

Figure 11. Actions for alignment: Building Block 1



Source: Authors

Building Block 2 – Beyond Addis, increase the efficiency of markets and partner with new actors

A focus on development finance and the enabling conditions for financing in developing countries remains limited to the intermediate and final steps of investment. However, a successful SDG alignment strategy requires incentives and policies aligned all along the investment chain, including in countries of origin of the funds (i.e. OECD countries). For example, Canada has announced that businesses with revenues of USD 300 million or more requesting COVID-19 economic aid would be required to disclose their climate impacts and commit to making environmentally sustainable decisions.

The Addis Agenda calls for "*policies, including capital market regulations where appropriate, that promote incentives along the investment chain that are aligned with long-term performance and sustainability indicators*" (paragraph 38). Following the global financial crisis, private sector actors, particularly in the financial sector, anticipated changes in regulations that would tip the balance of risks and returns in favour of greater non-financial focus (i.e. long-term performance and sustainability) to avoid future shocks.

Policies in OECD countries determine upstream how much private investment development finance providers will be able to leverage. The role of the governments and regulators is not to force the shift but to accompany and remove all obstacles to a more efficient allocation of resources for greater market integrity and market efficiency. Taking "billions to trillions" to the next frontier means lifting the barriers to transparency, accountability and getting the incentives right – this is the missing supplement to the AAAA.

The emergence of new actors along the investment chain, and the proliferation of multilateral initiatives on financing for sustainable development, are creating new risks to mitigate but also opportunities to be seized. Three major issues need to be tackled in order to promote alignment, ensure market integrity and efficiency, and grow the sustainable finance market: transparency, accountability and incentives. Actions needed include: identifying SDG metrics that are fit for the private sector, helping companies more clearly define their sustainability objectives, and phasing out policies that create barriers to SDG alignment.

- The SDG target and indicator framework was developed by governments for governments. Only 40 of 169 SDG targets were supported by business in developing countries (GrowInclusive, 2020[44]). However, business may be supporting targets not captured in the current measurement framework. For example, SDG target 10.4 makes reference to social protection policies without setting objectives for private sector practices that could achieve the same objective.
- Not enough businesses and financial institutions include SDGs in their strategies, and non-financial performance is still under-rated. A survey of the 75 largest asset managers found that less than half of investors are developing an approach to the SDGs (ShareAction, 2020[34]).
- Hundreds of initiatives claim to promote sustainability of business and finance, but an agreement on definitions is missing; rules for mandatory reporting are necessary and independent assessment put in place. For example, an assessment of ESG risks can be carried out differently from one agency to another. A high environmental score accorded by some ESG ratings can correlate positively with high carbon emissions if other environmental factors are given greater weight (OECD, 2020[45]).

The United Nations system and its partners began work before the crisis to make the case for SDG alignment. This report provides analytical support and recommendations to promote an emerging common framework developed jointly by the OECD and the United Nations Development Programme to bring all sources of financing along the investment chain behind the SDGs.

Figure 12. Actions for alignment: Building Block 2

Source: Authors

In support of the recommendations emerging from the UN-led financing for development process, and other notable initiatives (e.g. in the G7 and G20), voluntary community action plans could be promoted. New actors, including asset managers, banks, institutional investors, credit rating agencies, stock markets, should take concrete actions to improve transparency, accountability and incentives for SDG alignment.

Investors managing trillions of dollars can make efforts to reduce misalignment, including avoiding negative externalities such as carbon emissions, human rights abuse, etc. and take preventive measures to facilitate greener and more sustainable forms of finance such as develop asset classes beyond equities such as green bonds (e.g. asset managers and investment banks) and leverage capital markets to mobilise more finance directed to developing countries (e.g. public development banks). Institutional investors such as pension funds, sovereign wealth funds and insurers could further integrate ESG considerations and better monitor and evaluate ESG risk reduction, compatible with the SDGs and based on accountability for sustainable development impact. For example, Norway's Norges Bank Investment Management (NBIM) has worked to divest or press for changes to the business models for companies in sectors contributing to deforestation and pollution, such as plastics (Fouche, 2018[46]). Market regulators like rating agencies and stock markets could set stronger financial and non-financial disclosure requirements to raise transparency and harmonise reporting standards.

For this purpose, the Global Outlook provides a first non-exhaustive set of examples to identify how actions could be tailored across the different communities and in partnership with policy makers. Table 1 provides the menu of possible actions to be taken by both new actors and policy makers on the basis of consultations carried out in 2020.

Table 1. Community action plans

Communities	Actors: actions to align	Policy makers: actions to support alignment
Asset managers		
USD 91.5 trillion AUM	• Expand use of asset classes beyond equities (e.g. green bonds or bonds from mission-driven agencies such as development banks) • Invest in new tools and technologies to integrate SDG metrics • Build asset manager capabilities to source SDG investments • Incorporate SDG mandates into managers' objectives	• Encourage asset managers to make publicly available comparable, consistent, and verifiable ESG information (from corporate and investment strategies) • Create platforms that build relationships between asset managers and sustainable companies, sustainable development bond issuers, development finance institutions, and aid agencies
Central banks		
USD 30 trillion AUM	• Integrate SDG imperatives into macro prudential regulation • Quantitative easing: Central banks can adapt eligibility criteria for QE actions • Integrate sustainability factors into portfolio management	• Robust and consistent climate-related disclosure requirements • Support and develop taxonomy of economic activities related to green transition
Insurers		

USD 32.9 trillion AUM	• Adjust range of risk factors to insure and develop ESG-related insurance products • Incorporate ESG into repairs, replacements, disputes, and other claims services • Measure and monitor ESG risk reduction progress	• Support regulatory and legal frameworks for ESG risk reduction • Invest in capacity and technical assistance to develop insurance markets in emerging economies • Adopt policies to encourage companies to broaden coverage and risk factors
Investment banks		
USD 147.9 trillion AUM	• Measure, document, and disclose investments in fossil fuels • Bolster advisory services to companies supporting SDGs • Commit to underwriting green, social, and development impact bonds	• Require disclosures from financial institutions on ESG risks and "stranded assets" • Encourage stress tests to evaluate banks performance on environmental and social risks • Provide forward guidance on ESG risk management and due diligence
Public development banks		
USD 11.2 trillion	• Help develop local capital and productive sector markets • Enhance clarity and direction of PDBs mandates and governance structures • Leverage international finance in developing countries	• Ensure good governance • Help develop local capital and productive sector markets • Leverage international finance
Pension funds		
USD 35.6 trillion AUM	• Add SDG criteria to investment decisions • Strengthen expertise and capacity of fund managers on ESG • Set SDG targets in terms of SDG investments and outcomes	• Reduce capital requirements for pension funds partnering with DFIs and NDBs • Incentivise pension funds to factor in ESG impact through regulation • Improve availability, consistency, and quality of ESG information
Philanthropic organisations		
USD 7.1 billion	• Improve knowledge sharing with governments and donors • Make better use of existing platforms to improve data transparency on philanthropic giving	• Adopt more systematic approaches to engagement with foundations • Adapt regulation to improve enabling environment for philanthropy
Rating agencies		
	• Standardise timing of rating announcements • Shed greater transparency on ESG rating methods and models	• Consider turning rating agencies into public institutions • Regulate timing of rating announcements • Developing countries should build capacity to better engage rating agencies during reviews and appeals
Sovereign wealth funds		
USD 7.45 trillion AUM	• Embed SDGs into the investment process • Integrate ESG advisers into SWF management teams and boards • Assess fund managers on a longer horizon based in part on development outcomes	• Encourage SWFs to embed SDG objectives into their mandate • Encourage SWFs to publish an SDG investment strategy • Require SWF disclosures to legislatures or independent team to increase investment transparency

Stock exchanges		
USD 95 trillion market capitalisation	• Bolster reporting and disclosure requirements for listed companies • Create indices that single out best and worst ESG records • Provide written guidance on best ESG transparency practices	• Leverage ESG data from listed companies to provide information to regulators • Help exchanges establish ESG and corporate governance criteria for listed companies • Consider regulations for companies to provide ESG reporting to list on stock exchanges

Source: Authors based on stakeholder consultations.

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Notes

[1] It is estimated that in addition to the USD 2.5 trillion annual SDG financing gap, developing countries as a whole would require an additional USD 1 trillion in recovery spending to match recovery spending carried out by OECD countries over the same period. Compounding the gap in both recovery spending and SDG financing, the report further estimates a potential drop of USD 700 billion in external private finance in 2020. These figures provide an order of magnitude of the growing financing needs and limitations to access financing in developing countries The estimation of additional recovery spending in developing countries to reach a similar magnitude of recovery spending in OECD countries, calculated on the basis of the recession as forecast at the time of this report's publication.

[2] This is indicated in the communiqué of the African Ministers of Finance on 13 March 2020, published by the United Nations Economic Commission for Africa. See https://www.uneca.org/stories/communiqu%C3%A9-african-ministers-finance-immediate-call-100-billion-support-and-agreement-crisis.

1 Committing to Sustainable Development Goals in the aftermath of a global crisis

This chapter evaluates the magnitude of the shock caused by the COVID-19 recession for the Sustainable Development Goals (SDGs). The direct shock is unprecedented, and by implication, the financing needs for developing countries to meet the SDGs have risen significantly. The first section describes the economic aspects of the crisis, given its speed, breadth and depth, and the major challenges remaining after the initial response from policy makers. The second section shows that the SDGs are unlikely to be attained by 2030 given that resources have collapsed and needs have increased. This gap will persist, not only in the short run, but also far into the future.

In Brief

A global shock with long-term consequences

Following the outbreak of coronavirus (COVID-19), the world entered an historic global recession, which threatens to set back the achievement of the 2030 Agenda. In just a few months, at least two years of progress on poverty reduction were erased. In 2020, 100 million additional people are likely to be living in extreme poverty compared to the numbers projected in early 2020. With stringent lockdown policies in place, developing countries had to cope with a major economic shock in addition to the health shock. Within a span of weeks, previsions of global economic growth transformed into forecasts of the worst economic recession since the Second World War, dwarfing the global financial crisis. In the words of the United Nations (UN) Secretary-General, "What began as a health crisis has quickly become the worst human and economic crisis of our lifetimes."[1]

The challenges of the financial crisis are unlike any before. After a period of financial panic, with stock indices declining by 25% to 30% in most Group of Twenty (G20) nations in March 2020, actions by central banks and governments dampened the immediate financial fallout. The spread of the virus, the impact of lockdowns, and the retrenchment in consumption and investment have also led to contraction of economic growth of 6% globally and job losses up to 200 million. Advanced economies have managed to implement large monetary and fiscal stimulus packages, allowing debt to gross domestic product (GDP) ratios to rise by 20 to 30 percentage points of GDP in OECD countries. More constrained fiscally, most developing countries do not have the ability to respond to the crisis with packages of similar magnitude. Based purely on the recession as forecasted, it is estimated that developing countries would have required an additional USD 800 billion to USD 1 trillion, including USD 100 billion in low-income countries. As a result, the competition for credit to respond to the crisis could increase the unequal distribution of resources. Financing for sustainable development plays a role to help mitigate the risks of increased inequalities and can help rebuild in countries most in need.

The COVID-19 pandemic magnifies the scissor effect of increasing needs and declining resource availability identified in the first edition of the OECD *Global Outlook on Financing for Sustainable Development* in 2019. Both tax and non-tax revenues of governments are under severe strain due to sharp contractions in economic activity and the global decline in commodity prices. At the same time, the crisis is setting back the Sustainable Development Goals (SDGs) in the short and medium term. Over the long term, global uncertainty on the future path of growth is likely to slow investment in sectors such as infrastructure and innovation, further increasing the overall long-term financing needs.

The SDGs offer a blueprint to recover better through fully integrating environmental, social and economic impacts and trade-offs. The gaps in the global system, the underfunding of global public goods and the unequal distribution of vulnerability across countries and individuals can be filled by the holistic approach of the 2030 Agenda. The crisis could lead to a rethinking of health systems and how people work, produce, live, earn and redistribute income. Aligning to the SDGs means taking into account the importance of these needs when making investment and budget decisions

1.1. The global recession will constrain financing for sustainable development over the short, medium and long term

This section describes the main characteristics of the COVID-19 economic recession – it is unexpected, fast, deep and almost globally simultaneous – and demonstrates how it is increasing financing needs in developing countries in the short term and over the medium to long term. All public, private, domestic and external actors called upon in the Addis Ababa Action Agenda must mobilise their support to help narrow the gap between rising needs and declining availability of resources.

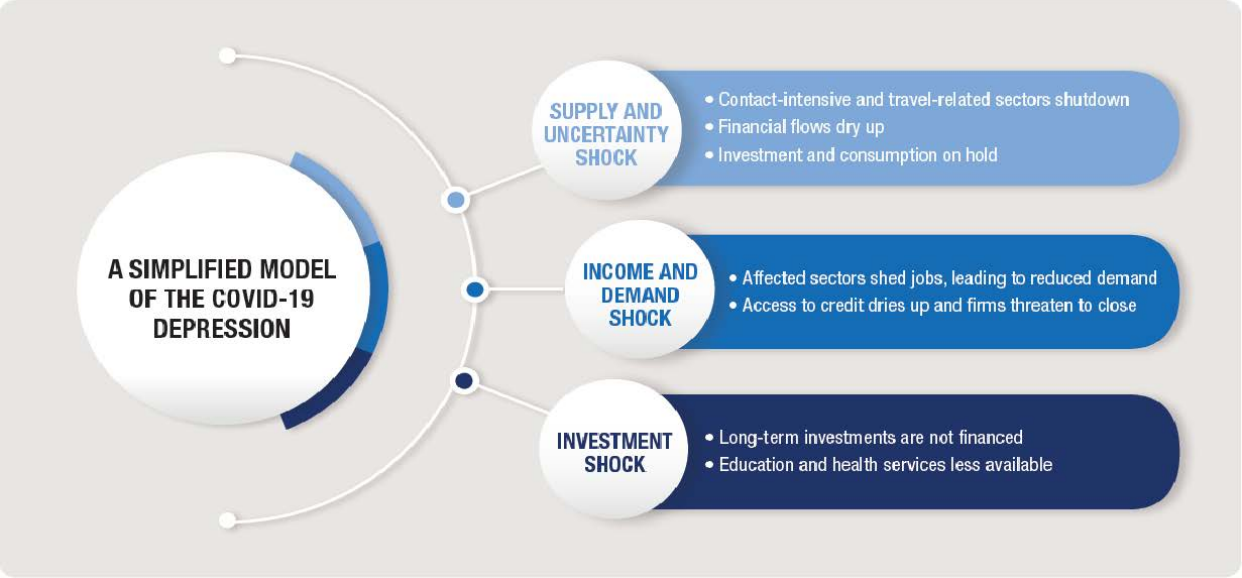
The recession is affecting the financing channels of both supply and demand, unlike during the global financial crisis of 2008-09 when an investment drought was the primarily driver of the recession. While the policy response in the wake of the pandemic was swift and massive, few developing countries were able to afford the kind of massive monetary and fiscal stimulus put in place in advanced economies. As a result, the economic impact is likely to be more concentrated on fragile contexts and on the poor and to widen the disparities across countries.

1.1.1. Short-term economic prospects plummeted globally

The immediate economic consequences of COVID-19 are the most dramatic in peacetime since the Second World War: a 6% decline compared to an average of -1% in the four previous global recessions (and -2% during the global financial crisis). In February and March 2020, when it appeared the world was passing through a history-changing event, three stunning aspects stood out: the speed, breadth and depth of the impact. This subsection looks at each aspect individually. It also describes the immediate policy response in the form of monetary and fiscal stimulus packages, which were necessary but could contribute to deepen inequalities across countries.

The dual supply-demand shock creates a loop where short-term and sector-specific losses of income will translate into long-term macroeconomic recession. Infographic 1 presents a simplified model of the COVID-19 recession that illustrates the dynamics in three steps. First, the spread of the disease led to a supply shock and the shutdown of some sectors, especially contact-intensive sectors (hospitality, entertainment, travel) but also government services (education and health, for example). These impacts led to increased uncertainty, wherein consumers and firms suspended their consumption and investment plans. In some countries, this initial shock also stemmed from an external demand shock that spread from countries under lockdown. Second, as jobs and incomes fell, the crisis quickly morphed into a demand-driven recession, as described by Guerrieri et al. (2020[1]). Finally, third, firms put their investment plans on hold given the broad uncertainty on current and future demand for their products and services.

Infographic 1.1. A simplified model of the COVID-19 recession



Source: Authors

A fast and broad recession is leaving no place untouched

In a matter of weeks, the world entered its worst global crisis since the Great Depression. In January 2020, the International Monetary Fund (IMF) expected world GDP to grow by 3.3%, as the COVID-19 risk appeared to be concentrated in the People's Republic of China (hereinafter China) with little potential for a spillover from health concerns to economic activity. While growth performance in developing economies had been disappointing in the past five years, 2020 was projected to continue the steady flat trend of slow growth. By March, this outlook was turned on its head: Chinese growth prospects collapsed and growth forecasts for OECD countries turned negative.

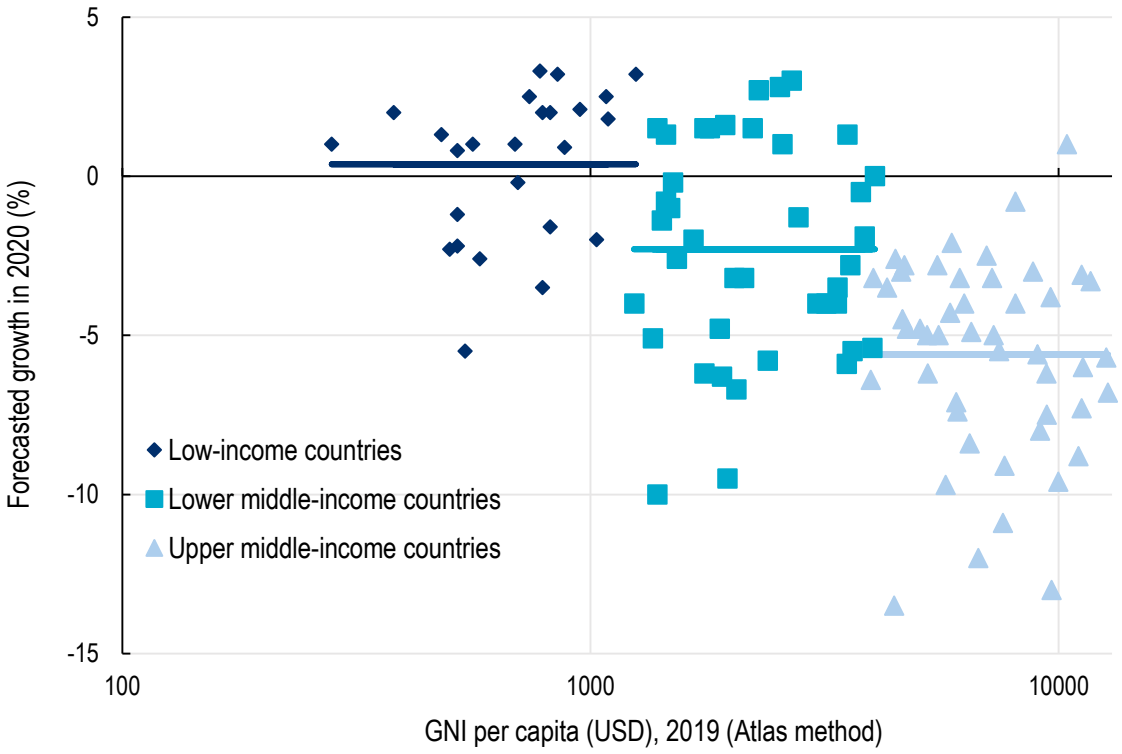
Growth forecasts in developing countries were hardest hit. Between March and April, IHS Markit's global Purchasing Managers' Index, a measure of companies' optimism, collapsed, dropping from 50 to 25.5, a record low. In another illustration of this shift in confidence, financial market stock indices fell by 20 to 30% in most G20 countries; the VIX index, a measure of financial uncertainty, surged nearly to its 2008 record. As in previous confidence shocks, the ripple effects for developing countries were immediate: equity indices in emerging markets (MSCI EM) declined by 16% between January and the end of May 2020, while global indices declined by only 8%. For a period of a few weeks, bond markets in emerging and frontier markets were frozen. As discussed in detail in Chapter 2, these events translated into a sharp reduction of financing flows to emerging and developing countries that were more sudden than during 2008-09. This financial turmoil translated rapidly into lower economic growth projections. In April, the IMF was forecasting a 3% global GDP decline, and a 1% GDP decline in developing countries, before further downgrading its forecast in June to GDP declines of 4.9% globally and 3% for developing countries.

Because of the COVID-19 pandemic, more developing countries have entered into economic recession than at any time since the Second World War. This is in contrast to the global financial crisis, which resulted in negative growth, mostly in developed countries (World Bank, 2020[2]). As indicated in Figure 1.1 90 of 122 non-high income countries had negative GDP growth in 2020, among them almost all upper middle-income countries and 31 of 44 lower middle-income countries. The richer of these economies are forecast to experience the larger shocks. There are a number of reasons for this relatively optimistic outlook for the lower-income economies (Goldberg and Reed, 2020[3]). One is their better prospects for containing the

disease (due to a less vulnerable demography and experience with past epidemics). A second is their less restrictive lockdowns and higher mobility; the fall in mobility is estimated at 40% in low-income countries against 70% in middle-income and developed economies. Third, they are less integrated in the global economy. IMF forecasts suggest the pandemic's impact will be "significantly more muted" on emerging markets and developing economies than on advanced economies, according to Sandefur and Subramanian (2020[4]). Nonetheless, those assumptions could prove to be wrong and official projections for developing countries could turn out to be overly optimistic.

Figure 1.1. Growth forecasts amid the COVID-19 recession in 2020 by income group

Direct impact worsens with income



Source: (World Bank, 2020[2]), *Global Economic Prospects, June 2020*, 10.1596/978-1-4648-1553-9; (World Bank, 2020[5]), *World Development Indicators* (database), http://datatopics.worldbank.org/world-development-indicators/.

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According to the World Bank and comparing pre-pandemic and current forecasts, total global loss of GDP for 2020 could amount to USD 9 trillion, with 40% of the loss in developing countries; half of the developing country loss could be represented by China (World Bank, 2020[2]). In per capita terms, this is equivalent to a loss of about USD 600 per person in the developing world for both 2020 and 2021. In terms of regions, Latin America is projected to suffer the worst downturn, with a 7.2% decline of GDP followed by a tepid rebound. The Middle East and North Africa and Europe and Central Asia regions are both projected to experience declines of more than 4% of their GDP. As of writing, with a second COVID-19 wave apparent in several advanced economies, considerable uncertainty remains. A rebound could be followed by a new recession, leading to further losses (OECD, 2020[6]).

Decisive policy actions staved off collapse of the financial system and spending shortfalls in developing countries in the short term

Governments and central banks in developed countries quickly disbursed historic amounts of emergency spending. To mitigate disruptions in markets, central banks immediately adopted drastic easing measures. Collectively, central banks in developed countries added USD 6 trillion to their balance sheets, including USD 2.3 trillion in measures announced by the United States Federal Reserve in March 2020 that created an immediate inflection point for financial markets (IMF, 2020[7]). The fast reaction of policy makers staved off an immediate collapse of the financial system. Developing countries also adopted unconventional monetary measures early in the crisis. For example, central banks in several developing countries purchased government bonds to counter financial outflows and the need for fiscal deficits. This radical departure from conventional wisdom mitigated the freefall in investor confidence and allowed firms continued access to finance in the short and the medium run (Arslan, Drehmann and Hofmann, 2020[8]).

In parallel, governments adopted fiscal measures totalling USD 11 trillion (IMF, 2020[9]). Advanced economies, with the greatest capacity to react, adopted various policies of economic support: credit guarantees, tax credits and unemployment benefits, among others. In total, it is estimated that they injected 9% of their collective GDP. In contrast, middle-income countries injected about 3% and low-income countries only 1% of their GDP in stimulus packages. A broad range of other support measures – equity injections, guarantees, etc. – also were used, again disproportionately so in developed countries. The results of these are mixed in terms of resources available for developing countries. On one hand, by staving off the panic and stabilising markets, these measures avoided an economic depression globally. On the other, the increase in long-term debt levels could reduce funds available for development, especially if monetary policy is normalised in the future.

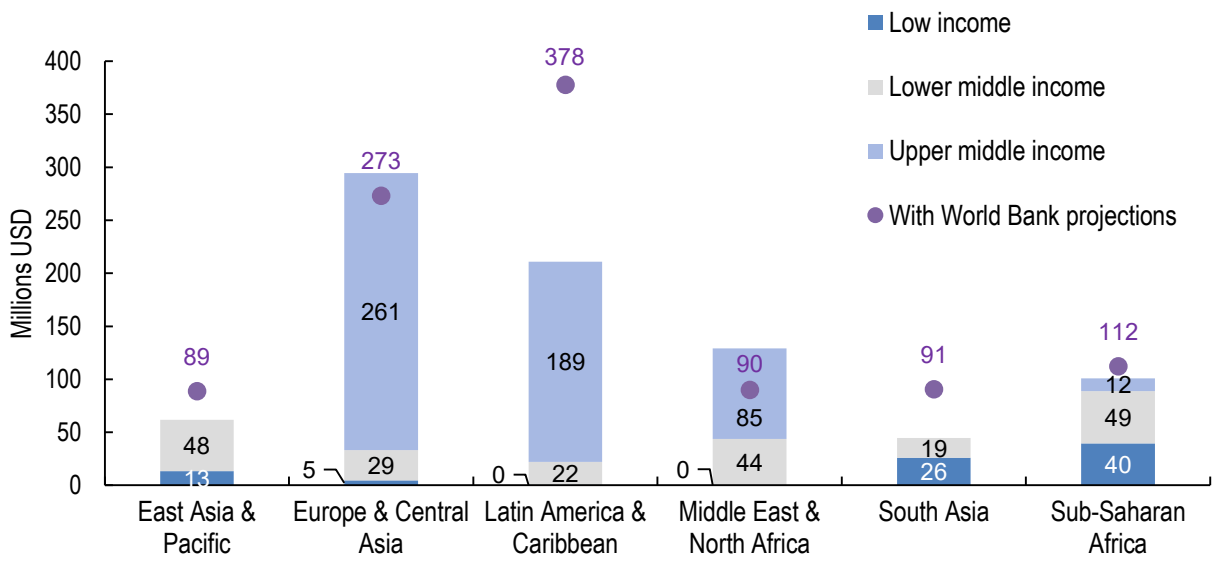
In terms of financing needs, the difference between developing and developed countries is evident from the magnitudes of stimulus packages. Monetary and fiscal policies in advanced economies have targeted several main objectives: minimise the impact of the coronavirus (COVID-19) crisis on firms by supporting them through provision of credit (often through guarantees) and tax deferrals and minimising the impact on incomes through insurance and subsidies (IMF, 2020[9]). Developing countries have sought to do the same; their lack of social protection policies is one of the main reasons that poverty and inequality are likely to rise as much as anticipated. Therefore, the amount needed by advanced economies can be a useful proxy for the financing needs of developing economies in the short run.

Stimulus packages have been highly unequal. Fiscal measures documented by the IMF amounted to about 18% of GDP for advanced economies and about 6% for G20 emerging economies[2] (IMF, 2020[9]). African countries' stimulus packages, in contrast, represent only about 1% of GDP (Overseas Development Institute, 2020[10]). Stimulus packages are correlated positively with income level and negatively with bond yields and sovereign rating (Alberola et al., 2020[11]). This is a strong indication that such packages are not determined by needs but by financial constraints linked with access to finance (through market or central banks' demand for bonds or quantitative easing) and future tax streams.

A credible assumption is that total financing needs for the policy response is that it needs to be proportional to the size of the economic shock. Such a benchmark would result in estimates of needs of about USD 1 trillion for developing countries. This estimate is based on a simple parameter: the correlation between the depth of the recession and the size of packages as established in G20 economies. Indeed, if one assumes that those are less financially constrained due to their size, it is reasonable to think that they determined their response according to economic needs and to an external constraint. G20 economies have mobilised between 1.5% and 2% of GDP in fiscal support. It should be noted that this excludes automatic stabilisers, which tend to be larger in advanced economies. Applying this parameter to the expected growth decline in other countries provides a possible benchmark for the appropriate size of the response, which can then be compared to the actual stimulus put in place in those countries. For developing countries as a whole, the resulting gap would amount to between USD 850 billion and USD 1 trillion (2020[2]), or 5% to 6% of the

GDP of these countries; low-income economies represent about USD 85 billion of this gap, or 6% of their GDP. Sub-Saharan Africa, as a whole, would have increased its packages – of about 1% of GDP – by about 6% of its GDP, or USD 100 billion, in line with the magnitudes found by the United Nations Economic Commission for Africa[3] and others.

Figure 1.2. Stimulus packages: Comparing the financing needs



Note: Stacked columns display stimulus financing needs using International Monetary Fund (2020[12]) projections for 2020 by region and income level. Diamonds display aggregate regional needs using the World Bank (2020[2]) *Global Economic Projections, June 2020*. The difference stems from large differences in growth prospects.
Sources: Center for Strategic and International Studies (2020[13]), *CSIS G20 COVID-19 Fiscal Relief Tracker Dataset* (database); International Monetary Fund (2020[12]), *World Economic Outlook: A Crisis Like No Other, An Uncertain Recovery*, https://www.imf.org/en/Publications/WEO//; World Bank (2020[2]), *Global Economic Projections, June 2020*; Hale et al. (2020[14]), *Oxford COVID-19 Government Response Tracker*, https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker.

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International institutions and the global community also mobilised in response to the pandemic to increase and complement available resources to meet the financial needs of developing countries. Multilateral institutions rapidly adopted new initiatives, closely followed by bilateral donors. The IMF eased the access to some of its USD 1-trillion lending capacity and broadened its emergency lending windows to USD 100 billion, including a zero-interest facility for low-income countries, of which about USD 88 billion had been used by the end of September 2020. The World Bank mobilised USD 14 billion between March and June 2020, mainly to the health sector but also to other sectors. More broadly, multilateral development banks pledged to mobilise USD 200 billion over the course of 2020. The G20 Meeting of Finance Ministers and Central Bank Governors on 15 April supported this mobilisation and adopted the Debt Service Suspension Initiative, whereby official bilateral lenders pledge to defer debt service payments from 73 poor countries.

Tourism and commodities suffered the greatest immediate losses, particularly jobs

Lockdowns had an immediate impact on a wide range of sectors in developing countries. The most drastic lockdowns occurred in developing countries such as India, leading to extensive migration and impact on livelihoods. Consumption was impacted more than investment, contrary to during the global financial crisis.

The pandemic also affected services, usually a more resilient sector. Even if the direct health impact of the coronavirus (COVID-19) crisis is limited, these forces are creating the following dynamics:

- a shock to exports and production through physical distancing, which leads to
- a reduction in labour and income, which leads to
- a permanent drop in consumption.

Unlike the global financial crisis, which primarily affected investment and industry, consumption and services have been the most affected in the current crisis (Djankov and Panizza, 2020[15]). Sectors that suffered the greatest losses include the following:

- Tourism: Tourism overall accounted for 10% of global GDP in 2019 and could decline by 60% to 80% in 2020. The sector is particularly labour intensive, which means that the impact on jobs will be even larger. The effect will be felt especially strongly in countries where tourism activities represent a large share of the economic activity, including small island developing states. In countries such as Jamaica and Thailand, unskilled employment could fall by more than 20% due to direct and indirect effects of the pandemic. The tourism sector also is important for small and medium-sized enterprises (SMEs) and often linked (not always positively) with biodiversity and cultural conservation.
- Commodity exports: The price of commodities fell sharply in the early months of 2020, especially for energy. As a result, commodity exporting countries – most notably Botswana, Equatorial Guinea, Iraq, Peru and Zimbabwe – are projected to experience growth decline of more than 8% (World Bank, 2020[2]). While activities in this sector are capital intensive and tend to have little direct employment impact, they will have disproportionate consequences on the exports, revenues and poverty levels of commodity exports.
- Manufacturing: As China has moved to the centre of global value chains, the impact of its slowdown spread faster through developing countries. From the investment side, China has become the largest foreign direct investment exporter to Africa, representing 16% of inflows, according to the OECD (2020[16]). On the trade side, the World Trade Organization (2020[17]) estimated a slowdown in trade of 18.5% for Q2 2020. The pandemic severely affected countries such as Bangladesh and Cambodia, which rely on garment manufacturing and saw an 80% decline in exports in April 2020 over April 2019. These impacts also have strong gender dimensions, as most employees in the garment-producing sector are women from rural areas. Ethiopia and Kenya also experienced an initial reduction in demand during spring 2020, but have rebounded in the summer (Mold and Antony, 2020[18]). Unemployment risks are particularly high for self-employed workers, of whom close to 100 million work in the manufacturing sector worldwide.
- Services: In urban settings, most activities require contact and very few services can be delivered remotely, as Internet connections are less reliable. Personal services, which represent a large share of unskilled employment in developing countries, had a month-long interruption that opportunities to work from home are unlikely to compensate for.
- Agriculture: The crisis is affecting agriculture employment and production in complex ways that vary across countries. India is a case in point. While sowed areas increased, all other inputs declined, and by May 2020, employment had decreased by 30% and earnings by 60% before recovering in July. At the same time, tensions over agriculture inputs and provision of credit led to a reduction of the use of inputs (Renita Pinto, Bhowmwick and Kapoor Adlakha, 2020[19]). As a result, poverty in rural settings could increase as migrants to cities return home, compounding the risks for many SDGs.

Job losses were severe across these sectors, with obvious consequences for SDG 8 (Decent Work and Economic Growth). The International Labour Organization (2020[20]) estimated that 10.5% of global working hours were lost in Q2 compared to Q1 2020, the equivalent of 305 million fulltime jobs. These

losses will be concentrated in lower middle-income countries (International Labour Organization, 2020[16]) and on informal workers, possibly reaching 60% in income losses in April 2020.

Unemployment is higher in developing countries due to a lack of social protection. Unemployment insurance exists in fewer than half of developing countries and its coverage is often limited (Gerard, Imbert and Orkin, 2020[21]). Other social protection systems are also limited. In South Asia, the region with the largest existing safety nets, social protection tends to be based on public works programmes, which are harder to maintain in times of physical distancing.

1.1.2. Over the medium and long term, developing countries face growing financing challenges

In addition to the immediate consequences of the coronavirus (COVID-19) health risks, the lockdowns and the drop in external demand and finance, the medium and long-term perspectives of developing countries have been changed irremediably and in a way that could seriously derail attainment of the SDGs. The growing financing needs and increasing budgetary constraints on official development assistance and all other sources of financing require all actors in the financing for sustainable development landscape to step up to avoid major development setbacks and collective backtracking on progress towards the SDGs.

This subsection outlines the most salient challenges for developing economies. Globally, the health uncertainty remains a key unknown for the medium term. Additionally, developing countries face limits in their ability to recover from the COVID-19 recession. In the longer run, the levers of growth that allowed millions to exit poverty are likely to change.

Medium term: Facing a second wave in a narrow policy space

In its Economic Outlook in June 2020, the OECD highlighted the possibility of a “double-hit” scenario (OECD, 2020[6]), wherein a second wave of the virus would delay the recovery. Under such a scenario, the rebound in 2021 would be tepid, with growth only slightly above pre-crisis trends for most OECD countries. For non-OECD countries, not only would the recession be starker under the double-hit scenario than under a single-hit scenario (-6.1% versus -4.6%, respectively), but the recovery of GDP growth would be shallower (+3.2% in 2021 against +5.6%).The economic recovery thus continues to hinge on successfully taming transmission of the virus. In addition, while the current situation is hardly comparable to past crises, the consequences of other disasters can serve as a guide to possible medium-term consequences. Epidemic events are rare, with only five major ones since 2000, and none had the health impact of COVID-19. They can nevertheless be indicative of possible future impact. Indeed, the World Bank (2020[2]), in a study of epidemic episodes since 2000, finds a decline of 6% in labour productivity five years after the onset of an epidemic due to lower capacity utilisation as well as less investment, which declines by 11%. A broader analysis of natural disasters shows a -8% impact on GDP after five years.

As noted, the progression of the disease is a source of considerable uncertainty. However, a second wave could particularly affect low-income countries. While initially present in China and then in developed countries, coronavirus (COVID-19) is now actively circulating in almost all developing countries. On the one hand, there are some reasons to believe that the direct health impact could be lower. The populations of these countries tend to be younger than those of developed countries, and young people seem to be infected less frequently, to be less contagious and to suffer less deadly consequences when they are infected. Furthermore, for some countries, the experience of Ebola has generated a higher level of preparedness for the COVID-19 pandemic. On the other hand, cohabitation across generations, which can add to vulnerabilities, is more frequent in developing countries while the deficiencies of their health systems will make it more difficult for them to manage an outbreak when it occurs. As a result, fatalities in developing countries are likely to be younger as the gradient of deaths is indeed worse per age (Ghisolfi et al., 2020[22]). Finally, COVID-19 will disproportionately affect poor households in developing countries, which have little

space for distancing and lack access to clean water and other amenities for protection (Brown, Ravallion and van de Walle, 2020[23]).

Even for developing countries not affected by a second wave, monetary and fiscal policy may have limited ability to counteract second round effects. Four sources of limited ability to support the economic recovery can be highlighted in particular. First, the formal sector is small, and its failure would have disproportionate effect on economic activity in the medium run. Second, the informal sector is likely to be hit particularly intensely. Third, public indebtedness limits the fiscal space to implement support measures. Fourth, and finally, domestic banking sectors are fragile and can only offer limited support.

More specifically, the first constraint on policy action is the scarcity of formal firms in low-income countries. As described by Severino (2020[24]), only a few formal firms constitute most of the tax base in these economies and are often the only ones investible by foreign capital, either development finance institutions or private capital. Such firms often have a significant indirect impact on the rest of the economy including SMEs and households. Among G20 developing economies, most fiscal support has been geared towards SMEs, though to a lesser extent than in advanced economies, i.e. about 1% versus 5% of GDP (IMF, 2020[25])). In smaller developing economies, the lack of fiscal space compounds risks to large firms, in that governments' arrears can weigh on the few firms they purchase goods and services from. Widespread failure of large formal firms could eliminate the few investment opportunities in those economies. Development finance has an important role to play to protect those firms from the worst effects of the COVID-19 recession.

The formal sector in developing countries is generally small relative to the large informal sector, which creates challenges for channelling financing where it is needed most. The informal sector also is harder to reach in terms of policy response. In response to the COVID-19 impact, all advanced economies have mobilised large amounts of credit and tax deferment to sustain firms during the supply and demand shock. OECD countries in particular have mobilised a range of tools on financial markets and through direct support to firms and especially to SMEs (OECD, 2020[26]). This kind of policy is more difficult to implement in a developing country context, as there are fewer formal firms and governments have limited ability to inject direct loans. Surveys conducted by the World Bank and other organisations have shown the deep shock suffered by firms in developing countries, where there is little available policy cushion (Woodruff, 2020[27]). Among surveyed firms in 12 countries, close to 10% of firms reported they had to close temporarily during March and April 2020 and about 3% had closed permanently (World Bank, 2020[28]).

In terms of the second constraint, informal sectors tend to be more contact-intensive and less amenable to working from home. Informal sectors account for a third of economic activity and two-thirds of employment in developing countries. Workers tend to be less educated and poorer. They are more prevalent in services than in manufacturing and will experience a larger decline in economic activity on average. Even within advanced economies, the drop in economic activity has disproportionately affected lower-income workers (Chetty et al., 2020[29]). People working in the informal sector will be less likely to be supported and more likely to see their activity curtailed by movement restrictions. Just in the Latin America region, 38% of all workers and 61% of informal workers do not have access to any kind of social protection. Increasing credit inclusion of informal firms is an important policy challenge (Arnold, Garda and Gonzalez-Pandiella, 2020[30]).

The third source of limited response capacity is the level of public and private indebtedness. Before the pandemic, the world was already going through the fourth wave of debt since the Second World War, with USD 2.5 trillion issued in 2019 against USD 1 trillion in 2000 for developing economies. Government debt has soared in the past on expectations of high growth, including in low-income economies where it rose by 20 percentage points on average after large declines in the 2000s. Of the 69 countries applying the low-income countries debt sustainability analysis in 2019, half were either already "in debt distress" or "at high risk of debt distress", compared to 23% in 2013 (IMF, 2020[31]). Non-financial corporate debt also ballooned in emerging markets, from USD 1.6 to USD 3.8 trillion between 2009 and 2019, leading to vulnerabilities

to “sudden stops” (Avdjiev, McGuire and von Peter, 2020[32]). Central banks’ decisions have mitigated the risk of an immediate liquidity crisis, but debt overhang can limit the propensity to invest and to stimulate demand in a context of a recession.

