Overview: Time to face the challenge

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

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

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

In brief

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

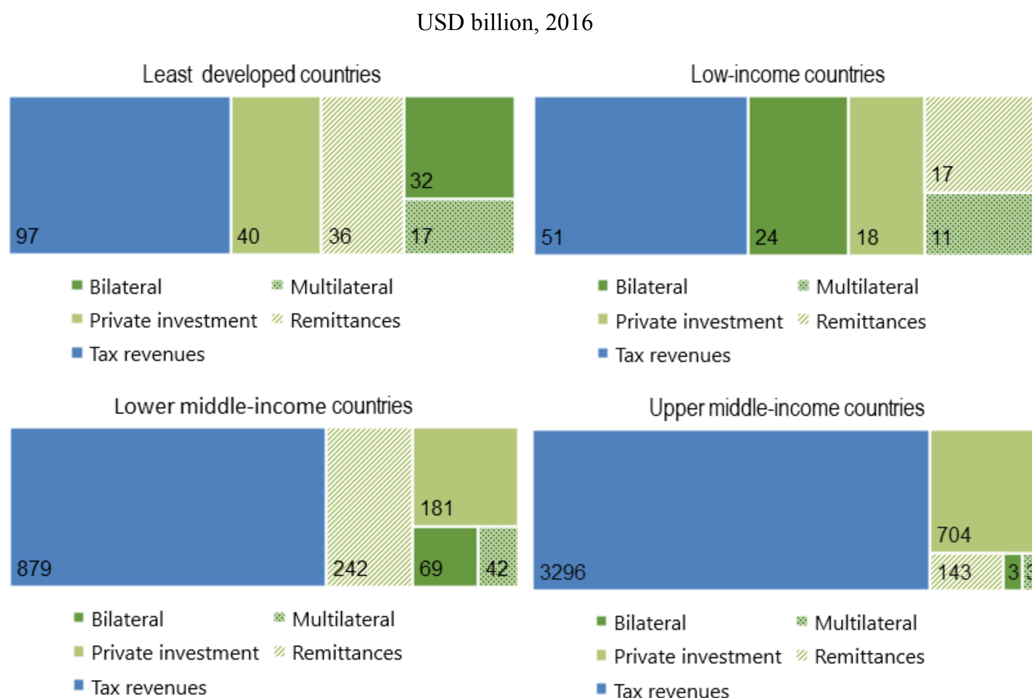
Worrying trends	Encouraging trends
Domestic resource mobilisation – (public) Tax revenue to GDP ratio (at 14% in least developed countries/low-income countries) still below the 15% recommended threshold; (private) domestic private investment in decline.	**Philanthropy** – USD 8 billion a year on average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

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

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

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

USD billion, 2016



Note: The estimates have been calculated for the list of developing countries eligible for ODA but exclude a number of countries and territories because of lack of data on tax revenue. Those excluded are the following low-income countries (LICs): Democratic People's Republic of Korea; Somalia, which is also a least developed country ([LDC]); and South Sudan (also an LDC).

Among lower middle-income countries and territories (LMICs), the following are excluded: Bhutan (LDC), Kosovo, Mongolia, Myanmar (LDC), Sri Lanka, Syrian Arab Republic, Vanuatu (LDC), West Bank and Gaza Strip. The third group to be excluded are upper middle-income countries (UMICs): Cuba, Fiji, Former Yugoslav Republic of Macedonia, Libya, Montenegro, Nauru and Venezuela.

Source: IMF (2017[7]), "World revenue longitudinal data", https://data.world/imf/world-revenue-longitudinal-dat; and OECD (n.d.[8]), "Global revenue statistics" (database), https://stats.oecd.org/index.aspx?DataSetCode=REV; OECD (2018[9]), "Creditor Reporting System" (database), https://stats.oecd.org/Index.aspx?DataSetCode=crs1; World Bank (2018[10]), "Migration and remittances data", http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data; IMF (2018[2]), "Balance of payments statistics 2017", http://www.imf.org/external/datamapper/datasets/BOP for private investment data.

