

Advance unedited version

**Report of the
Intergovernmental Committee of Experts on
Sustainable Development Financing**

Final Draft

8 August 2014

Table of contents

| | | |
|-------|--|----|
| I. | Procedural Introduction to the Report on the work of the ICESDF..... | 3 |
| II. | Organizational matters..... | 3 |
| III. | Introduction..... | 6 |
| IV. | The global context..... | 8 |
| | A. A changing global context | 8 |
| | B. The scope of financing needs | 9 |
| | C. Emerging patterns of resource flows | 11 |
| V. | Strategic approach | 18 |
| VI. | Options for an integrated sustainable development financing strategy | 21 |
| | A. Domestic public financing | 21 |
| | B. Domestic private financing..... | 26 |
| | C. International public financing | 31 |
| | D. International private financing..... | 35 |
| | E. Blended finance | 37 |
| VII. | Global governance for financing sustainable development | 42 |
| VIII. | Concluding remarks..... | 48 |

I. Procedural Introduction to the Report on the work of the ICESDF

(1) In Resolution 66/288 of 11 September 2012, the General Assembly endorsed the outcome of the United Nations Conference on Sustainable Development, entitled “The future we want”.

Paragraphs 255 and 256 of this document read as follows:

“255. We agree to establish an intergovernmental process under the auspices of the General Assembly, with technical support from the United Nations system and in open and broad consultation with relevant international and regional financial institutions and other relevant stakeholders. The process will assess financing needs, consider the effectiveness, consistency and synergies of existing instruments and frameworks and evaluate additional initiatives, with a view to preparing a report proposing options on an effective sustainable development financing strategy to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives.

256. An intergovernmental committee, comprising thirty experts nominated by regional groups, with equitable geographical representation, will implement this process, concluding its work by 2014.”

(2) In Resolution 67/203 of 27 February 2013, the General Assembly requested the intergovernmental committee to provide an update on the progress of its work before the beginning of the sixty-eighth session of the Assembly.

(3) By its decision 67/559 of 18 June 2013, the General Assembly welcomed the Committee’s membership comprised of 30 experts as nominated by the five regional groups of the United Nations, as listed in annex I of the decision. In the same decision, regional groups were authorized to appoint replacements for those experts from their group who cease to be members of the Committee, effective upon notification of the President of the General Assembly and the Committee by the relevant regional group. Experts already nominated by regional groups to serve as replacements for members of the Committee were listed in Annex II of this decision.

II. Organizational matters

A. Organization of work

(4) Sessions were held as follows: first session (28-30 August 2013, six formal meetings); second session (2-6 December 2013, ten formal meetings); third session (3-7 March 2014, nine formal meetings); fourth session (12-16 May 2014, ten formal meetings) and fifth session (4-8 August 2014, ___ formal meetings).

B. Opening

(5) On 28 August 2013, the Acting President of the sixty-seventh session of the General Assembly (Peru) opened the session and made a statement. A statement was also made by the Assistant Secretary-General for Economic Development on behalf of the Under-Secretary-General for Economic and Social Affairs.

C. Election of officers

(6) At its first meeting of the first session on 28 August 2013, the Committee elected Pertti Majanen (Finland) and Mansur Muhtar (Nigeria) as its Co- Chairs by acclamation.

D. Agenda

(7) At the same meeting, the Committee adopted the provisional agenda (A/AC.282/2013/1), which read:

1. Election of officers.
2. Adoption of the agenda and other organizational matters.
3. Follow-up to the outcome of the United Nations Conference on Sustainable Development, relating to the preparation of a report proposing options on an effective sustainable development financing strategy to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives.
4. Other matters.
5. Adoption of the report.

E. Modalities of work

(8) At the same meeting, the Committee adopted its modalities of work¹.