Finally, domestic banking systems enter this crisis with existing fragilities that could cause higher risk of default. In countries with weak banking systems, defaults as well as leniency over 2020 could translate into surges in non-performing loans and threaten financial stability if regulatory easing that postpones and redefines defaults is rolled back abruptly; in Africa, 22 central banks have introduced some form of loan deferral or refinancing framework (Rentsendorj and Schellhase, 2020[33]). This type of liquidity provision, as well as measures such as lowering capital requirements on banks, is important to bridge the short-term gap. However, they could also create a situation of overhang and bank fragility later, which would hamper normalisation of flow of credit to businesses and curb investment. Another frequently used measure has been to target the payments sector, mainly to encourage the use of digital channels and mitigate the shock to remittance flows (Garcia Mora, 2020[34]). Chapter 3 elaborates barriers to the domestic financial sector in developing countries and growing inequalities.

Pre-existing mega-trends could also impair longer-term perspectives

Longer run implications of the crisis are, of course, more difficult to determine. However, it has been a long-standing empirical observation that developing countries tend to take longer to recover from a major economic shock. The greater long-term challenges facing developing countries further underscore the importance of all actors playing a role to protect against spillover effects globally. Declines in growth rates tend to be more persistent – in other words, they are not only parts of cycles of ups and downs but can affect overall growth (Aguiar and Gopinath, 2007[35]). Growth in advanced economies tends to look like “hills”, with long expansions over decades, while developing economies tend to grow in spurts and have frequent, protracted crises (Pritchett, 2000[36]). The implications for the 2030 Agenda of this finding, which is based on past data, are ominous: it is essential for low-income countries to find a new path to sustainable economic growth to meet the SDG targets.

Moreover, traditional levers of economic growth changed in the years prior to the coronavirus crisis. Trade slowed since the global financial crisis, and the recent wave of protectionism has made it harder for countries to participate in global value chains. These have been important engines of industrialisation, economic growth and poverty reduction (World Bank, 2020[37]). Nevertheless, they have weakened due to the instability of the global trade environment, which the COVID-19 crisis is compounding. New digital technologies (cloud computing, 3D printing, etc.) do not necessarily lead to “reshoring” and in the right policy environment, they can even reinforce participation in trade as a pathway to economic prosperity (Hallward-Driemeier and Nayyar, 2017[38]).

In another trend, barriers to migration will remain and could stifle remittances in years to come. It will take time to remove forced quarantines and entrance bans. The immediate decline of remittances (see Chapter 2) will reverse if growth of advanced economies rebounds, but it will likely take more time to remove the barriers to migration. As a result, the important migration channel for development, whether through studying or working, will be a brake on income growth of countries, both those traditionally sending migrants and those receiving them.

Developing countries, reliant on China for investment, also face an extended drop in external finance. In the 2000s, China emerged as one of the major providers of development finance for infrastructure in developing countries (OECD, forthcoming[39]). This led to a surge in infrastructure investment, especially in transport and energy. While many countries have struggled to transform this spending into sustainable growth, a reduction in those flows would reduce opportunities for developing countries to access external finance.

Finally, the cost of combatting climate risks is higher in developing countries. Global warming has increased inequalities between countries over the past 50 years (Diffenbaugh and Burke, 2019[40]). Climate

change increases the variability of temperatures and rainfalls and the likelihood and intensity of natural disasters and social conflicts. Climate change could lead to losses of over 50% of potential GDP by 2100 in low-income countries (Burke, Hsiang and Miguel, 2015[41]). The financing for sustainable development needs are thus staggering. According to the Intergovernmental Panel on Climate Change (IPCC), limiting global warming to 1.5°C would involve annual investment in energy systems of around USD 2.4 trillion, representing about 2.5% of the world's GDP, for the next 20 years. In addition, needs for adaptation could amount to between USD 140 billion and USD 300 billion per year in developing countries (Micale, Tonkonogy and Mazza, 2018[42]).

1.2. The coronavirus (COVID-19) pandemic, coming amid slow and uneven progress, is further hampering achievement of the 2030 Agenda

As discussed, the COVID-19 recession will not only have short-term repercussions but could potentially lead to a decline of growth in the medium and long term. This section uses the filter of the SDGs and the 2030 Agenda to assess its impact on the needs of developing countries. It first shows that progress towards the SDGs was uneven prior to the pandemic. Even where progress towards the target of reducing poverty was continuous, it remained too slow for the goal to be achieved by 2030. The section also describes the impact of the COVID-19 shock on the SDGs, acknowledging the deep uncertainty over what years leading up to 2030 will look like, and demonstrates that while needs have increased, there is still space for policy choices to shape the recovery towards more sustainable development. As discussed in detail in Chapter 2, the Addis Ababa Action Agenda highlights the need for all actors, including and beyond the traditional development community, to leverage their support to reverse the current trajectory towards an increased SDG financing gap.

1.2.1. Progress toward the global goals was uneven before the crisis

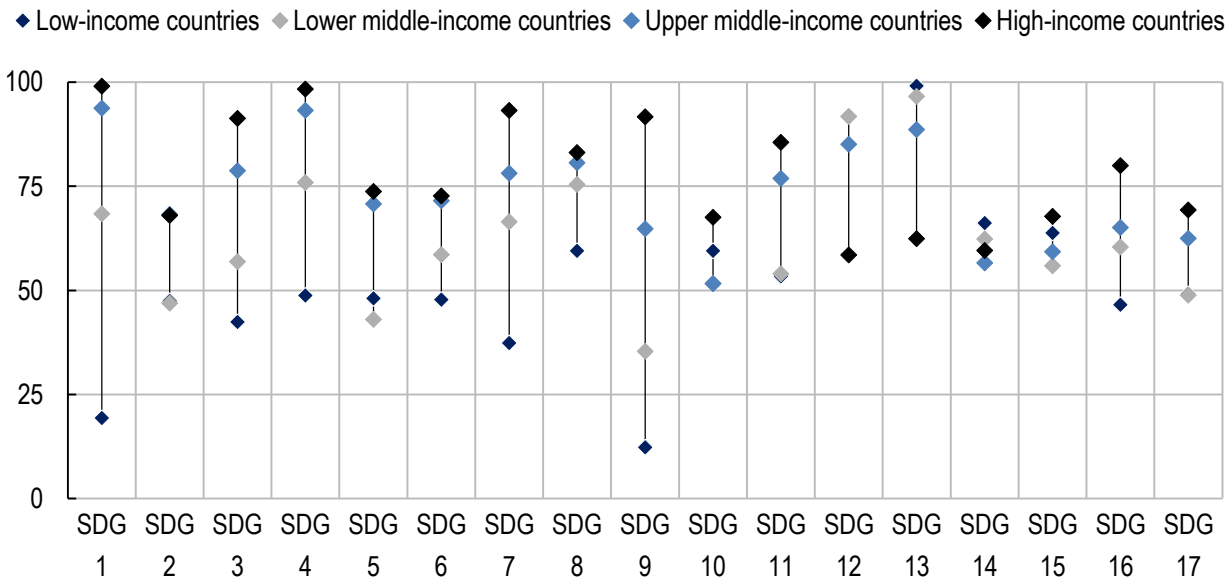
Before turning to the impact of the COVID-19 crisis, it is useful to take stock of progress towards the SDGs and the financing needs associated with them.

Developing countries were advancing slowly

As of 2020, and with up-to-date data limited, there has been some success on a handful of SDGs. Low income-countries' aggregate index, as computed by Sachs et al. (2020[43]) for the *2020 Sustainable Development Repor*t, is less than halfway met (below 50) for 10 of 17 goals. For lower middle income-countries, while only four goals had an index below 50 on average, 13 were below 75 (Figure 1.3).

In comparison, high-income countries are more than 75% close to the SDGs for seven of the goals, and more than halfway on all of them. They are lagging in climate-related goals, in particular SDG 12 ('Sustainable consumption and production') and SDG 13 ('Climate action').

Figure 1.3. The SDGs in 2020: Mixed success



Source: (Sachs et al., 2020[43]), *The Sustainable Development Goals and COVID-19. Sustainable Development Report 2020*, https://s3.amazonaws.com/sustainabledevelopment.report/2020/2020_sustainable_development_report.pdf.

StatLink https://doi.org/10.1787/888934181052

Between 2015 and 2019, the world had made significant progress to eliminate poverty (SDG 1): extreme poverty, while not eradicated, was trending downward, reaching 8.2% in 2019 due to rapid economic growth, especially in East and South Asia. Progress in health outcomes (SDG 3) and education attainment (SDG 4) was also notable, with strong investment in schools, immunisation campaigns and maternal health, though progress towards other targets, such as achieving reading proficiency, was slower. Infrastructure investment also increased significantly. For example, electrification rates (SDG 7) rose globally from 83% to 90% between 2010 and 2019, and industrialisation (SDG 9) was increasing slightly in least developed countries.

On the other hand, progress towards several other SDGs has stagnated or reversed. Food insecurity (SDG 2) rose between 2015 and 2018. Inequalities (SDG 10) have risen globally, even as extreme wealth and incomes have grown and protection of the most vulnerable has weakened. Progress for girls and women has been uneven (SDG 5). The global material footprint (SDG 12) continues to be on an unsustainable path, while current greenhouse gas emissions continued increasing between 2015 and 2019, with no sign of abatement (UN, 2019[44]). Biodiversity has been in decline. Fish stocks have continued to fall (SDG 14) and species extinction threatens sustainable development and compromises the world's global heritage, driven primarily through habitat loss from unsustainable agriculture practices as well as trade, deforestation and invasive alien species (SDG 15) (UN, 2020[45]). In addition, the share of the urban population living in slums is now growing after years of decline, and access to water and sanitation is not improving due to rapid urbanisation (SDG 11).

The financing gap remains large

This slow progress underlined the need for more finance aligned with the SDGs. Despite using different methodologies and data sources, several estimates of the needs for global finance converged towards a consensus on a gap of USD 2.5 trillion. This corresponds to about USD 500 billion for low-income countries and USD 2 trillion for other developing countries, or respectively 15% and 4% of GDP of additional

spending per year (Gaspar et al., 2019[46]). Even before the COVID-19 shock, closing this gap faced considerable challenges – not only to raise domestic revenues and allocate them to SDG-aligned expenditure but also to raise additional external finance. Richer economies tend to have larger governments, and state capacity – the ability to tax and finance public goods – tends to correlate with national income. To generate financing to attain the global goals, it will be necessary to raise both GDP per capita and tax rates.

Developing countries must raise the quantity of spending as well as its quality. There is a wide disparity in achievement of the SDGs even across countries of similar incomes. This gap reflects the (mis)alignment of spending to the SDGs and the efficiency at which this spending translates into impact. By improving efficiency to the level of the best performers and increasing necessary inputs, countries can meet the SDG targets.

Different studies differ on the composition of spending. Gaspar et al. (2019[46]), for instance, focus on five SDGs: the three related to water, roads and electricity, which together account for about half of the total estimated SDG spending needs, and the two related to education and health, which would account for the other half. Other studies take in a wider range of SDGs and include climate change spending needs, which could add up to 40% in infrastructure spending (UNCTAD, 2014[47]; UN, 2019[48]). Taking into account the potential of sustainable infrastructure could add 4% to 9% of GDP in needs, depending on the region (Rozenberg and Fay, 2019[49]).

1.2.2. COVID-19 widens the SDG financing gap to a chasm

The impact of COVID-19 compounds pre-existing financing difficulties by creating a short-term shock that will have long-term consequences on poverty and human development, with major setbacks to progress on narrowing the SDG financing gap. The USD 800 billion to USD 1 trillion financing need for an adequate stimulus is unlikely to be met in 2020 or in 2021, which will bear on future needs. While it does not fundamentally change the financing needs for long-term infrastructure or for climate change-related spending, the impacts of the pandemic will reduce available financing for sustainable development (see Chapter 2).

COVID-19 is derailing SDG targets in the short term

Poverty levels are rising again for the first time in decades and inequalities are likely to increase. In June 2020, based on new World Bank (2020[2]) GDP projections, the World Bank poverty estimates for 2020 were revised. About 100 million more people worldwide are expected to be in extreme poverty (below USD 1.90 per day purchasing power parity) than without COVID-19 (Mahler et al., 2020[50]). Both South Asia and Africa would suffer an equivalent increase in poverty headcount of about 30 million. Declining growth prospects are not the only factor. Inequalities are likely to rise significantly over the short term, with Gini coefficients increasing on average by 1.5% over five years, based on the experience of the previous five major pandemic events (Furceri, Loungani and Ostry, 2020[51]). Inequality is not only linked to income. The digital divide makes it harder to perform tasks from home, whether they are for work or schooling or simply to access information.

Additionally, food insecurity, which had already been increasing because of conflicts and the impact of climate change and disasters on food production, is increasing. In East Africa, for instance, the COVID-19 crisis, coming on top of the desert locust outbreak, will further reduce food supply. Acute food insecurity, defined as an emergency level of insecurity threatening lives or livelihoods, already affected 135 million people worldwide in 2018; that number could double by 2020 (Food Security Information Network, 2020[52]).

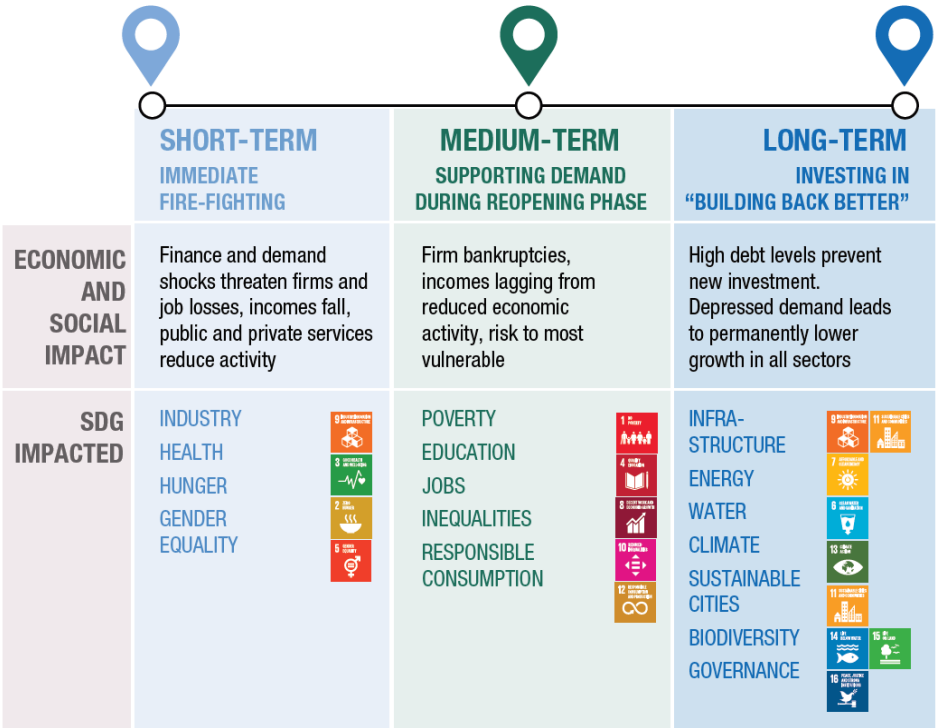
The economic shock provides some reduction in CO_2 emissions in the short term: emissions fell by 25% in China during its lockdown in February and global greenhouse gas emissions are forecast to fall by 8% in 2020 (IEA, 2020[53]). Reaching the global objective of limiting temperature rises to “well below” 2°C would

require emissions to be cut by the same rate of 8% each year until 2030. A green recovery, which could both achieve economic growth and lower emissions, is the key challenge for SDG-compatible growth.

The medium and long-term impacts of COVID-19 on the SDG financing gap

The short-term impacts will have indirect long-term effects through missed investments in education and health (Infographic 2). Beyond the direct health effects of COVID-19, lockdowns have significantly affected access to these services. While some education and health investments can be postponed and will translate into larger needs in the future, others cannot be delayed and will translate instead into deaths or permanently lower quality of life. A dramatic example is that of maternal health. As described by Robertson et al. (2020[54]), a 10% to 19% reduction in access to maternal care – their best-case scenario of the impact of the pandemic – would translate into 253 500 additional child deaths and 12 200 additional maternal deaths in 119 lower income countries. Lockdowns have also significantly disrupted vaccination services. For example, in May 2020 60% of countries had either stopped or significantly delayed vaccination campaigns. This is on top of considerable disruptions to other treatments, such as those for malaria, HIV/AIDS and tuberculosis. For instance, two-thirds of the countries where the Global Fund to Fight AIDS, Tuberculosis and Malaria operates experienced moderate disruptions of access to treatments and about 20% experienced high or very high disruptions, resulting in an estimated 1.4 million deaths from those diseases (The Global Fund, 2020[55]). The Global Fund estimates the additional cost of treatment at USD 28.5 billion. In general, additional investment will be needed in health systems to manage the impact of delayed basic care, overwhelmed hospitals and the direct human costs to healthcare personnel. Finally, the estimated cost of ensuring health security as a global public good is rising. The amount needed for global preparedness investment for future pandemics in light of the COVID-19 crisis is now estimated at USD 183 billion annually, including USD 95 billion for developing countries.

Infographic 1.2. The COVID-19 economic and social shock and its consequences for the SDGs



Source: Authors

For education, school closures will have a particularly high impact on future needs. School closures have occurred in 143 countries, affecting 1.2 billion students worldwide since April 2020, and schools in most countries were still fully or partially closed in August 2020 (UNESCO, 2020[56]). Kenya plans to reopen schools only in January 2021. As a result, and depending on the scenario, the World Bank forecasts a drop of 0.6 years of education, adjusted for quality on average, or 8% of the total of 7.9 years (Azevedo et al., 2020[57]). This drop will translate into significant lifetime losses of income for affected students, especially given that distance learning is an imperfect substitute. In addition to the direct impact on education, the crisis carries potential high negative externalities and impacts on SDGs other than those directly focused on education. For example, school closures are associated with a reduction in free school meals, and malnourishment can have a long-term impact on later achievements.

From these reports, it is possible to assume an increase of financing needs for health and education of about 8% to 10% per year. Applied to estimates of needs in these sectors and as calculated by Gaspar et al. (2019[46]), this amount would translate into additional needs of about USD 30 billion per year for low-income countries and USD 100 billion per year for middle-income economies between 2020 and 2030.

Beyond these medium and long-term impacts of the COVID-19 crisis on SDG financing, there remain two questions: first, growth trends to 2030 and, second, management of the debt overhang. Growth prospects will determine many SDG outcomes, for instance outcomes on eradicating extreme poverty to meet SDG 1. Under current growth projections, whereby developing countries revert to their pre-pandemic growth trend, extreme poverty would start declining again in 2021 but the decline would still fall short of the objective, with a global poverty rate in 2030 of 7% and close to 36% in sub-Saharan Africa (Mahler et al., 2020[50]). If growth were to decline to below its trend of the past decade, the global poverty rate could remain stagnant at 8% and rise to 40% in sub-Saharan Africa until 2030.

A resumption of growth would also provide the means to invest durably in infrastructure. This relates to the second question related to the debt overhand, as levels of public debt will prevent large infrastructure investments. While the nature of long-term investment in urban infrastructure, digital services, etc. has durably evolved with the crisis, it is hard to cost the nature of those changes. However, the ability of governments to finance future investment will be limited by high debt levels. The Debt Service Suspension Initiative frees up immediate liquidity (OECD, 2020[58]) but does not provide long-term debt relief. Restructuring the stock of debt in developing countries is an important role for development finance.

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Notes

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[2] These figures are based on data from the Center for Strategic and International Studies (2020[13]) that stop at the end of June 2020 and cover only fiscal measures. See https://datastudio.google.com/embed/reporting/92894631-b883-4140-a294-5d0ab65974fa/page/v7WYB. In some cases, these data are updated with the IMF Policy Tracker. For countries that are not G20 members, the authors use the Oxford COVID-19 Government Response Tracker. (Hale et al., 2020[14]), which has the broadest coverage in terms of countries but does not take into account all adopted fiscal policies. The tracker is available at https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker. As a comparison tool, the authors also use data from the Overseas Development Institute (2020[10]), available at https://set.odi.org/wp-content/uploads/2020/09/Country-fiscal-and-monetary-policy-responses-to-coronavirus_12-Aug-2020_updated.pdf.

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2 The financing for sustainable development landscape in the coronavirus (COVID-19) crisis

The financing for sustainable development landscape faces new pressures and challenges. The outlook presented in this chapter is worrying. Financing levels were insufficient prior to coronavirus (COVID-19). With the onset of lockdowns and the economic recession, the pre-pandemic financing gaps are widening and the decline in resources is markedly faster and more sizeable than during the global financial crisis 12 years ago. The chapter reviews trends and projections in domestic, international, public and private finance and highlights the negative impacts of the 2020 crisis on collective prospects to mobilise resources for the global goals. Better measures to assess the quantity and quality of scarce resources, i.e. their alignment and impact, are needed to make sure every dollar contributes to achieving sustainable and inclusive development.

In Brief

The financing for sustainable development landscape is facing historic pressures with a collapse in external private finance following the outbreak of the COVID-19 pandemic that surpassed the global financial crisis of 2008-09. All public, private, domestic and international resources called for by the Addis Ababa Action Agenda (AAAA) to finance the 2030 Agenda for Sustainable Development have been impacted to varying degrees and present diverse challenges to developing countries to finance the emergency response and to build back better over the long-term. While the future of financing for sustainable development remains uncertain, this chapter seeks to assess the trends in all sources within the landscape based on available data and to provide a better understanding of the key economic and financial drivers.

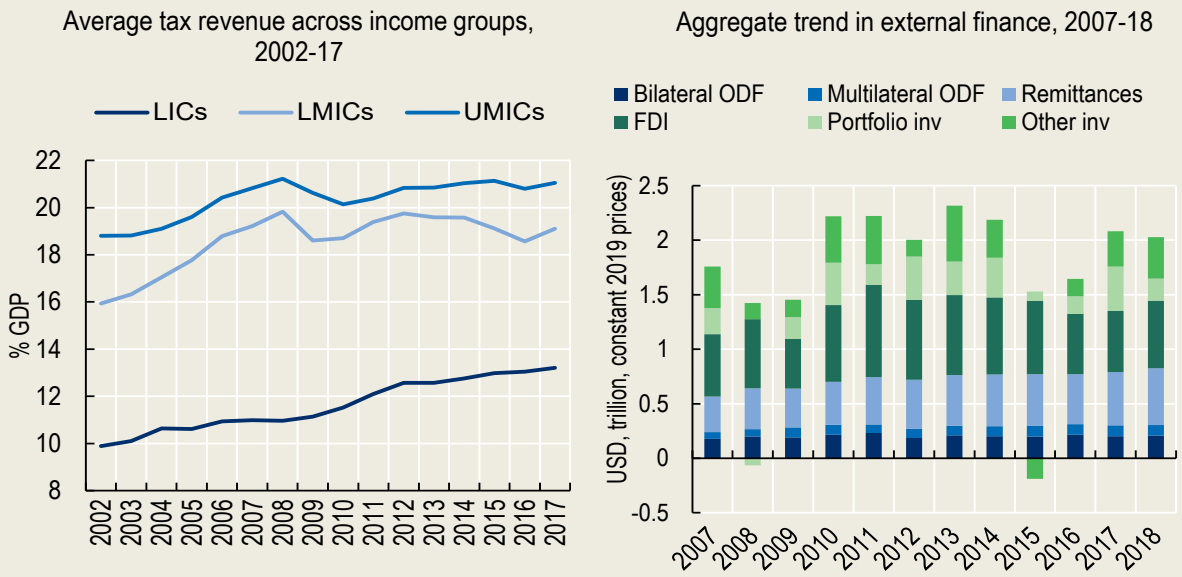
Tax revenue is the only long-term, viable source to fund public expenditure. It is also the largest source. In 2017, countries eligible to receive official development assistance (ODA) collected USD 5.3 trillion in tax revenue, more than double the sum of external inflows that year. Since the early 2000s, tax revenue has increased substantially across country income levels (Figure 2.1, left panel). The overall increase can be attributed to a combination of macroeconomic conditions, among them high average gross domestic product (GDP) growth, rising commodity prices, tax policy reforms to broaden tax bases, and tax administration reforms to increase collection efficiency and compliance.

However, tax revenue was not at sufficient levels to achieve the Sustainable Development Goals before the crisis. Average growth in tax revenue decelerated among low-income countries and stagnated among middle-income countries over 2012-17. This trend reflects tax-to-GDP gains in some countries offset by declines in other countries (e.g. resource-rich countries with declining revenue after 2011). Furthermore, tax revenue in about one-third of developing countries (46) was below 15% of GDP and below 20% of GDP in about two-thirds (79) of ODA-eligible countries – that is, below the thresholds commonly considered to be necessary for effective state functioning.

Other sources of external finance were also subpar prior to the pandemic. The total level of external finance recovered from a sharp drop in 2015 and stood at around USD 2 trillion in 2018. However, levels remained well below the peak of 2013 (Figure 2.1, right panel) that was driven by private investment inflows. In contrast to volatile private investment inflows, remittance inflows have steadily increased due to rising international migration and improvements in measuring the flow. Excluding China, remittances surpassed foreign direct investment (FDI) as the largest individual source of external finance since 2016. Official development finance (ODF) including other official flows (OOF) has remained stable over time and preliminary data suggest a small increase in ODA assistance in 2019.

A combination of domestic and external factors related to the COVID-19 pandemic puts pressure on all sources of financing. Current projections suggest that inflows of remittances and external private investment to ODA-eligible developing economies could decline by around USD 700 billion in 2020 over 2019. This would exceed the 2008 drop observed during the global financial crisis by 60% in real terms. Tax revenue could also decline as economies contract and governments introduce tax relief measures in the short and medium term.

Figure 2.1. Tax revenue and external financing of ODA-eligible countries prior to the coronavirus (COVID-19)



Note: The left panel shows unweighted average tax-to-GDP ratios for 113 countries and uses the World Bank classifications for income groups is used. In the right panel, the largest sample possible for ODA-eligible countries was used for each year.

Source: Tax revenue are based on OECD (2020[1]), *Global Revenue Statistics Database*, http://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm; IMF (2020[2]), *World Revenue Longitudinal Data (WoRLD) (database)*, https://data.imf.org/?sk=77413F1D-1525-450A-A23A-47AEED40FE78; and UNU-WIDER (2020[3]), *Government Revenue Dataset (database)*, https://www.wider.unu.edu/project/government-revenue-dataset. Official development finance is based on OECD DAC Tables 2a and 2b. Remittances based on KNOMAD (2020[4]), *Remittances inflows (database)*, https://www.knomad.org/data/remittances. FDI, portfolio investment and other investment data refer to net incurrence of liabilities and are from IMF (2020[5]), *Balance of payments (database)*, http://data.imf.org/bop. Missing data on FDI are imputed using World Bank (2020[6]), *World Development Indicators (database)*, https://datacatalog.worldbank.org/dataset/world-development-indicators.

StatLink https://doi.org/10.1787/888934181071

However, there is hope for recovery. Tax revenue could rebound with domestic and global economic prospects. Governments could increase the share of national income from tax revenue through base broadening, improved tax administration and collection efficiency, and increased participation in international tax co-operation instruments. For portfolio and other investment flows, there are signs of a recovery following quantitative easing in developed economies and easing of capital inflow restrictions in developing economies. FDI flows will recover more slowly. Changes to the international production and investment policy landscape arising from the pandemic may have a lasting impact on FDI flows. There is also much uncertainty regarding the medium-term impact of COVID-19 on remittances, which depend on labour market opportunities and migration policies.

The economic fallout from COVID-19 reinforces the need for better measurements of both the quantity and quality of existing resources. Prior to COVID-19, the magnitude of the annual USD 2.5 trillion Sustainable Development Goal (SDG) financing gap created an urgency to mobilise more external flows (i.e. mobilising trillions of dollars in private finance through the billions available in official development finance). However, more resources are unlikely to be mobilised in the current context. A better understanding of the quality of existing flows is needed to help assess how available financing can be better aligned to the global goals and achieve more positive impact.

2.1. Mapping the financing for sustainable development landscape

The financing for sustainable development (FSD) landscape comprises the financial resources, actors and instruments that could be deployed to promote sustainable development in developing countries. The term "financing for sustainable development" reflects a gradual broadening of the scope of financial resources from, first, international aid and then, development finance. Financing for sustainable development subsumes an array of financial resources, guided by the Addis Ababa Action Agenda (AAAA). The AAAA calls for a holistic approach and coherent actions by all actors across the three pillars of sustainability – economic, environmental and social.

From the viewpoint of the recipient country, financing for sustainable development includes both domestic and external sources that can be of private or public origin. Table 2.1 shows a mapping of these resources.

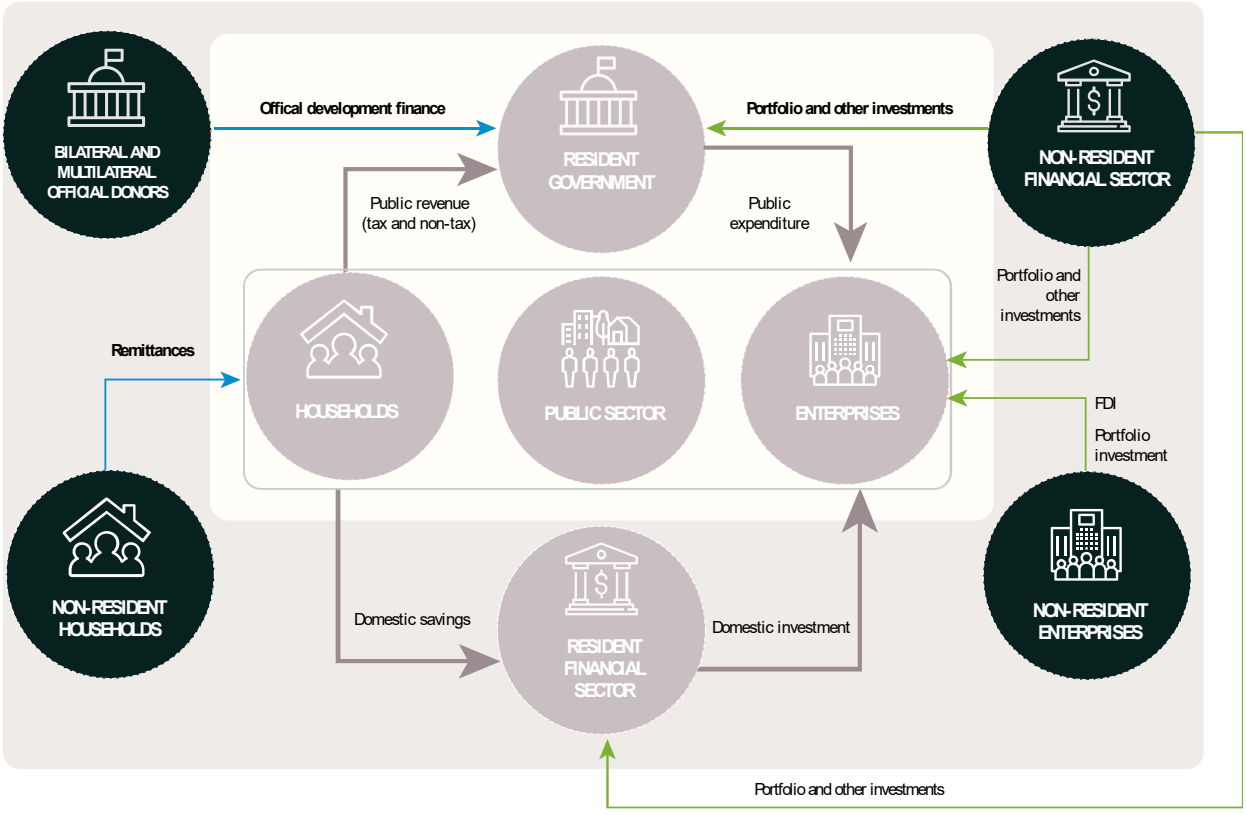
Table 2.1. Examples of resources in the financing for sustainable development landscape

	Public	Private
Domestic	Tax revenue	Commercial investment
	Public resource rents and royalties	Private savings
	Public long-term debt (domestic)	Domestic private debt
	Public savings	Domestic philanthropy
	Sovereign wealth funds	Domestic remittances
		Sustainable impact investing (SII)
External	ODA	FDI
	Other official flows	Portfolio investment
	Public long-term debt (external)	Other investment
	Public guarantees (external)	Remittances from abroad
	South-South co-operation	International market lending
	Triangular co-operation	International philanthropy
	Climate finance	Blended finance
		SII

Note: Resources shown in blue are discussed in Sections 2.2 and 2.3. Flows depicted in green are discussed in section 2.4. Resource categories and instruments listed are not necessarily distinct. For instance, some resources provided from South-South co-operation may be similar to flows classified as official development assistance. Further, sustainable impact investment and blended finance are specific modalities of private investment and can be domestic and external, involving public and private finance.
Source: Authors based on OECD (2020[7]), "Transition finance ABC methodology: A user's guide to transition finance diagnostics", https://doi.org/10.1787/c5210d6c-en.

The various resources to finance sustainable development are imperfect complements of one another rather than substitutes. The resources listed in Table 2.1 differ in terms of recipients, objectives and targets. For instance, while domestic public revenue directly funds public expenditure, remittances are targeted at households. Some flows such as ODA have the explicit objective to promote sustainable development, while private investment is primarily commercial. For some resources, trade-offs or crowding-out effects might exist. Infographic 2.1 maps the main sources, channels and targets and the main sending and receiving entities of the key financing resources discussed in Section 2.2 (domestic) and Section 2.3 (external).

Infographic 2.1. The relationship between different actors in the financing for sustainable development landscape



Note: The infographic focuses on the financial flows considered in this report
Source: Authors

Not all financing resources promote sustainable development to the same degree. The external inflows to developing countries described in this chapter have the potential to promote the SDGs ex ante. However, information on the ex post impact of resources is often scarce. As noted, the financing for sustainable development landscape attempts to capture resources that could potentially contribute to sustainable development. Section 2.4 of this chapter discusses the mobilisation-alignment-impact continuum that distinguishes between quantity (mobilisation) and quality (alignment and impact).

2.2. Domestic resources are set to decline following years of growth

Domestic resources are the central pillar to finance the 2030 Agenda for Sustainable Development (UN, 2015[8]). The AAAA, in paragraph 20, sets forth the significance of mobilising and effectively using domestic resources to achieve the SDGs (UN, 2015[9]).

This section first presents recent trends in domestic resource mobilisation and discusses the likely impacts of the COVID-19 pandemic on tax and non-tax revenues in 2020. It then outlines domestic resources beyond public revenue, classified as domestic savings and domestic private investment. The second subsection asks how domestic financial systems can help facilitate domestic savings and investment in support of sustainable development in a time of economic crisis.

2.2.1. Tax revenues remain the single largest resource to finance sustainable development

Domestic financing refers to public and private resources generated within a developing country rather than provided or channelled by non-resident actors. Domestic resource mobilisation, more specifically, refers to the collection by governments of public revenues through taxation and other means of revenue generation such as non-tax revenues and social security contributions.

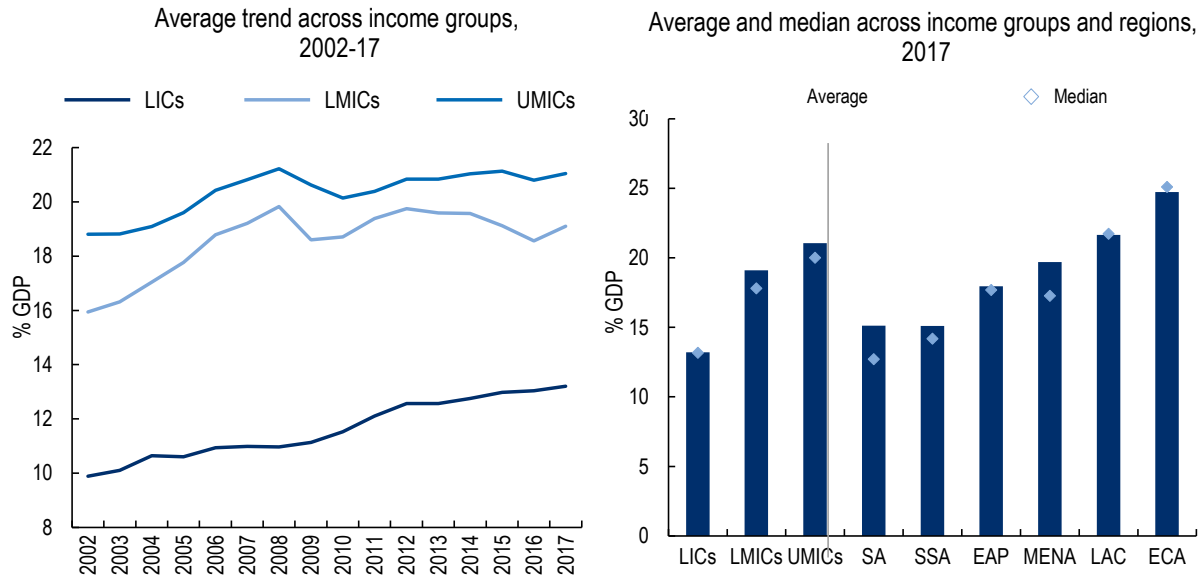
Tax revenue is the primary public revenue source to fund public goods and services, provide social protection systems, and invest in public infrastructure. In 2017, total tax revenue in developing countries amounted to USD 5.3 trillion, more than twice the sum of total external inflows. SDG target 17.1 calls for countries, including through international support, to strengthen domestic resource mobilisation. Increasing public revenues decreases a country's reliance on other financing sources such as public debt or official development assistance and helps to promote fiscal and debt sustainability.

Prior to the outbreak of COVID-19, tax revenue increased overall

Tax revenue increased across income groups since the early 2000s, but differences remain pronounced across income levels and regions. Between 2002 and 2017, tax revenue to GDP increased in 92 of the 113 ODA-eligible countries considered, as illustrated in Figure 2.2 (right panel). In 2017, Africa's average tax-to-GDP ratio was 17.2%, and Latin America and Caribbean (LAC) regional average stood at 22.8%. The OECD average was considerably higher at 34.2%. The evolution of average tax-to-GDP ratio in Africa and LAC followed a trend similar to the one identified for MICs: acceleration since the 2000s then stagnation between 2015-17 (OECD, 2020[1]; OECD/ATAF/AUC, 2019[10]).

The relationship between economic development and the share of national income mobilised as tax revenue is well established. Several factors influence tax-to-GDP ratios: the size of economic sectors that are difficult to tax (notably agriculture), large informal economies, limited tax administration capacity, low tax morale, corruption and weak governance. Factors influencing tax revenue collection include natural resource revenues that can remove incentives to generate non-resource revenue; geographic factors that, for example, affect collection of trade taxes differently in small island developing states (SIDS) than in landlocked economies; historical factors such as legal traditions reflecting a colonial past and how citizens view the state; political economy and regional competition; and international tax policy and co-operation.

Figure 2.2. Tax revenue to GDP increased but average growth (left panel) has been mixed since 2008, with persistent differences across country groups (right panel)



Note: Unweighted averages including a total of 113 countries (balanced panel). Regional groupings are SA = South Asia; SSA = sub-Saharan Africa; EAP = East Asia and Pacific; MENA = Middle East and North Africa' LAC = Latin America and the Caribbean; and ECA = Europe and Central Asia. Tax revenue includes social contributions.

Source: Authors based on OECD (2020[1]), *Global Revenue Statistics Database*, http://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm; IMF (2020[2]), *World Revenue Longitudinal Data (WoRLD) (database)*, https://data.imf.org/?sk=77413F1D-1525-450A-A23A-47AEED40FE78; and UNU-WIDER (2020[3]), *Government Revenue Dataset (database)*, https://www.wider.unu.edu/project/government-revenue-dataset.

StatLink https://doi.org/10.1787/888934181090

A number of countries achieved strong revenue performance linked to tax reforms and favourable economic conditions. In Nepal, the low-income country with the largest increase in tax revenue to GDP over 2012-17, the share of tax revenue rose from 13.9% in 2012 to 21% in 2017. This was driven by rising imports and remittances, expansion of the country's tax base, efforts to strengthen tax administration, and the streamlining of the tax structure.