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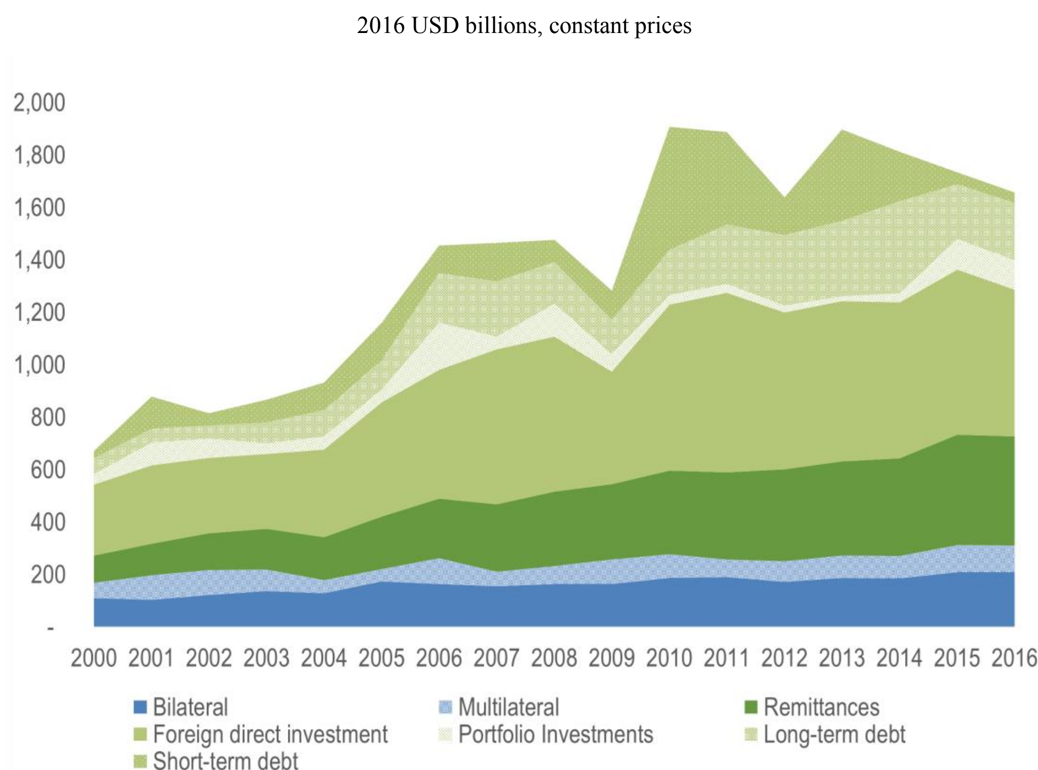
International actors, both public and private, contribute substantive amounts of cross-border finance to developing countries. The volume of external finance available to developing countries has substantially increased to USD 1.7 trillion in 2016 from USD 675 billion in 2000. But recent trends are sobering,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

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

2016 USD billions, constant prices



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

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

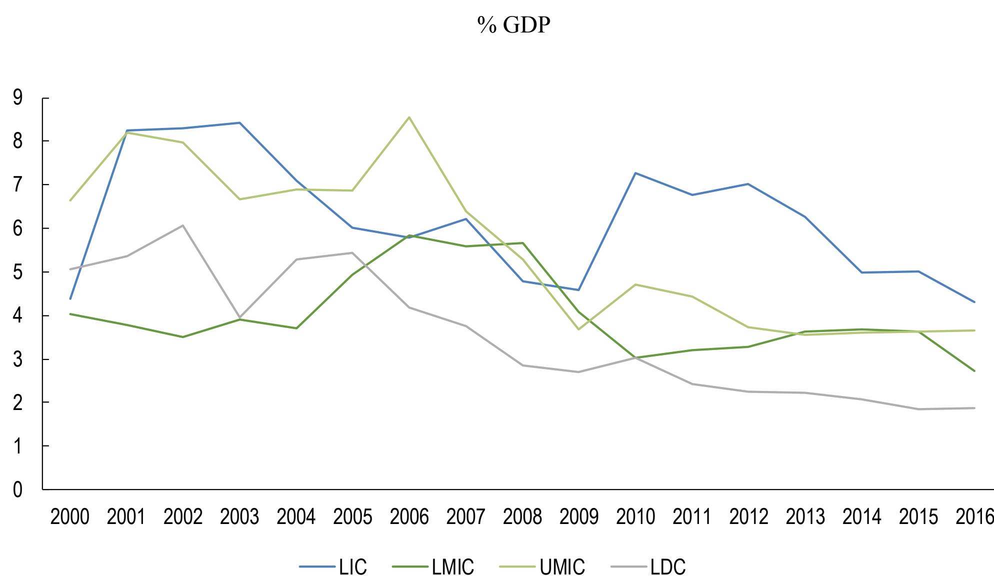
Migrants from developing countries are an important provider of FSD and the least volatile. They sent home a record USD 466 billion of remittances in 2017. In some countries, they make up as much as 30% or more of GDP, as in Tajikistan, Kyrgyzstan and Tonga.