(9) At the 3rd meeting of its first session, on 29 August 2013, the Committee agreed to organize its work into three clusters of topics, as follows:

1. Assessing financing needs, mapping of current flows and emerging trends, and the impact of domestic and international environments
2. Mobilization of resources and their effective use:
 - a) Domestic resources (public and private): increasing effectiveness and mobilizing additional resources
 - b) External resources (public and private): increasing effectiveness and mobilizing additional resources
 - c) Blended finance (domestic and international) and new initiatives
3. Institutional arrangements, policy coherence, synergies and governance issues

F. Proceedings of the Intergovernmental Committee of Experts

Closed meetings

(10) Pursuant to its modalities of work, the Committee conducted the majority of its work in closed plenary meetings, in an interactive format.

¹ Available from: <http://sustainabledevelopment.un.org/content/documents/1999FINAL%20Modalities%20of%20work-ICESDF-revised%2028%20August%202013-2.pdf>

Open meetings

(11) A briefing to the General Assembly on the work of the Committee (pursuant to paragraph 7 of General Assembly resolution 67/203) was held on 30 August 2013. The Committee also held an open briefing on the progress of the Committee's work on 16 May 2014.

(12) Interactive multistakeholder dialogues with Member States, intergovernmental organizations, NGOs, business sector and other Major Groups engaged in the Rio+20 Conference, the Financing for Development process and the post-2015 development agenda were held on 5 December 2013, 3 March, 12 May, 18 July and 5 August 2014. The multistakeholder dialogues were preceded by open briefings.

(13) A joint meeting with the Open Working Group on Sustainable Development Goals was held on 5 March 2014.

Other meetings

(14) The Committee held regional outreach meetings in Santiago de Chile (Latin America and Caribbean), in Helsinki, Finland (Europe), Addis Ababa, Ethiopia (Africa), Jeddah, Saudi Arabia (Arab region), and in Jakarta, Indonesia (Asia). In addition, numerous informal outreach events and multi-stakeholder dialogues were organized in different locations, including events with the international financial institutions.

G. Adoption of the report of the Intergovernmental Committee of Experts

(15) At its ___th meeting of its fifth session, on 8 August 2014, the Committee adopted its draft report (contained in document A/CONF.282/2014/___), and entrusted the Co- Chairs, in collaboration with the Secretariat, to forward the report to the General Assembly for its consideration.

Annex

I. Membership of the Committee per session

III. Introduction

(16) At the United Nations Conference on Sustainable Development (Rio+20), the international community agreed to undertake a major effort to promote sustainable development globally and in every nation and free humanity from poverty and hunger.² Member States also agreed to establish the Intergovernmental Committee of Experts on Sustainable Development Financing (the Committee)³ and tasked us with developing options for a sustainable development financing strategy to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives.

(17) Rio+20 reaffirmed all the principles of the Rio Declaration on Environment and Development, including, inter alia, the principle of common but differentiated responsibilities, as set out in principle 7 thereof.

(18) Our work is rooted in the principles expressed in the Rio+20 outcome document and in the universal values expressed in the United Nations Millennium Declaration,⁴ noting that peaceful and inclusive societies, gender equality and human rights for all, including the right to development, are strong enablers for sustainable development. Eradicating poverty is the greatest global challenge facing the world today and an indispensable requirement for sustainable development.

(19) The Monterrey Consensus of the International Conference on Financing for Development⁵ provided a basis for our analysis, with its emphasis on the use of all forms of financing, including public, private, domestic and international in a holistic manner, as well as its recognition that each country has primary responsibility for its own development, while the global community is responsible for an enabling international environment. However, we also recognized the need to update this framework to meet the challenges of the post-2015 development agenda.

(20) In this regard, we were mindful of the work of the Open Working Group on Sustainable Development Goals, and guided by the resolve of Member States that the post-2015 development agenda should reinforce the commitment of the international community to sustainable development based on a coherent approach that integrates its economic, social, and environmental dimensions. This approach involves working towards a set of global goals, universal in nature and applicable to all countries, while taking account of differing national circumstances and respecting national policies and priorities.

(21) Building on the modalities and spirit that led to the Rio Declaration and the Monterrey Consensus, we consulted widely with a range of stakeholders, including civil society, the business sector, and other major groups. This outreach was integral to our work and included multi-stakeholder consultations, regional meetings, and calls for contributions on our website. We are grateful for all the inputs we received.