Tax revenue was below the necessary threshold for effective state functioning

However, many developing countries collected tax revenue below the levels commonly regarded as necessary for effective state functioning. In total, about one-third of developing countries collected tax revenue below the 15% threshold for effective state capacity and GDP growth (Gaspar, 2016[11]). Notably, two-thirds of low-income countries collected less than 15% of GDP in the form of tax revenue, a significantly higher share than for middle-income countries. Two-thirds of all developing countries collected tax revenue at less than 20% of GDP.[1] While these thresholds are useful for illustrative purposes, a unique or optimal tax-to-GDP ratio does not exist for all developing countries.

A number of economic as well as tax administration and policy factors impede the raising of more tax revenues. The level of taxes raised as a share of national income can vary for a range of reasons. It should also be noted that while tax revenue as a share of GDP differs markedly across countries, the level of taxes collected given a country's potential to raise revenues – i.e. the level of a country' tax effort – is relatively similar across income levels (OECD, 2018[12]). A combination of the economic structure, tax

administration capacity and political economy help explain countries' different levels of collected tax revenue.

Many developing countries have significant informal sectors, limiting the collection of tax revenue. The informal sector, on average, accounted for 40% of GDP across developing countries over 2010-16 (Yu, 2020[13]). Employment in the informal sector is the largest labour source in three of four countries for which data are available (ILO, 2019[14]). In Africa, almost 86% of employment is informal (ILO, 2018[15]). Moreover, revenue is vulnerable to external shocks, particularly with respect to the terms of trade and in resource-endowed economies.

Tax administration capacity continues to be lower in many developing economies. In low-income countries, for instance, tax administrations have one-tenth of the staff of high-income countries (Inter-agency Task Force on Financing for Development, 2020[16]). Tax morale and compliance often are weak (OECD, 2019[17]). A host of inefficient tax incentives remain in place. A high prevalence of corruption can lead to higher tax evasion, and corruption itself is intrinsically linked to tax crime (OECD/World Bank, 2018[18]). Political economy factors including history, elite capture and regional competition can negatively affect tax revenue collection, too.

In addition to tax revenue, some countries also generate large revenues from non-tax sources. These tend to be more volatile than tax revenue. Non-tax revenue refers to government revenue derived from providing services and owning assets, including user and license fees, revenue from natural resources (e.g. selling land or minerals), and grants. They exclude funds arising from the repayment of previous lending by governments or from borrowing, or proceeds derived from sales of fixed capital assets, stocks, land and intangible assets or private gifts (OECD/ATAF/AUC, 2019[10]). Among African economies in 2017, total non-tax revenue exceeded tax revenue in Botswana, the Republic of the Congo and Equatorial Guinea. Botswana and the Kingdom of Eswatini had the highest non-tax revenue share relative to GDP, with a large share of these revenues (56% and 86%, respectively) coming from the Southern African Customs Union (SACU) revenue-sharing agreement, through which Botswana, Eswatini, Lesotho, Namibia and South Africa adopt common external tariffs and share revenues from customs and excise duties (OECD/ATAF/AUC, 2019[10]). For most African countries included in the OECD Global Revenue Statistics Database, non-tax revenue was below 5% of GDP. Non-tax revenues have been trending downward since 2008.

While there is consensus that many countries need to increase tax revenues, the feasibility, efficiency and equity of different type of taxes vary across countries. OECD levels may be neither feasible nor desirable in all countries. There are administrative difficulties in taxing income in developing countries, including their larger informal sectors and the prominence of sectors difficult to tax. Developing countries rely more on goods and services taxes and on corporate income taxation than do OECD countries (OECD, 2018[19]). Other taxes such as on property and wealth or environmental taxes remain largely underexplored in developing countries and represent potential additional revenue sources. As an example, property taxes account for about 6% of tax revenue in OECD countries.

As economies contract in 2020, domestic resource mobilisation is expected to decline

Several factors are expected to have sizeable, negative effects on public revenue across countries in 2020. For sub-Saharan Africa, government revenues could decline by 12% to 16% compared to a non-coronavirus baseline scenario (Calderon et al., 2020[20]). In consequence, fiscal deficits could deteriorate by about 2.7% to 3.5% of GDP. Developing countries with closed economies, less reliance on tourism, with a greater share of agricultural sector, and with lower tax revenue levels, may see a much lower impact on domestic resource mobilisation.

First, the plunge in global and domestic economic activity affects all major sources of tax revenue. Lower corporate profits, declining consumption and increases in unemployment will cause declines in revenue from corporate income taxes, goods and services taxes, and personal income taxes (Kapoor and Buiter,

2020[21]). The decline in international trade, travel and domestic consumption will suppress revenue from consumption taxes that most low- and middle-income countries rely on.

Second, declines in many global commodity prices are diminishing revenue from commodities and natural resources. Resource-rich countries that derive a high share of non-tax revenue from commodities and natural resources will be affected by the drop in many global commodity prices. Low-income countries, which rely more strongly on natural resource rents, could be affected most severely (Steel and Phillips, 2020[22]).

Third, necessary tax policy and administration relief measures are likely to result in lower tax revenue in the short term (OECD, 2020[23]). Governments are implementing a variety of tax measures to lessen the burden on taxpayers and keep the cash flows of businesses running at the expense of public revenue in the short term. (CIAT/IOTA/OECD, 2020[24]). By mid-April 2020, 104 countries (including 46 ODA recipients) had implemented tax relief measures (OECD, 2020[25]).

2.2.2. The domestic financial sector is not providing a sufficient buffer

Other forms of domestic resources provide important financial means for spending and investment in support of sustainable development. The domestic financial sector plays a key role in facilitating and intermediating these resources. Domestic savings provide resources that can be channelled towards domestic investment and promote long-term capital accumulation. Access to financial services and credit, including for small and medium-sized enterprises (SMEs), is important during lockdowns and for post-COVID-19 recovery.

This subsection presents trends in domestic savings and domestic private investment in developing economies prior to COVID-19. It also discusses the shortfalls of financial sector development in recent years that have left many developing countries with fewer reserves to raise liquidity to respond to the crisis.

The level of future savings is uncertain in light of the coronavirus (COVID-19)

After declining in the early 2010s, domestic savings increased again in 2016. Sufficient time series data on domestic savings are available for about two-thirds of ODA-eligible countries (96). Average gross domestic savings as a share of GDP increased between 2016 and 2018, reversing a downward trend from preceding years.[2] Average domestic savings as a percentage of GDP in low-income countries declined from 9% in 2010 to 7.5% in 2016, and then increased to 9.4% by 2018. Average savings in lower middle-income countries declined from 17.3% to 14.5% of GDP between 2012 and 2015. Savings bounced back to 16.7% in 2018 in these countries. Similarly, in upper middle-income countries, average savings declined from 21.6% of GDP in 2011 to 18.2% in 2015-16, with savings increasing again to 19.9% of GDP in 2018.

The impact of COVID-19 and subsequent lockdowns on domestic savings is dependent on the change in consumption and income. The global financial crisis of 2008-09 can serve as a point of reference. During that period, gross domestic savings as a share of GDP declined. Supply chain interruptions and uncertainty about future income may cause consumption to decline more sharply than income in the current environment, while saving rates could increase. A decline in national income lowers the available income saved and a constant saving rate would lessen absolute savings.

Domestic private investment is at risk amid economic recession and uncertainty

Domestic private investments are the main source of economies' fixed capital formation. Such investments can take the form of investment by private enterprises or finance from other sources channelled through financial intermediaries (OECD, 2018[26]). Gross fixed capital, which among other things includes plant, machinery and infrastructure such as roads and railways, is an important determinant of an economy's productive capacity and thus vital to promote economic development.

Data on domestic private investment remain limited in terms of indicators and country coverage. Domestic private gross fixed capital formation (GFCF) is one proxy for domestic private investment and refers to additions to private sector fixed assets minus net FDI inflows. However, this proxy should be interpreted with caution as first, FDI is a financial flow and may not accurately represent the foreign component in private GFCF and second, data on private GFCF are available only for about one-third (55) of ODA-eligible countries.

Nevertheless, with these caveats, GFCF as a share of GDP varied widely across countries before the COVID-19 crisis, ranging from as little as about 0.4% to more than 30%. There is no statistically significant relationship between domestic private investment as a share of GDP and gross national income (GNI) per capita. In a slight majority of countries, domestic private GFCF increased over 2015-16. In low-income and lower middle-income countries, on average, domestic private GFCF was higher in 2017-18 than 2010-12. In upper middle-income countries, in contrast, GFCF declined as a percentage of GDP over 2017-18. Domestic mergers and acquisitions, excluding in the People's Republic of China ("China"), declined by over 60% between 2010 and 2017 (OECD, 2018[26]).

Domestic private investment is expected to follow the pattern of cross-border private investment and decline in 2020, largely in a procyclical manner. The contributing factors are similar to those associated with shifts in FDI: as economic activity declines, firms face revenue shortages and the economic prospects of countries is less certain in the short to medium term. If economies recover in 2021, it is expected that domestic private investments will again increase.

The domestic financial sector in developing economies does not provide reserves

Despite progress in financial sector development, inequalities remain. Financial systems in low- and middle-income countries remain less developed than in OECD countries. The lack of depth of financial institutions, elaborated in more detail in Chapter 3, reflects the problem of insufficient domestic financial assets. The low level of domestic financial assets in developing countries contributes to low levels of tax revenue and domestic savings, with the ultimate effect of diminishing the financial resources needed to manage the post-COVID-19 recovery and build buffers against similar crises.

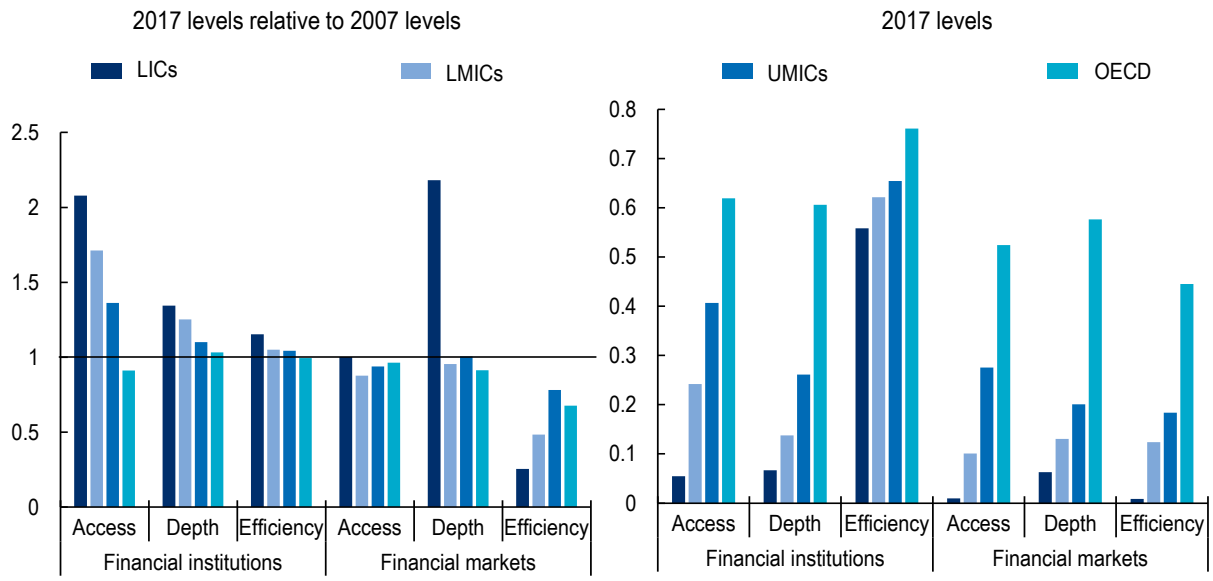
A well-functioning financial sector can be a key driver of economic growth. The financial sector consists of three components: financial institutions, financial markets, and the regulatory framework managing institutions and markets. For lower income countries, financial institutions such as commercial banks dominate the financial system, and the importance of financial markets (stock markets in particular) increases with higher income levels.

Both financial institutions and markets act as intermediaries between savings and investments, thereby contributing to economic development in several ways. First, financial institutions and markets mobilise domestic savings and channel them into productive investment. In this context, they pool savings and collect information about investment opportunities and thus contribute to optimising resource allocation. Second, financial institutions and markets provide crucial access to finance for households and SMEs. Third, by diversifying and managing risks, financial institutions and markets can reduce an economy's vulnerability to financial shocks.

The remainder of this section utilises IMF indicators to analyse trends in financial sector development. Figure 2.3 (right panel) shows the 2017 index rankings of for ODA-eligible countries by income group across the three indices of development of financial institutions and markets: depth, efficiency and accessibility and (left panel) how the rankings have changed since 2007.[3] The figures illustrate that the financial sector both in terms of institutions (measured by private sector credit, pension fund assets, insurance premiums, etc.), and markets (measured by stock market capitalisation, international debt securities, etc.) of ODA-eligible countries remains limited compared to OECD countries, despite some progress with respect to depth of financial markets in LICs since 2007. The efficiency of financial markets,

measured by the stock market turnover ratio, has decreased sharply since 2007 across income groups, reflecting stricter regulation of financial markets following the global financial crisis.

Figure 2.3. Financial institutions and markets in ODA-eligible countries remain underdeveloped compared to OECD countries



Note: The figure shows the non-weighted average by country group. The findings for OECD countries are as of 30 April 2020. Countries by income group are ODA-eligible countries for which data are available. LICs are low income countries; LMICs are lower middle-income countries; and UMICs are upper middle-income countries.
Source: Authors based on (IMF, 2019[27]), *Financial Development Index Database*, https://data.imf.org/?sk=F8032E80-B36C-43B1-AC26-493C5B1CD33B.

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Access to financial institutions is likely underestimated in the figure above. The International Monetary Fund (IMF) indicator measures financial sector accessibility by the number of bank branches and ATMs per 100 000 adults. However, it does not consider increases in account ownership by adults that the rise of mobile banking is facilitating. A recent report for the World Bank found that the share of adults in developing countries who own a bank account has increased from 55% in 2014 to 63% in 2017 (Demirgüç-Kunt et al., 2018[28]).

The figure above further does not capture financial sector stability, where some advancements have been observed as well. The global financial crisis of 2008-09 demonstrated the disastrous economic outcomes of inadequate financial sector regulation. Fostering stability has therefore become a major policy concern over the past decade. Nearly 40% of developing countries have adopted aspects of the Basel III banking regulation framework. However, supervisory capacity is lacking to enforce more complex rules (World Bank, 2019[29]).

2.3. Historic pressures on external resources

External flows are an important complement to domestic public and private resources to finance the SDGs. Traditional external financing in the FSD landscape is comprised broadly of three components: external private investment, remittances and official development finance (ODF). Each has different impacts and sources and can be influenced by a different set of events. While the impacts of COVID-19 on external

finance will vary depending on the country, in aggregate, they are expected to bring about an unprecedented drop in volumes of external financing for sustainable development.

This section presents the pre-COVID-19 trends in the external financing for sustainable development landscape; the pressures on external resources due to the COVID-19 pandemic; and discusses each of the three components to understand pandemic trends and post-pandemic expectations. Section 2.4 expands on the discussion of external resources trends, including in South-South development co-operation, private finance mobilised through official interventions and philanthropy.

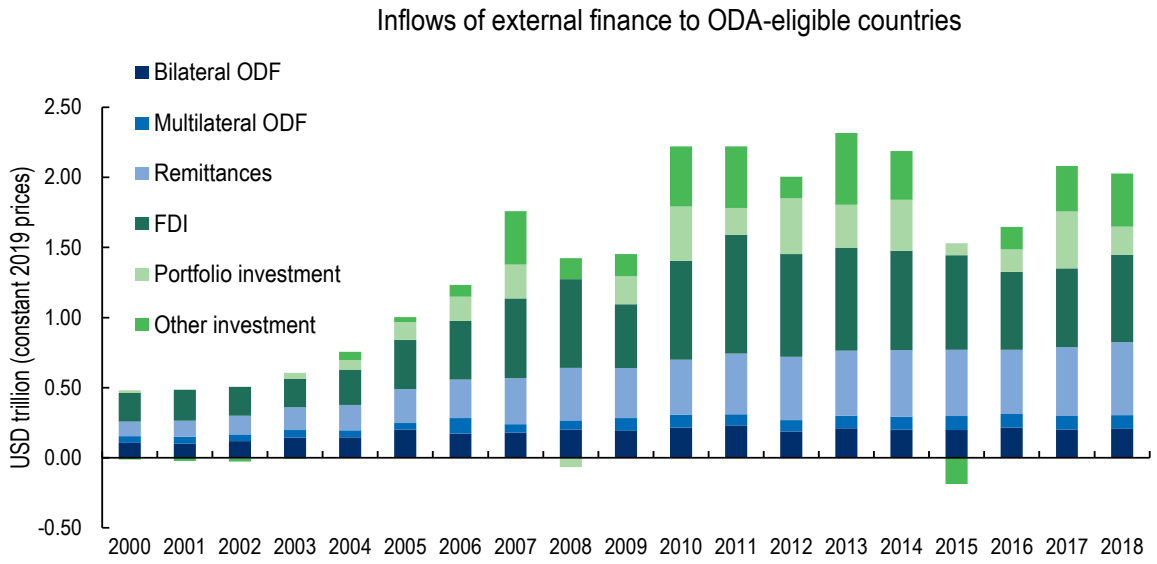
2.3.1. Total external resources were insufficient to fund the global goals prior to (coronavirus) COVID-19

Levels of external finance had only recently recovered from a 2015 drop in private investment before the pandemic, and even this recovery was limited to South Asia and the East Asia and Pacific region. The limited recovery of external inflows overall also suggests that progress to close the SDG financing gap was insufficient prior to the pandemic. The scarce domestic resources and limited fiscal space due to high debt levels, outlined in Chapter 1, further restrain developing countries' ability to finance the SDGs.

Pre-COVID-19 levels of external finance inflows recovered from the 2015 drop

In 2018, external finance for sustainable development amounted to a total of USD 2 trillion. FDI (30.6%) and remittances (25.7%) accounted for more than half of this volume, followed by other investment (18.7%), ODF (15%) and portfolio investment (10%). While the 2018 volume of external finance is an increase over 2015, it is still below the 2013 peak of USD 2.32 trillion. As shown in Figure 2.4 volumes of FDI, portfolio investment and other investment were lower in 2018 than in 2013. [4] Drops in external private investment, especially to China, were responsible for the USD 845-billion plunge in 2015 from 2014 levels. ODF, however, has remained stable and remittances continue to increase.

Figure 2.4. Before the coronavirus (COVID-19), the volume of total external finance had recovered from the 2015 drop, but was still below its 2013 peak



Note: The largest sample possible for ODA-eligible countries was used for each year shown in this figure.
Source: ODF is based on OECD DAC Tables 2a and 2b. Remittances are based on KNOMAD (2020[4]), *Remittances inflows (database)*, https://www.knomad.org/data/remittances FDI, portfolio investment and other investment refer to net incurrence of liabilities and are from IMF (2020[5]) *Balance of payments (database)*, http://data.imf.org/bop. World Development Indicators (2020[6]) are used to impute missing data on foreign direct investment (World Bank, 2020[6]), https://datacatalog.worldbank.org/dataset/world-development-indicators.

StatLink https://doi.org/10.1787/888934181128

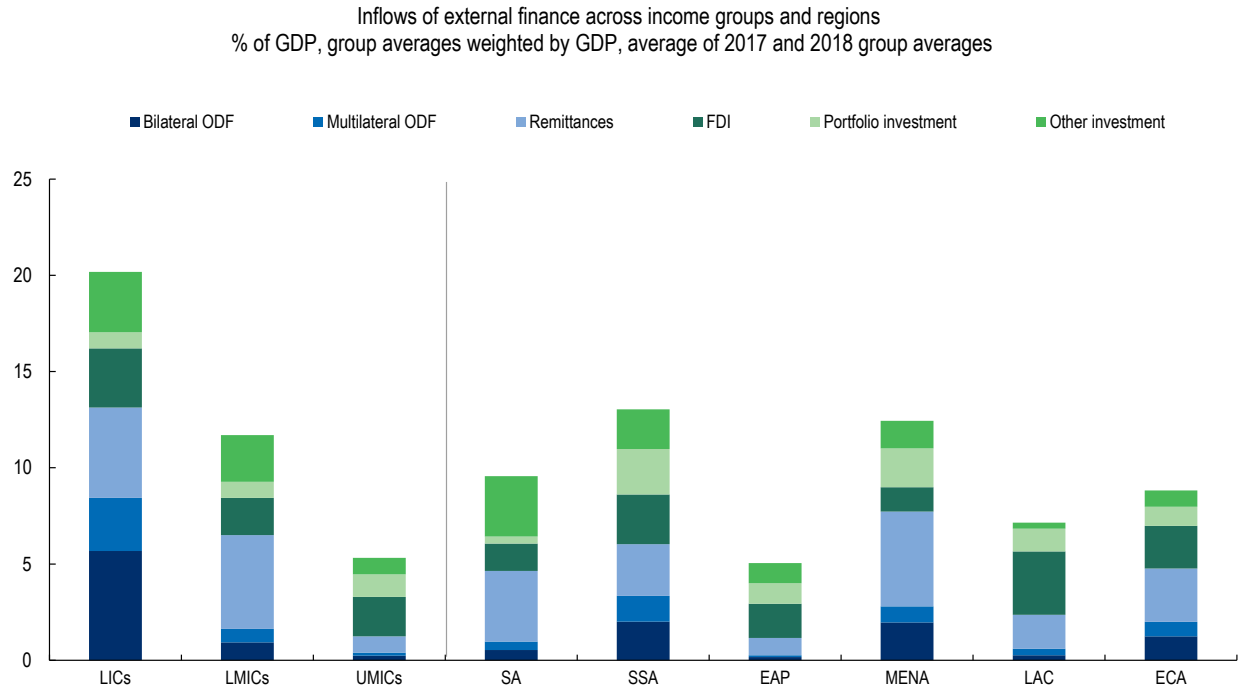
Private investments to upper middle-income countries drive the volatility in external finance inflows. These countries, particularly in East Asia in Latin America and the Caribbean, receive the bulk of private investments. External inflows are more volatile in these country groups than in low-income and lower middle-income countries because they rely more on private investment and less on concessional development finance and remittances, which made the 2008 and 2015 shocks to external finance less pronounced for low-income and lower middle-income groups.

Low-income countries receive on average the largest external finance inflows relative to GDP, although in terms of absolute United States dollars, these are relatively small. Lower income countries also are more dependent on external finance inflows but to different degrees for different components. The share of external private investment in GDP rises on average in parallel with a rise in national income, for instance, and the share of ODA gradually declines. Figure 2.5 shows how different components of external finance vary in importance within and across country income and regional groupings.

- Lower income countries are more dependent on external finance inflows. Among regions, sub-Saharan Africa and the Middle East and North Africa are the most reliant on external finance inflows. Notably, both regions experienced large inflows of portfolio investment as a share of GDP before the pandemic.
- Remittances are most prominent in lower middle-income countries. As a share of GDP, remittances (5%) are of similar importance to external private investment (4.7%). For some countries, remittances are a crucial source of income, amounting to about 30% of GDP or even, in the case of Tonga, 40% of GDP. In absolute terms, however, the single largest share of remittances to ODA-eligible countries flows to India (15% in 2018) and China (13% in 2018).

- In upper middle-income countries, external private investment accounts for almost all external finance. Portfolio investment and other investment represented similar shares in 2018, at to 0.8% and 1% of GDP, respectively. FDI made up 2.2% of GDP in 2018.

Figure 2.5. The external finance mix as a share of GDP differs across country and regional groups



Note: The largest sample possible for ODA-eligible countries was used for each year.
Source: ODF based on OECD DAC Tables 2a and 2b. Remittances based on KNOMAD (2020[4]), *Remittances inflows (database)*, https://www.knomad.org/data/remittances. FDI, portfolio investment and other investment refer to net incurrence of liabilities and are from IMF (2020[5]) *Balance of payments (database)*, http://data.imf.org/bop. World Development Indicators are used to impute missing data on foreign direct investment (World Bank, 2020[6]) at https://datacatalog.worldbank.org/dataset/world-development-indicators.

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The coronavirus (COVID-19) crisis will bring about an unprecedented decline in external finance

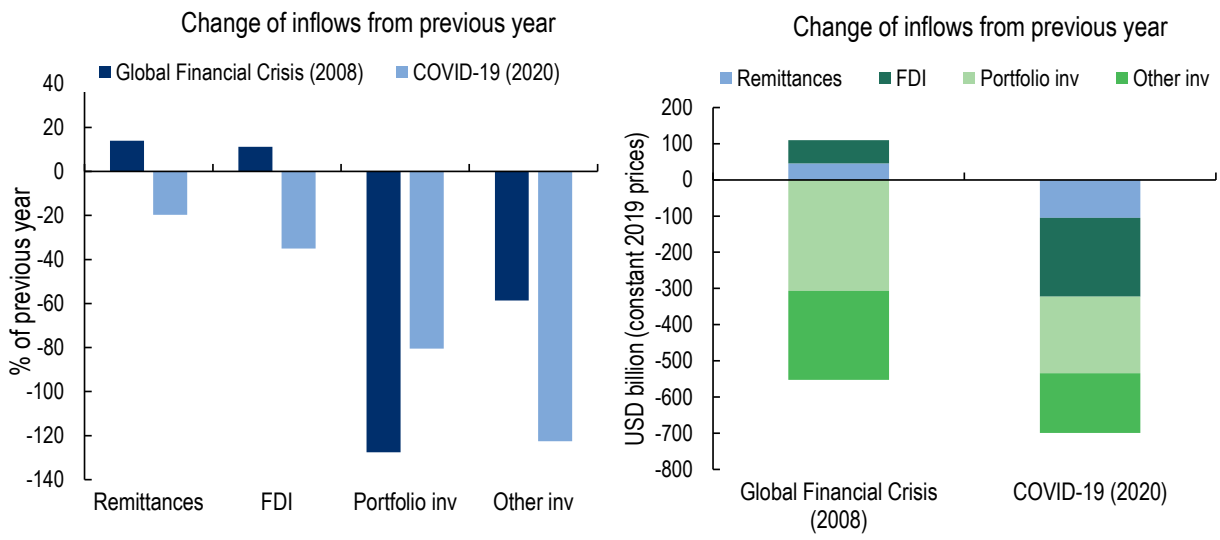
The historic significance of the current landscape is evident when the projected decline in external finance inflows in 2020 is compared with the 2015 and 2008 drops. While the economic fallout and impact of COVID-19 will depend on the level and composition of individual financing sources, it is expected to hit all countries. The COVID-19 shock is unprecedented in speed and magnitude.

While the 2015 drop was limited to portfolio and other investment flows to middle-income countries, the consequences of COVID-19 are affecting all countries and financing sources. In 2015, the drop in external finance of USD 845 billion, or 39% of the 2014 value of these flows, was certainly significant. Two-thirds of the 2015 external finance drop can be explained by a sudden stop of capital flows to China following Chinese stock market turbulences. A combination of slowing growth in emerging markets, rising United States yields and strengthening of the USD led to a decline of capital flows to other middle-income countries. A second driver of the 2015 external finance drop was portfolio and other investment inflows. For the COVID-19 crisis, however, all countries and flows are expected to be affected.

The global financial crisis of 2008-09 is a better comparison to the projected impact of coronavirus crisis. Like the COVID-19 pandemic, the global financial crisis affected all countries as the initial shock to the financial sector in developed countries spread to the financial and real sector across the globe. The global financial crisis also affected all sources of external finance. Portfolio (-128%) and other investment (-60%) inflows dropped instantly year-on-year, while remittances (-5%), bilateral ODF (-4%) and FDI (-28%) decreased over the course of one year. Multilateral ODF was the main countercyclical force, increasing by 38% in 2009.

The key difference between the COVID-19 shock and the global financial crisis is the observed speed and expected magnitude. In March 2020, emerging markets experienced portfolio outflows of USD 83 billion, an impact that was faster and more sizeable than in previous sudden stops (OECD, 2020[30]; Institute of International Finance, 2020[31]). The Institute of International Finance (2020[32]) projects that net inflows of portfolio investment and other investment to emerging markets in 2020 could drop by 80% and 123%, respectively, compared to 2019 levels. Inflows to low- and middle-income countries could decrease by 35% for FDI and by 20% for remittances compared to 2019 levels (World Bank, 2020[33]). In total, the result would be an estimated USD 699 billion reduction of private capital inflows in 2020 compared to 2019 levels in ODA-eligible countries – a drop 60% larger than the drop after the global financial crisis (Figure 2.6).

Figure 2.6. COVID-19 will set external private finance back by USD 700 billion, a 60% greater drop than after the 2008-09 financial crisis



Note: All data refer to ODA-eligible countries. The sudden stop of capital flows in 2015 is not shown here, as it would have included a USD 556-billion drop relating only to China. Other investment excludes IMF lending and Special Drawing Rights allocations.
Source: Historical remittance data based on KNOMAD (2020[4]), *Remittances inflows (database)*, https://www.knomad.org/data/remittances. Historical FDI, portfolio investment and other investment data refer to net incurrence of liabilities and are from IMF (2020[5]), *Balance of payments (database)*, http://data.imf.org/bop, and national central bank data. COVID-19 projections are based on combining historical data with projections on remittances and FDI by the World Bank (2020[33]), "COVID-19 Crisis through a migration lens", https://openknowledge.worldbank.org/handle/10986/33634, with portfolio and other investment data by the Institute of International Finance (2020[32]), *IF Capital Flows Report: Sudden Stop in Emerging Markets*, https://www.iif.com/Portals/0/Files/content/2_IIF2020_April_CFR.pdf.

StatLink https://doi.org/10.1787/888934181166

2.3.2. External private investment shows little resilience after the outbreak of COVID-19

If the SDGs are to be achieved, the potential of private investment to promote sustainable development must be maximised. Paragraph 35 of the Addis Ababa Action Agenda emphasises that flows of external

private investment “are vital complements to national development efforts”. External private investment comprises a host of debt and equities instruments and can be grouped into FDI, portfolio investment and other investment.

By design, FDI is best suited for investment promoting the SDGs. First, investing in the SDGs requires a long-term horizon and as the most stable source of external private investment, FDI can provide that longer-term project horizon. As FDI implies management, it is also more than just a cross-border flow of capital. A second advantage is that it can have a range of positive spill over effects such as transferring skills and technologies and providing access to international markets (Gestrin, 2020[34]).

Despite volatility, portfolio and other investment flows can be an important contribution to sustainable development, complementing FDI. First, the presence of portfolio and other investment means that the receiving economy is integrated in global capital markets. In addition, volatility also provides liquidity. Equity and bank loans can each flow to businesses and projects that are conducive to sustainable development. Likewise, government debt can be used to fund sustainable public expenditure.

External private investment underperformed before the COVID-19 pandemic

External private investment accounts for the majority of aggregate external finance inflows. In 2018, developing countries received USD 1.2 trillion in net inflows of external private investment, representing 59% of total inflows. While private capital flow components recovered from the 2015 drop, all three components – foreign direct, portfolio and other investment – remained below their 2011-13 peak levels of. This peak between 2011 and 2013 was a result of factors including the commodity price super cycle in 2011, stronger growth in developing economies, lower bond yields in the United States, the euro crisis, a weaker USD and trade uncertainty in subsequent years.

Portfolio inflows to ODA-eligible countries in 2018 declined by half over the previous year, to USD 203 billion, and despite signs of a slight recovery, remained well below the 2012 peak. Higher risk aversion and, in the United States, rising yields and tighter monetary policy by the Federal Reserve Bank help explain the decline (IMF, 2019[35]). External factors had a negative impact on several of the largest recipients of portfolio flows such as Argentina, India, Mexico, South Africa and Turkey. Following improved investor sentiment and declining United States yields, portfolio flows to developing economies recovered slightly in 2019. A weak growth outlook for developing countries hindered a more sizeable recovery (IMF, 2019[36]).

Other investment increased slightly in 2018 to USD 379 billion, then decreased in 2019. Other investment is driven by domestic rather than external factors affecting all countries. Bank lending, the main component of other investment, tends to be more strongly influenced by domestic pull than external push factors. The 2019 decrease was driven by a few countries (e.g. Argentina, China and India).

FDI inflows to ODA-eligible countries have steadily decreased from their USD 846-billion peak levels of 2011, completing the bleak, pre-COVID-19-picture of capital flows. In 2018, FDI inflows to ODA-eligible countries increased by USD 60 billion to USD 621 billion. This slight increase, however, does not indicate a trend reversal. Inflows to China drove nearly all of the increase, while FDI inflows to other regions stagnated or even decreased. In 2019, FDI inflows to developing countries declined by 2% (UNCTAD, 2020[37]). China experienced an even stronger decline driven by a host of factors: economic (declining commodity prices), business (digitisation and asset-light forms of production), and political (rising trade and investment policy uncertainty and concerns of geopolitical stability in emerging markets) (World Bank Group, 2020[38]; Gestrin, 2020[34]).

External private investment will remain low in 2020

External private investment tends to be procyclical and is expected to fall sharply in 2020. For example, external private investment plummeted following the global financial crisis. Net inflows of portfolio

investment and other investment immediately dropped by 128% and 59%, respectively, and FDI, year-on-year, declined by 28% with a lag of one year in 2009.

In March 2020, USD 83.3 billion of non-resident portfolio outflows left emerging markets (Institute of International Finance, 2020[31]). This marks the beginning of the decline in private investment and an investor flight to safety. The decline was twice as deep as the non-resident portfolio outflows after the 2008 financial crisis and greater than the cumulative non-resident portfolio inflows to emerging markets in 2019. Over subsequent months, the outflow slowed as countries attempted to reopen their economies. Debt flows to emerging markets recovered in April and May 2020, and equity flows recovered in June 2020. However, when compared to March outflows, this recovery is only partial. Cumulative portfolio outflows remain large.

All components of FDI were affected early in the crisis (OECD, 2020[39]). The impact on FDI via reinvested earnings varies greatly across sectors. The energy, consumer discretionary, industrials and materials sectors are most likely to see large year-over-year drops in multinational earnings (Refinitiv, 2020[40]). The primary and manufacturing sectors are especially prominent in FDI flows to developing countries and are likely to be hit harder. Other sectors such as health care, technology and communications are most likely to have increased earnings. Announced FDI greenfield investment, which for developing countries is more important than cross-border mergers and acquisitions, declined significantly in the first two months of 2020.

COVID-19 could have a lasting impact on external private investment

Portfolio and other investment have profited from accommodative policies, which could keep these flows afloat in the short-term. Quantitative easing on an unprecedented scale by central banks in OECD countries has created a global wave of liquidity and decreased yields in advanced economies. Policy makers in the largest developing countries have supported this trend by easing both capital inflow restrictions and regulations that limit banks' access to foreign funding (OECD, 2020[30]). If these accommodative policies continue, they could drive a post-COVID-19 hunt for yield in developing economies similar to the one following the global financial crisis.

Global and domestic risks loom on the horizon, making the post-COVID-19 outlook for portfolio and other investment flows highly uncertain. Domestically, there is the concern that the recovery of capital flows is detached from the real sector in developing countries. With the potential for debt defaults and rising fiscal pressures, debt sustainability issues could limit developing countries' access to capital markets in the coming years. Signs of renewed trade tensions between the United States and China could further harm investor confidence.

FDI flows are likely to remain subdued in 2021. In the most optimistic scenario, FDI flows in 2021 could remain around or just below pre-crisis levels (OECD, 2020[39]). The effect of the demand shock will be delayed. The recovery of FDI flows will therefore take longer than for portfolio and other investment flows.

Beyond 2021, FDI flows will depend on changes to international production. Unlike portfolio and other investment flows, FDI flows are more influenced by strategic decisions of multinational enterprises than by cyclical macroeconomic circumstances. Increasing digitisation, rising protectionism and the emergence of sustainability incentives are trends that have driven these decisions. COVID-19 could accelerate these trends. As many countries expand their investment screening mechanisms, shielding sensitive industries and financially vulnerable businesses from foreign takeovers, contrary to the global financial crisis, where most economies increased openness to investment (OECD, 2020[41]). The call for more resilient value chains could, however, also lead to more diversification of value chains, creating new opportunities for market entrants (UNCTAD, 2020[37]).

2.3.3. Remittances are declining as global economic activity stalls amid the coronavirus (COVID-19) crisis

Remittances have become the largest individual source of external finance to ODA-eligible countries (excluding China), surpassing FDI in volume since 2016. Remittances are commonly referred to as personal transfers or household income made by migrants or non-residents to friends and relatives in their countries of origin. However, remittances are not limited to personal transfers from migrants. Household income can be transferred via three main channels: personal transfers, compensation of employees and capital transfers. Informal remittances sent to developing countries, not counted in official statistics, could amount to a 35-75% increase in officially reported remittances (OECD, 2019[42]). The numbers presented in this report reflect a lower bound estimate.

Remittances are a vital source of financing to achieve the 2030 Agenda. Unlike other external flows, they reach households directly; unlike private investment flows, they have an altruistic rather than commercial motivation. The altruistic motivation may help explain the resilience of remittances. Remittances have a positive development impact at the household level by providing financial means to finance basic consumption. Remittances also have a positive effect on children's health care and education.

At the national level, remittances can finance investment by lowering credit constraints and increasing demand for goods and service. Remittances are also an important source of tax revenue and of deposit funding for banks. Remittances account for more than 70% of their inflows of external finance for countries such as Haiti, Kyrgyzstan, Nepal and Tajikistan); for El Salvador and Guatemala, remittances account for more than 80% of all external finance. From a balance of payments perspective, remittances provide a source of foreign currency to finance current account deficits or strengthen currency reserves. Remittances can also lead to an appreciation of domestic currency and decrease the competitiveness of the price of exports in global markets.

Prior to COVID-19, remittances levels increased steadily

Remittances to ODA-eligible countries followed a remarkable growth path pre-COVID-19, almost doubling from USD 275 billion in 2006 to USD 534 billion in 2019. Apart from a slight drop in remittances to middle-income countries in 2016, remittances steadily increased since 2009 across income groups. Across regions, the post-2009 growth was steady only for Latin America and the Caribbean. Remittances to other regions experienced a slight drop between 2014 and 2016 before growing again.

During the global financial crisis, remittances proved to be relatively resilient, dropping by just 7% in 2009. This was relatively small decline compared to the 28% drop that year in FDI, which is the most stable component of external private investment. The resilience of remittances during this crisis was a result of increased savings by migrants, currency downgrades that increased the local currency value of remittance inflows sent in United States dollars and more capital transfers due to returning migrants.

While SDG target 10.c calls for reducing the global average cost of sending remittances to 3% by 2030, there has been limited progress. High transfer costs cut into the amounts recipients receive, incentivising the use of informal channels and lessening the contribution of remittances to domestic financial sector development (Rühmann et al., 2020[43]). The global average cost of sending USD 200 of remittances decreased from slightly less than 10% in 2008 to 6.67% in Q2 2020. Progress appears to be slowing: global average remittance costs decreased by more than 1% from 2013 to 2015, but by only 0.34% from 2018 to 2020. (World Bank, 2020[44]).

The COVID-19 crisis could hit remittances more severely than previous financial crises

The simultaneous economic shock in originating and receiving countries could reduce the countercyclical reliability of remittances and make the drop in remittances more severe than during previous crises. The

top three countries in terms of remittances as a share of external finance – El Salvador, Guatemala and Kyrgyzstan – experienced record year-on-year drops ranging from 20% to 62% for April and May 2020. The previous record for the largest monthly year-on-year drop in remittances to developing countries, between 2007 and 2009, ranged from 16% to 34%. For all of 2020, the projected impact of the pandemic is equally dire: remittances to developing countries could shrink by 20% compared to 2019 (World Bank, 2020[33]). Fragile contexts and small island developing states (SIDS), which are most dependant on the inflow of remittances, would suffer most from this drop.

Economic shocks in the main remittance-sending countries and a large oil price drop further indicate the pandemic will have a stronger impact on remittances than the global financial crisis. In the United States, the largest source country of household remittances, job losses have been vast. Migrant workers have historically been at a higher risk of unemployment during an economic crisis (World Bank, 2020[33]). Similarly, migrants residing in oil-rich countries will struggle to maintain remittances due to the economic contraction in these countries (UNCTAD, 2020[45]). The current recovery from this oil-price drop is slow, with rising oil prices in May 2020 well below pre-COVID-19 levels (International Energy Agency, 2020[46]).