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

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

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

% GDP



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

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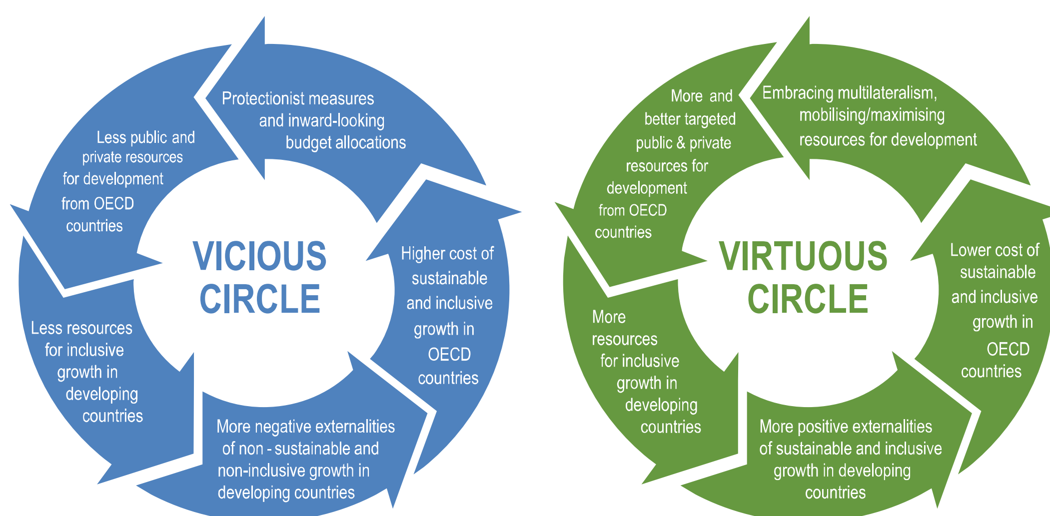
All nations need sustainable development globally to achieve more inclusive growth at home

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

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

Figure 0.4. Transforming the vicious circle into a virtuous circle



Source: Authors

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

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

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

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

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

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

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

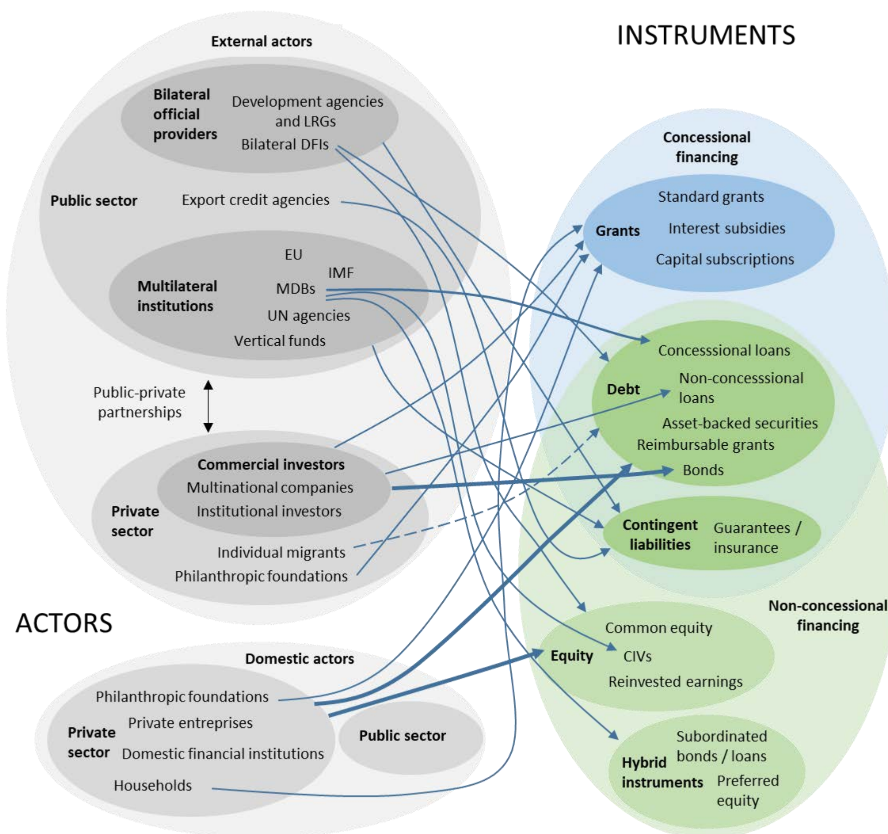
Once concentrated on *international aid*, the international co-operation agenda has moved to *development finance* and now towards *financing for sustainable development*. With this shift has come a great expansion of the number and diversity of *financial actors* who are called upon by the international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