² A/CONF.216/16, chapter I, resolution 1.

³ General Assembly Decision 67/559

⁴ Resolution 55/2

⁵ A/Conf.198/11, chapter 1, resolution 1, annex

(22) We began our analysis by assessing sustainable development financing needs, current financing flows and potential sources of financing. We found that needs are huge and the challenges in meeting them are enormous – but surmountable. Indeed, global public and private savings would be sufficient to meet the needs. Yet it is clear that current financing and investment patterns will not deliver sustainable development. In particular, expected returns on investments associated with sustainable development are often not as attractive as other opportunities, especially in the near term. At the same time, there are many competing demands on public resources, and governments have not been able to mobilize adequate public financing to undertake necessary investments that profit-seeking investors eschew.

(23) The solution includes better aligning private incentives with public goals and creating a policy framework that encourages for-profit investment in these areas, while also mobilizing public resources for essential sustainable development activities. The quality of finance also matters. Efforts to reduce corruption and to adopt more economically and socially effective public sector policies are thus important. Policies and incentives should also aim to better match investor preference with investment needs, so that, for example, long-term sustainable development needs are not financed with short-term funds.

(24) Our work concludes that there is no one simple policy solution. Instead, a basket of policy measures will be necessary, encompassing a toolkit of policy options, regulations, institutions, programs and instruments, from which governments can choose appropriate policy combinations. We recommend a cohesive approach, with national financing strategies as an integral part of national sustainable development strategies. While the design and implementation of policies will be on the national level, achieving sustainable development will require international support and cooperation. Our approach is based on the principle of country ownership, supported by a strengthened global partnership for sustainable development. We find that a concerted effort that draws on all actors and mobilizes all resources in an integrated manner, while maximizing their impact, will allow us to finance the investments necessary to achieve sustainable development for all.

(25) We begin the analytical section of our report with a discussion of financing needs and recent trends in financing flows. We then present a ‘strategic approach’ derived from an analysis of the flow of funds from sources to uses. The bulk of our report (Section VI) considers policy options to strengthen the four basic categories of financial resource mobilization available for financing sustainable development, namely domestic public, domestic private, international public and international private finance, with an additional focus on means for blending official and private resources and collaboration between various actors. Throughout this section, we emphasize the interplay of the different types of financing and their potential synergies. In Section VII, we address international policy imperatives for a strong international economic environment and its governance, fully aware that fractures in the global economic architecture will undermine the global project to deliver sustainable development. We conclude with a discussion of options for the way forward.

IV. The global context

A. A changing global context

(26) Since the adoption of the Millennium Declaration in 2000, many developing countries have experienced significantly faster economic growth than developed economies. For example, between 2005 and 2012, gross domestic product (GDP) grew by 1.2 per cent annually in developed countries, and 6.1 per cent in developing countries,⁶ with the gap between GDP per capita of developed and developing countries narrowing. (See Figure 1.) In this context, global poverty decreased significantly, and the world reached the poverty reduction target of Millennium Development Goal (MDG) 1 five years ahead of schedule. Several other MDG targets have also been met ahead of time, including access to improved drinking water, gender parity in primary education and political participation of women, while some others are on track to be met, such as the targets on fighting malaria and tuberculosis.⁷

(27) Despite these achievements, there are differences between and within countries, and much unfinished business remains to realize all of the MDGs. Close to one billion people continue to live in extreme poverty. Many live marginally above the poverty line and are vulnerable to falling back into poverty when faced with adverse shocks. This vulnerability is often associated with gender, disability, ethnicity, indigeneity and geographic location. Additional development challenges include growing unemployment, particularly among youths, as well as challenges associated with growth of cities.