The countries most affected by the economic shock and the oil price drop are also the most significant senders of remittances to developing countries. In 2018, 81% of remittances originated from high-income countries, with fully 43% originating just in the Group of Seven (G7) countries. More than 38% of remittances globally were sent from other high-income countries, including 9% from Development Assistance Committee (DAC) countries beyond the G7 and 29% from high-income countries such as the Gulf states. Only 19% of remittances received by developing countries were transferred from middle-income and low-income countries, mostly from India and the Russian Federation.

Remittance levels will depend on migration and the global economic recovery

Some of the increase in international remittances may be reflect improved measurement of these flows due to enhanced anti-money laundering laws and a shift from the use of informal to formal channels. Even so, international migration is the main driver of remittance flows, and it has been growing substantially. In 2019, an estimated 271 million people were international migrants, increases of 23 million since 2015 and of almost 100 million since 2000 (UN DESA, 2019[47]).

The medium- to long-term impact of COVID-19 on remittances remains highly uncertain. Remitters' economies might take longer than expected to recover and migration restrictions might continue, disproportionately harming the incomes of migrants. Nevertheless, COVID-19 has already exposed the vulnerability of diaspora groups, putting increased pressure on policy makers to protect migrant workers' rights. Border closings and lockdowns are boosting the use of digital transfer services, as transfer offices were closed due to the pandemic, and this has lowered remittance costs. Policy responses to keep remittances flowing will be crucial (see Chapter 4).

2.3.4. The impact of the pandemic on official development assistance is uncertain

Official development finance is provided by official bilateral and multilateral donors. Bilateral donors include DAC members and those countries reporting their development finance to the OECD. Multilateral donors include global organisations such as the United Nations system, the World Bank and the IMF as well as regional development banks and vertical funds.

Official development finance (ODF) is comprised of concessional (ODA) or non-concessional flows. The former includes mostly grant payments and, to a lesser extent, concessional loans with a primary objective to promote economic development and welfare in the recipient country. ODA loans must convey a grant element of at least 25%. Official non-concessional finance is referred to as other official flows (OOF) and is defined as official sector transactions that do not meet the ODA criteria. These include loans that do not

meet the concessionality criteria of ODA, grants for representational or commercial purposes, and export credits.

Official development assistance was stable prior to COVID-19 and increased to countries most in need

ODA is relatively stable and resilient over time. Gross ODA disbursement from bilateral and multilateral donors, on a cash basis, amounted to USD 198.3 billion in 2018, roughly similar to the 2017 total of USD 199.3 billion. The 2018 figure includes USD 141.2 billion from DAC members (including European Union institutions), USD 35.7 billion from multilateral institutions and USD 21.4 billion from other countries reporting their development finance to the OECD DAC (hereinafter non-DAC reporting donors). Compared to 2017, gross ODA disbursements from DAC members declined by 1.5% in real terms, but total ODA has remained fairly stable in recent years. The OECD (2020[48]) *Development Co-operation Profiles* describes the most recent data on ODA in detail, including an analysis by provider.

Preliminary data for 2019 suggest that net ODA flows from DAC member countries, on a cash basis, also have remained stable and increased slightly, by 0.1% in real terms, over 2018 (OECD, 2020[49]). On a grant equivalent basis, the new standard ODA accounting adopted by the DAC for the headline figure of ODA, total ODA rose by 1.4% in real terms in 2019 from 2018.[5] To better reflect the recipient perspective and assess a longer time span, official development finance flows are presented on a cash basis, i.e. the actual cash flow between donor and recipient countries. On the cash flow basis, net bilateral ODA flows to least developed countries (LDCs) increased by 2.6% in real terms in 2019. Net bilateral ODA inflows to countries in sub-Saharan Africa increased by 1.1% in real terms, by 0.4% to low-income countries and by 3.8% to lower middle-income countries. Upper middle-income countries, in contrast, experienced a decline of net bilateral ODA flows by 9% in real terms.

ODA plays a particularly important role in the financing mix of LDCs, fragile and conflict-affected contexts and countries, and SIDS. These groups tend to rely more strongly on ODA than other country groups. The share of ODA in total external financing for these groups is higher than in other countries, while tax revenue and private investment tend to be lower. In LDCs, gross ODA disbursements amounted to 5.1% of GDP in 2018, in SIDS to 1.8% of GDP, and in fragile and conflict-affected countries to 2.8% of GDP. In recent years, gross ODA disbursements increased to LDCs, SIDS and countries affected by fragility or conflict. In absolute terms, fragile and conflict-affected countries received the largest amount of gross ODA disbursements (USD 90.1 billion), followed by LDCs (USD 59.5 billion) and SIDS (USD 5.7 billion).

Official development assistance from DAC members particularly targets social sectors, which is of particular importance during global health crises. Almost 47% of bilateral, allocable ODA was allocated to social sectors in 2018; infrastructure sectors accounted for 29%, productive sectors close to 12%, and the banking and business sector slightly more than 5%. A quarter of ODA commitments were channelled through the recipient and donor governments in 2018. Project-type interventions represented 60% of total ODA commitments in 2018.

The effects of the coronavirus (COVID-19) crisis on official development assistance levels are as yet unknown

Official development assistance can help absorb the shocks from the likely decrease in external private investment and remittances – especially in countries that do not have the fiscal resources and reserves to do so on their own. In the immediate response to the crisis, multilateral donors such as the IMF and the World Bank provided swift liquidity to developing countries. The strategic role of official development assistance to build back better in the crisis recovery is discussed in Chapter 4.

The economic and fiscal challenges in donor countries will have as-yet unclear short, medium and potentially long-term effects on ODF. With donor countries' budgets tightening due to increased domestic

spending and public revenue shortfalls, developed countries face constraints in scaling up development spending. DAC members declared their ambition to "strive to protect ODA budgets" during the COVID-19 crisis (OECD, 2020[50]). But, how ODA will evolve in 2020 and thereafter is a question, ultimately, of political will and global solidarity (OECD, 2020[51]). Since many ODA budgets were finalised before the outbreak of COVID-19, the effect of the global economic recession on ODA levels might not appear immediately. The OECD (2020[51]) has outlined three possible scenarios to predict ODA levels in 2020:

- Increase in ODA levels: Many countries have signalled political commitment in support of a global sustainable recovery. The COVID-19 crisis has exposed the interdependence of countries and the importance of global public goods. Increased solidarity thus could lead to increases in total ODA levels and, in turn, would increase ODA as a share of gross national income (GNI).
- Maintaining ODA levels: As highlighted in their Joint Statement, DAC members have expressed their will to protect ODA levels. Indeed, OECD DAC Peer Reviews have found that protecting aid budgets against short-term shocks to public finance is an established practice. If ODA levels were to be maintained at 2019 levels, the ratio of DAC members' ODA to GNI would increase from 0.29% in 2019 to about 0.32% in 2020.
- Declining ODA levels: Given DAC members' own budget pressures in 2020, the overall level of ODA could decline in 2020. The OECD calculates that if DAC members were to keep the same ODA to GNI ratios as in 2019, total ODA could decline by as much as USD 11-14 billion, depending on a single-hit or double-hit recession scenario on member countries' GDP.

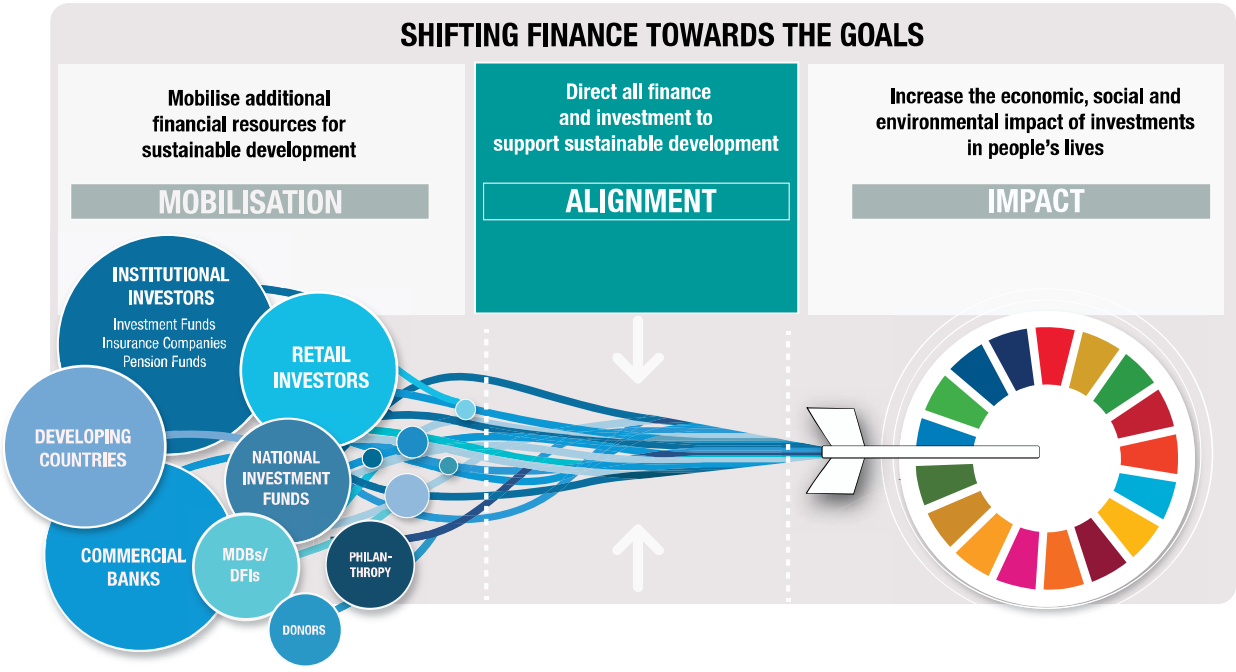
2.4. The call for better measures of quantity and quality of resources

The picture of the external development finance landscape is based on available data. However, limitations in data availability mean that some important resources remain unknown. Further, it addresses the quality dimension of flows only in terms of the ability to disaggregate measures (e.g. by sector or geography) and does not address the alignment of flows specifically to the 2030 Agenda.

The economic fallout from COVID-19 underscores the call for better measurements of both the quantity and quality of existing flows within the financing for sustainable development landscape. Prior to COVID-19, the magnitude of the USD 2.5-trillion SDG financing gap created an urgency to mobilise more external flows – specifically to mobilise trillions in private finance through the billions available in official development finance. However, more resources are unlikely to be mobilised in the current context. Instead, a better understanding of the quality of existing flows, as demonstrated in the 2019 edition of the *Global Outlook for Financing Sustainable Development*, can help assess how available financing can be made more efficient and effective.

With limited resource mobilisation, innovative strategies must be deployed to leverage additional resources. As shown in Figure 2.7 a three-step approach to financing the SDGs that mobilises, aligns and ensures positive impact is crucial. A significant share of existing financial resources is not yet channelled to support sustainable development and remains under the radar of international statistics. Chapter 3 explores what this report terms the new actors in the financial system (e.g. asset managers, institutional investors, banks, etc.) who own and manage trillions of dollars of financial assets that could be better aligned for sustainable development. International efforts are underway to increase the transparency of how data on resources held by these actors are captured and labelled. Measurement of the development impact is further needed to ensure that resources contribute to achieve the global goals. However, this remains the most challenging dimension to measure.

Figure 2.7. A three-step approach to shifting finance towards the SDGs



Note: Multilateral development bank (MDB) and development finance institutions (DFIs)
Source: OECD (2018[26]), *Global Outlook for Financing Sustainable Development 2019: Time to Face the Challenge*, https://doi.org/10.1787/9789264307995-en.

This section reviews data and estimates on additional private and public resources and introduces the total official support for sustainable development (TOSSD) framework that institutionalises this broader view of FSD resources. It then maps how much is known about the quality dimension of the external flows listed in this chapter and highlights where progress is still needed.

2.4.1. Recent progress to improve measures of quantity and mobilisation

Two types of broader financing for sustainable development resources should be considered in terms of achieving better measures of the quantity and mobilisation of resources for sustainable development:

- broader private resources such as private finance mobilised through official interventions, social impact investing and private philanthropy
- broader public resources such as those from development co-operation providers of the Global South and modalities such as triangular co-operation and Islamic finance.[6]

Private resources plays an increasingly important role to finance sustainable development

Private philanthropy is increasing and highly concentrated in social sectors

Private philanthropic donors provide flexible and innovative financing, and these flows have been increasing significantly. In 2018, private philanthropic foundations reported gross aid disbursements amounting to USD 7.1 billion to the OECD Creditor Reporting System.[7] The largest philanthropic donor that year was the Bill & Melinda Gates Foundation, which disbursed a total of USD 3.9 billion gross official development finance disbursements.

Like official development finance, the largest share (60%) of private philanthropic development flows targeted social sectors in 2018. Health alone represents about 44% of total philanthropic financing. About

36% of philanthropic flows in 2018 were channelled through non-governmental or civil society organisations, followed by about 25% through private sector institutions and 22% through think tanks. Foundations responded to the challenges of the COVID-19 pandemic by quickly raising funds and extending support, particularly to ensure universal access to a future vaccination for the disease.

Private finance mobilised through official interventions could be better directed to countries and sectors most in need

Mobilising additional private finance towards sustainable development through official interventions can boost private finance in support of the SDGs. While mobilisation refers to private finance that would not have been leveraged without the official development finance intervention, blended finance refers to a broader category that includes the use of development finance for the mobilisation of additional finance (private or public) towards sustainable development. As part of its regular data collection, the OECD DAC measures private finance mobilised via six instruments that do not yet cover grants and concessional loans. The DAC estimates of private finance mobilised are thus a conservative estimate of all private finance mobilised. These estimates help to assess the size of one aspect of blended finance volumes. With the resource limitations presented by COVID-19, blended finance instruments present one option to help to maximise even scarcer concessional public resources. Chapter 4 provides additional details and recommendations.

Amounts mobilised from the private sector increased over the past decade, and more than half of the total private finance mobilised in 2017 and 2018 went to the energy, banking and financial services sectors in middle-income countries. In 2018, USD 48.4 billion was mobilised from the private sector by official development finance interventions, an increase of 28% over 2017. Multilateral providers mobilised three-quarters of these funds (OECD, 2020[52]). In 2017 and 2018, only 5.3% of private finance mobilised went to least developed and other low-income countries. Research has found that there is an inverse relationship between the fragility of the recipient country and the private finance mobilised. In other words, the more a country is economically, environmentally and politically fragile, the less private finance is mobilised for the country (Basile and Neunuebel, 2019[53]).

The OECD is producing a variety of work around blended finance including to least developed countries (OECD/UNCDF, 2019[54]) as well as sector-specific reports, such as for water and sanitation (OECD, 2019[55]) and agriculture. It also conducted surveys on blended finance funds and facilities (Basile and Dutra, 2019[56]; Basile, Bellesi and Singh, 2020[57]). Additionally, the OECD is preparing further policy guidance to support DAC members with the implementation of the Blended Finance Principles.

Reporting on public resources beyond the OECD DAC has improved

Development co-operation provided by countries beyond the membership of the DAC plays an increasing role to provide global development co-operation. South-South co-operation (SSC) refers to the exchange of knowledge, skills, expertise and resources among countries in the so-called Global South. SSC includes co-operation in political, economic, social, cultural, environmental and technical areas. The role of this co-operation and of triangular co-operation was highlighted with the signature of the BAPA+40 outcome document in 2019 (UN, 2019[58]).

Comprehensively measuring SSC remains challenging, however, due to relatively broad and varying definitions of development co-operation across countries and regions. While SSC activities in Latin America and the Caribbean most often take the form of technical co-operation, economic co-operation including trade, investment and development finance is more prominent among Asian countries. While many SSC transactions would qualify as ODA, providers often do not report them. Statistics on SSC are either incomplete, inaccurate or not available. (Besherati and MacFeely, 2019[59]). Reporting is most established, or systemic, among Ibero-American countries (Iberoamerican General Secretariat, 2018[60]). In another step towards regionally comparable reporting, the United Nations Development Programme and

the New Partnership for Africa's Development have for the first time presented SSC activities for nine African countries (UNDP/African Union, 2019[61]).[8]

Development co-operation activities reported by non-DAC members increased over the past decade. Currently, 20 non-DAC member countries are reporting their development assistance to the DAC. Since these flows are officially reported flows, they are included in the concessional development finance figures. Total ODA provided by these 20 countries totalled USD 22.5 billion in 2018, up from USD 17.6 billion in 2017. In 2018, 4 non-DAC reporting countries – Kuwait, Saudi Arabia, Turkey and United Arab Emirates – ranked among the 20 largest providers of ODA measured in absolute USD terms.

Estimates for countries not reporting development co-operation activities suggest that other countries do have large ODA-like programmes, particularly China and India. The OECD (2020[48]) estimates that the total concessional flows for development from ten providers from the Global South amounted to USD 7 billion in 2018. The largest provider in 2018 was China, with USD 4.5 billion in gross ODA-like flows, followed by India with flows of USD 1.3 billion.

Triangular co-operation leverages the value-added of a broad range of stakeholders

Triangular co-operation complements South-South and North-South development co-operation by drawing on the complementary strengths of different partners. Triangular co-operation is defined as countries, international organisations, civil society, the private sector, private philanthropy and others working together in groups of three or more. The OECD repository on triangular co-operation projects suggests that use of this flexible, cost-effective and innovative modality is increasing, with more projects with bigger budgets and longer duration (OECD, 2020[62]). Between 2010 and 2018, a total of 679 projects were reported to the database. The average budget for triangular co-operation projects was USD 1.7 million; about 40% of projects involved non-state actors and about three in ten activities targeted government and civil society (OECD, 2018[63]).

Islamic financing promotes social responsibility

Islamic finance is a socially responsible way of conducting finance that relates closely to the principles of sustainable development. Islamic finance is one area of the sharia, the Islamic law derived from religious scriptures that provides clear guidance on how to manage financial resources and business dealings (OECD, 2020[64]). Islamic finance is characterised by the prohibition on collecting interest (also called *riba*) on financial transactions, avoidance of speculation in the market or money trading, investing in intrinsic commodity value, and close links between the real economy or assets in each financial transaction.

Islamic finance provided financing worth around USD 2.5 trillion in 2018 that provides useful resources to deliver the 2030 Agenda (OECD, 2020[64]). Data on the contribution of Islamic finance are scarce. But its potential is estimated to be substantial and collaboration between Arab and DAC donors is advancing. Islamic finance further provides a context-sensitive co-operation modality in countries with Muslim-majority populations such as the 57 member countries of the Organisation of Islamic Cooperation, many of which are developing economies and fragile contexts. Islamic social finance can provide innovative modalities to channel resources through *zakat* (compulsory alms giving), *sadaga* (voluntary alms giving) and *waqf/awqaf* (charitable endowments). Moreover, Islamic lending through *sukuk* (a sharia-compliant, asset-based security) and Islamic microfinance provide ways to mobilise resources for large-scale programmes (e.g. infrastructure) and to increase financial inclusion.

Integrating broader resources into a new statistical measurement framework: Total official support for sustainable development

The new TOSSD framework considers a broader set of official and officially supported resources and links them to the SDGs. This is in line with the first two steps of the three-step approach illustrated in Figure 2.7

- mobilising more resources and ensuring their alignment with the SDGs. It is envisioned that this international framework will include more providers from the Global South than do existing OECD data on development co-operation. Flows included in the framework need to contribute to the achievement of at least one SDG target and, theoretically, not negatively affect the achievement of another SDG target (OECD, 2019[65]). For example, support to combatting crime should not come at the cost of the rule of law or of accountable and transparent institutions (Bejaroui, Gaveau and Benn, 2019[66]).

TOSSD seeks to capture both cross-border development finance and support for international public goods such as combatting climate change, global health, and peace and security. The framework has two pillars. Pillar I presents cross-border flows to recipient countries and includes traditional development finance, South-South co-operation and triangular co-operation. Pillar II includes support to international public goods, development enablers and global challenges. In addition, TOSSD seeks to capture private finance that is mobilised through official interventions.

Results from 42 responding providers to the TOSSD data survey provided a first estimation of the additional financing captured in the framework, showing an estimated USD 33-billion worth of additional activities in 2017 not yet captured in current international statistics[9] (OECD, 2019[67]). Providers already reporting to the DAC accounted for USD 20 billion of this amount and South-South providers and other multilateral institutions reported the remaining USD 13 billion. An additional USD 3 billion was collected as external official resources in Indonesia. Taken together, these estimated flows represent an increase of 60% over the current official development finance statistics. Based on the survey, preliminary estimates of total TOSSD expenditure show USD 215 billion for Pillar 1 (cross-border flows) and USD 80 billion for Pillar 2 (global and regional expenditures) in 2017. Private finance mobilised amounts to another USD 40 billion in 2017.

The case study of Indonesia finds that TOSSD is appropriate for reflecting the financing for sustainable development provided by Indonesia. It also shows that the support extended by South-South providers goes beyond SSC to include, for instance, food aid, infrastructure building, etc. An additional thematic case study. conducted on tracking peace and security expenditures in support of the SDGs and in particular SDG 16 (Bejaroui, Gaveau and Benn, 2019[66]), found that based on initial estimates, the TOSSD expenditures for peace and security amounted to USD 16 billion in 2017.[10]

2.4.2. Towards better measures of quality for alignment and positive impact

Enhancing the granularity of financial data can help assess the non-financial components of resources, including the destination of flows and the sectors in which they are invested. These qualitative aspects provide a means of improving the alignment of a flow with sustainable and inclusive development. Not every dollar of FDI will have the same development impact.

However, the alignment of a flow is not synonymous with the impact of a flow. As further explained in Chapter 3, a financial flow is aligned with the SDGs if it has two objectives: first, accelerating progress across the SDGs while doing no harm to any single objective (sustainability) and second, mobilising resources to leave no one behind (equity). Yet not every flow that is aligned realises its intended impact. For example, if an investment is intended to be used for building a hydropower plant (sustainability) in a developing country (equity) but the project was poorly implemented and not maintained afterwards, the financial flow was aligned with the SDGs without having the desired impact. Alignment therefore is an ex ante concept, while impact is an ex post concept.

This subsection provides examples of recent progress to measure the alignment of financial flows. Measures of impact are further addressed in the following Chapters 3 and 4.

Measuring the SDG alignment of financing depends on the granularity of available data

The ability to measure the alignment of a financial flow is closely linked to the granularity of the data available. There are different degrees of granularity possible: data can show flows received by a country, by a sector or industry within a country, or by a specific project that was financed. The more granular the data, the more precise the analysis of the purpose of financing and thus its alignment.

The granularity of the data source is closely related to its explicit objective to promote development, transparency and accountability. The most detailed information on flows in the financing for sustainable development landscape is available for ODA provided by DAC members and other reporting countries and institutions. The OECD CRS provides granular data on every development project implemented by official donors and is publicly available. Comparably good data are also available for a number of philanthropic foundations that report activities to the OECD CRS.

Smart data help assess the alignment of official development finance with the SDGs

Smart data tools are increasingly used to assess the alignment of official development finance with the Sustainable Development Goals. Released in 2019, the OECD SDG Financing Lab uses natural language processing, a machine learning approach, to link official development finance to the SDGs. This helps identify how official providers of development finance currently target the SDGs. The algorithm uses project descriptions of the official development projects reported in the OECD CRS to attribute one or several SDGs to each project line.

OECD estimates suggest that while some SDGs receive significant ODA funding, others are left behind. The results of the OECD SDG Financing Lab suggest that 14% of assigned USD amounts over 2015-17 targeted SDG 10 to reduce inequalities, or a total of USD 69.4 billion over the three years. The other most targeted SDGs identified are SDG 16 on peace, justice and strong institutions (10%, or USD 51.8 billion); SDG 3 on good health and well-being (9%, or USD 46.9 billion); and SDG 9 on industry innovation and infrastructure (9%, or USD 46.2 billion). In contrast, several SDGs received only limited support: only 3% of assigned USD amounts, or USD 15.1 billion, are attributed to SDG 13 on climate action. SDG 1 (no poverty), SDG 5 (gender equality), SDG 15 (life on land), SDG 12 (responsible consumption) and SDG 14 (life below) each received less than 3% of attributed ODF.

The alignment of ODF could also be assessed using the SDG focus field recently added to the OECD CRS. Donors can self-report targeted SDGs on a voluntary basis for 2018 flows onwards. However, only USD 25 billion out of DAC members' total gross ODA disbursement of USD 142 billion in 2018 was attributed to one or multiple SDGs. Of this amount, approximately 28% (USD 7.1 billion) targeted SDG 1 on reducing poverty, followed by SDG 8 on decent work and economic growth (USD 3.3 billion), SDG 16(USD 3.2 billion), and SDG 4 on quality education (USD 3 billion). To interpret these aggregate results, providers reporting to the CRS will need to improve reporting coverage in future years.

Increasing the granularity of FDI data will improve alignment

FDI Qualities Indicators systematically show a more positive impact of FDI on economic and environmental aspects of sustainability than on social aspects. The average foreign firm is more innovative and productive than the average domestic firm. This productivity premium at least partly is passed on to the workers, as foreign firms also pay higher wages than domestic firms. While FDI stocks are still concentrated in fossil fuels, FDI also is directed to more energy-efficient industries with less CO2 emissions. An increasing share of FDI to the energy sector is going to renewable energies. The picture is more mixed in the social dimension of sustainability. There is evidence that jobs in foreign firms are less secure, prevail in sectors with lower shares of trained workers and do not necessarily provide more on-the-job-training. Although FDI helps reducing the gender employment gap in some developing economies, these female-dominated industries are also the ones with more gender wage inequality (OECD, 2019[68]).

While granular data are also available for other forms of private investment, these are less accessible. A number of commercial service providers collect data on global private investments. Given the private nature of these flows (e.g. reasonable confidentiality issues), this type of data is less granular than for official development flows. Furthermore, this type of data is only available with a paid subscription and is more complex to navigate than the OECD CRS.

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Notes

[1] Using a data set including more countries, Prichard (2016[70]) found that 65 countries collected less than 15% of GDP in non-resource taxation. See https://doi.org/10.1016/j.worlddev.2015.11.017.

[2] The term unweighted average gross domestic savings refers to gross domestic product after subtracting household and general government expenditure. In the methodology, negative savings are treated as zero savings to show available "surplus" resources. For more information, see the methodology note in Annex.

[3] Note that the data coverage differs both by country group and index considered. In 2017, for example, data on financial market access were available for only 18% of low-income countries that are part of the dataset, which supports the stylised fact that financial markets are underdeveloped in low-income countries.

[4] It should be noted that not all actors providing these international capital flows are private. For example, FDI and portfolio investment can also come from state-owned enterprises. Likewise, other investments can contain flows from public actors such as central banks or sovereign wealth funds. As the source of flows is not identifiable from the IMF balance of payments data and the World Bank, these three types of international capital flows are included under "external private investment" for simplicity.

[5] Background for the new methodology is provided in OECD (2020[49]): "In 2014, DAC members decided to modernise the reporting of concessional loans by assessing their concessionality based on discount rates differentiated by income group, and introducing a grant-equivalent system for calculating ODA figures. Instead of recording the actual flows of cash between a donor and recipient country, DAC members agreed that the headline figure for official development assistance would be based on the grant equivalents of aid loans, i.e. the 'gift portion' of the loans, expressed as a monetary value. The grant equivalent methodology would provide a more realistic comparison of the effort involved in providing grants and loans and encourage the provision of grants and highly concessional (or soft) loans, especially to low-income countries." See http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2019-detailed-summary.pdf.

[6] Islamic finance is a financing modality with engagement of both public and private actors. While banks account for the largest share of today's Islamic finance industry, section 2.4 focuses on the use of Islamic finance for development co-operation.

[7] Private philanthropy reports following the same statistical standards and definitions as ODA. However, this resource is classified under the broader ODF category.

[8] The nine countries are Benin, Botswana, Côte d'Ivoire, Djibouti, Ethiopia, Lesotho, Madagascar, Sudan and Uganda.

[9] It is important to note that given the limited time to carry out the survey and the non-participation of many important providers, this amount should not be regarded as an accurate and reliable measurement of actual volumes of financing but rather as a very preliminary estimation.

[10] Six country pilots were conducted as of June 2020 (TOSSD pilot page). Another thematic pilot on health is scheduled to start in 2020.

3 The next frontier to finance sustainable development

Despite the global financial crisis and coronavirus (COVID-19) pandemic, the value of financial assets held by new actors in global capital markets continues to increase. The financing gap to achieve the 2030 Agenda represents only 1% of the hundreds of trillions of dollars held in the global financial system. However, financing is not aligned in support of the global goals, as demonstrated by rising equalities and the lack of accountability for measures of sustainability. That the root cause of the crisis is not financial makes it all the more urgent to better understand environmental, social and governance factors that impact the long-term risk-adjusted returns on investments. This chapter explores how government leaders are taking action to advance alignment of the global financial system in favour of more resilient, inclusive and sustainable development.

In Brief

The USD 2.5-trillion annual gap in financing for the Sustainable Development Goals (SDGs) outlined in the previous chapters appears small compared to the broader universe of financing – equivalent to only 1% of global financial assets. Financial intermediaries[1] such as banks, institutional investors, and asset managers, own and manage an increasing share of financial assets. These new actors hold financial assets valued at more than USD 378.9 trillion that have grown at 5.9% year on year since 2012. Despite the increase, however, these financial assets did not reduce the SDG financing gap before the COVID-19 crisis. Infrastructure financing, for example, represents only a small portion of investment by long-term institutional investors.

Moreover, financial assets are do not meet an assessment of SDG alignment discussed in Chapter 2. First, they are contributing to growing global inequalities and second, they lack accountability for their sustainability impact.

On the first criteria, less than 20% of total financial assets are held by institutions in countries eligible for official development assistance (ODA), and data on financial assets are missing for 95% of these countries. Weak domestic financial and social security systems create hurdles for SDG alignment of financial intermediaries in developing countries. In addition, illicit financial flows, wasteful tax incentives, and the persistently high cost of remittance transfers in many developing countries further drain financial assets.

On the second criteria, investments that integrate some sustainability measurement are estimated to total USD 30 trillion, or 8% of total global financial assets, and roughly USD 3 trillion of those investments seek positive impacts.

In the wake of COVID-19, SDG alignment is an imperative. The pandemic, like climate change, knows no borders and is a global threat. As long as the virus persists in one country, it remains a threat to all countries. Integrating environmental, social and governance (ESG) risks can help to preserve the long-term, risk-adjusted value of assets. Investors are under increasing pressure to measure and disclose their exposure to environmental and social risks. Portfolios that seek to avoid ESG risks may outperform the broader market over the long term and have registered lower losses in the COVID-19 era. However, ESG ratings remains unregulated and estimates are therefore unreliable due to a lack of transparency, proliferation of methodologies and inflation of sustainability performance.

Investing in SDG alignment offers an opportunity to build resilience in the markets. The 2030 Agenda provides a blueprint for economic recovery that benefits people and planet. More than 100 countries have already adopted carbon neutrality goals for 2050. However, fossil fuel subsidies currently cost upwards of USD 4.7 trillion. Resources borrowed and invested by governments today should not contribute to widening inequalities between countries and should leverage SDG market opportunities.

3.1. The unknowns: Mapping the trillions needed to finance the Sustainable Development Goals and respond to the coronavirus (COVID-19) crisis

The annual financing gap to achieve the SDGs is USD 2.5 trillion, coupled with increasing needs and declining resources following the COVID-19 outbreak estimated at USD 1.7 trillion, are seemingly small amounts – equivalent to only 1.1% of global financial assets (USD 4.2 trillion) – relative to the broader universe of financing.[2] In the era of COVID-19, with its greater spending needs and restricted funding sources, governments rely on financial institutions to help mobilise financing and overcome fiscal constraints. Financial institutions such as institutional investors, banks and asset managers play an important role to ensure the availability of capital and integrate long-term risks into investment decisions. These financial actors guide the market by deciding which kinds of companies to invest in, determining which kinds of risk criteria to assess, and labelling categories of finance and investments.

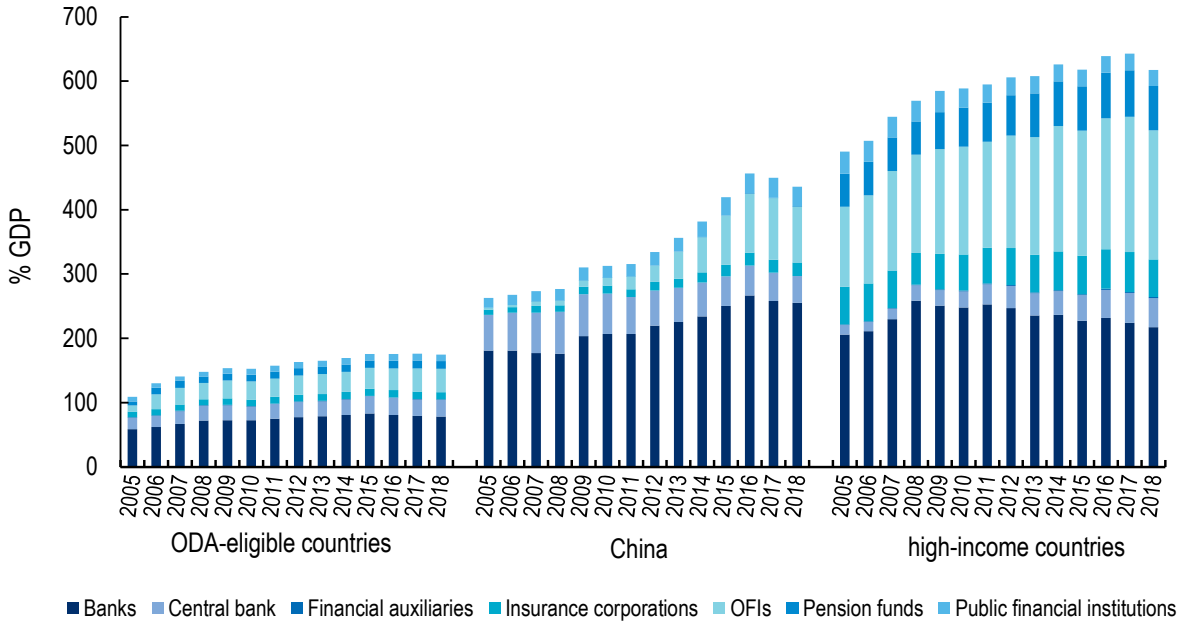
This section looks at the extent to which finance can help shift the global economy towards a more sustainable and equitable growth path. It specifically addresses two key issues: first, the articulation of global financial assets with the SDG financing gap and second, the global trends in financing owned and managed by financial actors.

3.1.1. The increasing value of financial assets does not reduce the financing gap

Since 2012, global financial assets have grown at 5.9% per annum and amounted to USD 378.9 trillion in 2019, due mainly to the rise of financial intermediation (International Development Finance Club, 2020[1]). The value of financial assets now outweighs global gross domestic product (GDP). Over the past 50 years, credit by banks and other intermediaries to households and businesses has grown three times as fast as economic activity (Cournède, Denk and Hoeller, 2015[2]). Today, financial assets represent six times GDP in high-income economies and 3 times GDP in middle-income countries. Figure 3.1 shows that total financial assets as a percent of GDP increased most rapidly in the People's Republic of China, by 60% from 2006 to 2018, driven by other financial intermediaries (OFIs) which increased 30-fold. Financial assets in developing countries increased by 33% over the same period. In high-income economies, financial assets increased by 20% due to a three-fold increase in central bank assets following implementation of quantitative easing.

Figure 3.1. Financial assets held by new actors as a % of GDP across country groups, 2005-18

Total financial assets by year and country group



Source: Financial Stability Board (2020[1]), *Global Monitoring Report on Non-Bank Financial Intermediation 2019*, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/.

StatLink https://doi.org/10.1787/888934181185

However, the growth of financial markets does not automatically result in positive impacts on the real economy. Following the outbreak of the COVID-19 pandemic, financial markets rebounded quickly. Stock markets recovered their pre-crisis levels between February and August of 2020, thanks in large part to government spending and other liquidity support by central banks. The Chicago Board Options Exchange's volatility index also declined rapidly, by 62.5% over the same period. Despite recovery in capital markets, labour markets remain slow to recover (see Chapter 1).

In addition, not all financial assets are directly investable. The rapid growth of many intermediaries OFIs can in part be explained by asset price appreciation (Financial Stability Board, 2019[3]). There are many potential negative impacts of increasing growth of financial systems, particularly in weakly regulated markets. Examples include misallocation of capital by funding projects with too low profitability, for instance when distortions exist in the tax system; valorisation of assets that does not consider the negative impacts on society, the environment and the economy; and lack of transparency as financial systems, regulations and capacities become increasingly complex, potentially facilitating illicit financial flows, and opacity about underlying credit risk that misleads ultimate investors into funding too much lending.

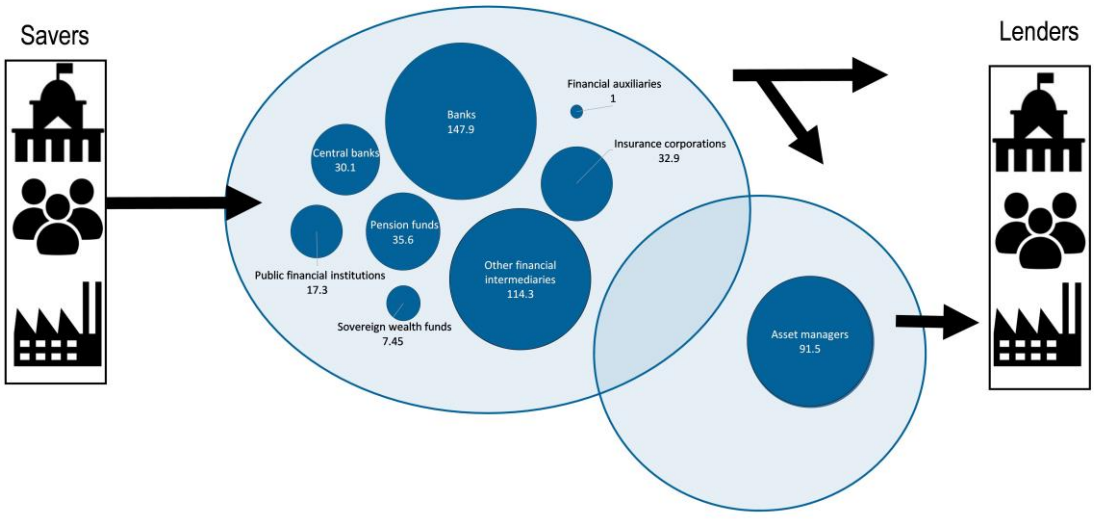
The potential positive contributions of finance to narrow the SDG financing gap remain underexplored. For example, the largest gap in financing to achieve the SDGs is for infrastructure investment needs, estimated at USD 70 trillion through 2030. However, infrastructure asset holdings by institutional investors are low. For example, only 1.3% of financial assets of pension funds are allocated to the sector. A lack of reliable and standardised information is a major barrier to investment and required to channel long-term investment towards the SDGs (see Section 3.2.2.) (OECD, 2020[4]).

3.1.2. Owners and managers of financial assets are playing different roles to respond to the crisis

This subsection provides an overview of the volumes owned and managed by the new actors, or financial intermediaries**.** Owners and managers of financial assets have different legal obligations and responsibilities, one of the major distinctions between them. Asset owners are legally responsible for the assets owned (such as savings), while most asset managers are bound by their fiduciary duty to make investments according to the best interest of the institution for whom they manage assets.

Nonetheless, there is significant overlap between asset owners and managers. In many instances, asset owners hold stakes in the asset management firms to which they delegate responsibility for funds (e.g. bank-owned asset management firms). Furthermore, institutional investors can be considered fiduciaries of the resources invested by their clients or citizens. Chapter 4 elaborates in detail the SDG alignment of these actors. Figure 3.2 illustrates both overlaps and differences before the COVID-19 pandemic. In the wake of the crisis, the respective weights of these actors could shift, given that there is greater demand on the financial system's liquidity. However, if loans and other investments are not repaid, the financial system could face losses from default.

Figure 3.2. Mapping of financial asset owners and managers (USD trillions)



Note: The value of assets managed and owned cannot be calculated due to significant double-counting and overlap.
Source: Authors based on Financial Stability Board (2020[1]), *Global Monitoring Report on Non-Bank Financial Intermediation 2019*, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/ and BlackRock (2014[5]), "Who owns the assets? Developing a better understanding of the flow of assets and the implications for financial regulation", https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-who-owns-the-assets-may-2014.pdf.