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

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

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

Figure 0.5. The spaghetti bowl of sustainable development finance instruments



Source: Authors

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

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

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

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

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

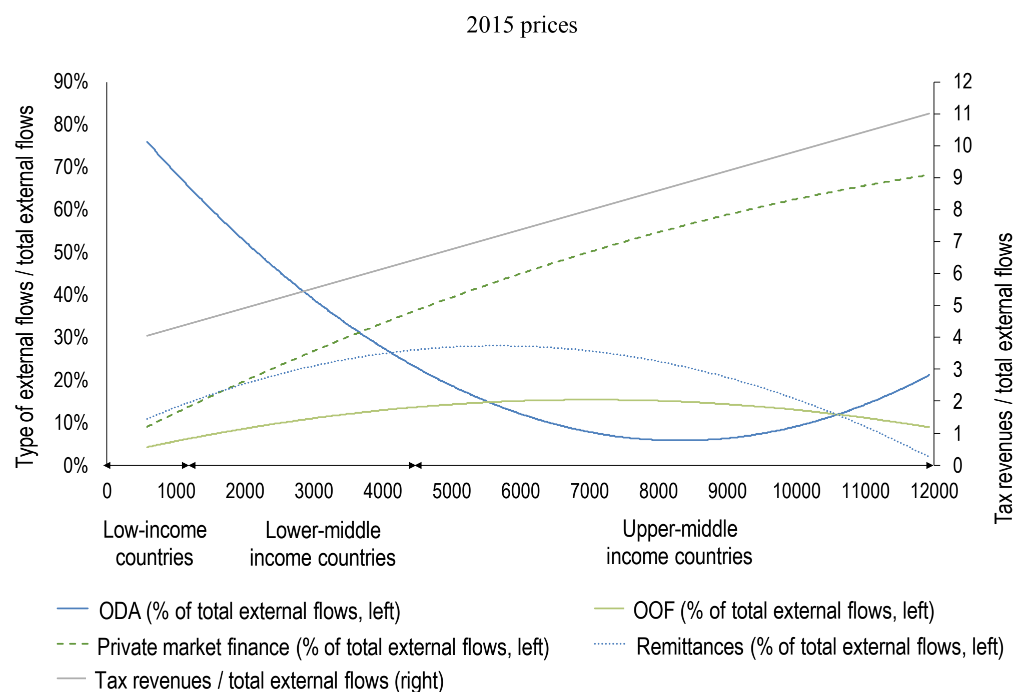
As countries transition from one category of income-per-capita to the next, their needs (demand) and the mix of resources available to public and private actors (supply) change. For example, countries exiting the OECD Development Assistance Committee (DAC) list of recipients cease to be eligible for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

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

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

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

2015 prices



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

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

Towards a more efficient global system of financing for sustainable development

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

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

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

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

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

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

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

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

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

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

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

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

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

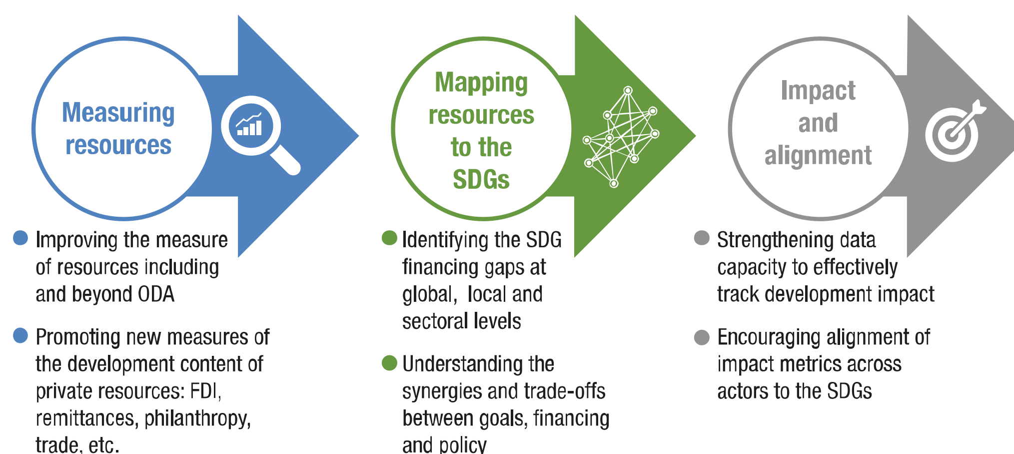
Better measurement of flows, alignment with the SDGs and impact is the first step towards reforming the sustainable development finance system