(28) Insufficient progress is related to several factors, including disparities in growth rates across regions and rising inequalities. While the narrowing of the GDP per capita gap between developed and developing countries reflects impressive gains in East Asia as well as emerging and developing Europe, some countries have not yet recovered from weak growth in the 1980s and 1990s, despite improvements since 2000. Indeed, the gap between GDP per capita of Latin America, Sub-Saharan Africa, and the Middle East and North Africa and that of the developed countries is greater today than it was more than 30 years ago (see Figure 1). Productivity growth in some developing and emerging economies remains too slow to significantly reduce the gap with developed countries.⁸

(29) At the same time, income inequalities within many countries have increased, and social inequalities and inequalities of opportunity also remain high. There are exceptions, though; for example, income inequality has fallen in some countries in Latin America, highlighting the fact that public policies can make a difference.⁹

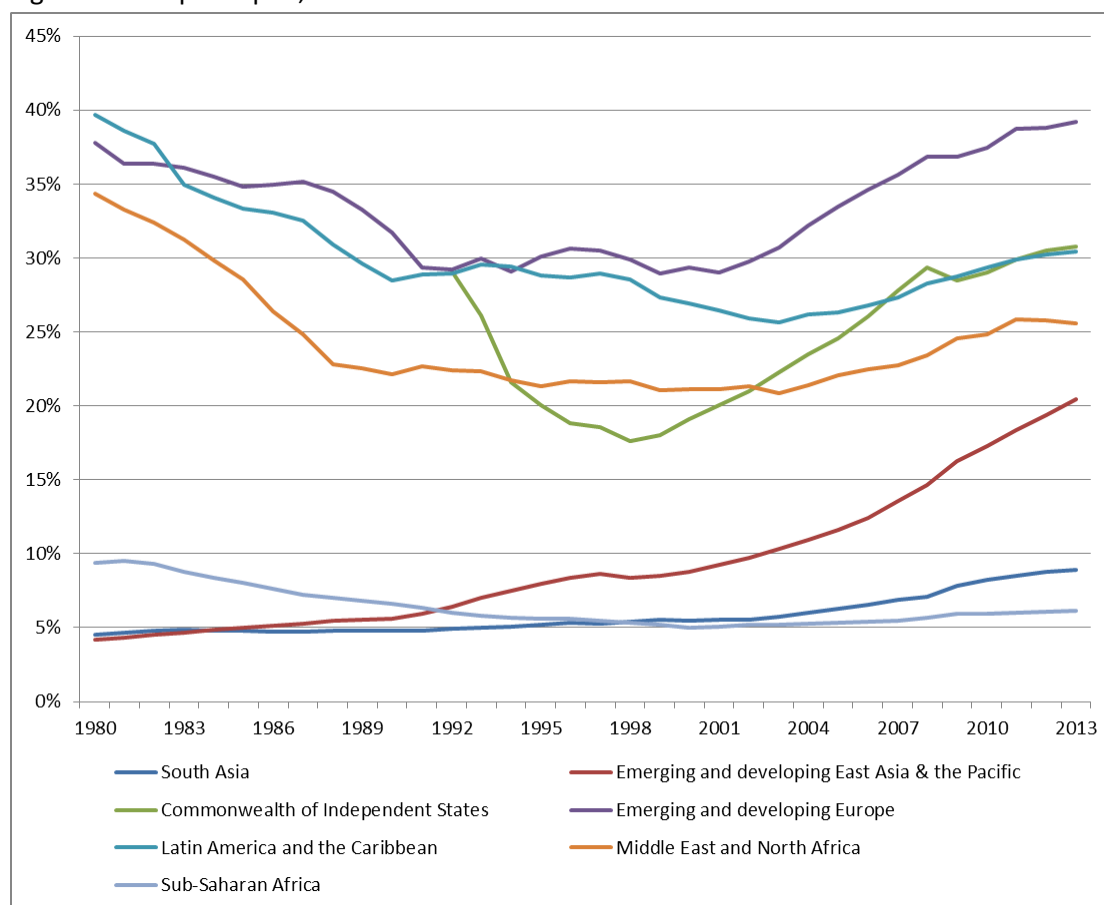
⁶ At constant prices; United Nations, *World Economic Situation and Prospects*, 2014.

