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

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

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

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

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

Financing for sustainable development capacities under stress

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

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

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

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

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

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

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

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

Slow economic growth is a cause for concern

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

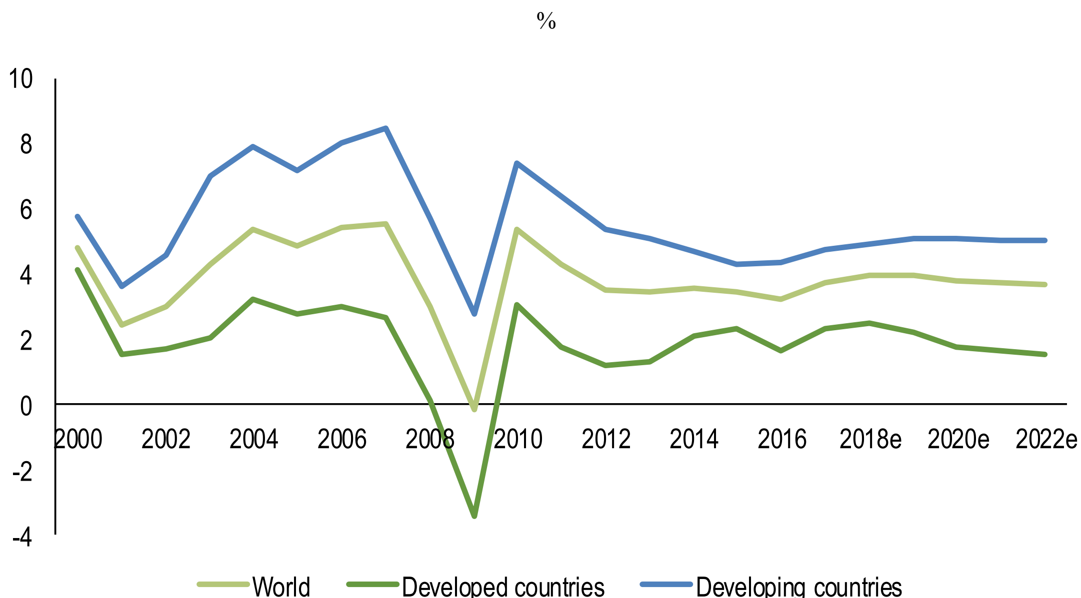
In the domestic context, economic growth expands the tax base of a country, leading to more domestic public resources. Revenues from corporate and personal income taxes and from value-added taxes increase with higher levels of economic activity. A slowdown in growth in developing countries consequently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

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

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

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

%



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

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

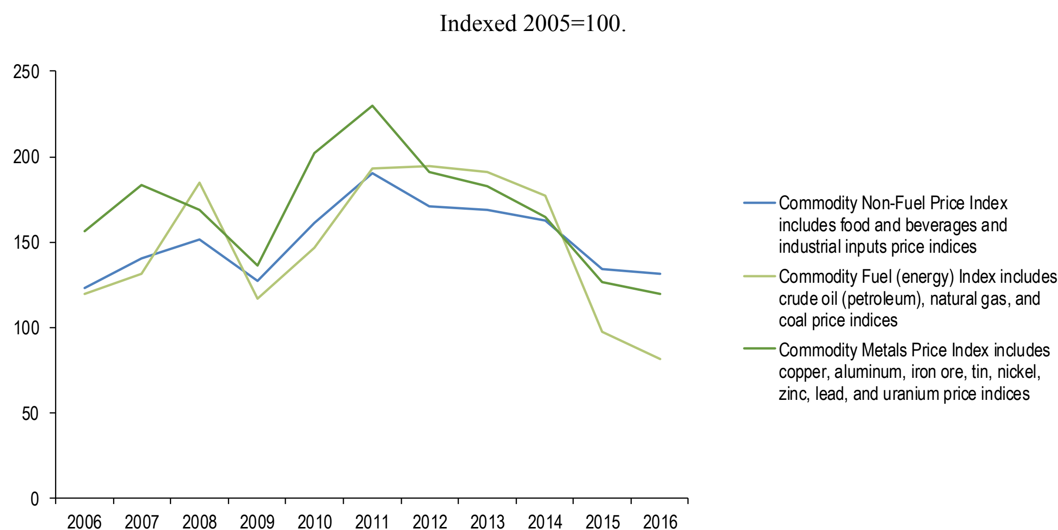
For developing countries, growth performance and prospects are often linked to the trade and price of commodities. On one hand, many developing countries depend on revenues from the export of commodities and natural resources to generate domestic resources. UNCTAD (2017[5]) reports that 64% of developing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