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

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

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

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



Source: Author

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

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

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

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

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

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

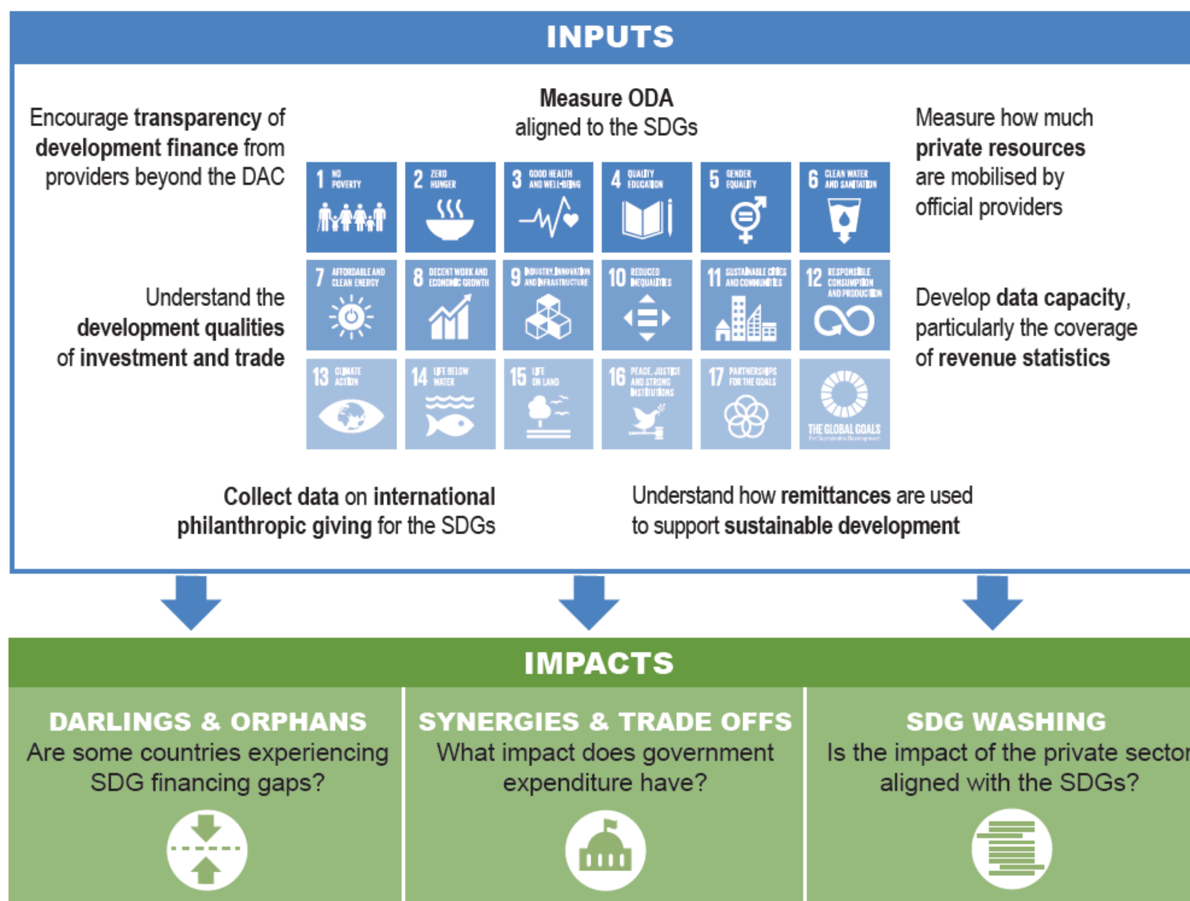
The total annual investment gap in key sustainable development sectors is estimated at USD 2.5 trillion (UNCTAD, 2014[16]). This figure is 17 times current ODA volumes (USD 146.6 billion in 2017) and more than 10 times the estimated MDG financing gap. While such estimates inevitably raise methodological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