Owners of financial assets are mobilising finance during the crisis

Four kinds of actors own assets conceptually and legally: institutional investors (e.g. pension funds or insurance companies), banks, public financial institutions, and financial auxiliaries.[3] Asset owners have varying degrees of freedom to implement investment strategies. Pension funds, for example, are subject to quantitative portfolio restrictions relating to investment in certain asset classes (e.g. foreign investment). Insurance corporations face fewer quantitative investment restrictions and are more often subject to risk-

based capital regulation. Ownership structures also differ, which can influence investment decisions. For example, certain actors are mainly publicly owned (e.g. central banks or sovereign wealth funds) and others are mainly privately owned (e.g. commercial banks and investment funds).

Institutional investors own the largest share of global financial assets, at roughly USD 189.9 trillion or nearly half of total global financial assets.[4] They collect savings and supply funds to financial markets. They also have considerable influence on companies and banks via their equity and voting rights and generally adopt financing strategies based on long-term investment considerations. Institutional investors' long-term investment considerations can have countercyclical and stabilising effects on financial markets.

In comparison to banks, most institutional investors do not have full banking licenses and are not supervised by a national or international banking regulatory agency. Following the global financial crisis, new regulations were put in place, including through the Basel III accord and the Dodd-Frank law in the United States that, among other changes, introduced new requirements such as liquidity ratios and strengthened the role of credit rating agencies. The unfinished business of financial regulation and gaps in regulation of what is called shadow banking, or non-bank financial intermediation, present compounded risks. These are discussed further in Section 3.3.2.

Commercial and investment banks had a total of USD 147.9 trillion in assets under management in 2018, representing 39% of global financial assets. Banks play an important role by borrowing savings from individuals, companies, governments and other entities and providing loans to purchase other securities. In this way, they ensure the availability of financing and fill the information gap between lenders and borrowers.

The COVID-19 crisis has placed additional strain on commercial banks' liquidity and brought increased risk of default and insolvencies. In the United States alone, the outstanding amount of undrawn credit lines represents, on average, 81% of total committed credit lines and is about eight times the amount of bank debt that was already on firms' balance sheets at the end of 2019 (Acharya and Steffen, 2020[6]).

Central banks have seen the fastest growth rates among all financial intermediaries, increasing from USD 5 trillion to USD 30 trillion in total assets between 2002 and 2018, or annualised growth, post-crisis of 8.5%. The largest central banks – those of and the European Union (EU), Japan, the United Kingdom and the United States – have grown considerably with quantitative easing that allowed to increase open market operations, i.e. buying and selling government securities (van de Ven and Fano, 2017[7]). With historically low interest rates and unprecedented negative interest rates, central banks have created a system that is very leveraged and vulnerable to external shocks. To better mitigate risk, central banks promote efforts to integrate climate-related considerations.

To respond to the impact of COVID-19, central banks are front and centre. Large-scale central bank liquidity support has helped supply credit to the real economy and support financial intermediation during the pandemic. Six central banks have enhanced swap lines, and the United States and China have expanded their lists of central banks with swap arrangements. Central bank assets as a ratio of GDP are at record highs in OECD countries while developing countries have little margin for additional currency interventions to respond to the crisis (Section 3.2.1).

Public financial institutions have also played a key role to mobilise finance during the crisis. Public financial institutions own USD 17.3 trillion in financial assets. Public development banks, the largest type of actor in this category including subnational, national and regional development banks, hold an estimated USD 11.2 trillion in assets and have played an important role in the COVID-19 recovery in OECD countries (see Box 3.1). For example, the European Investment Bank plans to leverage more than 1% of the EU GDP which totalled USD 24 trillion in 2019 through a pan-European guarantee with a focus on financing SMEs, throughout the EU (Treasury of France, 2020[8]).

Box 3.1. Public development banks shift support after the outbreak of COVID-19 to build a more resilient financial system

The International Development Finance Club (IDFC) is a group of 26 major public development banks, including national and regional banks that invest more than USD 600 billion collectively per year.

Before the crisis, in 2015, IDFC and multilateral development banks agreed on common principles for climate finance tracking (mitigation and adaptation) and have been reporting together on this basis. IDFC and the MDBs subsequently committed in 2017 to align finance with the Paris Agreement, and have since developed corresponding methodologies. The IDFC is also examining the compatibility of their activities vis-à-vis the broader SDGs which showed progress to ensure ex-ante and ex-post evaluation mechanisms exist. Yet, few members evaluate impact based on the SDGs.

Following the outbreak of the crisis, public development banks are helping governments implement emergency and recovery programmes using their countercyclical mandate to provide emergency loans, financing facilities and guarantees by reallocating funding or by putting in place easing measures for repayments. Their support to local financial systems helps ensure corporate liquidity and maintain jobs. The businesses and sectors most affected by the crisis, such as small and medium sized enterprises, transport, tourism, energy, industry, commerce, services, etc. are receiving targeted financial support. Finally, some members have issued dedicated bonds that mobilise finance from capital markets to support their interventions in addressing the COVID-19 crisis.

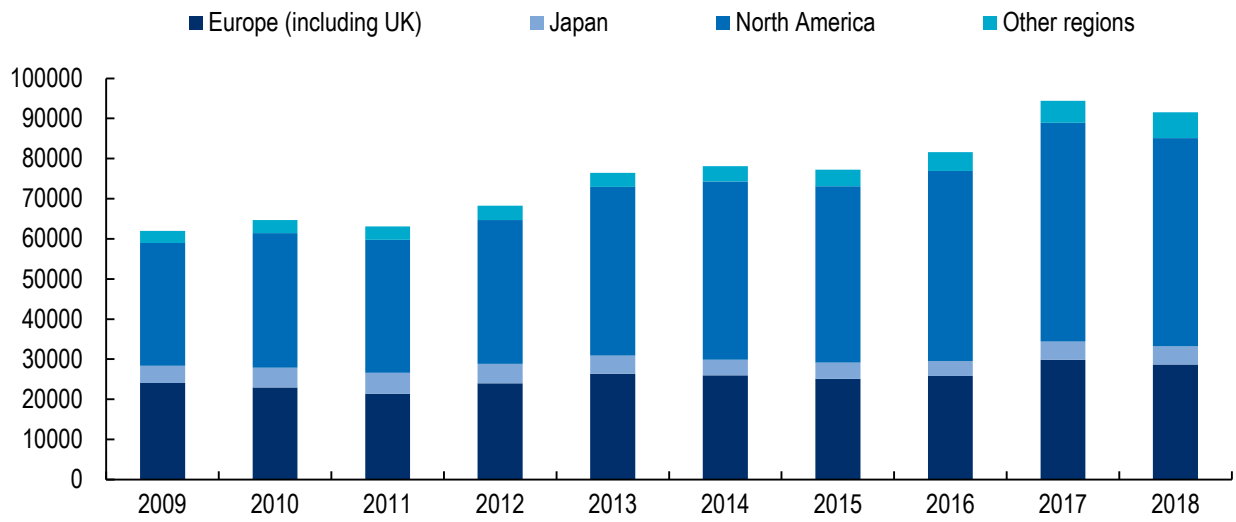
Source: Authors based on International Development Finance Club (2020[1]), *International Development Finance Club website*, https://www.idfc.org/publications/.

Asset managers are reviewing how risks are assessed to ensure financial resilience following the pandemic

Asset managers hold USD 91.5 trillion, an increase over their USD 60-trillion holdings in 2009 and just under a quarter of total global assets. As shown in Figure 3.3**,** North American asset managers manage more than half of these assets. The five largest asset managers include BlackRock, Vanguard, State Street, Fidelity and Allianz.

Figure 3.3. Share of resources held by asset managers, by country and/or region, 2009-18

Total value of assets managed, by manager domicile, USD billion



Source: Authors based on Thinking Ahead Institute (2019[9]), *The World's Largest 500 Asset Managers*, https://www.thinkingaheadinstitute.org/-/media/TAI/Pdf/Research-Ideas/a_public/PI500_2019.pdf.

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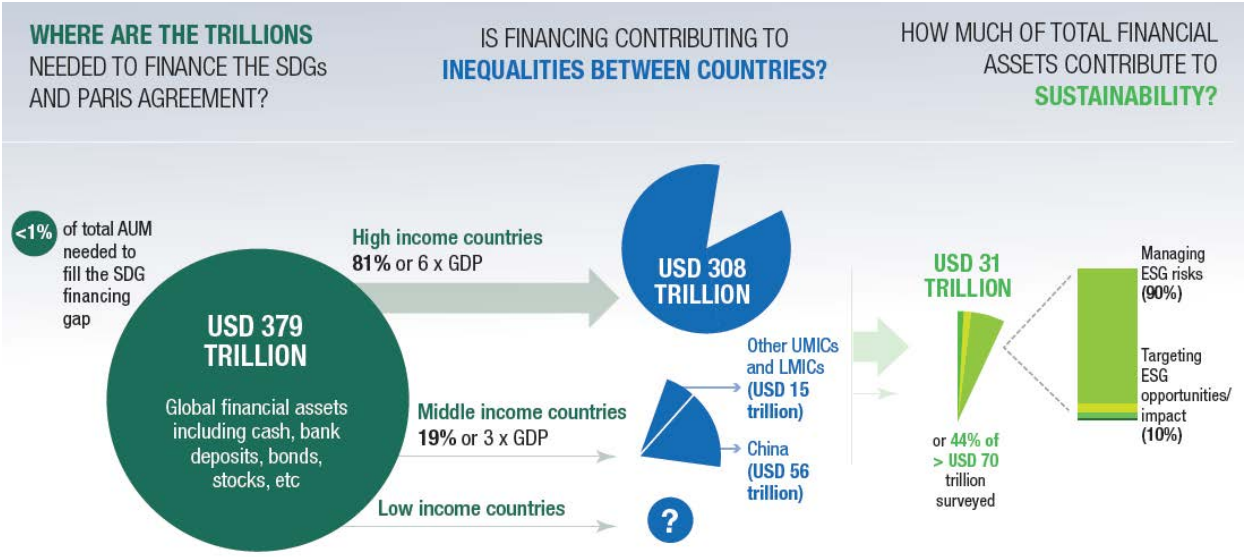
Asset managers play the role of steward and fiduciary to pool savings from large groups of investors including consumers, companies and financial intermediaries. An asset manager that fails in its duty to act in the best interest of its client may be prosecuted, required to make restitution, incur fines and/or suffer severe reputational damage that can prevent them from growing and maintaining their business in the future. Governments regulate fiduciary responsibilities in many ways. For example, some countries do not have a legal definition of fiduciary responsibility; others hold that fund managers must integrate long-term ESG considerations to succeed in their fiduciary responsibility to ensure the long-term value of assets (see Section 3.2.2).

In response to the COVID-19 pandemic asset managers are reviewing how long-term risks are assessed to better ensure financial resilience. For example, BlackRock has placed a greater emphasis on social considerations, like global health, within sustainability frameworks as an area where businesses can distinguish themselves from others on the market. Sustainability-related issues and relevant disclosures are being given a stronger focus in light of the growing impact of these issues on long-term value creation (BlackRock, 2020[10]). Chapter 4 provide actions to be taken by financial intermediaries and governments to strengthen transparency, accountability and incentives for more robust frameworks for sustainable finance.

3.2. Financing is not aligned to promote equality and sustainability

This section examines the SDG alignment of these financial intermediaries and various hurdles to alignment. As illustrated in the infographic 3.1 below, SDG alignment is assessed across two objectives: the mobilisation of resources to leave no one behind and the acceleration of progress across the SDGs, while doing no significant harm to any single objective. It is an ex-ante rather than ex-post assessment of how resources target the global goals.

Infographic 3.1. How much of the trillions in the system are contributing to equity and sustainability?

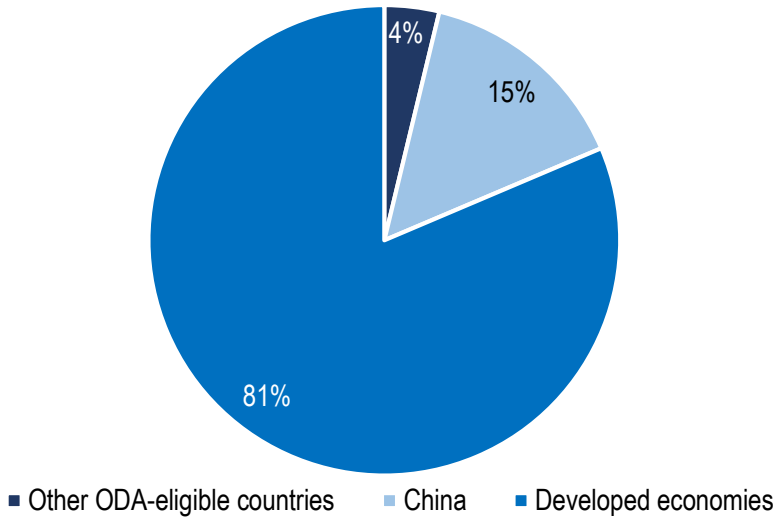


Source: Authors based on Financial Stability Board (2020[1]), *Global Monitoring Report on Non-Bank Financial Intermediation 2019*, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/ and Global Sustainable Investment Alliance (2018[11]), *Global Sustainable Investment Review 2018*, http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf.

3.2.1. Financial assets are not reaching countries most in need

This subsection examines the extent to which global financial assets are unequally distributed among countries. Developing countries hold USD 75 trillion in assets under management out of the total USD 379 trillion, or less than 20% of total global financial assets (Figure 3.4). Despite the large volume of assets under management, the distribution of assets among developing countries is itself uneven and the countries that have the largest financing gaps are not the countries with the largest share of assets. 80% of assets are held by China. China has succeeded in increasing its share of financial assets due to equity market expansion, including several of the largest initial public offerings in emerging markets, and export-led growth. However, only 5.6% of ODA-eligible countries (8 out of 142) are included in reporting, suggesting their lower level of integration than developed countries in the global financial system and the likely negligible size of their financial assets (Financial Stability Board, 2020[12]).

Figure 3.4. Shares of global financial assets are unevenly distributed across countries



Source: Authors based on Financial Stability Board (2020[1]), *Global Monitoring Report on Non-Bank Financial Intermediation 2019*, https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/.

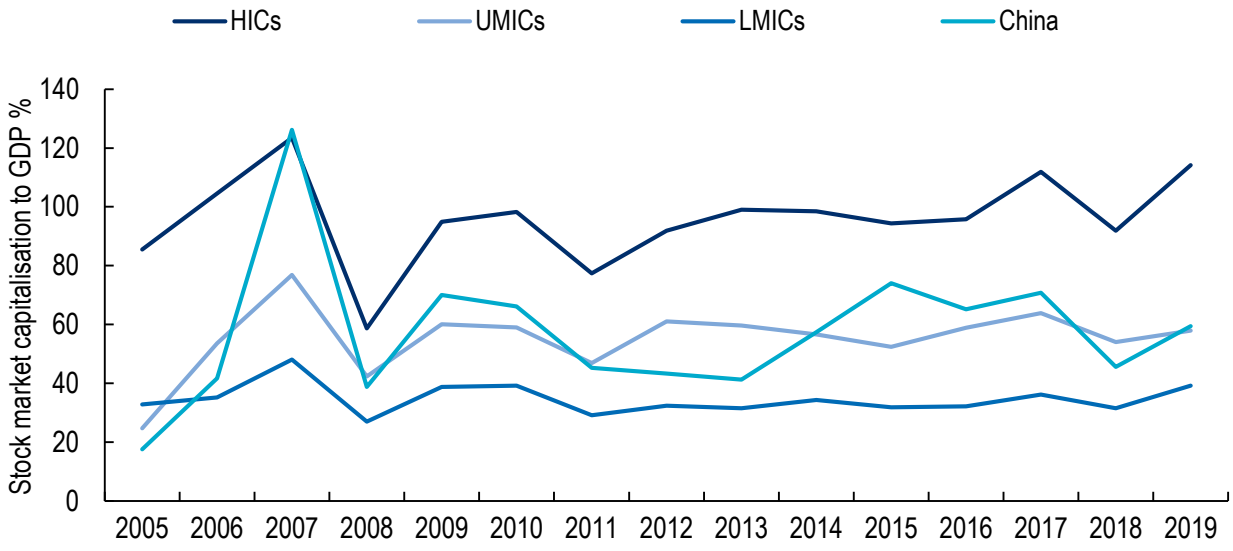
StatLink https://doi.org/10.1787/888934181223

Hurdles to alignment: Depth of domestic financial systems

COVID-19 highlights the need for stable financial reserves to serve as a buffer during crisis and to finance the recovery. While financial sector development in developing countries has increased, many still lack institutional depth. Foreign investors largely drive financial development in developing countries, but foreign investors also bring more volatility than sustainable, local capital markets.

Stock market capitalisation to GDP provides a measure of the size of local capital markets. As shown in Figure 3.5, values varied significantly across country income groups over the 15-year period of 2005-19. The value of stock markets in high-income countries (HICs) recovered after the global financial crisis now nearing pre-crisis levels of over 110% of GDP. In upper middle-income countries (UMICs), excluding China, stock market size has remained stagnant at around 60% of GDP. In lower middle-income countries (LMICs), stock market size has remained below 40% of GDP. Notably, data are unavailable for low-income countries (LICs), again suggesting negligible local capital markets.

Figure 3.5. Stock market capitalisation to GDP by income level over time



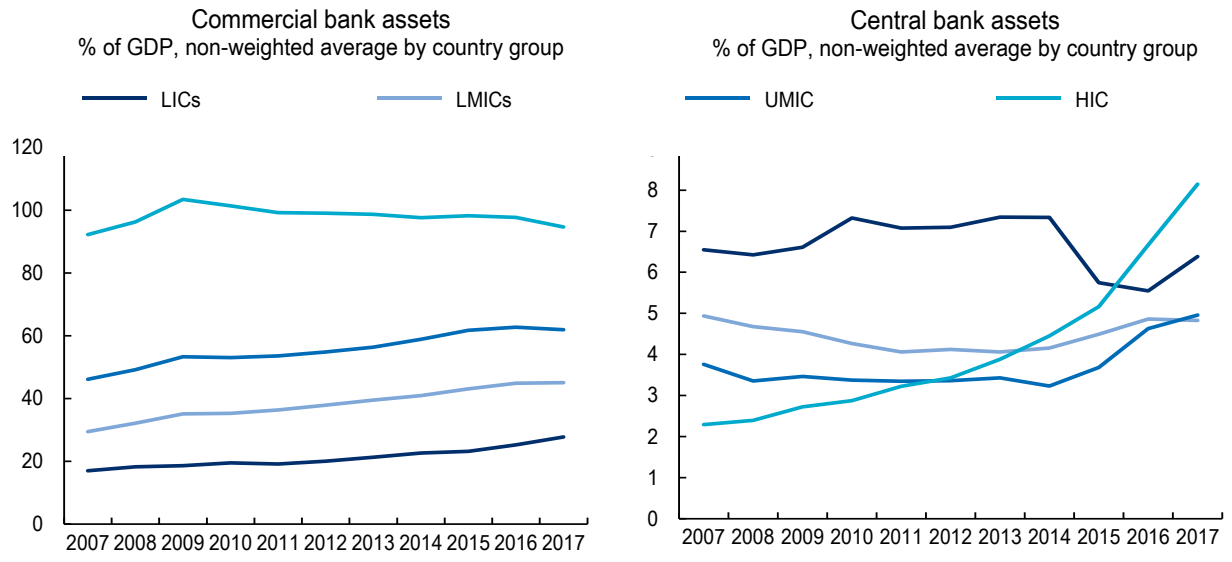
Source: World Bank (2020[13]), *World Development Indicators (database)*, https://datacatalog.worldbank.org/dataset/world-development-indicators.

StatLink https://doi.org/10.1787/888934181242

The banking sector is also needed to expand local capital markets. However, the commercial banking sector's share of GDP is five times lower in low-income countries (roughly 20% of GDP) than in high-income countries (around 100%), as shown in the left panel of Figure 3.6**.** Regulatory banking restrictions imposed by many developing country governments can excessively favour government securities or require conservative portfolio requirements (Bank for International Settlements, 2019[14]).

From 2007 to 2010, central banks accounted for a higher share of GDP in LICs, LMICs UMICs than in high-income countries due to their greater reliance on foreign currency reserves. But, as shown in the right panel of Figure 3.6, the increase in central bank assets as a share of GDP following the global financial crisis in 2009 was limited to high-income countries. Most OECD countries, particularly major reserve currency issuers, had a greater margin to increase central bank reserves following the crisis.

Figure 3.6. Commercial bank assets and central bank assets to GDP

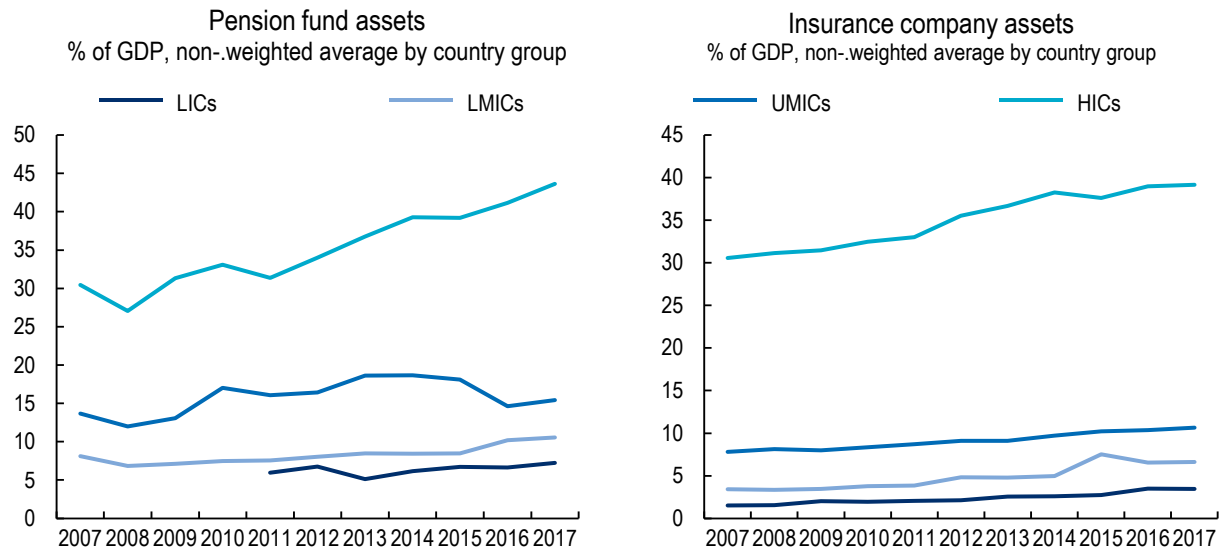


Source: Authors based on IMF (2020[15]), *International Financial Statistics (database)*, https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b (accessed May 2020).

StatLink https://doi.org/10.1787/888934181261

As Figure 3.7 illustrates, in 2017, pension funds represented less than 20% of GDP in developing countries and insurance companies less than 15%, compared to nearly 45% and 40% respectively in high income countries. In 2017, only one-third to one-half of the global population were covered by essential health services. Large informal sectors prevent financial systems from providing social protection**.** Informal employment represents 90% of total employment in low-income countries, 67% in middle-income countries and 18% in high-income countries (ILO, 2020[16]). A lack of access to social protection exacerbates the vulnerabilities of informal economy workers and their families, particularly during COVID-19 lockdowns (OECD/ILO, 2019[17]).

Figure 3.7. Pension fund and insurance company assets to GDP by income category, 2007-17



Note: Data coverage for both indicators drops in 2017. To avoid a bias from this sudden change of sample composition, the 2016 value for a country is used when the 2017 value is not available.
Source: Authors based on World Bank (2020[13]), *World Bank Development Indicators database,* https://datacatalog.worldbank.org/dataset/world-development-indicators (accessed May 2020).

StatLink https://doi.org/10.1787/888934181280

Hurdles to alignment: Inefficiency of domestic and international financial and taxation systems

Inefficiencies in the global system, among them illicit financial flows and remittance transfers, drain resources domestically. The unequal geographic distribution of financial assets also is linked to inefficiencies in domestic and international financial and taxation systems. These inefficiencies facilitate the outflow of assets and profits from lower-income countries. Aggressive tax avoidance by businesses and wasteful tax incentives by governments can further limit the ability of low-income country governments to align spending and economic activity to the SDGs.

Illicit financial flows (IFFs) are a significant cause of financing leakages in developing countries. Defined as money illegally earned, transferred or used, IFFs are closely associated with and often stem from illegal acts such as tax evasion, corruption, trade mispricing, money laundering and terrorist financing. The exact size of these flows is disputed, but there is broad consensus that a significant share of capital may be illicit. It is estimated that, each year, more than USD 1 trillion is paid in bribes worldwide and that anywhere from USD 20 to 40 billion is stolen by public officials (OECD/The World Bank, 2014[18]).

It is also estimated that a higher percentage of resident assets are held off-shore from lower-income than from high-income countries, due in part to tax evasion and avoidance. While some financial assets held off-shore are legitimate, a significant proportion are thought to be illicit and/or undeclared for tax purposes. Evidence suggests that at least 44% of African financial wealth is held offshore in tax havens, with tax losses estimated at EUR 17 billion annually (OECD, ATAF, African Union, 2020[19]). Aggressive tax avoidance by multinational enterprises is estimated to cost countries as much as USD 240 billion annually, and developing countries are disproportionately affected because they rely more on corporate tax revenues than do developed countries. Efforts to reduce the volume of illicit financial flows are discussed in Chapter 4.

Another cause of SDG misalignment resulting from the tax system is the prevalence of wasteful tax incentives. Many developing countries provide significant tax incentives that are poorly designed, with the result that tax revenues are limited and investments are not aligned to the SDGs and Paris Agreement commitments. According to surveys of investors, tax incentives are a low priority in investment decisions, with redundancy rates exceeding 70% in 10 of 14 surveys analysed by the International Monetary Fund (IMF et al., 2015[20]). Such redundant or wasteful tax incentives are essentially a transfer from a government to the companies.

Persistently high remittance transfer fees further divert resources from households in developing countries. As shown in Chapter 2, remittances are the largest individual source of external finance to ODA-eligible countries (excluding China), surpassing ODA several times over. However, the cost of sending remittances to ODA-eligible countries remains high – between 6.8% and 7% on average in 2017-19 or between USD 30.26 billion and USD 31.15 billion annually. A reason for the persistently high cost of transferring remittances may be lack of access to lower-cost options, particularly mobile banking options, as well as low competition among a small number of providers of remittance transfer services and broader anti-money laundering restrictions (World Bank, 2020[21]).

3.2.2. Common standards and transparency to define sustainable finance are lacking

This subsection considers how to assess and measure the amount of financing that can be considered sustainable. A growing number of public initiatives seek to develop common language to label and define sustainable finance and investment. Among these are the SDG alignment framework of the Group of Seven (G7), OECD and United Nations Development Programme; the EU taxonomy for sustainable activities; and the UN-led Global Investors for Sustainable Development Alliance.

At the same time, globally, professionally managed ESG portfolios valued at more than USD 30 trillion incorporated some form of sustainability consideration globally in 2018 – an increase of 34% in just two years. This figure may overestimate the value of sustainable investments, however, and should be treated with caution given that fund managers use some measures that lack transparency and intentionally inflate sustainability performance (Boiardi, 2020[22]).

The proliferation of hundreds of different ESG rating agencies has led to different measurement standards. The construction of ESG scores, for example, can lead to vastly different results for the same company due to a lack of common definitions and reliable data. Fund managers differ as to which companies meet environmental, social and governance standards (Esty and Cort, forthcoming[23]). However, without a common comparable language, fragmented criteria and standards for non-financial risk criteria, the legitimacy of ESG and other sustainability metrics is reduced. For example, the OECD Business and Finance Outlook finds that a high environmental score accorded by some ESG ratings can correlate positively with high carbon emissions if other environmental factors are given greater weight (OECD, 2020[24]).

A wide array of financing activities and strategies currently comprise the spectrum of what is considered sustainable finance, ranging from funds that seek to do no harm (i.e. mitigate risks) to those that seek positive impacts based on thematic or geographic focus. In the broadest sense, sustainable finance includes both a do no harm objective and impact-based financing (Figure 3.8). Many of these categories overlap. Private sector actors rely on ESG criteria to assess social and environmental risks. It is important to note that an assessment of ESG risks is not an assessment of how investments actually impact environmental and social issues.

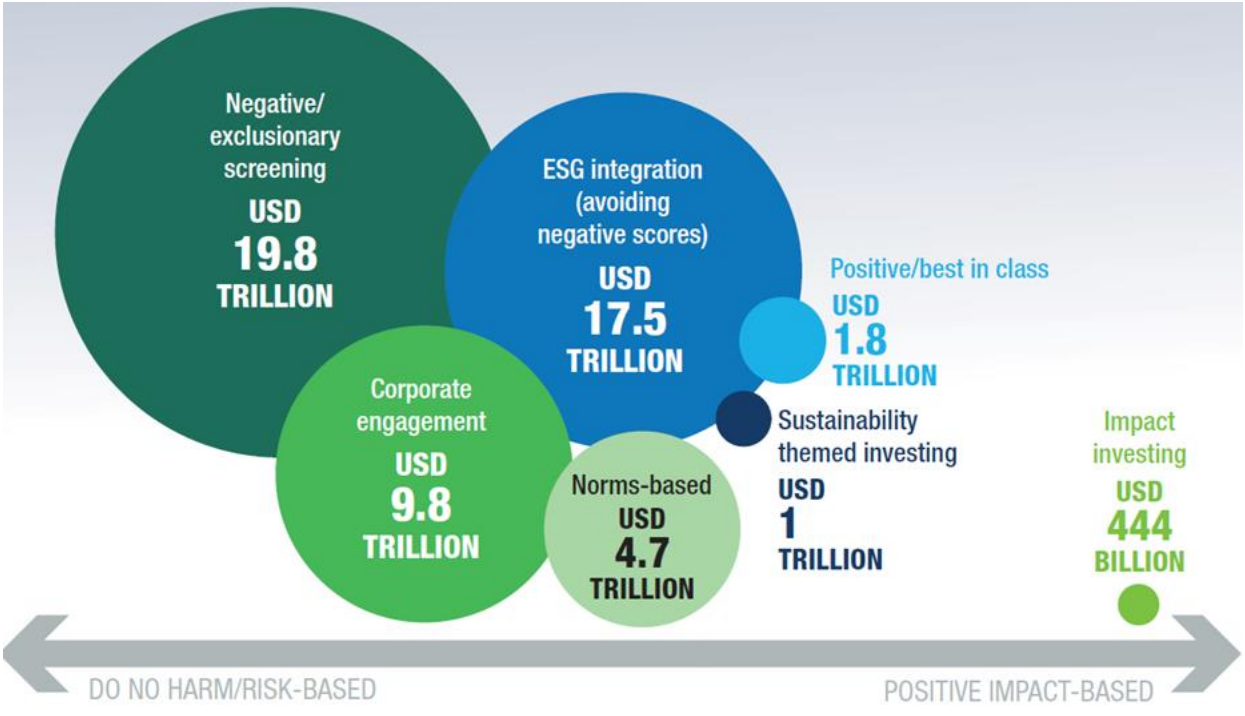
- Negative or exclusionary screening is the largest category of sustainable finance and is estimated at USD 19.8 trillion, which suggest this is the most accessible sustainability strategy.
- ESG integration is the next largest category, estimated at USD 17.5 trillion and including the integration of environmental, social and governance factors into financial analysis.

- Other categories include corporate engagement and shareholder action, estimated at USD 9.8 trillion, and norms-based screening, estimated at USD 4.7 trillion and including screening based on norms such as the UN Global Compact, the OECD Guidelines for Multinational Enterprises and the International Labour Organization conventions, among others. Many of these strategies overlap.

Roughly 10% of sustainable finance, or USD 3 trillion, is defined as seeking to achieve positive impacts. These forms of financing are more challenging to implement. They include positive/best-in-class screening (USD 1.8 trillion); sustainability-themed investing (USD 1 trillion), consisting mainly of green bonds; and sustainability-themed equity funds, social bonds and COVID-19 response bonds, and impact and/or community investing (USD 444 billion) (UNCTAD, 2020[25]).

However, impact investing is the only form of financing that requires an actual assessment of positive impact and is also the smallest category (UN DESA, 2020[26]). Increasingly public and private initiatives promote the 2030 Agenda as a common impact assessment framework to guide investors in directing financing towards achievement of the global goals. A survey of the 75 largest asset managers found that only 48% of investors are developing an approach to the SDGs (ShareAction, 2020[27]).

Figure 3.8. Few types of sustainable investment are based on non-financial impacts



Note: The amounts in the figure do not add up to the estimated USD 30-trillion estimate sustainable investments due to double-counting across several categories.

Source: Authors based on Global Sustainable Investment Alliance (2018[11]), *Global Sustainable Investment Review 2018*, http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf; European Sustainable Investment Forum (2018[28]), European SRI Study 2018, http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf; Responsible Investment Association Australasia (2019[29]), *Responsible Investment Benchmark Report: Australia 2019*, https://responsibleinvestment.org/wp-content/uploads/2019/07/RIAA-RI-Benchmark-Report-Australia-2019-2.pdf.

3.3. The coronavirus (COVID-19) pandemic reinforces the economic case for SDG alignment

The global pandemic shows that SDG alignment is an economic imperative. Like climate change, the pandemic recognises no borders. It is a global threat, and as long as the virus persists in one country, it remains a threat to all countries. The risks that result from a global health crisis and subsequent lockdowns – economic recession, rising poverty levels, unemployment and debt distress – are far reaching. This section explores how accounting for environmental and social risks can secure the value of assets over the long term, and how investing in SDG alignment is an opportunity to build resilience in the markets.

3.3.1. Integrating environmental, social and governance risks is essential to preserve the long-term value of assets

Uncertainty and volatility of markets ultimately lower the long-term value of assets. Following the 2015 Paris Agreement on climate change, and before the COVID-19 crisis, green finance was gaining prominence as a means to align finance towards more sustainable development. The pandemic, though, has created a level of economic uncertainty reminiscent of the 2008-09 global financial crisis. Against this backdrop, a wide range of actors – citizens, clients and shareholders alike – are calling for the integration of not only climate-related risks but also risks related to global health issues, human rights abuse and gender equality, to name but a few.

Climate change is well understood by investors as a systemic risk to the global economy that undermines the ability of the financial system to deliver long-term returns. A survey of 231 Group of Twenty (G20) economists from finance ministries and central banks finds that respondents saw a green route out of the crisis as also being highly economically effective (Hepburn et al., 2020[30]). More than 100 countries have already adopted carbon neutrality goals for 2050. Investors are coming under increasing pressure to measure and disclose their exposure to climate-related risk. Among the reasons:

- As temperatures rise, economic damage becomes more costly. On a global scale, damages from global warming could reach USD 30 trillion per year by 2100, representing more than 4% of global GDP. Some scenarios project as much as a 50% loss of annual GDP by 2100 due to temperature increase (Ens and Johnston, 2020[31]).
- Fossil fuel subsidies cost upwards of USD 4.7 trillion in 2019, or 6.3% of global GDP (IMF, 2019[32]). Fossil fuel subsidies act as negative carbon price signals. In 44 OECD and G20 countries, an estimated USD 178 billion was spent on fossil fuel in 2019 (OECD, 2020[33]).[5] In addition, a conservative estimate places average commitments of official development finance for upstream and downstream fossil fuel activities at USD 3.9 billion annually over 2016-17 (OECD, 2019[34]).
- Renewable energy is becoming more affordable. Wind and solar unit prices have more than halved since 2011. It is now cheaper to build new solar and wind farms than to run existing coal plants.

Portfolios that seek to overcome environmental, social and governance risks can outperform the broader market over the long term and are registering lower losses in the COVID-19 era. ESG-rated funds often outperform non-ESG funds, suffer less volatility and experience lower losses. During the COVID-19 period, all three emerging market sustainable index funds outperformed the iShares Core MSCI Emerging Markets ETF by 1.58 percentage points (Freyman, 2020[35]). In a survey of 3 750 investors across 15 countries, 81% of respondents indicated they view COVID-19 as a risk for markets, while 79% also view COVID-19 as presenting opportunities (UBS Wealth Management, 2020[36]). New issuances of COVID-related bonds could further bolster the social bond market (Hube, 2020[37]).

3.3.2. SDG alignment provides opportunities to build resilience in the markets

The SDGs provide the blueprint to build back better through an economic recovery that benefits people and planet. Today, world leaders are signalling their commitment to invest in safeguards against future disasters while also promoting a more sustainable and inclusive future (OECD, 2020[38]). A window of opportunity for a "great reset" in favour of broader SDG alignment has emerged (Schwab, 2020[39]).

However, resources borrowed by governments today should not contribute to widening inequalities across countries. OECD economies had more capacities to react (Chapter 1), and they injected 9% of their collective GDP in the recovery, while low-income countries only injected 1% of their GDP in stimulus packages. Developing countries face challenges to finance a response to COVID-19. High debt levels will increase if lockdowns are again needed in the future. The potential USD 700-billion decline in external private resources to developing countries, outlined in Chapter 2, raises the question of whether these countries will slip further behind.

However, responses to the crisis must not sideline investment in the SDGs. Before the pandemic, countries were taking steps to make SDG-conscious investments. For instance, more than 16% of all fiscal stimuli related to the global financial crisis (a total of more than USD 500 billion) were directed at green activities (Agrawala, Dussaux and Monti, 2020[40]). In addition, the United Kingdom began formulating restrictions for pension fund trustees who disregard the long-term financial risks or opportunities from ESG. To receive public finance, businesses in Canada are required by the Canadian government to publish annual, climate-related disclosure reports consistent with the Task Force on Climate-related Financial Disclosures – that describe how they manage climate risks in corporate governance.

Nonetheless, post-COVID-19 economic recovery strategies, at least as now envisioned and implemented, do not rise to the step-change needed. Countries' commitments to the 2030 Agenda also collectively fall short of what is needed to shift towards a pathway consistent with carbon neutrality (OECD, 2020[41]). In addition, there is unfinished business from the global financial crisis including shadow banking, or non-bank financial intermediation, which represents more than half of the financial system (Adrian and Jones, 2018[42]).

Pandemic recovery must harness the broader SDG market opportunities. The SDGs create USD 12 trillion in private sector investment opportunities annually (10% of GDP), mainly in food and agriculture, cities, energy, and materials. Health and well-being and could generate up to 380 million jobs. Achieving SDG 5 (gender equality) alone could unlock up to USD 28 trillion for global GDP by 2025 (Business and Sustainable Development Commission, 2017[43]).

Following the pandemic, governments can create incentives for investment and job creation in SDG-aligned sectors. Some examples include:

- **Health** - For every USD 1 invested in preparedness, the average return was USD 2.10, with some projects providing returns upwards of USD 18.70 (Boston Consulting Group, 2015[44]). COVID-19 has accelerated public spending on health research to design a vaccine and prevent future pandemics.
- **Sustainable infrastructure** - Globally, an estimated USD 59 trillion in infrastructure investment will be needed over the next 15 years to replace aging facilities and keep up with population growth and economic development (Citigroup, 2018[45]). Implementation of the International Energy Agency's Sustainable Recovery Plan could create roughly 9 million jobs, including jobs related to improving energy efficiency as well as jobs in the electricity sector, particularly in grids and renewables in three years (IEA, 2020[46]).
- **Tourism** – In OECD countries, tourism represents an estimated 4.4% of GDP; domestic tourism represents 75% of the sector (OECD, 2020[47]). Governments across the world are seeking to rebuild tourism infrastructure to rebound faster and reassure travellers to boost their post-COVID-19 recovery. Conditionality of financing can further help reduce carbon emissions in this sector.

- **Digitalisation** – Following the pandemic, remote working will become more normalised and online commerce will continue to grow, presenting new possibilities. In recognition of the potential, the European Commission has introduced the European Recovery Plan, which includes EUR 750 billion for investments in digital infrastructure (e.g. 5G networks), artificial intelligence, the circular economy, etc.

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Notes

[1] Financial intermediaries are defined as institutions (banks, institutional investors, asset managers, etc.) that liaise between different actors to facilitate financial transactions, transforming the savings of individuals into financial assets (for the saver) and liabilities (for the borrower).