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

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

Figure 1.2. Commodity prices have dropped

Indexed 2005=100.



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

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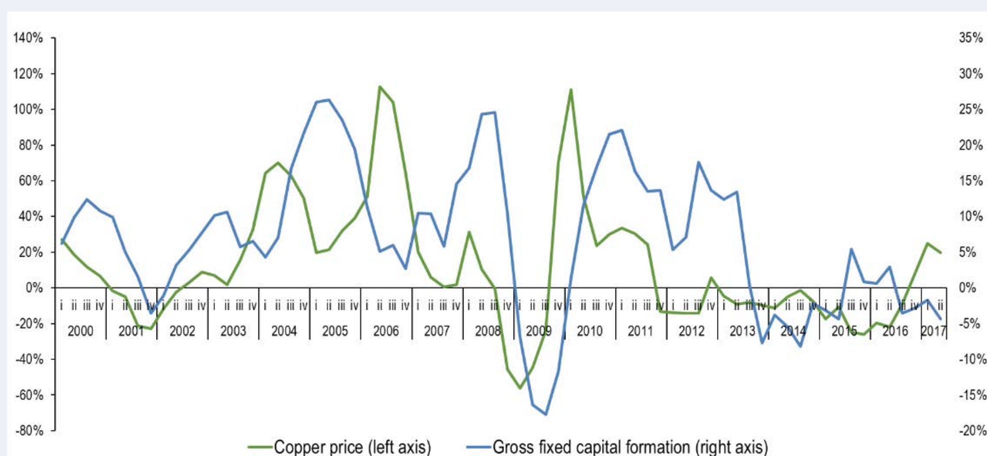
Box 1.1. The Chilean counter-cyclical response to the end of the commodities super-cycle

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

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

Figure 1.3. Effect of copper prices on investment



Source: Copper price data from the Central Bank of Chile (2018[7]), *Base de Datos Estadisticos,* https://si3.bcentral.cl/Boletin/secure/boletin.aspx?idCanasta=FHLES3325; data on gross capital formation from OECD (2018[8]), "National Accounts Statistics" (database), https://www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en.

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

Increasing debt levels result in reduced absorption capacities

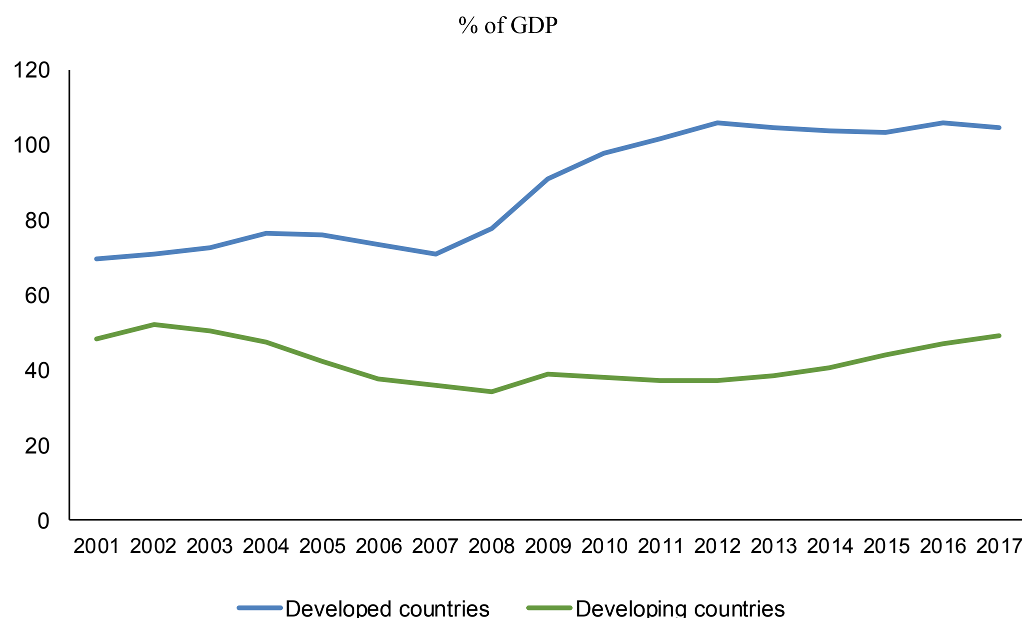
Debt levels are on the rise in both developing and developed countries, putting constraints on resources that can be devoted to sustainable development. Global debt hit a record high of USD 164 trillion in 2016, the equivalent of 225% of global GDP (Gaspar and Jaramillo, 2018[1]).