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

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

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

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



Source: Author

Actions to improve the measurement and monitoring of development finance

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

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

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

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

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

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

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

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

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

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

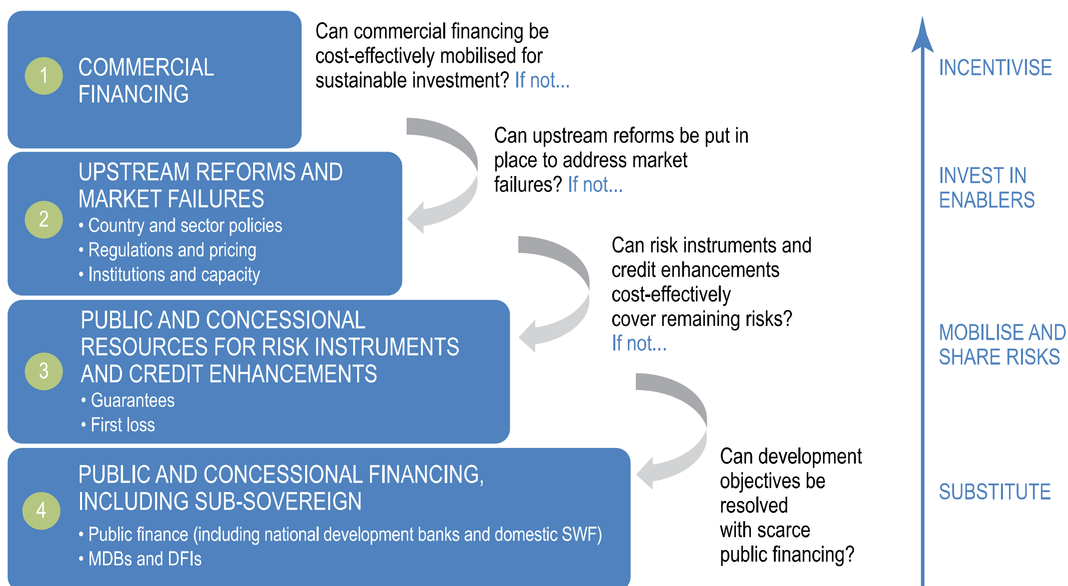
Figure 0.9. Three opportunities to maximise the impact of finance on sustainable development

Source: Author

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

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

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



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

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

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

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

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

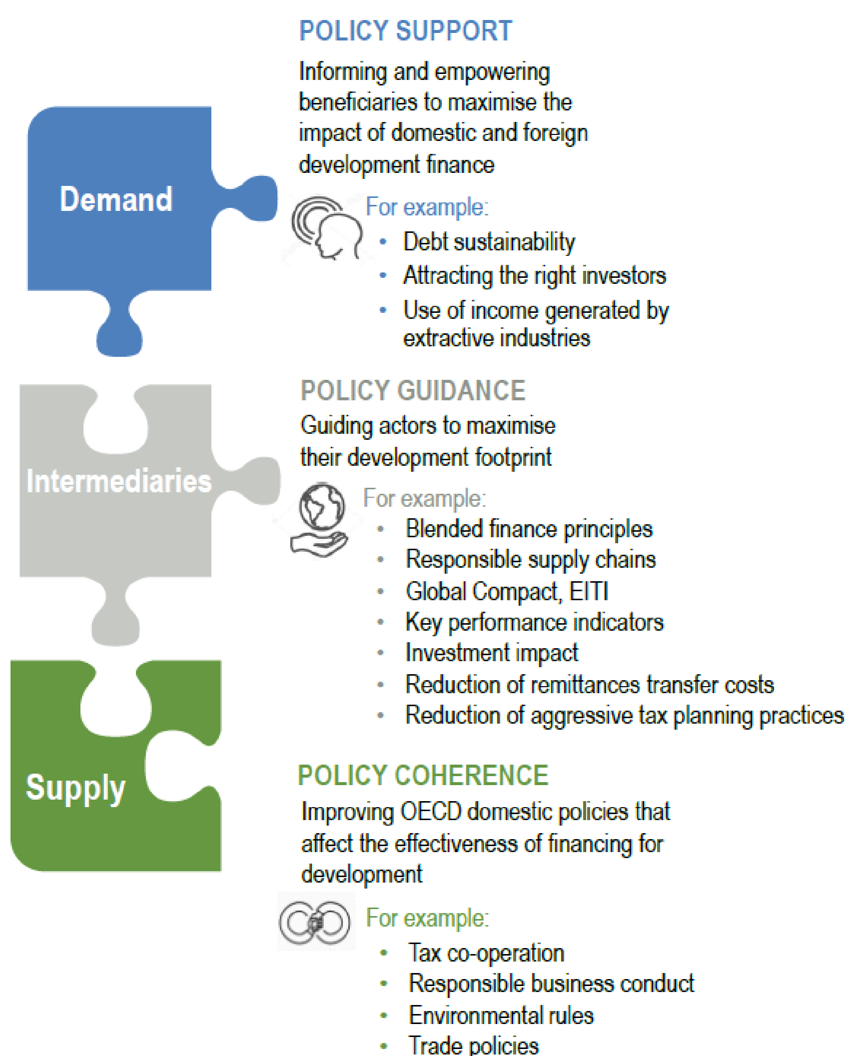
Improving the functioning of the FSD system requires better policies at three levels (Figure 0.11). First, on the demand side, policy support can help developing countries be in a position to make the most of available choices. Actors in developing countries create demand for a growing array of financing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