[2] The SDG financing gap is measured on a flows basis as an annual investment gap and is useful to assess recent developments in financing. This chapter examines a complementary measure – the stock of global financial assets. The measure of stocks presents the accumulation of holdings of assets and liabilities at a given time and is better suited for structural analysis of financial risk. For example, climate-related risk assessment and disclosure, notably championed by the Task Force on Climate-related Financial Disclosures, relies on a stock-based assessment of climate-related financial risks.

[3] Financial auxiliaries hold USD 1 trillion in assets. They are corporations or quasi-corporations that take part in activities such as insurance brokerage and investment advice and corporations providing infrastructure for financial markets.

[4] Financial assets are defined as intangible or non-physical assets whose value is derived from a contractual claim. The four main types of instruments are bank deposits, stocks, bonds and loans.

[5] It is also important to recognise the potential trade-offs of a low carbon transition. In the context of COVID-19 and historically low fuel prices, governments are increasingly looking to cut fossil fuel subsidies to raise resources for spending. If and when fuel prices increase again, the question will arise as to how to ensure public support for subsidy cuts that transfer costs to households. Many low-income households may not be able to absorb higher fuel costs.

4 Actions for alignment

This chapter calls for concrete actions to align financing in support of the Sustainable Development Goals (SDGs). It examines how OECD countries, development finance providers and other relevant actors can contribute. It explores how to unleash more of the potential of the Addis Ababa Action Agenda (AAAA) for SDG alignment across two sets of policy actions. Building Block 1 details how to increase the quantity and quality of resources to mobilise more financing and ensure resources achieve greater sustainable development impact. Building Block 2 is a series of actions to strengthen the integrity and efficiency of markets and to engage a broader set of financial actors beyond the traditional financing for sustainable development landscape to complement the AAAA and support SDG alignment. These building blocks provide analytical support for the SDG Alignment Framework that the OECD will launch with UNDP under the mandate of the French G7 Presidency later this year.

In Brief

Five years after their adoption, the 2030 Agenda and the Sustainable Development Goals (SDGs) remain the best blueprint to successfully rebuild after the coronavirus (COVID-19) crisis, just as the Addis Ababa Action Agenda (AAAA) is the best framework to finance the goals. The pandemic, however, is exacerbating the disparity of resources between developed and developing countries, and this widening gap in financing for sustainable development compounds the risk of further setbacks in achieving the global goals. Business as usual and development co-operation as usual will not curb the trend of increasing inequalities and misalignment.

This chapter focuses on two building blocks of actions that can help address the unprecedented financing challenges of the COVID-19 era: the traditional financing for development landscape described in Chapter 2 and the new actors beyond this landscape described in Chapter 3. Both building blocks are required to shift the trillions and align resources with the SDGs. This means mobilising finance for equality – leaving no country behind – and for sustainability – leaving no one SDG behind.

Domestic resources remain the most sustainable long-term source of financing for sustainable development. In the context of growing fiscal constraints, developing countries require support for domestic resource mobilisation and tax reform to increase public revenues and to reduce domestic financing leakages. Deeper international co-operation is needed to counter tax avoidance and emerging tax issues (e.g. taxing the digital economy), including enhanced inclusion of developing countries in international tax discussions. Development finance providers must also play their role to increase efforts to maintain official development assistance budgets and avoid the collapse of external financing, including private investment. These actors must scale up innovative finance approaches and tools, such as blended finance and COVID-19 and SDG bonds, and do more to promote digital financial services. Debt suspension and relief should be used as levers to promote greener and more resilient growth in developing countries.

With a debt crisis looming, development finance providers also must do more to ensure the positive development impact of all resources over the long term (align for sustainability). At the national level, demand for and supply of SDG financing needs to be better matched. At the global level, the international community must build on and accelerate its work to develop a framework for assessing national SDG financing needs.

The emergence of new actors along the investment chain, and the proliferation of multilateral initiatives on financing for sustainable development, are creating new risks to mitigate but also opportunities to be seized. Three major issues need to be tackled in order to promote alignment, ensure market integrity and efficiency, and grow the sustainable finance market: transparency, accountability and incentives. Actions needed include: identifying SDG metrics that are fit for the private sector, helping companies more clearly define their sustainability objectives, and phasing out policies that create barriers to SDG alignment.

The United Nations system and its partners began work before the crisis to make the case for SDG alignment. This report provides analytical support and recommendations to promote an emerging common framework developed jointly by the OECD and the United Nations Development Programme to bring all sources of financing along the investment chain behind the SDGs.

4.1. Unleash the potential of the Addis Ababa Action Agenda to finance sustainable development in the coronavirus (COVID-19) era

The sustainable development agenda is at a tipping point. Action to chart a greener, more inclusive and more resilient pathway is needed, today, before development and climate setbacks become irreversible. Despite hard-fought progress to deliver a better future for people, the planet and prosperity over the past decade, the distance to the SDGs is rapidly growing as the pandemic and climate-related events send shockwaves that derail collective efforts. Millions of people are falling back into poverty and hundreds of millions more are losing their jobs and livelihoods (Chapter 1). The cumulative impacts of the pandemic in 2020 – increasing the gap to finance the SDGs - are a wake-up call. Now, the international community must accelerate actions to shift the additional trillions needed to rebuild and help achieve the 2030 Agenda.

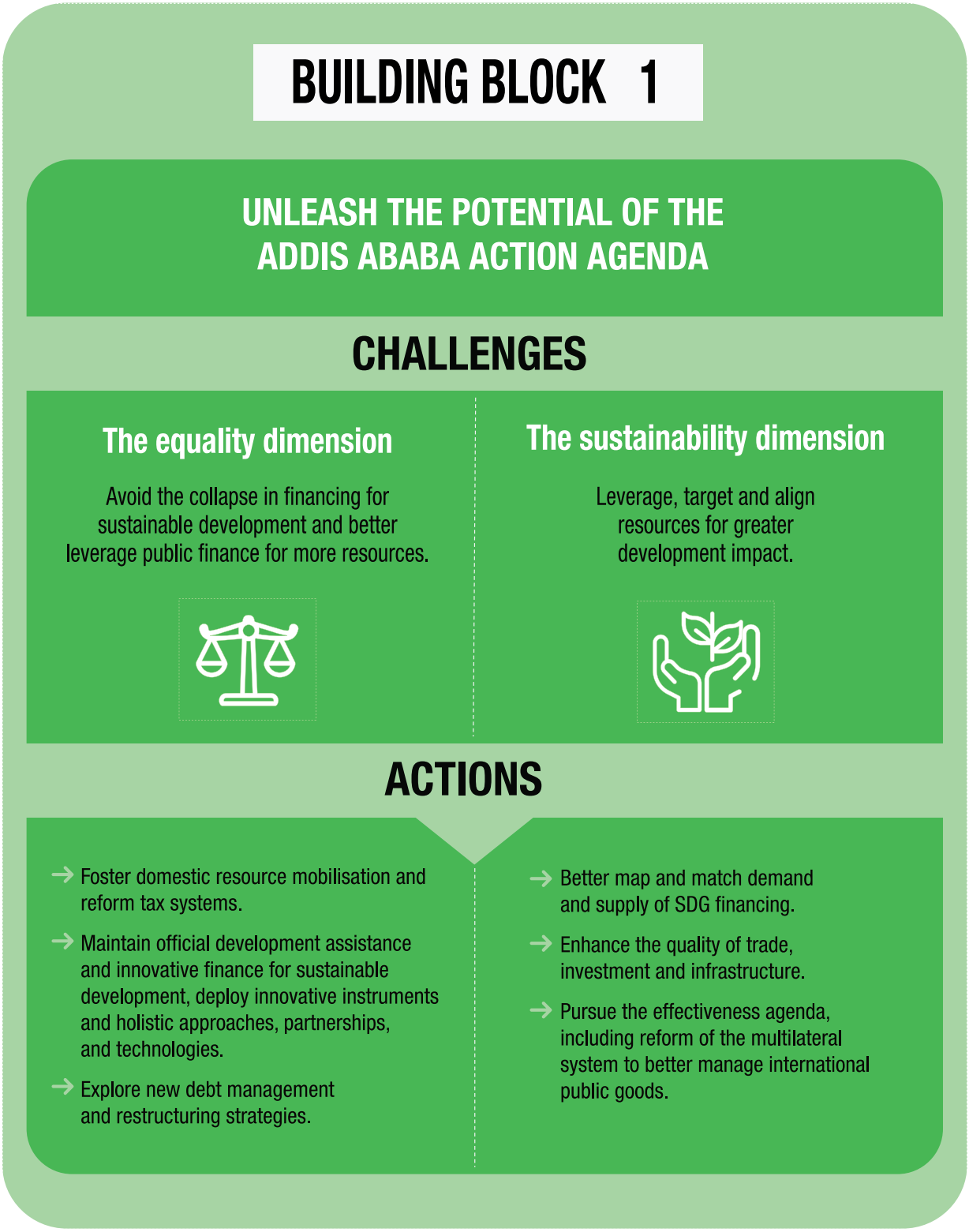
Resources are not being directed to where needs are greatest. This will lead to SDG setbacks for all countries. OECD countries have mobilised trillions of dollars for domestic COVID-19 recovery, yet ODA budgets are at risk of shrinking. Solidarity between countries is needed to address the unprecedented financing constraints in developing countries. Development finance (i.e. ODA and other official flows) is an investment in the resilience of economic systems. Health, refugee and climate crises are among the global challenges that require development finance. Their negative spill over effects have no borders, and failure to tackle these crises in one country could increase the cost and threaten the capacity to progress in other countries.

Five years after their adoption, the 2030 Agenda and the SDGs remain the best blueprint to successfully build back better after the crisis, and the Addis Ababa Action Agenda remains the best framework to finance the goals. These agendas set out the ambitious strategy needed for a more holistic approach to finance sustainable development. The 2019 *Global Outlook on Financing for Sustainable Development* made specific recommendations to better mobilise (quantity) and align (quality) all available public, private, domestic and international resources in support of sustainable development. With all sources of financing under stress, none will be sufficient on its own to ensure that developing countries surmount the crisis. The holistic approach to financing development of the AAAA offers several levers that should be better exploited to overcome the inequalities. The trillions of dollars currently misaligned in the system, for instance, represent existing resources that could be shifted to where the needs are most acute – both to avoid the collapse of financing in developing countries and to build back a better, more sustainable and resilient system.

Aligning finance to the SDGs requires a dual assessment. One is the equality assessment, in which finance should flow to where the needs are greatest to mitigate the risk of negative spill overs such as future pandemics, refugee crises and increasing carbon emissions in developing countries. The other is the sustainability assessment, in which finance should do no harm and positively contribute to the SDGs. Both assessments are required to strengthen the resilience of the system (Chapter 3). Policies should aim to increase the efficiency of markets and remedy their failures, including leaving no one and no goal behind.

Sections 4.1.1 and 4.1.2 outline an ambitious strategy for development finance providers to unleash the potential of the AAAA and address first equality (quantity) and then sustainability (quality) aspects of SDG alignment. This strategy is summarised in Figure 4.1.

Figure 4.1. Actions for alignment: Building Block 1



Source: Authors

4.1.1. Better leverage public financing to increase its quantity, avoid the collapse and combat inequalities

Developing countries face a risk of external finance collapse (USD 700 billion) that surpasses the drop following the global financial crisis by 60% (Chapter 2). These growing financial inequalities in developing countries will magnify the effects of the crisis globally, creating cascading setbacks to collective progress towards the SDGs. For example, if developing countries experience future COVID-19 or other outbreaks due to a lack of sufficient healthcare and social protection, OECD countries could find themselves at greater risk of subsequent waves of contamination and migration. Investing upstream to prevent future outbreaks is an investment to reduce these risks and potential negative spill over effects.

Developing countries will face a longer and slower recovery path from the current crisis than developed countries (Chapter 1). Spending by advanced economies in response to the pandemic represents 9% of their collective gross domestic product (GDP). Developing countries have less capacity to respond, however. Middle-income countries injected about 3% of GDP, and low-income countries only about 1% of GDP, in stimulus packages, representing a USD 1 trillion deficit in the magnitude of spending in response to the pandemic relative to high-income countries. As developing countries' capacities to finance emergency and recovery responses are increasingly constrained, debt levels have surged, reducing fiscal space even further. For those most in need and heavily reliant on external finance, there is a risk of insufficient resource inflows due to divestment linked to both economic uncertainty and diversion of resources to feed expensive stimulus packages in wealthier countries.

In the face of unprecedented economic and financing constraints, development finance can provide support to developing countries to staunch the bleeding of resources in the short term. All possible efforts must be made to foster domestic resource mobilisation and tax reform to improve public finances and reduce leakages (e.g. illicit financial flows); achieve ODA commitments and leverage its catalytic potential; mobilise additional resources using innovative finance; and reduce debt distress and explore more sustainable debt management strategies. The following sub-sections explore these topics in turn.

Support domestic resource mobilisation and tax reform to improve public finances

Domestic resource mobilisation remains the most sustainable long-term source of financing. While revenues are likely to fall during the pandemic, and the immediate focus in most countries will understandably not be on tax increases, it is important to identify both the potential sources of increased revenues, and the processes to facilitate collecting them. Domestic financing leakages are an obvious place to start, not least as tolerance of tax avoidance and evasion is rapidly evaporating in response to the pandemic. Such leakages drain significant resources from developing countries that could be used to respond to the pandemic and build more sustainable public finances. Chapter 3 showed that aggressive tax avoidance by multinational enterprises is estimated to cost countries globally as much as USD 240 billion annually, and developing countries are disproportionately affected because they rely more on corporate tax revenues than do developed countries. Tax base erosion and profit shifting (BEPS) is therefore a significant problem that requires international action, including by donors to address.

International co-operation is vital to counter tax avoidance as many of the methods used to avoid and evade taxes make use of mismatches between tax systems, or entail shifting profits and/or assets overseas. There are a growing range of bodies, tools and instruments for international tax co-operation The Inclusive Framework on BEPS brings together 137 countries, on an equal footing, to agree and implement standards to counter corporate to avoidance, while the Global Forum of Transparency and Exchange of Information for Tax Purposes consists of 161 members committed to implementing common standards on transparency and exchanging information to combat tax avoidance and evasion. Developing country engagement in these forums, and associated multilateral instruments is growing, for example the number of African country members of the Global Forum on Transparency and Exchange of Information for Tax Purposes increased from 4 in 2009 to 32 in 2020 (OECD, 2019[1]), while exchange of information

networks have also grown, from 913 relationships created by African countries in 2014 to 3262 in 2020. The speed of integration is not as fast as it could be, particularly among least developed countries, where many are not yet participating in international tax co-operation instruments (UN IATF, 2020[2]); further efforts are therefore needed by all to support and encourage all countries to benefit.

There are a range of actions that OECD countries can take to support developing countries improve their ability to tax cross-border activity. Continuing to expand developing country access to offshore information is vital. Successfully taxing cross-border activity often requires access to information held offshore. The international tax transparency standards are putting an end to bank secrecy globally. Over 100 countries are already implementing the new standard on Automatic Exchange of Financial Account Information. This has resulted in the identification of over EUR 100 billion in additional revenues. As a result of this work, information on 47 million accounts worth EUR 4.9 trillion has been exchanged and offshore bank deposits have fallen by over USD 410 billion over the last decade. Not all developing countries have access to this valuable source of information however, further actions are needed to ensure more developing countries can also benefit fully from this enhanced co-operation, including building the political will to put the necessary measures in place, and technical assistance to support implementation.

Information exchange is also crucial for tackling illicit financial flows, but restrictions need to be removed to make full use of it. In addition to helping identify tax avoidance and evasion the information available through tax information exchange agreements could also be valuable in identifying illicit financial flows, including corruption and money laundering. Currently however the information is restricted to use only for tax purposes, limiting its value in addressing other financial crimes. Most information exchange agreements include provisions to extend the use of information on agreement between countries, activating such provisions could provide a quick and effective way to support the campaign against illicit financial flows.

Modernising and adjusting tax systems to a digital world can also benefit from international co-operation. The OECD, through the OECD Global Forum on value added tax (VAT) (comprising over 100 countries), has developed standards and solutions to address the VAT challenges of the digitalisation of the economy, which include the risk of creating an uneven playing field if non-resident companies are able to avoid charging VAT. Over 50 countries have implemented the standards on cross-border supplies of digital services, raising significant revenues (for example South Africa has raised over ZAR 5 billion (approx. USD 276 million) between June 2014 and September 2019. Developing countries can benefit from the experience already gained in implementing these standards, not least as all the main digital platforms, which are vital partners for implementation, are now already familiar with the standards.

Taxing the profits arising from the digitalising economy is a more challenging task, where the 137 members of the Inclusive Framework are currently negotiating new standards based around two pillars the first would create a new taxing right for market jurisdictions, whilst looking to simplify the processes for taxing the profits from certain routine functions of MNEs. The second pillar would establish a global minimum rate of tax, to reduce the incentive for companies to adopt aggressive tax avoidance strategies. Both of these pillars offer potential gains for developing countries. While the impacts are difficult to model the economic impact analysis suggests the combined effect of both pillars could be around 4% of global corporate income tax revenues (up to USD 100 billion). There is also a significant cost to not implementing an agreed multilateral solution, as unilateral measures could lead to retaliatory tax and trade measures, which could cost up to 1% of global GDP (OECD, 2020[3]). All countries therefore need to work together on resolving the remaining political challenges, including accommodating developing country priorities.

Beyond tax co-operation and exchange of information, development finance providers can provide capacity building and peer-to-peer exchange to raise additional revenues in developing countries. As part of the Addis Tax Initiative (ATI), launched in 2015, donors committed to doubling funding to support domestic resource mobilisation in the period 2015-2020, yet by the end of 2018 ATI members were less than halfway to meeting the target with commitments reaching USD 275 million (from the 2015 level of USD 182 million).

Ensuring continued funding beyond the end of 2020 will be vital to enable further capacity building. Peer networks, e.g. through Regional Tax Organisations, have been shown to be especially valuable, and need to be encouraged further. Tax Inspectors Without Borders (TIWB) is a peer-to-peer forum bringing in expertise which has helped raise over half a billion dollars in revenues in supporting audits of MNEs. TIWB programmes provide a significant return on investment and represent excellent value for money. On average, USD 70 in additional tax revenues have been recovered by Host Administrations for every dollar spent on TIWB operating costs between 2012 and 30 June 2020 (OECD/UNDP, 2020[4]). Expanding the TIWB approach beyond auditing, including to supporting investigating tax crimes, has significant potential, all countries with established capacity should consider temporarily releasing expertise to support such initiatives. In addition countries that have already digitalised their tax administrations should be willing to support other countries through the process of digitalisation, which has become even more important as the pandemic has shown how effective digital administration is part of an effective response to such shocks.

Efforts to repatriate funds are an important tool to help avoid leaks in the domestic resource base of developing countries. Many developing countries lack the judicial capacity necessary to produce legitimate requests for asset recovery. The Financial Action Task Force is currently working to identify mechanisms, laws, structures and other approaches to overcome the challenges in asset recovery cases and ensure effective asset recovery operations. In parallel, OECD countries can take actions to reduce the incentives and opportunities from channelling illicit financial flows through their own territories.

Redouble efforts to maintain ODA volumes

With the outbreak of COVID-19, ODA remains the bedrock of international co-operation and is vital for poorer and fragile developing countries. In 2019, ODA totalled USD 153 billion, or ratio of ODA to gross national income (GNI) of 0.31%, and reaches hundreds of developing countries. Especially in the context of COVID-19, ODA has played a key role, targeting social sectors such as healthcare, which is particularly important in terms of financing vaccines and other treatments - related to COVID-19 as well as clean water, sanitation and education, which often struggle to attract private investment. In February 2020, the World Health Organization published a Strategic Preparedness and Response Plan that outlined the main operational needs to fight the pandemic, estimating the plan's funding requirements at USD 675 million. Development finance providers contributed to this Plan by providing more than USD 125 million (OECD, 2020[5]).

Development finance providers must make every effort to maintain ODA budgets as GDP growth contracts. DAC members agreed to "strive to protect ODA budgets" during the COVID-19 crisis (OECD DAC, 2020[6]). Nonetheless, given acknowledged pressure on DAC members' own budgets, the overall level of ODA could decline in 2020. The OECD calculates that if DAC members keep the same ODA-to-GNI ratios as in 2019, total ODA could decline by as much as USD 11 billion to USD 14 billion, depending on a "single-hit" or "double-hit" recession scenario for member countries' GDP (OECD, 2020[7]). Political will is key to safeguarding ODA. The OECD DAC High Level Meeting in November 2020 is a critical opportunity for development finance providers to discuss how to meet their commitments during the crisis.

Despite the challenging economic context, several DAC members are taking a leadership role to redirect resources to developing countries to combat the pandemic. For example, through its Team Europe initiative that builds on existing programmes, the European Union (EU) has committed USD 20 billion to developing countries as part of its global response to COVID-19 that targets partner countries and fragile populations (Borrel, 2020[8]).[1] As resources are redirected to support the emergency response, it will be necessary to pre-empt the long-term consequences of such trade-offs, including ensuring, for example, that they do not slow efforts on climate action.

Staunch the bleeding of private investment while mobilising more through innovative financing approaches

Developing countries suffering sudden investment outflows must carefully assess policy trade-offs in the short run to avoid dramatic and prolonged financial volatility. Some countries have eased measures on capital inflows. The People's Republic of China ("China"), India and Peru, have relaxed controls on, respectively, cross-border borrowing, foreign portfolio investment, and short-term external liabilities. Several others have relaxed currency-based measures, among them Indonesia, Peru and Turkey (OECD, 2020[9]). Capital controls on outflows, on the other hand, are typically implemented as a last resort tool in crisis circumstances, and developing countries have so far not resorted to them. In this situation, international co-operation is particularly important to find the best means of ensuring finance stability, including through multilateral platforms and frameworks such as those provided by the OECD capital movements code (OECD, 2020[9]; OECD, 2020[10]). The temptation to provide tax incentives to encourage (re)investment must be carefully managed as poorly designed incentives can result in a significant loss of revenue, with no impact on investment. Implementing international standards for taxation can help increase revenues, whilst also providing increased tax certainty for investors.

The COVID-19 crisis creates new impetus for development finance providers to innovate resource mobilisation to ensure no one is left behind. The pandemic has profoundly altered and in some ways accelerated certain trends. For example, new financial instruments (e.g. COVID-19 and SDG bonds) are emerging as a means of mobilising financial support to developing countries in responding to the crisis. In addition, digitalisation of the economy has become a policy priority to help adapt to lockdowns and the need to socially distance. Alongside lockdowns, many developing countries have introduced measures facilitating the use of digital financial services, such as lowering transaction fees or increasing limits on transactions.

Blended finance presents growing opportunities to mobilise additional private finance. For example, the use of blended finance to mobilise private resources has resulted in USD 205.1 billion of private finance mobilised by development finance between 2012-18; 17 DAC members now engage in blending, and 167 facilities were launched over 2000-16 to pool finance for blending (OECD, 2020[11]). A wide variety of blended finance instruments exist, including direct investments, credit lines, bonds, de-risking instruments such as guarantees and insurance, hedging, grants, and technical assistance.

However, private finance mobilised by ODA must be strengthened to reach countries and sectors most in need. Of total private finance mobilised by official development finance interventions between 2012 and 2017, only USD 9.3 billion, or 6%, went to least developed countries (LDCs), whereas over 70% went to middle-income countries (OECD/UNCDF, 2019[12]). For blended finance to work effectively, a common policy framework and guidance are essential. The OECD DAC Blended Finance Principles are a policy tool for all providers of development finance – donor governments, development co-operation agencies, philanthropies and other stakeholders – and have been adopted by the past two Group of Seven (G7) Presidencies and the last Group of Twenty (G20) Presidency.[2] Applying the Principles – tailoring blended finance to the local context and dedicating appropriate resources for monitoring and evaluation – can help better direct resources to countries and sectors most in need.

Beyond blended finance instruments, other forms of innovative financing include efforts to find new sources of ODA such as new funds and incentive mechanisms for social protection. Governments, multilateral development banks (MDBs), development finance institutions (DFIs), among others, can help catalyse new sources of finance and financial innovations to scale up investment in the SDGs. Governments and the private sector globally raised USD 150 billion in four months using COVID-19 bonds (Hirtenstein, 2020[13]). While debt financing labelled as COVID-19 bonds is expected to address the impacts of the pandemic, a common definition or criteria for determining which financing achieves the intended impact is needed. Another example, the Leading Group on Innovative Financing for Development, which began work in 2006, has a longstanding history of co-ordination among development finance providers and developing

countries to promote innovative financing mechanisms that generate additional ODA financing. For example, work by France to implement a solidarity tax (airline levy) demonstrates the possibility to generate billions of dollars to finance the SDGs. It also shows the potential of tax policy to help to help support international public goods and leaving no one behind. Other funds led by multilateral organisations can further raise resources in support of the emergency response. For example, the International Labour Organization has responded to the massive loss of jobs in the garment industry in developing countries by establishing a new fund to protect workers' income and health (ILO, 2020[14]).

Greater incorporation of ICT tools in the delivery of development co-operation can facilitate the transfer of domestic resources. In November 2018, the United Nations (UN) Secretary-General established the Task Force on Digital Financing of the Sustainable Development Goals with a mandate to recommend and catalyse ways to harness digitalisation in accelerating financing of the SDGs. A recent Task Force report notes that while digitalisation is transforming finance, these transformations must align with the 2030 Agenda and reflect how citizens want their resources (e.g. taxes and investments) to be used (UN, 2020[15]). It also highlights the potential of crowd funding, digital insurance, digital transfers and blockchain-powered supply chain finance to help mobilise additional resources in developing countries. The 2030 Agenda, makes the specific call, in SDG target 8.10, to "strengthen the capacity of domestic financial institutions to improve access to banking, insurance and financial services for all." Yet globally, an estimated 1.7 billion people, concentrated mainly in developing countries, do not have access to a bank account to store or receive payments, (World Bank, 2020[16]). Financial inclusion can be improved through innovative technological advances. For example, the rapid expansion of mobile banking in Kenya through M-Pesa, an initiative sponsored by the United Kingdom Department for International Development, has permitted the Kenya government to grow its local financial markets, including through growth of pension, insurance and savings.

Development finance providers should help ensure greater shares of remittances reach their destination through promoting innovative financing instruments and better technology and lowering regulatory barriers. The G20 has committed to supporting the new target on remittances under SDG 10 in 2016. SDG 10.C, which aims to reduce transfer costs to less than 3% and to eliminate remittance corridors with costs higher than 5% by 2030. However, more progress is needed. As noted in Chapter 3, the cost of sending remittances to ODA-eligible countries remains high – between 6.8% and 7% on average in 2017-19 or between USD 30.26 billion and USD 31.15 billion annually. Exclusive partnerships between national post offices and the large money transfer operators heighten the cost of transfers. Relaxing restrictions and barriers to entry of new players, including mobile operators, would help. The use of diaspora bonds in several countries has proven an effective means for governments to further mobilise additional resources linked to SDG spending and could generate USD 50 billion in developing countries annually (Shalal and Arnold, 2020[17]). The lockdowns and job losses due to the COVID-19 pandemic, however, have stifled migrant workers' ability to send remittances back to their home countries, which decreases the likelihood of investment in such initiatives. Further researching the capacity of blockchain technologies can help reduce transfer fees (OECD, 2020[18]). Global principles for the financial sector and blockchain technology could be further developed to ensure consumer protection, align regulatory standards and minimise know your customer requirements while respecting ethical values.

Pre-empt the next debt crisis by ensuring that resources foster progress towards the global goals

Even before the COVID-19 crisis, developing countries faced mounting risk of debt distress and SDG setbacks. Of the 69 countries applying the low-income countries debt sustainability analysis in 2019, half were either already "in debt distress" or "at high risk of debt distress", compared to 23% in 2013 (IMF, 2020[19]). Commodity exporters in particular have experienced high fiscal deficits leading to increasing debt. Foreign currency debt also increased rapidly (by about 10 percentage points of GDP between 2013 and 2018 for low income-countries), increasing risks linked to exchange rate movements. As a result, debt

service is higher in so-called bad times as currencies of developing countries depreciate. In addition, new forms of lending both from private and official creditors, and in particular collateralised debt, have made restructuring even more difficult. Formal co-ordination institutions such as the Paris Club now represent a minority of lending volumes to developing countries, which has made agreement on global restructuring more difficult to negotiate and enforce.

Immediately following the outbreak of the COVID-19 pandemic, the development community took action to prevent the collapse of financing in developing countries through debt suspension. G20 finance ministers agreed to a Debt Service Suspension Initiative (DSSI) until the end of 2020 in an effort to provide some fiscal breathing space for the poorest countries, and the initiative could be renewed for all or part of 2021. As of late September 2020, 43 countries (of 73 eligible countries) had requested of their official bilateral creditors to suspend their debt payments, for a total possible temporary relief of USD 8.6 billion (out of a possible USD 11.5 billion). However, implementation has been imperfect, and not all bilateral official creditors offered the same terms. Moreover, some countries have not requested a standstill at all because of fears of triggering default clauses on their private commitments or worries that they would not be able to borrow from non-concessional sources. Furthermore, DSSI failed to induce private creditors to participate voluntarily; any further restructuring of debt will need to include them in re-establishing debt sustainability (OECD, 2020[20]). Despite these limitations, the standstill offers a blueprint for international co-ordination on restructuring debt of the poorest countries.

Debt suspension and relief should be used as a lever to promote a greener and more resilient growth path in developing countries. The DSSI has helped improve transparency of external debt, including with new methodologies piloted by the International Monetary Fund (IMF) and the World Bank to make sure deferred payments are allocated to SDG-compatible expenditure. Thus, the DSSI can also be used to make government-issued SDG bonds more credible. However, additional efforts beyond the DSSI are needed to ensure that debt restructuring and management are sustainable. Development finance providers should take the following key actions:

- actively participate in the efforts of debt restructuring, including greening debt and employing innovative tools such as nature for debt swaps
- work with relevant stakeholders and partner countries to enhance debt transparency and qualities, for example through the Voluntary Principles of Debt Transparency adopted by the Institute of International Finance, or by ensuring debt restructuring follows the UN Basic Principles on Sovereign Debt Restructurings and other soft law principles and instruments, such as the G20 Operational Guidelines for Sustainable Financing (UN, 2020[21]).
- support existing debt management initiatives and reinforce technical assistance to identify the best type of SDG financing.

Debt suspension immediately following the outbreak of the pandemic helped avoid adding outflows linked to official debt service on top of the existing short-term collapse in external financing in developing countries. But over the long term, these resources must contribute to building back a greener and more resilient growth path. The challenge of debt sustainability and other forms of resource mobilisation demonstrates the importance of ensuring not only the quantity but the quality of resources. The next subsection outlines the key actions required to maximise the development impact of all public, private, domestic and external sources of financing.

4.1.2. Improve the quality and sustainability of financing to build back better

The global “billions to trillions” mobilisation effort is not moving fast enough and a step change is needed to shift the trillions. In 2015, the World Bank-IMF Development Committee meetings called on the development finance community to invest ODA in the private sector to mobilise the trillions needed to narrow the SDG financing gap. However, mobilising additional private finance through ODA remains limited

as demonstrated in the sections above and a more dynamic approach is required. As Chapter 3 notes, asset managers, banks, institutional investors and others including DFIs and MDBs hold trillions of dollars in assets. These resources are frequently misaligned with the 2030 Agenda, however (fossil fuel subsidies for example). The COVID-19 crisis forces leaders to consider a new risk-based paradigm. The investments made today can either mitigate or expand risks for sustainable development in the future. Shifting the trillions is a call to better assess the quality of the different sources of financing both to ensure these do not contribute to further backtracking and to help accelerate progress toward the SDGs in the future.

The sustainability assessment of SDG alignment is necessary for all sources of financing to embed resilience and build back better. Aligning finance with the SDGs means leaving no goals behind. For instance, biodiversity loss is cited as a possible origin of the COVID-19 pandemic. Yet, two of the least-funded SDGs are those relating to life on land and life under water.

Given the imminent risks of future climate and health shocks, particularly in developing countries, planning ahead is an urgent task for development finance providers. The cost of global epidemics and increasing climate-related events will only increase with time unless preventive action is taken. For instance, according to a recent study, the cumulative economic losses due to natural disasters in 2019 were nearly equivalent to total ODA volumes in the same year (USD 150 billion) (Löw, 2020[22]). The financing deployed today to recover from the crisis must be directed with a long-term vision that integrates potential risks to people and planet. The development community can strengthen the quality of these resources in two ways: first, by improving the national SDG supply and demand matchmaking and financing strategies and second, by bolstering international support for the multilateral system and international public goods.

National level: Better match demand and supply of SDG financing

The COVID-19 pandemic requires better tools to ensure national SDG financing needs are met. The growing scissors effect described in this report – rising SDG needs and declining resources – calls for a renewed effort to shed light on the supply and demand for all available resources at country level. A one-size-fits-all approach will not address the wide range of vulnerabilities and local contexts across developing countries that each face very different development finance challenges.

A central challenge is that most countries lack strategies to finance the SDGs. More than 70% of Voluntary National Reviews, or 79 out of 109, reported on national development plans and strategies but did not detail how governments would finance the SDGs in 2019 (Harris, 2019[23]). Assessing SDG financing needs and available resources is challenging at national level, given the wide range of actors and growing complexity of different sources of financing that can hamper co-ordination and alignment with national financing strategies.

In recent years, the international community has worked collaboratively to develop a framework for assessing national SDG financing needs. Integrated National Financing Frameworks (INFFs) provide a tool to help countries operationalise the AAAA, as well as how-to financing strategies at country level. Sixty countries have thus far received financial support for designing their INFF, under the supervision of the UN Development Programme (UNDP). However, there is no pipeline of bankable SDG-compatible projects in developing countries, which the *United Nations Secretary-General's Roadmap for Financing the 2030 Agenda for Sustainable Development 2019-2021* cites as a key constraint to channelling financing to achieve the 2030 Agenda and the Paris Agreement on climate (UN, 2020[24]). Identifying such projects requires better country-level capacities, particularly among investment promotion agencies, to formulate high-quality, bankable projects.

Development finance providers can help support this process and improve the strategic use of ODA within the broader mix of sources of financing at country level. As developing countries transition from lower to higher income categories, their access to different sources of financing shifts, with accompanying risks of financing gaps and setbacks. With the historic levels of lending taking place in the context of COVID-19,

countries can use the OECD Transition Finance Toolkit[3] and conduct Multi-Dimensional Country Reviews[4] to ensure that resources borrowed today do not lead to development setbacks in the future.

Strengthening engagement between the development co-operation and investment communities is an important strategy to better align private finance, including foreign direct investment (FDI), to the SDGs. FDI plays an important financing role in developing countries and by linking domestic firms with MNEs and helping host economies integrate into global value chains, FDI also can enhance productivity and innovation, create quality jobs and develop human capital, and raise living and environmental standards. Evidence from past crises also shows that foreign-owned affiliates can exhibit greater resilience during crises thanks to their linkages with their parent companies and their and access to these companies' financial resources. Moreover, a gradual growth of FDI is essential to a smooth phasing-out of ODA as countries advance along the development continuum.

Not all FDI contributes positively to progress towards the global goals, however. The OECD FDI Qualities Initiative (OECD, 2019[25]) looks at the impact of FDI on the SDGs across five areas to help enhance its impact: productivity and innovation; employment and job quality; skills; gender equality; and carbon footprint. Broadly speaking, the analysis points to more positive FDI impacts on the economic and environmental sustainability dimensions than on social dimensions, with the caveat that specific country conditions can amplify or mitigate these impacts (OECD, 2019[25]).

Development finance providers can also seek to improve the quality of trade and investment at country level. Revamping aid for trade can help improve the qualities of trade, for example, through the integration of developing economies into global value chains and economic diversification. Development finance providers can work with MNEs and investment policy makers to ensure that temporary unemployment or social protection schemes established during the crisis become permanent and are tailored to specific groups in need (e.g. women) and to different country contexts. Development finance providers' investment promotion agencies already collaborate with counterpart agencies in developing countries, particularly to provide capacity building and technical assistance to countries most in need, such as LDCs. One example is support to integrating responsible business conduct principles and standards into business and investor operations. Another is the World Trade Organization's structured discussions on investment facilitation for development, which seek to establish best practices and guidance for international co-operation to advance the development impact of investment promotion and facilitation (Baliño and Bernasconi-Osterwalder, 2019[26]).

Tax incentives to attract private investors can affect both revenues and behaviours, and are likely to be especially challenging in the response to the pandemic, as countries seek to balance the need for revenues, with the desire to attract investment and jobs. As outlined in Chapter 3, tax incentives are a significant challenge in many countries, forgoing significant revenues - often with limited or no evidence of a benefit in return – and in some cases actually encouraging activities likely to undermine progress towards the SDGs. Increasing the transparency and accountability of tax incentives is essential to reduce the risks of wasteful incentives, for example through ensuring that incentives are incorporated into the tax law and are not discretionary, have clearly defined and verifiable criteria, can only be granted by the Minister of Finance, are administered and monitored by the tax administration, and where practicable are temporary.[5] The OECD Task Force on Tax and Development developed principles on transparency and governance of tax incentives to help all stakeholders support improved tax incentive regimes.[6] Development finance providers can further lead by example through increasing the transparency and accountability of the tax incentives provided on ODA funded goods and services, which many LDCs have identified as challenging (ODI, 2018[27]).

Development co-operation providers can also work to improve the quality of infrastructure financing.[7] To ensure that financial resources spent on infrastructure enhance sustainable development and mitigate the risk of debt crises, a thorough examination of the quality and uses of infrastructure finance is necessary. This involves taking a holistic approach that considers how infrastructure will contribute to economic

growth, the social groups the infrastructure is likely to benefit, its environmental consequences and its cost-efficiency (OECD, forthcoming[28]). For example, climate-resilient infrastructure leads to fewer disruptions and reduced economic impacts, with an overall net benefit estimated at USD 4.2 trillion (in developing countries only). This translates into a USD 4 benefit for each dollar invested in resilience (Hallegatte, Rentschler and Rozenberg, 2019[29]).

Development finance providers, among others, have recently started to address the sustainability concerns of infrastructure investments. In recognition of the importance of quality infrastructure investment, for instance, the G7 endorsed the Ise-Shima Principles for Promoting Quality Infrastructure Investment" under the Japanese Presidency in 2016. In June 2019, the G20 endorsed the Principles for Quality Infrastructure Investment**.** Another recent initiative is the Blue Dot Network, announced by the Australia, Japan and the United States in November 2019 at the Indo-Pacific Business Forum in Thailand. It aims to assure private investors – including United States pension funds and insurance companies with a combined portfolio of trillions of dollars in long-term assets – of the economic, environmental and social sustainability of infrastructure investments to better mobilise their resources to address the infrastructure gap worldwide.

Development finance providers can also help to ensure that taxation is aligned to support SDG financing strategies at country-level. Tax systems can support the SDGs through four interrelated pathways:

1. Taxes generate the funds that finance government activities in support of the SDGs;
2. Taxation affects equity and economic growth;
3. Taxes influence peoples' and businesses' consumption and production behaviour and choices: and,
4. Fair and equitable taxation promotes taxpayer trust in government and strengthens social contracts that underpin development.

Reforming tax systems to make the best use of these pathways is challenging, requiring significant commitment, both from the government seeking to implement the changes, and from development partners supporting such reforms. Box 4.2 demonstrates how countries can utilise medium term revenue strategies (MTRS), to both plan reforms, and coordinate support for implementation, for example, as a part of their INFFs to better align domestic resources to the achievement of the 2030 Agenda. The OECD can support this process through its Multi-Dimensional Country Reviews and Transition Finance Toolkit.

Box 4.1. Medium-term revenue strategies can ensure alignment between countries' SDG financing strategies and the tax systems

Developing and implementing a medium-term revenue strategy (MTRS) or similar tax reform plans can help ensure alignment between a country's plan to realise the SDGs and the tax system. The Platform for Collaboration on Tax (2017[30]) recommended the MTRS as an approach that can provide a strong basis for reform. The MTRS approach is designed to have four interdependent aspects that can help address some of the persistent challenges observed where such a strategy is missing:

1. The strategy should be linked to expenditure needs and identify the contribution revenues can be expected to make; where Integrated National Financing Frameworks (INFF) exist, the MTRS can be linked to the INFF.
2. As tax priorities are too often driven by short-term considerations, commitment to reforms over a longer term can help prioritise different longer term objectives that are vital for developing the tax system, including complex tax administration reform, and for encouraging behavioural change in taxpayers.
3. As tax reform requires sustained political and societal support, the MTRS should be developed in a consultative way, with buy-in from across society, to help ensure sustained commitment.
4. The MTRS provides a clear, country-owned, plan, enabling all development partners to both co-ordinate their support and align it to the strategy, thus reducing the risks of duplication, and diversion.