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

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

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

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



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

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Innovation and technology bring opportunities and threats

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

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

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

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

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

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

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

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

The rise in migration has far-reaching effects

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

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

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

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

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

Financing for sustainable development needs are increasing

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

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

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

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

An increased ambition for the development agenda

Greater ambitions accompany the shift from MDGs to SDGs

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

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

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

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

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

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

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

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

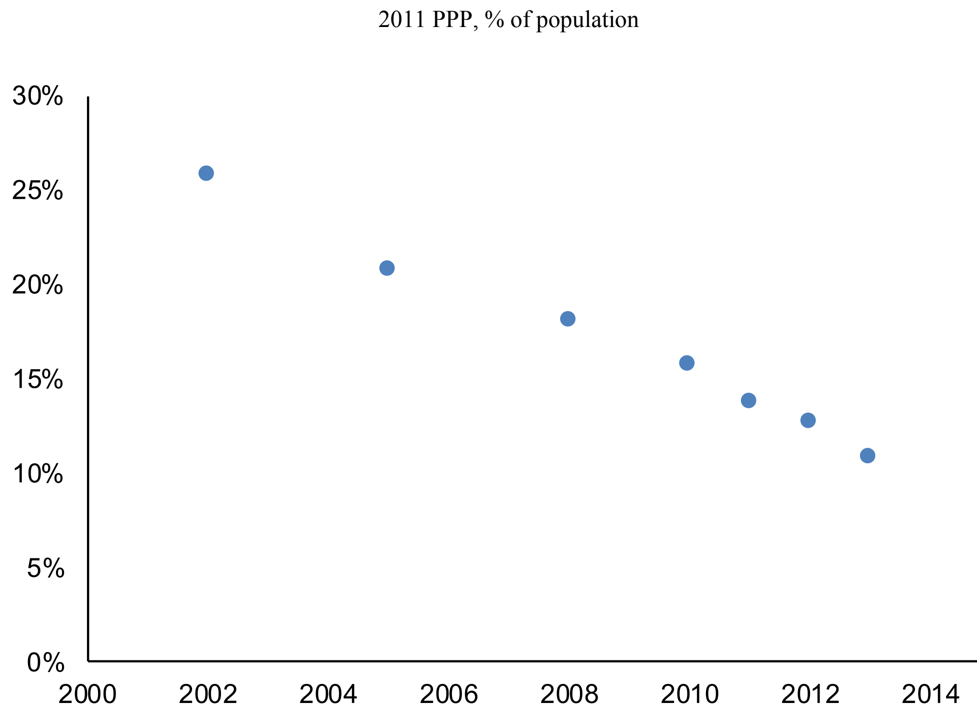
Success and failure to reduce global poverty and inequalities