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

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

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

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



Source: Author

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

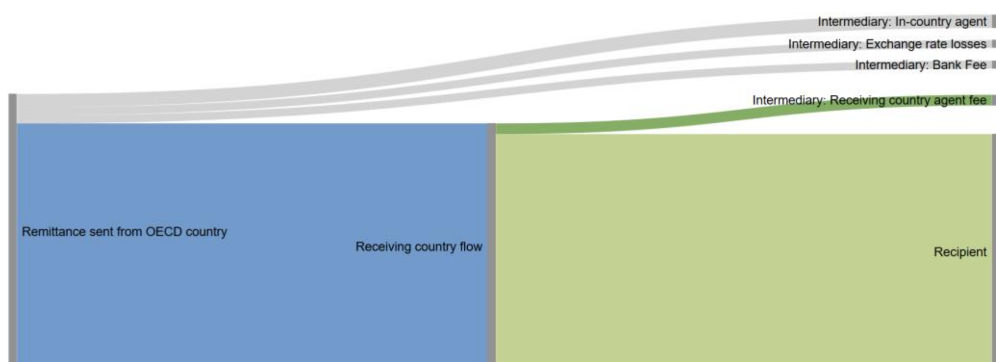
FSD intermediaries can be considered the third level for policy guidance. Intermediaries could divert resources away from beneficiaries and development objectives, depending on the nature of their practices and the potential for capturing rents. More needs to be done, including in new areas of the Addis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

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

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

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

Figure 0.12. Leakages in remittance transfers



Source: Authors

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

Actions to improve policies in the market for sustainable development finance

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

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

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

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

Invest in domestic enablers of sustainable development

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

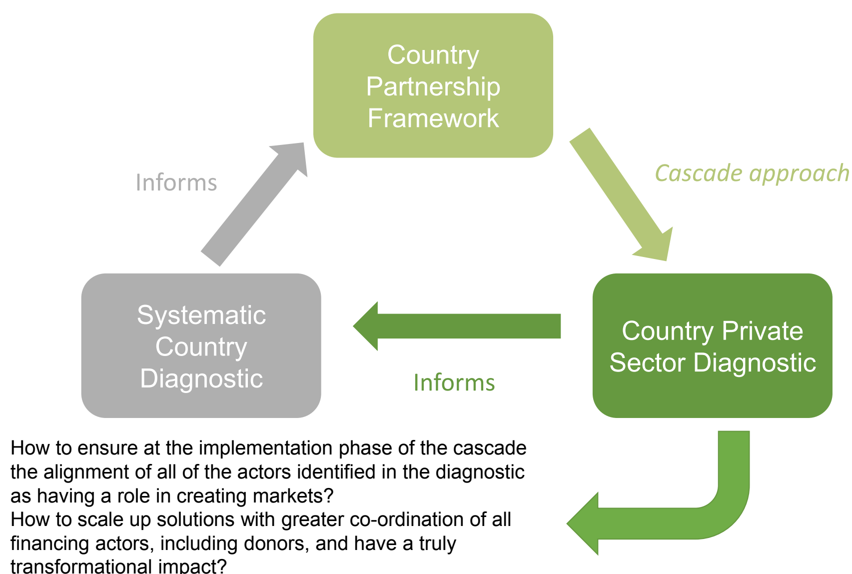
Better implementation of the Addis Ababa Action Agenda requires more integrated development strategies and operations