The Platform for Collaboration on Tax (2020[31]) reports that 23 countries are in the process of discussing, designing or implementing an MTRS with the support of the Platform, primarily the International Monetary Fund and World Bank.

Countries may be looking increasingly at underexploited tax bases as they rebuild. As outlined in Chapter 2 the tax to GDP ratio in many developing countries is substantially lower than OECD countries. A large share of this difference can be attributed to OECD countries obtaining a much greater share of GDP in taxes on labour and social security contributions. While expanding the tax base on labour may be the best option for some countries, in the COVID-19 era where job creation will be a high priority for many countries, alternatives to labour taxation may be sought. Underexploited tax bases in many countries include property taxation and wealth taxation (both of which are generally progressive and can support the reduction of inequality), carbon taxation that can help countries meet their Paris commitments, and health behaviour orientated taxes such as taxes on tobacco, sugar and alcohol. Such taxes can combine with broader tax measures to help meet the SDGs. Box 4.2 outlines findings from recent OECD research on how Côte d'Ivoire (OECD, 2020[32]) and Morocco (OECD, 2020[33]) can improve the design of their tax systems to generate additional financing for their health systems through a combination of reforms including both social security contributions and health behaviour oriented taxes. Support should be provided for countries to enable tem undertake similar analyses to identify potential for improved domestic financing approaches, especially on health and the environment.

Box 4.2. Tax reform for sustainable health financing

Lessons from Côte d'Ivoire and Morocco

Better designed health taxes levied on goods that adversely affect health can play an important role and create new opportunity as a source of funding. Both Côte d'Ivoire and Morocco, for instance, have levy taxes on tobacco, alcohol and sugar-sweetened beverages, and there is significant scope to increase their revenue-raising potential. In Morocco, tobacco tax revenues are relatively high but the design of the taxes could be improved, and tax rates on alcohol could be increased. In Côte d'Ivoire, tax rates on tobacco also could be increased, and the plan to introduce new excise duties (such as on cosmetics), as anticipated in recent regional legislation, should proceed.

Both Morocco and Côte d'Ivoire also can improve the design of their compulsory health insurance schemes by scaling them up to increase population coverage and include a more comprehensive range of health care services. However, to raise more revenues for the general state budget to finance health systems, countries should use their entire tax mix in ways that are fair and least harmful for economic growth and have with low administrative and compliance costs. This approach should include a wide range of taxes, including corporate and personal income taxes, consumption taxes such as the value-added tax, and property taxes.

Source: OECD (2020[34]), *Mobilising Tax Revenues To Finance The Health System in Côte d'Ivoire*, www.oecd.org/tax/tax-policy/mobilising-tax-revenues-to-finance-the-health-systemin-cote-ivoire.htm; OECD (2020[35]), *Mobilising Tax Revenues To Finance The Health System in Morocco*, https://www.oecd.org/tax/tax-policy/mobilising-tax-revenues-to-finance-the-health-system-in-morocco.htm.

International level: Addressing global challenges requires co-ordinated partnerships

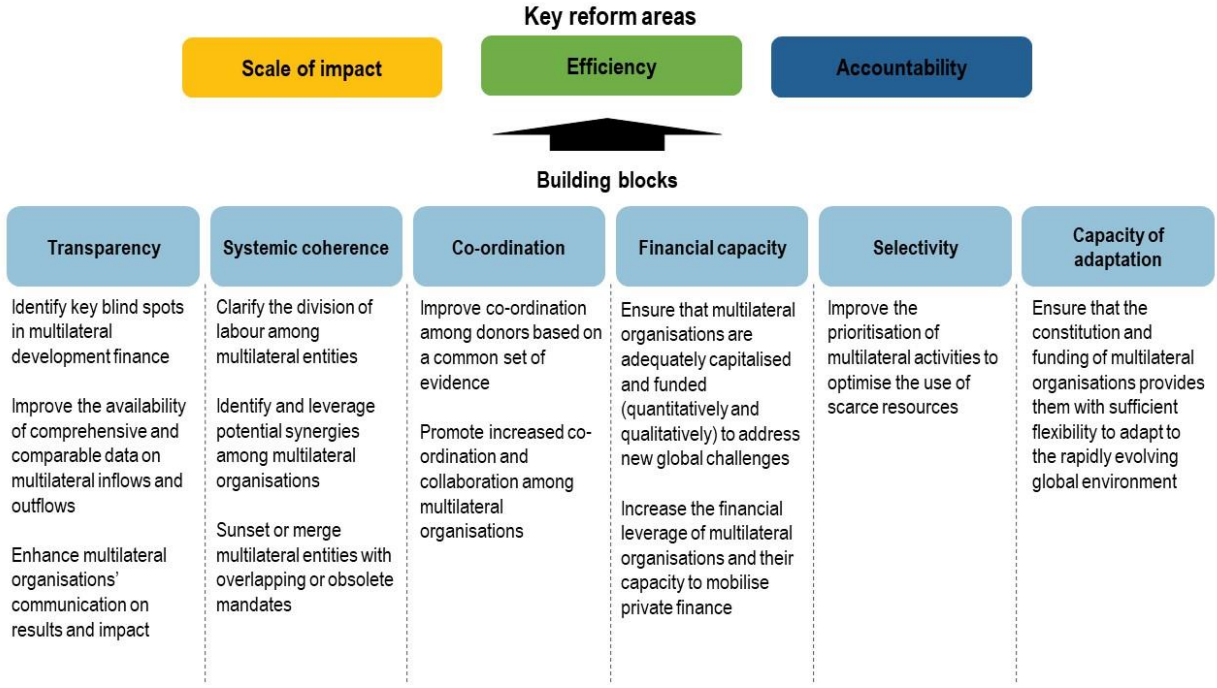
The pandemic demonstrates the need for co-ordinated approaches and partnerships across all actors to address global challenges. From bilateral and multilateral providers' emergency debt support response and foundations' pledges to help deliver vaccines and health treatment to the private sector with governments ramping up support for COVID-19 financing instruments – all actors are stepping up to respond to the crisis. The value of co-ordination is clear: no single actor can tackle global challenges alone.

Multi-stakeholder efforts to enhance development co-operation effectiveness in the COVID-19 era should continue to align to the Busan principles (OECD, 2011[36]) that were advanced under the aegis of the Global Partnership for Effective Development Co-operation (GPEDC).[8] As part of a global effort to assess the effectiveness of development co-operation, 86 partner countries and territories, more than 100 development partners, and hundreds of representatives from civil society organisations and the private sector participated in the third GPEDC monitoring round in 2018 that reviewed progress against four principles: country ownership, focus on results, inclusive partnerships, and transparency and accountability. In a joint statement issued early in the pandemic, in May 2020, the Global Partnership Co-chairs (Bangladesh, Democratic Republic of the Congo and Switzerland (and a fourth non-executive Co-chair underscored the potential human and economic costs of not delivering on the effectiveness commitments, noting that the Busan principles can be an even more relevant tool for effective partnerships at country level during the COVID-19 pandemic and recovery (GPEDC, 2020[37]).

In recent years, the multilateral development system has grown in importance as a channel of development co-operation, with DAC providers channelling an increasing share of their ODA through multilateral organisations. Multilateral organisations also are playing a key role in the immediate response to the crisis. However, the COVID-19 pandemic and the triple crisis looming in developing countries (health, economic and humanitarian) demonstrate the need to building a stronger multilateral system – one that is equipped to address global challenges of a new magnitude (OECD, 2020[38]). In the spirit of building back better,

multilateral stakeholders should use the current crisis as an opportunity to build a more effective and coherent system by focusing on key reform areas, such as scaling up the impact of multilateral development finance, enhancing its efficiency and promoting greater accountability (Figure 4.2).

Figure 4.2. Building blocks to help reform the multilateral development finance system



Source: OECD (2020[38]), *Multilateral Development Finance Report*, http://www.oecd.org/fr/developpement/multilateral-development-finance-2020-e61fdf00-en.htm.

4.2. Towards SDG alignment of financing: A call for collective action

The international community must develop new approaches to shift the trillions and help align finance with the SDGs. While traditional development finance providers must continue to leverage public finance, the private sector must also step up with the trillions that they invest and manage. Looking at SDG alignment through the lens of development co-operation alone misses the big picture. Misalignment starts at home: domestic policies in OECD and other countries, in addition to international regulations, guide where, in what and how the private sector decides to invest.

Shifting the trillions requires tipping the balance of risks and returns across markets. Pursuing risk management strategies that seek the twin goals of financial and non-financial returns can help to build a more resilient system and preserve the value of assets. However, a number of market inefficiencies limit achievement of the twin goals, among them poor incentives and insufficient transparency, accountability and integrity. These impede better allocation of resources and, as in the case of green or SDG washing, allow the use of sustainability labelling or branding without reliable assessment of how financing impacts progress towards the global goals. Moreover, the maintenance of certain asset values are also incompatible with some SDG goals. SDG 13 stopping global warming, for example, will require leaving hundreds of billions of dollars of coal, oil, and gas in the ground and worthless.[9]

The AAAA, which provides a foundation to improve market efficiency and integrity, requires a renewed focus on the investment chain. It calls for "policies, including capital market regulations where appropriate,

that promote incentives along the investment chain that are aligned with long-term performance and sustainability indicators" (para 38) (UN, 2015[39]). Following the global financial crisis, private sector actors, particularly in the financial sector, anticipated changes in regulations that would require a greater non-material financial focus (i.e. long-term performance and sustainability) to avoid future shocks. While governments and regulators enacted reforms to build financial market resilience (e.g. the Dodd–Frank Wall Street Reform and Consumer Protection Act enacted by the United States in 2010), they have been slow to adopt policies to reduce the risk of SDG washing. Initiatives and standards pertaining to sustainable business or finance have become more pervasive, for example environmental, social and governance (ESG) managed funds; the issuance of green bonds; and increasing adherence to the UN Principles for Responsible Investment (PRI). Yet there have been few reforms since 2015 that have significantly changed incentives to promote or accompany SDG alignment of finance.

The COVID-19 crisis could create momentum for action to carry out the unfinished business of the AAAA. Relevant provisions could be strengthened by a companion framework for SDG alignment that would aim to restore the predictability and coherence of policies as well as the efficiency and integrity of markets. This would help actors identify individual and collective actions along the investment chain contributing to the SDG alignment effort and shift the trillions towards more sustainability.

This remainder of this chapter explores new actors outside the traditional financing for sustainable development landscape and actions they can take for SDG alignment. It identifies ongoing efforts by the international community to shift the trillions in favour of the financing for sustainable development agenda in the COVID-19 era and beyond, and proposes a roadmap to capitalise on political momentum towards a common framework for SDG alignment outlined in Figure 4.3.

Figure 4.3. Actions for alignment: Building Block 2

Source: Authors

4.2.1. Build on the Addis Ababa Action Agenda to shift financial markets in favour of SDG alignment

The AAAA reflects a global consensus that no single source of financing would be sufficient to achieve the 2030 Agenda. It built on earlier financing for sustainable development agendas (e.g. the Doha Declaration on Financing for Development and the Monterrey Consensus on Financing for Development) that sought to establish a more holistic approach to financing sustainable development including and beyond traditional development finance. The AAAA recognised that while the public sector leverages billions of dollars to finance sustainable development, the private sector holds the trillions. These trillions are needed to realise the scale and speed of progress that are called for in the Decade of Action.

The COVID-19 crisis reveals the interdependence of financial and non-financial returns, i.e. the imperative for private finance to align to the SDGs. Financial returns rely on collective action to avoid global shocks such as climate-related risks that incur financial losses. Following the outbreak of the COVID-19 pandemic, the volatility of global capital markets caused asset values to plunge in the face of uncertainty about prolonged economic lockdowns. Asset managers and institutional investors increasingly recognise that non-financial ESG risks can have a material impact on risk-adjusted returns and long-term value (OECD, 2020[40]). As investors seek to sustain and increase value, they require improved metrics and data on sustainability to make better-informed investment decisions that help to avoid future shocks.

The global financial system is a complex, adaptive system and policy makers must work to enhance its resilience. Growing complexity and interdependence have made the global financial system susceptible to widespread, irreversible, and cascading failure. The global financial crisis of 2008 and the current crisis illustrate how interconnected global financial markets can be subject to cascading shocks. It revealed significant limitations in the financial sector's ability to predict disruptions, and in the capacity of both economists and those responsible for the "real economy" to understand the impact of those disruptions. The costs of these errors were and are being borne by individuals around the world. A systems resilience framework can enable policy makers to better accommodate the inevitable future disruptions to financial markets (Hynes, Love and Stuart, 2020[41]).

Obstacles to alignment along the investment chain

Along the investment chain, public and private actors play differentiated roles to finance sustainable development. While the private sector plays a central role in driving growth and job creation, the public sector must seek partnerships in the business world to support the development process. Such partnerships can help guide private sector behaviour towards more sustainable production and consumption patterns, and private international capital flows can complement national development efforts.

However, there are two central obstacles to increasing market efficiency and meeting demand for sustainable development financing. First, the SDGs remain disconnected from the private sector. SDG targets and indicators require better translation into relevant private sector metrics. Second, domestic policies in OECD countries that can be the root cause of inefficiency in markets (i.e. misallocation of resources across different types of assets or countries) have not caught up to meet the demand for sustainability and SDG alignment of financing.

Translating the SDGs into private sector metrics is challenging

The SDG targets and indicators were primarily drafted by and for governments. This is reflected in the makeup of the UN Statistical Commission, the group responsible for agreeing on the SDG targets and indicators: its membership comprises 24 revolving governments but no private sector representatives (UN, 2020[42]). SDG targets are thus poorly suited to measure the non-financial performance of the private sector. The private sector largely continues to perceive the SDGs as a policy framework rather than an investable framework that industry can engage with.

Private sector support for the SDGs is largely outside the ambit of the 2030 Agenda targets and indicators framework. For example, the World Economic Forum analysed 800 observations of business providing support for the SDGs in developing countries and found only 40 of 169 SDG targets were supported and only 22 of these targets were supported more than once (GrowInclusive, 2020[43]).

Many SDG targets are not fit for the private sector or adapted to private sector activities, for example:

- Gender: SDG target 5.5 calls for ensuring women's opportunities for "leadership" in economic life. However, the private sector contributes by offering jobs with equal pay and conditions to women.
- Trade: Many private sector efforts to facilitate trade are not captured by the trade-related targets that are policy-focused, with the exception of SDG target 17.11 on exports.
- Fishing: Conservation and sustainable use of oceans and their resources are left to governments and international organisations rather than private sector practices.
- Market prices: Many private sector efforts to increase access to information about markets and prices are not captured. Yet SDG target 2.c refers to the functioning of food commodity markets and their derivatives (global versus local).
- Wages and social protection: SDG target 10.4 makes reference to social protection policies without setting objectives for private sector practices that could achieve the same objective.

In many instances, private companies contribute to the spirit of the SDGs rather than the metrics defined in the SDG targets. The SDGs remain largely aspirational and not a reference for private sector disclosure, performance or ratings because in many sectors and for many companies, the SDGs do not help deliver on a firm's primary fiduciary duty – that is, to maximise profits for shareholders. While the private sector has adopted ESG and other sustainability measurement tools, these frequently still do not protect consumers against misleading information (SDG washing). It is not enough that a company's operations contribute to a particular SDG if their impact is not assessed across all SDGs and throughout the company's supply chain. For example, car manufacturers can contribute to the reduction of carbon pollution (SDG 13) by replacing internal combustion engines with electric engines, while at the same time relying on lithium and cobalt that come from unsustainable mining done under poor working conditions (SDG 12).

As demand for sustainability increases, policies struggle to keep up

Sustainability standards have proliferated over recent years. The UN identifies 115 multi-stakeholder initiatives involving 5 181 constituent members that seek to grow the sustainable finance market (Van Acker and Mancini, 2020[44]). The expanding system of sustainability products, certifications and standards is complex and many policy makers now find it impenetrable. The complexity has other implications. Research published by ShareAction (2020[45]), for instance, suggests that membership in initiatives as the PRI does not guarantee a strong approach to responsible investing. Another study found that only half of all companies subscribing to the PRI mention the SDGs in their reporting, and as few as 10% provide details on how they actually integrate the SDGs in their investment strategy (Novethic, 2019[46]).

The sustainable finance market remains immature. Consequently, assessing its magnitude is challenging. The market is growing, spurred by shifts in demand from across the finance ecosystem that are being driven by the pursuit of traditional financial value and by the pursuit for non-financial, values-driven outcomes. However, as outlined in Chapter 3, estimates of financing that qualifies as sustainable vary significantly, ranging from as high as USD 30.7 trillion[10] to as low as USD 3 trillion (IMF, 2019[47]). Sustainable finance can reflect different levels of ambition: for example, investment could be labeled as solidarity, responsible, ethical, "green", "sustainable", for impact, etc. The discrepancy in estimated volumes of sustainable financing, and the lack of consensus on terminology and standards of sustainable finance, are emblematic of an immature market.

Moreover, there is a gap between market aspirations for greater sustainability and regulations governing the market. Greater coherence between domestic and international SDG financing strategies is needed to address the proliferation of policies and regulations**.** While the AAAA, in paragraph 38, calls for alignment of policies, regulations and incentives with the SDGs, the focus of the financing for sustainable development (FSD) process has been on policies in developing countries rather than in countries of origin of the financing. Significant work remains to effectively tackle international tax evasion and avoidance, as demonstrated through the ongoing work on BEPS. Other misaligned sources of finance include fossil fuel subsidies. As noted in Chapter 3, fossil fuel subsidies cost upwards of USD 4.7 trillion in 2019, or 6.3% of global GDP (Coady et al., 2019[48]), and 44 OECD and G20 countries spent an estimated USD 178 billion on fossil fuel subsidies in 2019 (OECD, 2020[49]).

Market forces will correct some early failures and will likely drive, for instance, a consolidation and harmonisation of standards. However, it is also important that early movers are protected, and good practices rewarded to spur emulation and sustain the SDG alignment movement. Policies should facilitate self-adjustments of the market. To help policies catch up to market demand, three key obstacles – transparency, accountability and incentives – must be overcome. The three issues emerged in a stock taking of some key initiatives on sustainable finance[11] that is to be released as part of the joint OECD-UNDP work on SDG alignment.[12]

First, a lack of transparency reduces comparability. It is not mandatory to disclose methodologies, which sometimes are regarded as intellectual property. For example, ESG rating agencies often do not provide complete and public information about the criteria and the assessment process developed to evaluate corporate sustainability performance (Escrig-Olmedo et al., 2019[50]). Moreover, among methodologies that are disclosed, there are stark inconsistencies in terms of how sustainability is measured. For example, Tesla was recently rated in the bottom 10% of all companies by JUST Capital yet received an A grade from MSCI (Nauman, 2020[51]). An important asymmetry of information is created by the absence of common definitions and metrics. The mushrooming of initiatives creates noise on the market and does not help investors make informed choices about the allocation of their assets or help consumers make informed choices about products.

Second, ensuring accountability for non-financial returns is complex. The absence of harmonised rules on reporting non-financial returns has resulted in selective reporting or cherry-picking of results in favour of positive sustainability outcomes, rather than additionality[13] or net impact.[14] Rating agencies, for example, generally focus on financial performance and do not include non-financial performance with their own methodologies, or include it to limited extent. Boffo, Marshall and Patalano (2020[52]), in a report on ESG investing for the OECD, demonstrate that prioritisation of criteria can be complex. For some ESG rating providers, high E (or environmental) ESG scores positively correlate with high carbon emissions. The E score captures metrics such as renewable energy management, resource use, water output and management, impact on ecology, and biodiversity as well as carbon footprint, although it does not prioritise carbon footprint or intensity.

Regarding the third of the obstacles, there are increasing calls for regulators to catch up with markets and set out guidance to create incentives to align. Better incentives require better rules. If they are not designed with international considerations, new regulations could cement fragmentation. The lack of policy coherence and clarity of regulations is holding up alignment. The incentives, rewards and sanctions are neither coherent nor structured to capitalise on the improving economic case underpinning sustainable finance. As noted in Section 4.1.1, while blended finance aims to provide financing to the poorest countries, only 6% actually targets LDCs. Meanwhile, only 4% of FDI goes to LDCs, largely due to the private sector's perception of these countries being high-risk (e.g. currency risks, political risk, lack of liquidity). Improved incentives are needed to encourage more private investment in low-income and fragile contexts.

The challenge will be to ensure standards converge in support of the 2030 Agenda, with a requisite level of ambition and within and across communities of actors along the investment chain. All efforts should be

consolidated to reach the scale needed for financing the SDGs and leave no one behind. For example, while exclusionary principles are widely used, they are limited in that they only protect from doing harm without contributing to positive impact. The USD 68-billion UN Joint Staff Pension Fund includes exclusionary clauses for human rights, tobacco and arms, and it recently announced it would divest from investments in publicly trade coal companies by the end of 2020 (Chief Investment Officer, 2019[53]). Yet, the pension fund does not include metrics to invest for non-financial returns linked explicitly to the SDGs.

Policy options to increase integrity and efficiency of markets

What could be done to remove these obstacles identified along the investment chain? This moment in time presents a golden opportunity. The COVID-19 crisis has galvanised a movement for SDG alignment. At the same time, there is growing realisation that the twin goals of higher financial and higher non-financial returns are within reach if long-term risks can be better managed. Calls to enhance the integrity and efficiency of markets have increased following the outbreak of the pandemic. For example, the G20 action plan in response to COVID-19, launched in April 2020, calls on G20 countries and the international community to improve market efficiency, strengthen resilience and create the conditions for a sustainable recovery. It is important to ensure that policies are supportive of this movement, contribute to removing obstacles to SDG alignment and do not become obstacles themselves by not adjusting quickly enough to the changing needs of investors. As governments intervene with stimulus packages, subsidies and bailouts, it is equally important that all scarce public resources spent have maximum short and long-term impact and do not support non-sustainable practices.

Private sector: Protect market integrity

Ensuring market integrity requires clearer standards for the private sector and more robust safeguards to protect against deceitful practices. Some prominent private sector actors are urging higher-quality sustainability standards, among them Larry Fink, Chairman and Chief Executive Officer of BlackRock, the world's largest asset manager with more than USD 7 trillion in assets under management. In a recent open letter to corporate executives, he calls for greater transparency and more widespread and harmonised sustainability standards (Fink, 2020[54]). At the same time, policy makers and academics are calling into question the traditional model of capitalism that holds that the only aim of business is financial return: they point to the climate crisis, rising inequalities and the global pandemic as evidence of the need to integrate long-term, non-financial risks and returns into the equation (Badré, 2020[55]).

The example of the green finance market could be instructive for financing the SDGs. The Paris Agreement was the impetus, providing the critical driving force to align policies in support of the climate-related SDGs. Recent initiatives such as the EU Taxonomy for sustainable activities and various efforts by the Climate Bonds Initiative) have worked to achieve consensus around the green finance market and its terminology. The International Capital Market Association has registered approximately 400 green bond frameworks and about 400 regulations have been published, two-thirds of which cover developed markets. Almost USD 200 billion of green bonds were issued in 2019 alone, a record for green finance (Climate Bonds Initiative, 2019[56]). While this volume is still clearly insufficient to finance the low-carbon transition, policy makers and investors have a much clearer understanding of the financing needs, the necessary financing instruments and how much more needs to be done for this transition compared to the financing needs for the SDGs. Policy makers should seek to build on these solutions for financing the SDGs.

The identification of SDG metrics, by building on existing initiatives that are fit for the private sector, could help to clarify standards. Strategies of business and portfolio managers need to shift from a logic of either using ESG factors to better manage risk and possibly enhance financial returns or selecting best-performing ESG companies to an approach of including and reporting on SDG considerations. A first step could be for the international community to identify SDG targets fit for the private sector. Companies' and

investors' performance could be measured against relevant targets. This could build on existing initiatives, such as the SDG Compass, a tool jointly developed by the UN Global Compact (2015[57]).

Governments and multilateral organisations are leading other initiatives that can also help business more clearly define their sustainability objectives and enhance their impact:

- Organisations including the OECD contribute to raising the bar on sustainability by helping companies understand their impacts on the SDGs across their entire supply chains and integrating risk-based due diligence into their business operations, for instance with the Guidelines for Multinational Enterprises and the Due Diligence Guidance for Responsible Business Conduct (OECD, 2019[58]).
- The Principles for Responsible Investment (2020[59]) initiative works to understand the investment implications of ESG factors and support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The number of PRI signatories has grown from 100 to 3 000 in a few years.
- More than 3 300 certified B Corporations across 150 industries in 71 countries are legally required to consider the impact of their decisions on their workers, customers, suppliers, community and the environment.
- Some business groupings are engaged in a dialogue with governments to improve regulations and underlying metrics (e.g. on impact measurement), including Business for Inclusive Growth – a network of companies set up to help business reduce inequalities (OECD, 2020[60]).

Against this backdrop, a global consensus is emerging that finance must make a positive contribution to sustainable development, using the SDGs as a basis for measurement. The Global Investors for Sustainable Development (GISD) Alliance has adopted a definition of sustainable development investing that promotes positive impact as a prerequisite and suggests that investors can strengthen their contribution through active ownership, including engagement for more sustainability in companies, sectors and projects and more investment in developing countries (GISD Alliance, 2020[61]).

To help bring about this positive contribution to sustainable development, there is a need to first close the gap between high-level principles and reporting standards for impact. In the area of impact, the Impact Management Project (IMP) provides a forum for building global consensus around how to measure, manage and report impacts. The project brings together several public and private actors along the investment value chain, including both practitioners and standard-setting organisations such as the OECD.[15] Five standard setters[16] have agreed to work together on a comprehensive corporate sustainability reporting. Facilitated by the IMP, this work will help provide the basis for a comprehensive corporate reporting system.

In the absence of common definitions or standards, benchmarking could also play a critical role to increase transparency and better inform investors and consumers of the performance of companies on sustainability issues. For example, the World Benchmarking Alliance aims to measure and compare companies' performance on the SDGs. An independent benchmarking mechanism with a publicly available methodology and results could be put in place for sustainable finance that would force some disclosure while respecting privileged information. Such a mechanism could promote a race to the top in which leading companies would be incentivised to do more and laggards would be held to account.

Public sector: Improve market efficiency

Market efficiency starts at home by ensuring coherence of domestic policies with the international agenda. The same assessment of the sustainability of financing by the private sector should be applied to governmental actors. All countries are affected by the performance of other countries, as the COVID-19 crisis starkly illustrates. Measures to promote SDG alignment in OECD countries should not create further market segmentation or distortions that would be detrimental to collective progress towards the SDGs.

Increasing the efficiency of the markets will allow a better-informed allocation of assets, including across countries.

The 2030 Agenda recognises that the success of one country to achieve progress on the SDGs will be dependent on the performance of other countries. A disconnect between domestic and international SDG financing strategies, therefore, detracts from the effectiveness of all efforts. For example, it is crucial to ensure not only that stimulus packages help raise the bar on sustainability standards but that they do not sat the same time contribute to diversion of resources from crucial sectors and from developing countries most in need is crucial. This is easier said than done, however. For example, in the period between the beginning of the pandemic in early 2020 and 15 July 2020, G20 countries committed at least USD 151 billion to fossil fuels but only USD 89 billion to clean energy in their stimulus and recovery packages (Gerasimchuk and Urazova, 2020[62]).

Governments should aim to collectively set the right incentives and phase out support for misalignment. Subsidies to industries that have a clear negative impact on the SDGs should be stopped. Taxation that rewards positive SDG activity and penalises negative activity could also help. In some cases, green taxes and levies on polluting imports could be implemented, whereas in others, more strict prohibitions might be warranted. In the context of the COVID-19 crisis, sustainability performance and commitments should complement public support such as stimulus packages, bailouts or subsidies so that finance delivers better recovery and builds resilience.

Standards on non-financial reporting should favour mandatory over voluntary mechanisms when possible. Stricter rules on reporting of non-financial results, disclosure and harmonisation of metrics, and revised liabilities and ratings of performance can help increase transparency and accountability. These rules should be globally harmonised or at least built in a coherent manner to avoid risk of cementing fragmentation. Third-party verification could be required for the biggest companies to ensure accountability.

International, voluntary non-financial reporting standards are already being implemented and should be expanded. The Task Force on Climate-related Financial Disclosure (TCFD), for example, aims to develop voluntary, consistent climate-related financial risk disclosures for companies to use when providing information to investors, lenders, insurers and other stakeholders. Industry actors have started moving towards the adoption and implementation phases: more than 1 440 organisations have taken up TCFD recommendations, representing a market capitalisation of over USD 12.6 trillion. Some countries are taking action at the government or financial authority level: New Zealand is the first country to formally move towards a comprehensive, mandatory reporting regime for TCFD disclosures; under proposed legislation, the requirement would apply to certain publicly listed financial entities as of 2023. The Swiss Financial Market Supervisory Authority, the United Kingdom Financial Conduct Authority and the Hong Kong Monetary authority are currently working on approaches for improved disclosure of climate risks by major financial institutions, which could lead to mandatory TCFD disclosures.

The implementation of national mandatory and/or legal frameworks for non-financial reporting also is further helping to increase accountability. A number of countries, among them New Zealand, have mandated climate reporting, and governments in other countries (e.g. Canada, Japan, the United Kingdom, the EU) are also looking to introduce legislation. Beyond environmental objectives, other countries also are seeking to integrate social considerations in their strategies. For example, France enacted the *Loi Pacte* that incentivises companies to include what it calls a “purpose” that enshrines the notion of social interest – i.e. they consider the social and environmental issues inherent in their statutes and strategies – and creates a new category of a company with purpose (*entreprise à mission*) that is subject to regular monitoring by its employees and an independent body.

Domestic stimulus packages should include a financing for sustainable development chapter on how recovery supports SDG alignment, and several national stimulus packages have made progress in ensuring sustainability. For example, Canada has announced that businesses with revenues of USD 300

million or more requesting COVID-19 economic aid would be required to disclose their climate impacts and commit to making environmentally sustainable decisions. The scaling up of sustainable finance or efforts to develop a more mature the market can help close the SDG financing gaps, respond to the COVID-19 crisis and build back better.

To avoid market fragmentation, governments should adopt comparable taxonomy regulations across different dimensions of the SDGs. To address risks of fragmentation of markets and restore predictability for investors, policies should focus on incentivising businesses to incorporate sustainability objectives aligned with the SDGs. The idea is not to replace all private standards with public ones, but to agree on watchdog mechanisms and minimum requirements to protect investors against deceitful practices. The EU has been a pioneer in developing a unified classification system for sustainable activities – the EU Taxonomy on sustainable finance taxonomy – to provide businesses and investors practical tools to identify environmentally sustainable economic activities and investment opportunities. Despite minimum social safeguards,[17] the Taxonomy focuses on environmental objectives and does not yet cover all SDGs, but work to include social considerations is ongoing.

4.2.2. Bring all actors along the investment chain behind the SDGs

While the AAAA recognised the need for private sector engagement, it fell short of translating the SDGs into industry-relatable targets and metrics. In the era of COVID-19, the AAAA also does not expressly provide governments with a framework to rebuild and prepare recovery packages that are aligned with the 2030 Agenda.

A supplementary framework to the AAAA, led by the UN and other actors, could serve as a reference for SDG alignment and be translated into concrete action plans by the various actors and communities active along the investment chain. Communities such as businesses, stock exchanges, pension funds, asset managers and sovereign funds need to progressively commit to integrate this new paradigm. Action plans should be developed by all communities involved along the investment chain. A reference document should include a monitoring and accountability mechanism, with progress reported annually.

This section sets out the actions that governments can take to support the UN-led financing for sustainable development agenda and to help implement action plans for SDG alignment among a broader set of actors.

A new approach to financing sustainable development in the era of COVID-19 and beyond

The UN system and its partners took action before the crisis to begin development of a common framework for SDG alignment. The UN Secretary-General accelerated the financing for sustainable development agenda in 2018 with the adoption of the Strategy for Financing the 2030 Agenda roadmap (UN, 2018[63]). Estimating global gross private sector financial assets at hundreds of trillions of dollars), the report urged that all available finance be channeled towards sustainable development. It further called for a transformation of the financial system to leverage opportunities to increase investments in the SDGs at scale.

The COVID-19 crisis could create momentum for a fourth international conference on financing for sustainable development, as was stipulated in the AAAA that charts a path to SDG alignment. In the meantime, follow-up and monitoring on the financing for sustainable development agenda must leverage national and regional initiatives. The UN Secretary-General, Canada and Jamaica convened the Initiative on Financing for Development in the Era of COVID-19 and Beyond 2020 in May 2020 as a first step. Concrete financing solutions to the COVID-19 health and development emergency and recommendations for a common framework for SDG alignment that would supplement the AAAA were discussed.

The initiative injected fresh ideas and policy options for financing the SDGs, including the idea of SDG alignment, to the FSD process. As the leader of this process, the UN can help ensure the recommendations are translated into regional and domestic laws and practices including via heightened co-ordination with

regional groups. In another effort, the EU announced the launch in September 2019, at the Climate Action Summit, of an International Platform on Sustainable Finance to co-ordinate regulatory policy tools for capital markets. The platform aims to exchange best practices and bring together different initiatives on environmentally sustainable finance and investment, including green taxonomies, disclosures, standards (e.g. green bonds), labels and benchmarks. This international platform to date comprises EU member states, Argentina, Canada, Chile, China, India, Indonesia, Kenya, Morocco, New Zealand, Norway, Senegal, Singapore and Switzerland. It is also supported by the Coalition of Ministers for Climate Action and several organisations.[18]

Towards an SDG alignment framework

National and regional initiatives to develop a common SDG alignment framework have accelerated as the horizon to achieve the 2030 Agenda approaches. The G7 and G20 have both highlighted the importance of SDG alignment, most recently at the G7 in France in 2019 and the G20 in Saudi Arabia in 2020. The G20 Development Working Group is currently working on a G20 framework on FSD, including exploring whether to dedicate one of its three pillars to the mobilisation of finances and their use for sustainable development. As many of these initiatives are relatively new, there are ongoing efforts broaden the scope of the frameworks and improve their capacity. For instance, both the EU and China have indicated their intention to update and possibly expand their respective frameworks[19] to include new sectors.

The United Kingdom and Italy, respectively, are hosting the G7 and G20 in 2021 and are co-hosting the UN Climate Change Conference, COP26, in Glasgow. Both countries have championed sustainable finance as having an important role in the post-COVID-19 recovery. The upcoming G7, G20 and COP26 presidencies provide a unique opportunity to capitalise on momentum securing action for alignment. The Italian presidency of the G20 has announced it is exploring whether to include the alignment of public and private investment to the SDGs as part of its priorities.

In support of these national and regional initiatives, the French G7 Presidency mandated the OECD and UNDP to define a “robust common framework for SDG-compatible finance”” (G7 France, 2019[64]). The aim of such a framework is to create a roadmap, identify building blocks, engage different communities in a coherent manner, and set out long-term objectives and recommendations needed to achieve alignment. To be launched in November, the framework will provide the tools, standards and policies needed to deliver greater transparency, accountability and better incentives.

Develop community action plans for SDG alignment

Voluntary community action plans are an important step to help incentivise public and private actors to support a government-led SDG alignment framework. The framework needs the support of the new actors in financing sustainable development, as many of these are already taking steps to align. Now is the time to amplify their efforts and chart a path for co-ordinated action. Ten emerging community action plans outlined in Table 4.1 provide an overview of the new actors and how their role relates to SDG alignment and set forth a series of voluntary actions to accelerate alignment. The action plans are based on stakeholder consultations, including in the context of the OECD-UNDP joint SDG alignment work, and are intended to provide a foundation for public-private collaboration. The examples of actions to align are illustrative and not intended to be comprehensive. Detailed community action plans are provided as supplementary materials for this chapter.

New actors including asset managers, banks, institutional investors, credit rating agencies and stock markets can take concrete actions to improve transparency, accountability and incentives for SDG alignment. Investors with trillions of dollar in assets under management (AUM) can make efforts to reduce misalignment, including by avoiding negative externalities such as carbon emissions, human rights abuse, etc. They also can take preventive measures to facilitate greener and more sustainable forms of finance by, for example, developing asset classes beyond equities such as green bonds (e.g. asset managers and

investment banks) and leveraging capital markets to mobilise more finance directed to developing countries (e.g. public development banks). Institutional investors such as pension funds, sovereign wealth funds and insurers can further integrate ESG considerations and better monitor and evaluate ESG risk reduction in ways that are compatible with the SDGs and based on accountability for sustainable development impact. Market regulators such as rating agencies and stock markets can set stronger financial and non-financial disclosure requirements to increase transparency and harmonise reporting standards.

For new actors to succeed, policy makers must work together to facilitate integration of the global goals and long-term risks for people and planet. Market efficiency and integrity will rely on policy makers setting the right incentives for investors, regulators and portfolio managers that are aligned with the 2030 Agenda and the Paris Agreement. Policy makers can strengthen regulatory and legal frameworks based on a common framework to aligning finance in support of the SDGs (e.g. sustainability taxonomies). Policy makers also can build the evidence base on economic policies that support a green transition and a more resilient financial system. Developing such regulation at the national level will require greater co-operation and dialogue with the private sector, building on and scaling up existing initiatives such as the TCFD and the UN PRI, among others. These activities can help countries identify the best practices, SDG-compatible private sector metrics and strategies to incentivise greater investments for the SDGs.

Table 4.1. Community action plans

Communities	Actions by actors to align	Actions by policy makers to support alignment
Asset managers		
USD 91.5 trillion AUM	• Expand use of asset classes beyond equities (e.g. green bonds or bonds from mission-driven agencies such as development banks) • Invest in new tools and technologies to integrate SDG metrics • Build asset manager capabilities to source SDG investments • Incorporate SDG mandates into managers' objectives	• Encourage asset managers to make publicly available ESG information (from corporate and investment strategies) that is comparable, consistent, and verifiable • Create platforms that build relationships between asset managers and sustainable companies, sustainable development bond issuers, development finance institutions, and aid agencies
Central banks		
USD 30 trillion AUM	• Integrate SDG imperatives into macro prudential regulation • Adapt eligibility criteria for quantitative easing actions • Integrate sustainability factors into portfolio management	• Robust and consistent climate-related disclosure requirements • Support and develop taxonomy of economic activities related to green transition
Insurers		
USD 32.9 trillion AUM	• Adjust range of risk factors to insure and develop ESG-related insurance products • Incorporate ESG into repairs, replacements, disputes and other claims services • Measure and monitor ESG risk reduction progress	• Support regulatory and legal frameworks for ESG risk reduction • Invest in capacity and technical assistance to develop insurance markets in emerging economies • Adopt policies to encourage companies to broaden coverage and risk factors
Investment banks		

USD 147.9 trillion AUM	• Measure, document and disclose investments in fossil fuels • Bolster advisory services to companies supporting SDGs • Commit to underwriting green, social and development impact bonds	• Require disclosures from financial institutions on ESG risks and stranded assets • Encourage stress tests to evaluate banks' performance on environmental and social risks • Provide forward guidance on ESG risk management and due diligence
Public development banks		
USD 11.2 trillion	• Help develop local capital and productive sector markets • Enhance clarity and direction of public development banks' mandates and governance structures • Leverage international finance in developing countries	• Ensure good governance • Help develop local capital and productive sector markets • Leverage international finance
Pension funds		
USD 35.6 trillion AUM	• Add SDG criteria to investment decisions • Strengthen expertise and capacity of fund managers on ESG • Set SDG targets in terms of SDG investments and outcomes	• Reduce capital requirements for pension funds partnering with DFIs and Public Development Banks • Incentivise pension funds to factor in ESG impact through regulation • Improve availability, consistency and quality of ESG information
Philanthropic organisations		
USD 7.1 billion	• Improve knowledge sharing with governments and donors • Make better use of existing platforms to improve data transparency on philanthropic giving	• Adopt more systematic approaches to engagement with foundations • Adapt regulation to improve enabling environment for philanthropy
Rating agencies		
	• Standardise timing of rating announcements • Increase transparency on ESG rating methods and models	• Consider turning rating agencies into public institutions • Regulate timing of rating announcements • Developing countries should build capacity to better engage rating agencies during reviews and appeals
Sovereign wealth funds (SWF)		
USD 7.45 trillion AUM	• Embed SDGs into the investment process • Integrate ESG advisers into SWF management teams and boards • Assess fund managers on a longer horizon based in part on development outcomes	• Encourage SWFs to embed SDG objectives into their mandate • Encourage SWFs to publish an SDG investment strategy • Require SWF disclosures to legislatures or independent teams to increase investment transparency
Stock exchanges		

USD 95 trillion market capitalisation	• Bolster reporting and disclosure requirements for listed companies • Create indices that single out best and worst ESG records • Provide written guidance on best ESG transparency practices	• Leverage ESG data from listed companies to provide information to regulators • Help exchanges establish ESG and corporate governance criteria for listed companies • Consider regulations for companies to provide ESG reporting to list on stock exchanges

Source: Authors based on stakeholder consultations.

