Executive summary

The pandemic and Russia's war of aggression against Ukraine heighten the risk of a Great Divergence between developed and developing countries, and increase pressure on financing for the Sustainable Development Goals (SDGs). The COVID-19 crisis prompted the largest global recession since the Second World War. The nascent global economic upturn masks a protracted recovery in the poorest countries. The war in Ukraine is further driving up food and energy prices, affecting the most vulnerable households.

The impact of health, economic, social, political and environmental shocks are now generating a ratchet effect in developing countries, which could lock them into a protracted recovery and reverse course away from the SDGs. The need for SDG financing to build back better (BBB) has increased, particularly in the poorest countries. The cost of maintaining peace and security has surged due to Russia's war against Ukraine, and governments must juggle competing priorities across the SDGs: accommodating the influx of refugees under stretched development budgets, promoting a net-zero transition in the context of soaring energy prices, etc.

Following the COVID-19 outbreak, available resources are not keeping pace with those growing SDG financing needs, resulting in a scissors effect. The SDG financing gap in developing countries increased by 56% percent in 2020, totalling USD 3.9 trillion. The war further casts a shadow over the financing for sustainable development outlook, with heightened uncertainty due to:

- **Mounting pressure on official development assistance (ODA)**. ODA from DAC countries rose to USD 162.2 billion in 2020, its highest level ever recorded, and a 7% increase over 2019. However, global inflation is degrading the purchasing power of ODA, at the same time that it is being called upon to respond to growing humanitarian and development challenges.
- **Future constraints on government revenue.** Developing countries' available government revenue (i.e. government revenue available after debt service payments) is expected to remain almost 20% below pre-pandemic projections into the foreseeable future. Projections for 2022-24 for middle-income countries (MICs) suggest government revenue will be lower by about USD 95 billion annually due to the political and economic context.
- **Spiralling debt and debt servicing costs.** Between 2020 and 2025, external debt service in developing countries is projected to reach USD 375 billion on average, already a jump from the USD 330 billion on average between 2015 and 2019. With 45% of their outstanding debt maturing by 2024, compared with 36% for all developing countries, low-income countries (LICs) are particularly exposed to rollover risk (OECD, 2022[1]).

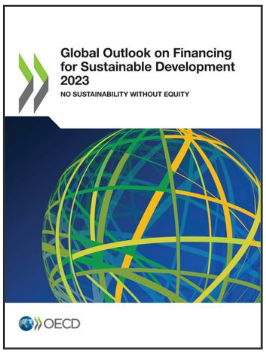
- **Increased volatility of private investment.** External private flows to developing countries excluding China declined significantly by 13% (USD 148 billion), but the drop was milder than anticipated. While capital flows declined by -20%, remittances flows almost completely recovered by the end of 2019. However, estimates for 2022 suggest that recovery of cross-border capital flows will be short-lived. Portfolio investment and other investment are expected to decline by 50% and 45%, respectively, in 2022, while foreign direct investment (FDI) is projected to drop by 23%.

The good news is that a sustainability boom is underway, with fast-growing supply and demand for sustainable finance and investment, that could shift trillions of dollars in the system towards the SDGs. COVID-19 served as a wake-up call to public and private actors about the impact of non-financial risk (i.e. global health, climate change, geopolitical instability, etc.) on financial performance. The line between sustainability risk and financial risk is blurred. Investors recognise the need to limit future sources of market volatility and to seize investment opportunities. The SDGs, by definition, are universal in that they encompass all countries, developed and developing. Moving to a universal SDG paradigm can help ESG risk-mitigation strategies integrate potential transboundary impacts.

SDG-alignment of finance can only deliver to the fullest for the 2030 Agenda if countries with larger SDG financing needs also benefit from it. The *OECD Global Outlook on Financing for Sustainable Development 2023* proposes a two-step approach for developed countries to reinforce the *equity* pillar of SDG alignment, while promoting the *sustainability* pillar for SDG alignment of all actors along the investment chain.

The first step calls on developed countries to prioritise support for domestic resource mobilisation and integrated national financing strategies, to help the poorest countries avoid the looming fiscal and credit crunch. External support should specifically target domestic revenue mobilisation, for example, by fulfilling Addis Tax Initiative commitments, supporting medium-term revenue strategies, and strengthening international tax co-operation and carbon pricing frameworks for sustainable revenue generation. Developed countries can further help developing countries deepen sustainable finance markets by promoting assessment of SDG qualities of investment. Next, developed countries can help attract external finance aligned to integrated national financing strategies in developing countries, including by pooling technical assistance to help countries access sustainable funds, and by targeting debt swaps, bonds and guarantees where appropriate. Finally, higher income countries can help improve the global frameworks for the transparency and accountability of external debt in the poorest and most vulnerable countries.

The second step builds on the 2021 *Global Outlook* and OECD-UNDP *Framework for SDG Aligned Finance* to call for mutually reinforcing actions by all actors along the investment value chain to shift trillions towards the Goals (OECD/UNDP, 2020[2]). Working with institutional investors, asset managers, development finance institutions and other financial intermediaries, higher income country governments can promote a shared public-private commitment (e.g. adherence to the 1% SDG Investment Club) to shift 1% of the trillions in the global financial system in support of SDGs in developing countries. For such commitments to succeed, developed countries should ensure that risk perception criteria and ratings reward long-term action to achieve the SDGs. Developed countries can also implement stronger regulations to avoid SDG-washing at home. Linking ESG and SDG key performance indicators, promoting global and interoperable frameworks for sustainable finance criteria, and raising adherence to guidelines for responsible business conduct, each represents key actions. Finally, higher income countries can strengthen the policy coherence of domestic and external financing for sustainable development; for instance, by reducing domestic support for fossil fuel subsidies that lead to harmful spillovers globally.



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