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

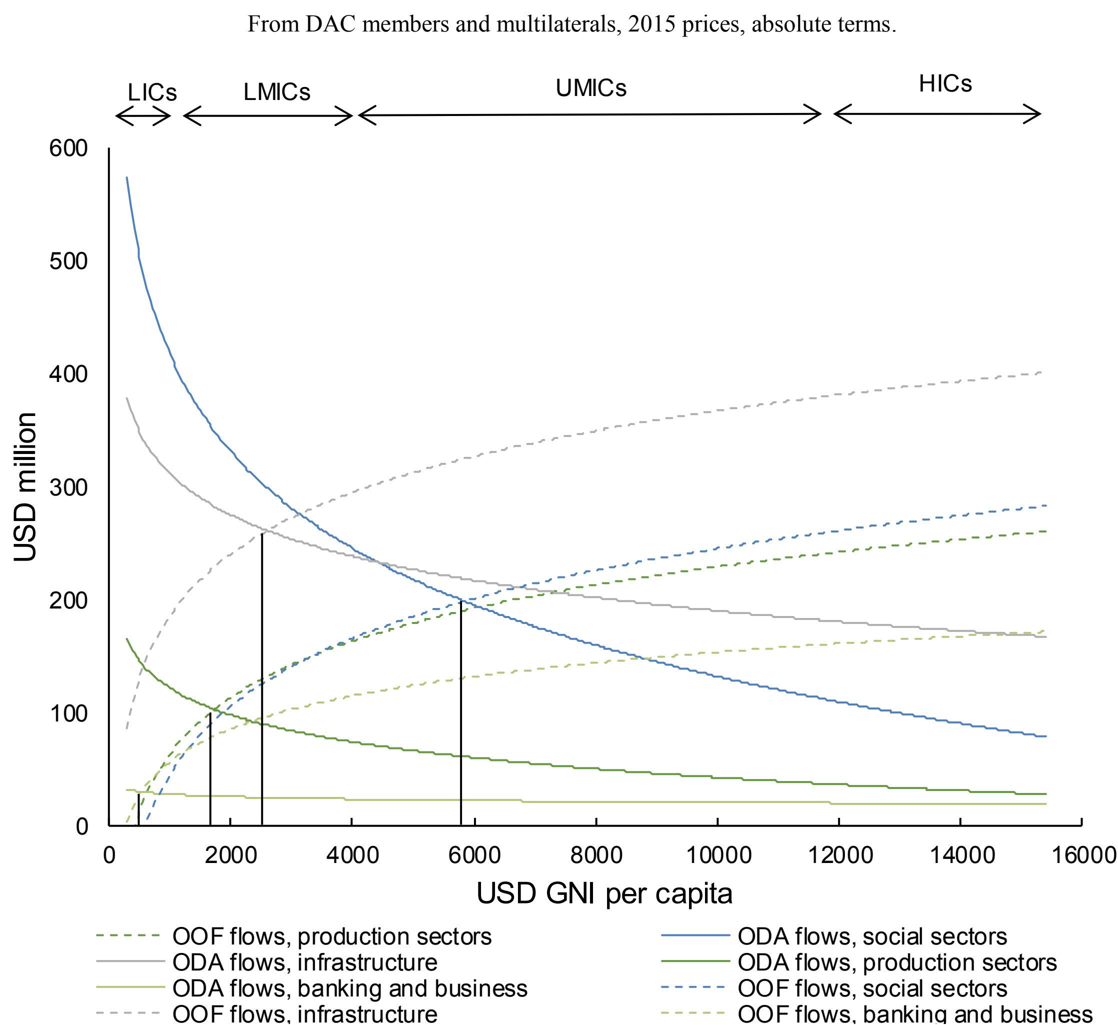
Special attention must be given to specific *policy* goals such as education or health that are subject to potential setbacks as countries transition to higher income and to changes in the finance they can access (Figure 0.14).

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

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

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

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



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

StatLink http://dx.doi.org/10.1787/888933853414

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

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

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

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

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

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

Notes

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

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

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

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

[5] See Charlevoix G7 Communiqué.

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

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

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

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

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

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

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

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