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Annex 4.A. Community action plans for SDG alignment

Public development banks (PDBs) and their role in SDG alignment

As publicly owned financial institutions with a development mandate, development banks can play a countercyclical role in financial systems, helping to soften effects of credit crunches and deleverage private banks in times of financial crises. They also playing critical role in financing infrastructure. Public development banks (PDBs) have a massive collective financial footprint: the national and bilateral banks that make up the membership of the International Development Finance Club (IDFC) represent USD 3.8 trillion in total assets – roughly 2.5 times the size of the total assets of multilateral development banks (Crishna Morgado and Taskin, 2019[65]).

Equipped with national, mission-driven mandates, PDBs can mobilise additional commercial capital to deliver on both the 2030 Agenda and Paris Agreement, thus contributing to both the equality and sustainability dimensions of the alignment agenda. PDBs and sub-national development banks have specific comparative advantages over internationally operating MDBs and bilateral banks that make them particularly important actors in the alignment agenda (Abramskiehn et al., 2017[66]; Griffith-Jones, Attridge and Gouett, 2020[67]; OECD, 2019[68]).

- **Proximity to local markets and embeddedness in the national context**. While both international and domestic development banks often work with government institutions and local private actors, domestic banks are closer to the local financing, policy and development context in their country of operation. This proximity often translates into long-standing relationships with local partners that can allow PDBs to more readily target projects with high sustainable development impact. Additionally, sub-national governments, municipalities and local communities are easier reached by domestic institutions, in particular sub-national development banks.
- **Providing financing in local currency**. PDBs provide financing in local currency – which international institutions often have difficulty in doing – and support local capital market development, including through the mobilisation of additional, local commercial capital.
- **Sectoral expertise**. In many cases, PDBs have a narrow policy mandate focusing on a specific sector (e.g. agriculture, infrastructure, etc.) or type of client (e.g. SMEs). Such institutions thus benefit from long-standing and specialised expertise in managing sector- or client-specific risks. Moreover, they can focus their activities on specific market gaps (World Bank Group, 2018[69]).

As such, PDBs can also play a key role in developing the domestic financial sector by: providing concessional and non-concessional finance in local currencies, mobilising additional commercial capital, and shaping a sustainable investment environment by creating markets, reforming investment policies, removing barriers to investment and developing project pipelines.

Actions for alignment: Public development banks

Actions Public Development Banks can take themselves (in conjunction with shareholders):

- **Ensure good governance:** features shared by the best-performing PDBs include a strong mandate, clear rules of cooperation with the private sector and some mutual understanding between the PDB and government on the expected return on capital – the best way to ensure this is through a qualified and independent board of directors (Griffith-Jones, Attridge and Gouett, 2020[67]). Many PDBs have inherited legacy governance structures that make this difficult. Support from the international community in terms of governance guidelines would be useful.
- **Help develop local capital and productive sector markets:** work with regulators and government authorities to create local-currency bond markets; help expand clean technology markets
- **Leverage international finance:** in countries with shallow capital markets, accessing international finance is particularly important: PDBs need to make themselves attractive investment partners and catalyse investment from international investors, MDBs, DFIs and international climate funds (Griffith-Jones, Attridge and Gouett, 2020[67]).

Actions policy makers can take to accelerate alignment:

- **Consider establishing/greening a PDB** or sub-national development bank where appropriate.
- **Enhance clarity and direction of PDBs mandates,** e.g. developing divestment strategies from fossil fuels to renewable energy.

Central banks and their role in SDG alignment

The role of central banks in economic policy making has evolved rapidly since the 2008 financial crisis and particularly during the current pandemic. As Chapter 3 showed, central banks have seen the fastest growth rates among all financial intermediaries, increasing from 5 trillion USD to 30 USD trillion in total assets from 2002 to 2018, or annualised growth post-crisis of 8.5%. For decades, central banks were primarily concerned with upholding price stability. After engaging in successive waves of quantitative easing (QE) to pump liquidity into economies during the last financial crisis, central banks are now viewed as central economic players in their own right with a broader mandate of responsibilities (Tooze, 2020[70]). This view has been cemented by the COVID-19 crisis, in which central banks of reserve currencies in countries with deep and liquid financial markets are helping to finance massive recovery and stimulus packages by lending directly to governments. This remit is likely to expand further as central banks help to manage the enormous build-up of public debt in the aftermath of the pandemic.

Central banks are becoming more prominent in promoting green and sustainable finance. Membership of sustainable finance networks, such as the *Network of Central Banks and Supervisors for Greening the Financial System* (NGFS) and the *Sustainable Banking Network* (SBN), is growing. In addition to membership in such networks, central banks are increasingly engaging in other green activities, such as integrating climate risks into macro-prudential policy, creating guidelines for climate risk management and green lending, and imposing disclosure requirements. Central banks in many developing countries are frequently even more active in promoting green finance and sustainable development than their counterparts in advanced economies. A possible explanation for this is that in developing countries, the case for central banks to take action against climate change and other sustainability issues is stronger than in advanced economies (Dikau and Volz, 2020[71]).

Actions for alignment: Central banks

Actions that central banks and supervisors can take:

- Integrate green and SDG imperatives in macro-prudential regulation (e.g. credit ceilings, higher risk-weights for sectors harming SDGs) and stress-testing related to systemic risks arising from elements of the SDGs **Invalid source specified. Invalid source specified.**.
- Quantitative easing: Central banks can adapt eligibility criteria for QE actions **Invalid source specified.**.
- Integrate sustainability factors into portfolio management **Invalid source specified.**.

Actions that policy makers can take to accelerate alignment of central banks:

- Achieve robust and internationally consistent climate and environment-related disclosure **Invalid source specified.**.
- Support the development and implementation of a taxonomy of economic activities contributing to the green and low-carbon transition **Invalid source specified.**.

Sovereign wealth funds and their role in SDG alignment

Sovereign wealth funds are pools of assets owned and managed directly or indirectly by governments to achieve national objectives (OECD, 2008[72]). Countries that heavily rely on one source of income (e.g. oil revenues for Norway and the Middle East) often make use of these funds to diversify and become less reliant of one single revenue stream (WEF, 2017[73]). Total sovereign wealth fund assets under management are estimated worth around USD 7.2 trillion (WEF, 2017[73]).

Sovereign wealth funds are diverse in terms of their structures, geographical distribution, and mandates. The main types are: stabilisation funds, which protect government budgets from commodity price volatility; savings or reserves funds, which preserve wealth for future generations; pension reserve or "buffer" funds, which invest excess reserves to guard against future pension liabilities; and strategic investment funds, also known as development funds, which have a double line objective of financial returns alongside developmental and policy goals. While sovereign wealth funds tend to be associated with countries that have oil and gas revenue, many non-resource rich countries have pooled national assets to make strategic investments. Some strategic investment funds are capitalised from the state budget, such as Senegal's FONSIS, while others are capitalised from pension assets, such as the Ireland Strategic Investment Fund (ISIF). Other countries have sub-funds within a larger sovereign investment authority that target specific sectors, such as the Nigerian Infrastructure Fund (Halland, 2016[74]).

Because sovereign wealth funds are long-term in nature, fund managers in theory would deploy patient capital with an eye toward higher long-term returns, take risks that would not be possible in environments where there is pressure to quickly deliver above-market adjusted returns, and avoid "harmful" asset classes that are higher risk long-term. Many managers have developed explicit ESG strategies and have borrowed heavily from the Global Impact Investment Network's Impact Reporting and Investment Statistics and other metrics to guide part of their portfolio allocations (UNEP, 2018[75]).

In 2017, six sovereign wealth funds with assets of more than USD 3 trillion founded the One Planet SWF Working Group to establish a climate risk mitigation framework to guide their sustainable investment strategy (IISD, 2018[76]). That framework included a commitment to incorporating climate change into the management of assets, fostering agreement among asset owners on climate-related principles, indicators, and methodologies, identifying sound climate-related investments and risks, and more. The International

Forum of Sovereign Wealth Funds, comprised of 31 members with more than USD 5.5 trillion in assets, has codified sovereign wealth fund best practices on good governance, accountability, transparency, and sound investment practices through the Santiago Principles (IWG, 2008[77]). Norway's Norges Bank Investment Management (NBIM) has worked to divest or press for changes to the business models for companies in sectors contributing to deforestation and pollution, such as plastics (Fouche, 2018[78]). The UAE's Mubadala Fund has invested in wind and solar projects in developing countries (UNEP, 2018[75]).

Despite ad hoc progress by NBIM and others , sovereign wealth funds by and large have not invested in developing sustainable and measurable metrics for SDG investments. Many fund managers are still assessed by quarterly performance, with a focus solely on financial returns. Sovereign wealth funds investments in green finance are estimated to be less than 1% of total assets under management (UNEP, 2018[75]). Initiatives like the Santiago Principles have not yet charted a clear path toward SDG alignment.

Actions for alignment: Sovereign wealth funds

Actions that sovereign wealth funds can take themselves:

- Embed the SDGs into the investment process: sourcing, screening (including positive and negative screening tools), allocation decisions, and return targets
- Develop ESG outcomes, performance metrics, and benchmarks to be used in the investment process
- Incorporate ESG advisors onto sovereign wealth fund management teams and boards
- Assess fund managers on a longer term horizon and based on performance on financial returns and developmental objectives

Actions that policy makers can take to accelerate alignment of sovereign wealth funds:

- Encourage sovereign wealth funds to embed environmental, social, and governance objectives into their mandate
- Consider matching funds to sovereign wealth funds for SDG financing to de-risk investments in those asset classes and mobilise additional funds
- Support sovereign wealth funds in publishing a sustainable investment strategy every few years, and for development funds, publish SDG specific strategies
- Require sovereign wealth funds disclosures to legislatures or an independent evaluation team to increase transparency of fund investments

Pension funds and their role in SDG alignment

Pension funds are a pool of assets that form an independent legal entity that pays for people's retirements. The assets are bought using pension plan contributions, for the exclusive purpose of financing pension plan benefits. The plan/fund members have a legal or beneficial right or some other contractual claim against the assets of the pension fund. Pension funds take the form of either a special purpose entity with legal personality (such as a trust, foundation, or corporate entity) or a legally separated fund without legal personality managed by a dedicated provider (pension fund management company) or other financial institution on behalf of the plan/fund members (OECD, 2005[79]).

Pension assets amounted to USD 33 trillion at the end of 2019, with USD 32.3 trillion coming from the OECD area, and only USD 700 billion coming from non-OECD countries. The United States is by far the largest pension market, accounting for USD 18.75 trillion, while the United Kingdom (USD 3.58 trillion),

Australia (USD 1.78 trillion), the Netherlands (USD 1.75 trillion), Canada (USD 1.53 trillion), and Japan (USD 1.44 trillion) follow well behind (OECD, 2019[80]). While pension assets are concentrated in a handful of developed countries, middle-income countries have seen substantial growth of pension markets. Nigeria's pension market grew from USD 6.9 billion in 2007 to USD 24.6 billion in 2017, while China's from USD 20.8 billion to USD 197.8 billion over the same time period (OECD, 2019[80]). Most of Africa has low pension coverage. Only 17% of older persons in sub-Saharan Africa and 37% in North Africa receive an old-age pension (Brookings Institute, 2017[81]).

Pension funds around the world have begun prioritising sustainable investment due to investor demand, evidence of financial returns, regulatory changes, and rising climate risks. The United Kingdom is implementing regulations that require pension fund trustees to factor in ESG impact, and requires those who do not incorporate ESG to justify why not. The European Union has adopted similar regulations to reduce structural and behavioural barriers to sustainable investing (Mooney, 2018[82]). Japan's fund has plans to raise its allocation of ESG investments from 3 to 10%. Danish pension funds have formed a partnership with Denmark's development finance institution to commit USD 600 million to finance sustainable development projects around the world, such as clean energy in Pakistan, education and hospitals in Africa, and solar energy in Ukraine. Two Dutch pension funds, APG and PGGM, have created a decision tree of sustainable development investments, which they have published online for others (IISD, 2019[83]). Despite progress, significant barriers to pension fund alignment remain, including lack of quality data on SDG investments, difficulties in mapping financial data to SDGs, wide variations in methodologies used by funds to track SDG alignment, and insufficient regulatory incentives (Smith, 2020[84]).

The United States pension funds have an outsized ability to shift pension funds toward sustainable investing given their size. A recent regulation, however, actually restricts US pension funds from considering ESG, requiring fund managers to prove they are not sacrificing financial results by investing in ESG funds. State Street Global Advisors and other US asset managers are pushing back on the ruling, defending their fiduciary responsibility to provide sound advice to clients based on evidence of high financial and non-financial returns from sustainable investments (Junior, 2020[85]).

Actions for alignment: Pension funds

Actions for alignment

Actions that pension funds can take themselves:

- Add SDG criteria to investment decisions
- Report on how pension funds incorporate SDG criteria into their activities to inform public discussion with beneficiaries on which SDGs to focus on, and whether to focus on minimising harm or positive change
- Strengthening the expertise and capacity of pension fund managers, especially by building-up knowledge of sustainability portfolios
- Set SDG targets, either in terms output and impact of investments on the SDGs, assets under management for SDG investments, and assets under management for existing investments, negative impact reduction, etc.

Actions that policy makers can take to accelerate alignment:

- Reduce capital requirements for pension funds partnering with DFIs and IFIs
- Create an index for pension fund options based on ESG criteria, and consider incentives to encourage adoption of the portfolios that excel on ESG metrics
- Introduce regulations that incentivise pension funds to factor in ESG impact, and require justification for pension funds that do not
- Improve the availability, consistency and quality of ESG information to help pension funds better understand how they might further integrate ESG in their investment decisions

Insurers and their role in SDG alignment

Insurance is a form of financial intermediation in which funds are collected from policy holders and invested in financial or other assets which are held as technical reserves to meet future claims arising from the occurrence of the events specified in the insurance policies. Individual policy holders (the insured) pay regular payments (premiums) to an insurance company. These premiums are pooled with those of other policy holders so that in the event that an insurance claim is filed, the company can pay out of this pool to cover the loss. Insurers safeguard against the risk of loss for clients (OECD, 2003[86]).

Gross premiums have continued to grow in OECD countries due to increased demand for insurance products. Total gross premiums of life and non-life sectors totalled USD 5.1 trillion in 2018, a 19% increase over 2010, equivalent to 6% of world GDP. Since 2017 gross premiums grew by 2.5% and 3.5% in the life and non-life insurance sectors. Emerging markets only account for 20%of insurance premiums, despite having 80% of the population, so there is significant room for growth (III, 2020[87]). That said, demand for insurance is growing in developing countries, with the Asia-Pacific expected to account for 42%of global premiums by 2030, with China leading the way at 20% of global premiums. Latin America and eastern Europe are also on track to see coverage grow in the coming decade.

A group of insurers representing 20% of world premium volume and USD 14 trillion in assets under management have signed onto the Principles for Sustainable Insurance (PSI), an industry consortium that helps insurers integrate environmental, social, and governance issues into their business models. With its members, PSI has begun conversations on defining specific insurance SDGs, mapping insurance products to the SDGs, and connecting portfolios to the goals while measuring impact (2020[88]). SwissRe, a PSI

member and the second largest insurance company, has committed to achieving net zero emissions with its products by 2050, and has developed quantitative evaluation methodologies for its SDG underwriting. The insurance industry has also been closely involved in the Task Force on Climate-related Financial Disclosures to develop underwriting and pricing tools for climate risk mitigation (Johansson, 2020[89]). The Global Federation of Insurance Associations, which includes insurers that cover nearly 90% of premiums, also forges co-operation in the industry on global governance standards.

Despite progress made, insurers are not collectively factoring ESG risks into their pricing, nor are they systematically moving from a focus on downside risk to forward looking impact. New laws requiring disclosure of climate risk in the United Kingdom, France, and the European Commission, if applied to insurance companies, could help them do so. Moreover, the success of individual insurers such as SwissRe that are covering climate, food security, and other risks in emerging markets could encourage other insurers to broaden coverage, expand product offerings, and embed ESG principles into their mandates.

Actions for SDG alignment: Insurers

Actions that insurers can take themselves:

- Adjust the range of risk factors it considers in making business decisions, incorporating environmental, social, and governance risks, reflecting longer term risks to the economy and the planet, and develop insurance products to mitigate those risks
- Create processes for assessing ESG issues inherent in the risk portfolio and integrate ESG into underwriting, risk management, and capital adequacy decision making
- Incorporate ESG factors into repairs, replacements, disputes, and other claims services
- Measure and monitor ESG risk reduction progress, measured by number of ESG insurance products, ESG risk mitigation premiums as a percent of total premiums, etc.

Actions that policy makers can take to accelerate alignment:

- Incentivise the insurance industry to supply risk reduction solutions, and work with it to agree on industry standards for risk reduction
- Support regulatory and legal frameworks for risk reduction that factor in ESG
- Help insurance companies develop climate protection and adaptation measures, insurance for emergency relief and reconstruction in the event of a disaster, pandemic-induced disaster relief, food insecurity insurance, and SME support
- Invest in capacity building and technical assistance to develop insurance markets in emerging economies
- Adopt policies that encourage companies to broaden coverage and insure more people, especially in underdeveloped insurance markets like in Asia

Asset managers and their role in SDG alignment

Asset managers manage investments on behalf of asset owners. They manage capital not just for people, but also for institutional investors. Blackrock, for example, is an independent asset manager that accounts for its own investments and also the investment accounts of others. Asset owners are legally responsible for the assets owned (such as savings) while asset managers act as an intermediary between asset owners and the final investments. They are bound by their fiduciary duty to make investments according to the instructions provided by the institution for whom they manage assets. A significant overlap exists between

the two categories. In many instances, asset owners hold stakes in the asset management firms to which they delegate responsibility of funds (e.g. bank-owned asset management firms) (Celik, 2014[90]).

Total assets under management of the 500 largest managers was USD 91.5 trillion at the end of 2018, and managers with USD 82 trillion AUM have already signed onto the Principles for Responsible Investment. ESG investments continue to grow, including a 17.8% from 2017 to 2018 (Willis Towers Watson, 2019[91]). A Morgan Stanley survey from 2018 demonstrated that there is room for further growth, finding that 84%of asset owners are pursuing or actively considering integrating ESG into their process, and 60%have done so in the past four years (Morgan Stanley, 2018[92]). Some forward-looking asset managers have moved beyond the ESG framework and "do no harm" doctrines to structuring investments to support the SDGs, using tools such as green bonds and sustainable food equities. HSBC has listed a UN SDG bond, RobecoSAM has a sustainable food equity fund, Pax Ellevate has a Global Women's Leadership Fund, and the World Bank has issued a sustainable cities bond (17 Asset Management, 2019[93]).

Despite ad hoc progress, according to a BNP Paribas Survey of 347 asset owners and managers, only 16%of asset managers apply ESG investment strategies to at least 50%of their mutual funds, although 78%of respondents reported that ESG plays a role in their organisation. The report notes that there is no internal reporting structure in many asset management organisations, and only 23%consider ESG principles embedded into day-to-day operations of their organisation. The biggest barrier to SDG alignment, according to the managers, is simple, reliable, and standardised data (66%), namely inconsistent coverage across asset classes, conflicting ESG ratings and indices, and a lack of advanced analytical tools and technologies (BNP Paribas, 2019[94]).

Actions for alignment: Asset managers

Actions that asset managers can take themselves:

- Invest in new tools and technologies to aggregate SDG investment data (existing ESG-ratings but also new data sources) so that asset managers have more granular information from companies, portfolios, and funds. Incorporate existing SDG data that is financially material to investment performance.
- Expand sustainable investment to asset classes beyond equities (especially green bonds or bonds from mission-driven agencies such as development banks), and develop new structured investment instruments and products to support specific SDGs
- Build the talent and capabilities in individual asset managers to source SDG investments
- Incorporate SDG mandates into asset manager's objectives, and incorporate development impact into the "fiduciary responsibility" of investors

Actions that policymakers can take to accelerate alignment:

- Create platforms that build relationships between asset managers and sustainable companies, sustainable development bond issuers, development finance institutions, and aid agencies
- Make publicly available comparable, consistent, and verifiable ESG information (from corporate and investment strategies)
- Develop an evidence base of successful ESG integration approaches undertaken by asset managers to shape portfolio construction and evaluation decisions

Commercial and investment banks and their role in SDG alignment

Investment banks are financial intermediaries that connect buyers and sellers of financial products and transactions. They provide an array of services such as asset securitisation, mergers and acquisitions, and equity and debt placement with institutional investors. Their clients, especially at larger global banks, are primarily corporations, pension funds, governments, and hedge funds. Commercial banks comprise deposit taking, lending, and payment services (OECD, 2019[95]). Following the financial crisis of 2008, national governments undertook reforms to tighten regulations, increase the resilience of banks in the event of losses, and prevent spill overs across the global financial system, while the international community undertook parallel steps through the Basel III accords. The top 1000 banks manage over USD 147.9 trillion in assets under management in 2018, and represent 39% of global financial assets. 29 are in the European Union, 19 are in China, and 11 are in the United States (FSB, 2020[96]).

Banks have begun taking steps to become more sustainable. The Principles for Responsible Banking is a partnership between the UN and 185 banks that manage more than USD 47 trillion in total assets. It is a largely voluntary network, focused on getting each institution to agree on the principles, set internal targets, publicly report on progress, and analyse how the bank's investments impact the people and planet. The principles are: aligning business strategy to meet the SDGs, maximising impact and publishing targets, working responsibly with clients and customers, proactive stakeholder engagement, strong governance and culture, and transparency and accountability (UNEPFI, 2020[97]).

These initiatives, combined with activist groups such as the Partnership for Carbon Accounting Financials (PCAF) and the Task Force on Climate Disclosures, have prompted banks to take action. The Bank of England decided to make climate change a systemic risk that has to be stress tested (Bank of England, 2019[98]). JP Morgan Chase created its own development finance institution. BNP Paribas, Standard

Chartered, and three other European Banks with loans worth USD 2.7 trillion agreed to measure and report on their carbon assets (Chasan, 2018[99]). More than 100 financial institutions have committed to phasing out coal. This July, Morgan Stanley became the first US-based global bank to commit to disclose how its loans and investments impact climate change, joining the PCAF which now has 66 financial institutions that manage USD 5.3 trillion in assets, and encouraging with other large US investment banks to join the initiative.

Despite progress, banks continue to finance the fossil fuel industry while promoting sustainable lending, with US banks lagging compared to European and Australian banks (WRI, 2019[100]). Moreover, while the Principles for Responsible Banking are ambitious, they are also voluntary. Efforts to develop a standardised methodology for measuring SDG commitments, common reporting and disclosure standards, and SDG investment criteria have been largely ad hoc and at the discretion of each financial institution.

Actions for alignment: Commercial and investment banks

Actions that commercial and investment banks can take themselves:

- Measure, document, and disclose loans and equity investments in projects tied to fossil fuels
- Bolster advisory services to small and medium enterprises, women-led companies, renewable energy projects, and clean technologies, and hire specialists
- Partner with development finance institutions and development banks by matching capital that goes to sustainable companies and projects
- Commit to underwriting green, social, and development impact bonds for clients seeking to raise capital for sustainable investments

Actions that policy makers can take to accelerate alignment:

- Banking regulators should require regular, comprehensive disclosures from financial institutions on social and environmental risks and exposure to potential “stranded assets”
- Mandate banks to conduct stress tests to understand how they would perform under various social and environmental shocks, and publish the results
- Provide guidance on ESG risk management and due diligence in lending transactions in line with international standards

Stock exchanges and their role in SDG alignment

The stock market represents the companies that list equity shares for investors to buy and sell. Globally, it functions as a network of exchanges that allow buyers and sellers to make trades of shares of public companies. Stock exchanges are the platforms that facilitate the trading of those equity securities. The World Federation of Stock Exchanges (WFE), the industry group of 250 exchanges and clearinghouses, estimates its membership has a total market capitalisation of USD 95 trillion. The largest exchanges are the New York Stock Exchange (USD 23.21 trillion), NASDAQ (USD 11.22 trillion), Tokyo Stock Exchange (USD 5.61 trillion), Shanghai Stock Exchange (USD 5.01 trillion) and Hong Kong Stock Exchange (USD 4.4 trillion) (Statista, 2020[101]). As the platform where investors, companies, and regulators interact, stock exchanges are key to improving corporate governance and ESG disclosure.

Most regulators do not have an explicit mandate to incorporate sustainable development criteria into their exchange operations. However, not doing exposes investors to financial risk, missed listing opportunities, and instability in equity markets, such as by failing to deal with the risk of “stranded assets” for listed energy companies. Nonetheless, stock exchanges are developing sustainability mechanisms due to demand from

institutional investors seeking quality ESG data and transparency, groups such as the Extractive Industries Transparency Initiative spotlighting the importance of sustainable corporate governance, and global initiatives led by the World Federation of Exchanges, which has advanced a roadmap for stock exchanges to improve sustainable development practices (World Federation of Exchanges, 2016[102]). Some larger exchanges, like NASDAQ, now publish ESG reporting guides for listing companies (NASDAQ, 2019[103]).

The Sustainable Stock Exchange Initiative is a partnership of nearly 102 stock exchanges representing over 70%of listed equity markets, with a market cap of USD 88.2 trillion. It tracks the initiatives by Sustainable Stock Exchange Initiative members, such as reporting, guidance, presence of an ESG index, provision of ESG bonds, and mandatory ESG listing requirements. It includes several large exchanges such as the Nasdaq and the Hong Kong Exchanges and Clearing Limited. However, not all exchanges adhere to the same degree of compliance. Fewer than half of stock exchanges have issued sustainability reports or are covered by a sustainability-related indices, while only a quarter require ESG reporting for listed companies (SSE, 2020[104]).

The top nine exchanges constitute USD 63 trillion of the USD 95 trillion in total market capitalisation for global stock exchanges and they are all from the United States, European Union, and China. Alignment to address the SDGs and make stock exchanges more sustainable will need to be led by those institutions, given the concentration of market value in a handful of exchanges.

Actions for alignment: Stock exchanges

Actions that stock exchanges can take themselves:

- Incorporate sustainability into the exchange's structure and mandate
- Bolster reporting requirements for listed companies, encourage disclosure of data tied to specific SDG focus areas, such as pay parity by gender
- Create indices that single out companies with strong and weak records on ESG, human rights, gender equality, sustainable supply chains. Establish minimum thresholds in each of these areas for listing companies in sustainable indices
- Produce written guidance on best ESG reporting and transparency practices for listed companies.
- Bolster the exchange's technical assistance capacity to assist listed companies with compliance with reporting and transparency measures

Actions that policy makers can take to accelerate the alignment of stock exchanges:

- Create frameworks for regulators to evaluate ESG related risks in monetary terms
- Require stock exchanges to publish an ESG strategy and ESG reporting guidelines
- Support exchanges in establishing corporate governance criteria for listed companies
- Use technology to turn annual report ESG data from listed companies into quantitative information that can be used by regulators and markets, for example, to anticipate looming ESG controversies

Rating agencies and their role in SDG alignment

Credit rating agencies play a central role in guiding investor decisions. They "collect information about bond issuers and the bonds that they have issued, and […] publish assessments of the prospects for

repayment of specific bond issuances" (White, 2013[105]). These assessments, the credit ratings, help lenders gather information about the borrower before making a loan and monitor the borrower once the loan has been made. While, in principle, every lender with sufficient resources could gather such information, there are two additional roles credit rating agencies play in the financial system: they provide a means of comparison and provide market participants with a common standard to refer to credit risk (OECD, 2010[106]). To avoid a plethora of standards, the credit rating agency market is a natural oligopoly, with three companies - Standard & Poor's, Moody's and Fitch – having a market share of more than 90% in the European Union (ESMA, 2019[107]).

The main lever of rating agencies to facilitate sustainable investment is the inclusion of ESG criteria into their credit ratings. This can have the effect of lowering borrowing costs for bond issuers performing well in terms of sustainability. As of now, credit ratings only include those ESG criteria that are material for a bond issuer's ability to repay debt (FT, 2019[108]). Transparency on how exactly this is done is limited. Increasing the weight of ESG criteria in credit ratings and improving transparency by disclosure requirements such as by the ESMA (2019[109]) will therefore be crucial. Two of the three largest credit rating agencies also go beyond their core business of credit ratings by recently starting to offer ESG ratings measuring the exposure of an investment to ESG risks and its ability to manage these risks. To ensure that ESG ratings do not harm investor trust in sustainable investment, progress needs to be made on the transparency of ESG rating methodology thus helping to explain significantly different ESG ratings of the same company (World Economic Forum, 2019[110]).

Particularly in times of economic turmoil, credit rating agencies are a key factor determining whether capital flows to developed or developing economies. Credit rating policy tends to be pro-cyclical: "Ratings tend to be sticky, lagging markets, and then to overreact when they do change" (Elkhoury, 2008[111]). Both can imply an advantage for developed over developing economies. First, developed economies usually have better credit ratings than developing economies, and therefore profit more if ratings tend to be "sticky". Second, in times of economic turmoil, developing economies suffer most even before credit ratings change, as investors seek a flight to safety. If credit rating agencies then "overreact" (see e.g. Ferri et al. (1999[112]) for the case of the Asian financial crisis, 1997), this again disproportionately harms borrowing conditions and capital market access of developing economies. Following COVID-19, credit rating agencies have again been active downgrading emerging market sovereigns (Fitch Ratings, 2020[113]), partly punishing participation in the DSSI (White & Case, 2020[114]). More transparency by credit ratings agencies in rating changes can help investors assess whether the rating change is justified. Developing economies can regulate the timing of credit ratings and need to develop more capacity engaging with credit rating agencies (Mutize, 2020[115]).

Actions for alignment: Rating agencies

Actions that rating agencies can take:

- Rating agencies should consider standardising the timing of their rating announcements – or deferring their release in times of crisis – to prevent the procyclical nature of their actions.
- Rating agencies should shed greater transparency on ESG rating methodologies and models (World Economic Forum, 2019[110]).
- Rating agencies should undertake more research into the qualitative factors (political systems and political risk factors) of emerging and developing economies as they have an implication on the economic health of the economies (Bhogal, 2016[116]).

Actions that policy makers can take to facilitate alignment of rating agencies:

- Policy makers could consider turning rating agencies into public institutions or enhance/mandate disclosure rules on rating agencies' methodologies, models and assumptions to enable investors to better perform due diligence (UNCTAD, 2015[117]).
- Policy makers should consider regulating the timing of rating announcements to mitigate the procyclical nature of rating actions that can disrupt markets. Regulators of rating agencies such as the Financial Sector Conduct Authority in South Africa have the power to determine the timing of ratings (Mutize, 2020[115]).
- In improving the integration of ESG elements, policy makers may also wish to introduce reporting requirements that include disclosure on ESG related information, this will help improve ESG ratings.
- Developing countries in particular should build capacity to better engage with rating agencies during reviews and appeals (Mutize, 2020[115]).

Philanthropies and their role in SDG alignment

Philanthropy refers to the use private initiatives and resources for the public good. The term "private philanthropic flows for development" refers to transactions from the private sector that promote economic development and welfare of developing countries as their main objective, and which originate from foundations' own sources (notably endowment, donations from companies and individuals, as well as income from royalties, investments and lotteries) (OECD, 2018[118]).

Philanthropies are increasingly important actors in sustainable development and thus for **"SDG alignment"** – the redirection of various sources of global finance towards the sustainable development of countries that need it most. Philanthropic flows are still modest in volume compared to official development assistance (ODA) but in key sectors such as health and reproductive health, private foundations are increasingly significant players. They provided USD 23.9 billion for development over 2013-15, i.e. almost USD 8 billion per year on average. While philanthropic giving remains relatively modest compared to ODA (5% of the three-year total) and financing for development more broadly, foundations have already become major partners in some specific areas. For example, in the health and reproductive health sectors in 2013-15, foundations' support was the third-largest source of financing for developing countries, following that of the United States and the Global Fund to Fight AIDS, Tuberculosis and Malaria (OECD, 2018[118]).

Over a third (37%) of private philanthropy for development was targeted towards SDG 3 on "Good Health and Well-Being" in 2018, followed by SDG 8 (25%) on "Decent Work and Economic Growth", SDG 5 on "Gender Equality" (23%) and towards SDG 11 on "Sustainable Cities and Communities" (23%). In terms

of sectoral distribution, foundations concentrate their financial contributions to a limited number of socio-economic sectors. In 2018, a majority of these funds targeted health and population (USD 3.2 billion; 44% of private development finance), followed by agriculture (11%), support to government and civil society (7%) and education (5%). In contrast, little private philanthropy was allocated for example towards physical infrastructure sectors (e.g. transport and storage, energy and communication) or production sectors beyond agriculture (e.g. industry, mining and construction) (OECD, 2020[119]).

Actions for alignment: Philanthropies

Actions that philanthropies can take themselves:

- **Foundations could improve knowledge sharing with governments and the donor community, especially in some key geographies (middle-income countries) and sectors (health and education).** With little evidence of direct co-ordination and collaboration between foundations and ODA providers, one can assume a degree of overlapping initiatives between philanthropic and ODA-supported initiatives. Thus, closer collaboration in middle-income countries and in key sectors supported by philanthropy would ensure that foundations' efforts are mutually reinforcing, mindful of national development strategies and complementary to other existing initiatives rather than duplicative. Dedicated philanthropic dialogue platforms, especially at the sectoral level, could provide a stable base for dialogue and partnerships.
- **Foundations could make better use of existing platforms at the global, regional and local levels to improve the transparency and availability of data on philanthropic giving in support of development.** There are already many country-level and international reporting initiatives, such as the OECD DAC statistics on development finance (already joined by the Bill & Melinda Gates Foundations and the United Postcode Lotteries), 360giving, Glasspockets and the International Aid Transparency Initiative (IATI). In addition, networks like netFWD together with the Foundation Center, WINGS and others should encourage the philanthropic sector to further share information and help make data a global public good (OECD, 2018[118]).
- **Foundations could play a catalytic role in further building the evidence base on some promising strategies to achieve the SDGs.** Tacking stock of the knowledge that exists based on philanthropic efforts, identifying gaps in funding, and supporting new research on the effectiveness of giving would also go a long way. This recommendation is echoed by the OECD Centre on Philanthropy's recent report on domestic giving in India, where a recent increase of philanthropic flows from mandatory corporate social responsibility efforts and larger voluntary donations from individuals creates an opportunity to better understand the sector's ability to transform those resources into development outcomes.

Actions that policymakers can take to facilitate philanthropies' alignment with the SDGs:

- **Governments in developing countries could further strengthen the enabling environment for philanthropy by adopting or adapting existing regulation, from establishing a legal status clearly distinguishing foundations from CSOs to possible tax incentives.** Unintended consequences should also be looked into: some anti-terrorist laws and anti-money laundering regulations may have disastrous effects on foundations' ability to support partner NGOs on the ground.
- **The donor community could adopt more systematic approaches to engagement with foundations.** These approaches could include the development of strategies for engagement acknowledging foundations' financial and non-financial contribution to development (disconnected from the objective to fundraise), appointment of focal points responsible for developing and maintaining relations and working with foundations, staff exchange programmes between foundations and donor institutions and more flexible partnership models taking into account the constraints of smaller foundations.

Notes

[1] The Team Europe package combines resources from existing programmes (approximately EUR 11 billion) with support from financial institutions such as the European Investment Bank and the European Bank for Reconstruction and Development (EUR 5 billion) and from EU member states (EUR 4 billion).

[2] The OECD (2020[120]) Blended Finance Principles are available at https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/. The OECD is currently working on a series of guidance notes to advise on the implementation of each of the five principles: 1) anchor blended finance use to a development rationale, 2) design blended finance to increase the mobilisation of commercial finance, 3) tailor blended finance to local context, 4) focus on effective partnering for blended finance, and 5) monitor blended finance for transparency and results.

[3] http://www.oecd.org/dac/transition-finance-toolkit/

[4] https://www.oecd.org/development/mdcr/

[5] See, for example, https://www.oecd.org/tax/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.pdf

[6] https://www.oecd.org/tax/tax-global/transparency-and-governance-principles.pdf

[7] The OECD is supporting these efforts through its Sustainable Infrastructure Policy Initiative that aims to pilot the development of instruments, analysis and data related to sustainable infrastructure. See OECD (2019[122]) at http://www.oecd.org/finance/Sustainable-Infrastructure-Policy-Initiative.pdf.

[8] See the GPEDC (2020[123]) webpage for more information at https://www.effectivecooperation.org/landing-page/about-partnership.

[9] "Lex in depth: the $900bn cost of 'stranded energy assets'", Financial Times, February 4, 2020, https://www.ft.com/content/95efca74-4299-11ea-a43a-c4b328d9061c.

[10] This is the estimate for assets under management in 2018 that the Global Sustainable Investment Alliance defines as sustainable.

[11] These initiatives include the UN Global Compact; UN Principles for Responsible Investing; the EU Taxonomy for sustainable finance; the Global Impact Investing Network; Global Investors for Sustainable Development Alliance;; the Global Reporting Initiative; Global Sustainable Investment Alliance; Impact Management Project; UN Environment Programme Finance Initiative Principles for Positive Impact Finance; the Sustainability Accounting Standards Board; the Taskforce on Climate-related Financial Disclosures; UN Sustainable Stock Exchange Initiative; and the World Benchmarking Alliance..

[12] As noted, the OECD and UNDP received the G7 mandate during the French Presidency to "take stock of existing initiatives in view of defining a robust common framework for SDG-compatible finance with all relevant stakeholders". See http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/G7%20Financing%20for%20Development%20Declaration.pdf.

[13] Additionality refers to the extent to which a new input (action or item) adds to the existing inputs (instead of replacing any of them) and results in a greater aggregate. See the Impact Management Project glossary at https://impactmanagementproject.com/glossary/#i.

[14] Net impact refers to positive and negative and primary and secondary long-term effects produced by an intervention, directly or indirectly or intended or unintended. See the Impact Management Project glossary at https://impactmanagementproject.com/glossary/#i.

[15] A list of the organisations in the IMP Structured Network is available on the website of the Impact Management Project (n.d.[124]) at https://impactmanagementproject.com/impact-management/structured-network/.

[16] The five are the Carbon Disclosure Project), the Climate Disclosure Standards Board), Global Reporting Initiative, International Integrated Reporting Council and the Sustainability Accounting Standards Board.

[17] These include alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organization on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

[18] The organisations are the OECD, European Bank for Reconstruction and Development, European Investment Bank, the International Organization of Securities Commissions, the Network for Greening the Financial System and the UN Environment Programme Finance Initiative.

[19] China has three main frameworks for green finance definitions: the "*Guiding Catalogue for the Green Industry*, originally established in 2016 and updated in 2019; the *Green Bond Endorsed Project Catalogue*, often referred to as the Chinese green bond taxonomy; and green credit guidelines, coupled with key performance indicators for green credit and green credit statistics forms.

Global Outlook on Financing for Sustainable Development 2021

A NEW WAY TO INVEST FOR PEOPLE AND PLANET

The *Global Outlook on Financing for Sustainable Development 2021* calls for collective action to address both the short-term collapse in resources of developing countries as well as long-term strategies to build back better following the outbreak of the COVID-19 pandemic. The financing gap to achieve the Sustainable Development Goals (SDGs) in developing countries was estimated at several trillions of dollars annually before the pandemic. The report demonstrates that progress to leave no one behind has since reversed, and the international community faces unprecedented challenges to implement the holistic financing strategy set out in the Addis Ababa Action Agenda (AAAA). The report finds that trillions of dollars in financial assets held by asset managers, banks and institutional investors are contributing to inequalities and unsustainable practices. It highlights the need to enhance the quality of financing through better incentives, accountability and transparency mechanisms, integrating the long-term risks of climate change, global health, and other non-financial factors into investment decisions. The report concludes with a plan of action for all actors to work jointly to reduce market failures in the global financial system and to seize opportunities to align financing in support of the 2030 Agenda for sustainable development.

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