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

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

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

2011 PPP, % of population



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

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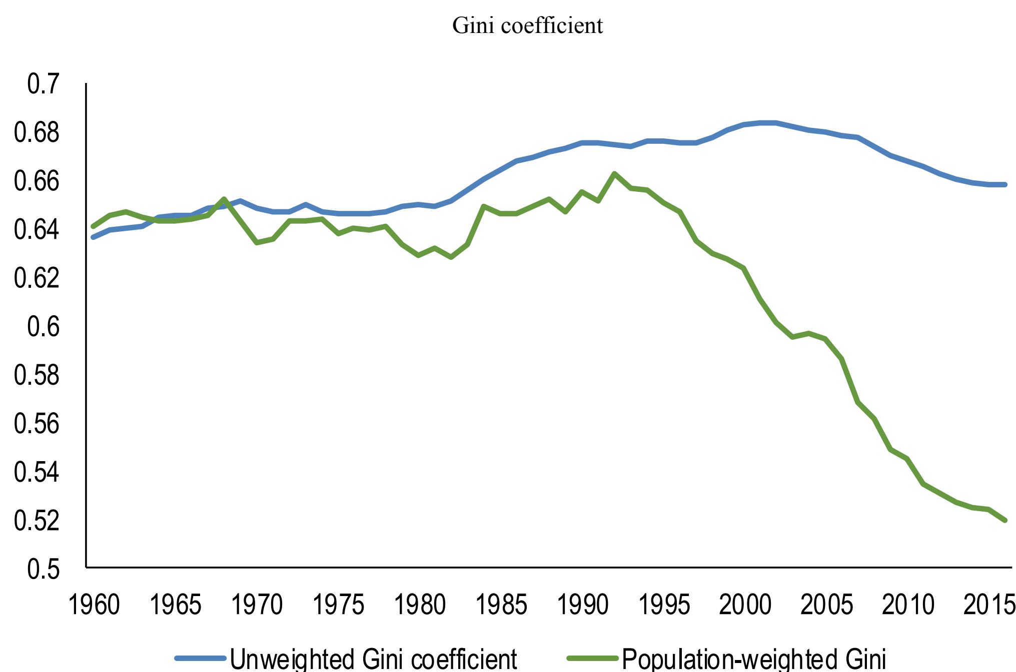
Nevertheless, the benefits of global poverty reduction are unevenly distributed. For example, more than 70% of global poverty reduction is attributable to progress in China where, since 1980, 850 million people who lived below the international poverty line of USD 1.90 per person per day (2011 PPP) have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

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

Figure 1.6. Inequality between countries has decreased

Gini coefficient



Note: The graph shows two ways of measuring inequality between countries based on Gini coefficients estimated from countries' real per capita GDP. One is the unweighted Gini where each country counts equally and the other is the weighted Gini where countries are weighted by the size of the population. The sample consists of 87 countries for which real capita GDP data throughout the period from 1960 to 2015 are available.

Source: World Bank (2018[22]), "World Development Indicators" (database), https://data.worldbank.org/products/wdi.

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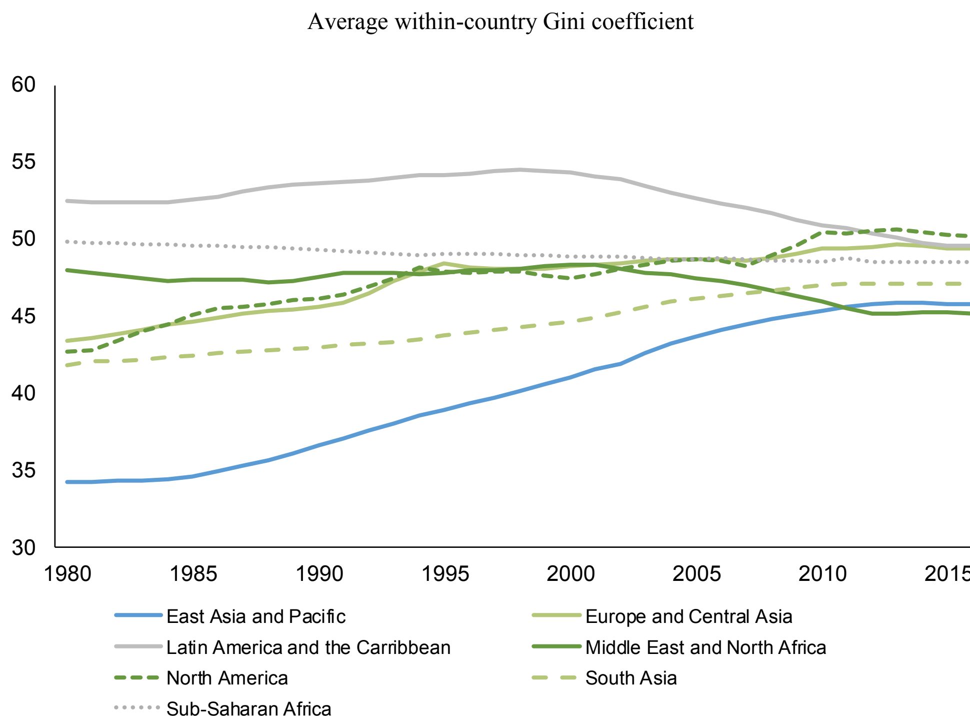
However, income inequalities within countries have widened both in developed as well as developing countries (Figure 1.7). In most countries, the gap between rich and poor is at its highest level in 30 years (OECD, 2015[23]). Although high-income countries tend to have the lowest levels of income inequality,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

Figure 1.7. Inequality within countries is increasing in many regions

Average within-country Gini coefficient



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

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

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

More and more challenges extend beyond national borders

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

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

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

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

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

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

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

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

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

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

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

Transforming the vicious circle to a virtuous circle

The consequences of capacities under stress

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

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

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

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

Linking development and inclusive growth

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

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

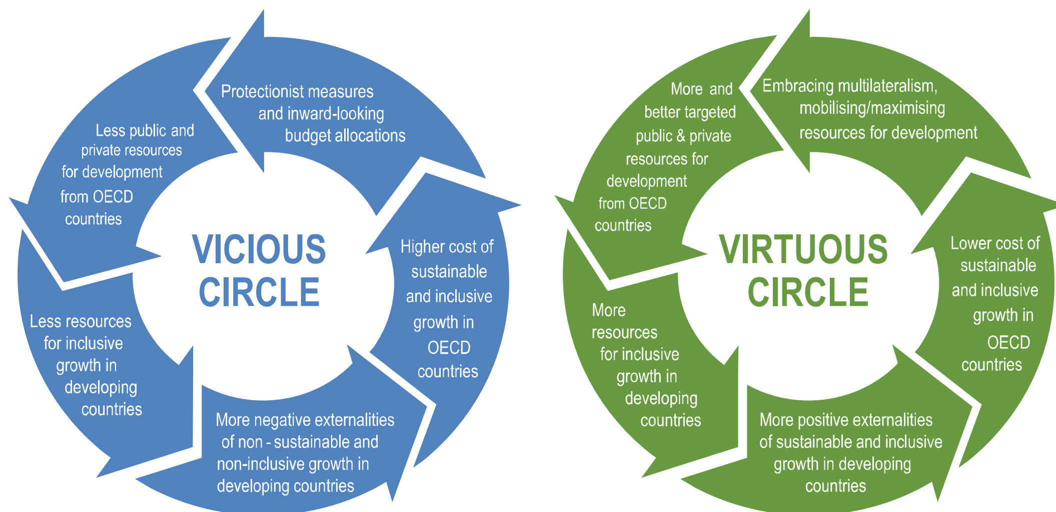
In the face of technological advances and demographic shifts that already are profoundly changing their economies, many developed countries are looking for ways to ensure continued growth and the equitable distribution of benefits. The IMF and the OECD, among other international organisations, also have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

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

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

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

Figure 1.8. Transforming the vicious circle into a virtuous circle



Source: Authors

A call to transform the sustainable development finance system

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

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

What has changed in the financing for sustainable development system?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

What remains to be done?

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

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

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

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

Notes

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

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

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

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

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

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

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

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