⁷ UN, 2014, *The Millennium Development Goals Report 2014*, New York

⁸ OECD, 2014, *Perspectives on Global Development 2014: Boosting Productivity to Meet the Middle-Income Challenge*, Paris

⁹ UN, 2013, *Report on the World Social Situation 2013: Inequality Matters*, New York

Figure 1: GDP per capita, relative to advanced economies



Source: Calculations based on IMF World Economic Outlook, April 2014

(30) Risks and vulnerabilities have also become more pronounced. Environmental degradation, climate change, natural disasters and other threats to the global environment (such as oceans, forests and biodiversity), pose additional challenges to the ability of all countries, and developing countries in particular, to achieve sustainable development. The global economic and financial crisis revealed risks within the international financial system, as well as the vulnerability of countries to external financial traumas, adversely impacting their capacity to mobilize resources for development. Clearly, without a stable financial system the post-2015 development agenda risks being derailed by a sudden regional or global financial crisis.

B. The scope of financing needs

(31) Against this backdrop, financing needs for poverty eradication and sustainable development remain significant. These include addressing i) basic needs related to eradicating poverty and hunger, improving health and education, providing access to affordable energy and promoting gender equality; ii) national sustainable development investment financing needs, such as for infrastructure, rural development, adaptation and climate resilient development, and energy; and iii) global public goods, including the protection of the global environment and combatting climate change and its impact, as well as other areas.

(32) Quantifying needs is complex and necessarily imprecise, since estimates are dependent on a host of assumptions including the macroeconomic and policy environment – at sector and economy-wide levels – and international rules, norms and standards. The cost of achieving sustainable development also depends on the effective use of resources. Estimates of financing needs thus vary widely. The estimates presented in our report are indicative, aimed at providing an order of magnitude of financing requirements, rather than precise figures. In addition, we have not attempted to combine the estimates of needs by economic sector, type of demand, or category of country into a global estimate, as such an aggregation exercise does not adequately take into account the synergies and cross-cutting nature of sustainable development, among others.

(33) With regards to social needs, a rough estimate of the cost of a global safety net to eradicate extreme poverty in all countries (measured as increasing incomes of the poorest to the \$1.25 a day standard) is around \$66 billion annually.¹⁰ Large investment requirements are also identified in addressing hunger, and health and education needs.¹¹ Ultimately, the eradication of poverty requires sustained and inclusive growth and job creation. In that regard, estimates of annual investment requirements in infrastructure – water, agriculture, telecoms, power, transport, buildings, industrial and forestry sectors – amount to \$5 to \$7 trillion globally.¹² There is evidence that many micro, small and medium enterprises (MSMEs), which are often a main provider of employment, have difficulty obtaining financing. The unmet need for credit for SMEs has been estimated to be up to \$2.5 trillion in developing countries and around \$3.5 trillion globally.¹³

(34) There are also vast financing needs for the provision of global public goods. The order of magnitude of additional investment requirements for “climate-compatible” and “sustainable development” scenarios (which include goals and targets related to climate) are estimated to be of the order of several trillion dollars per year (see Figure 2).¹⁴ In assessing financing needs, it is pertinent to appreciate that the costs of inaction are even larger than the costs of action, especially for the poorest and in the realm of climate change. For example, delaying mitigation action, particularly for the countries that emit the largest quantities of greenhouse gases, is estimated to significantly increase the cost of transitioning to a low carbon economy in the medium and long term.¹⁵

(35) Financing needs also differ across countries and regions. While financing needs are disproportionately large relative to the size of their economies in many developing countries, there are specific needs in least developed countries (LDCs), Small Island Developing States (SIDS), Land Locked Developing Countries (LLDCs), countries in Africa and countries emerging from conflict. Challenges facing middle-income countries should also be addressed.

¹⁰Chandy, L, and Gertz, G., 2011, *Poverty in numbers: the changing state of global poverty from 2005 to 2015*, Brookings Institution

¹¹Some estimates of these needs include: US\$ 50.2 billion annually to eliminate hunger by 2025; US\$ 37 billion to achieve universal health care; US\$ 42 billion to achieve universal primary education and expand access to lower secondary education; see Greenhill and Ali, 2013, *Paying for progress: how will emerging post-2015 goals be financed in the new aid landscape?* ODI Working Paper

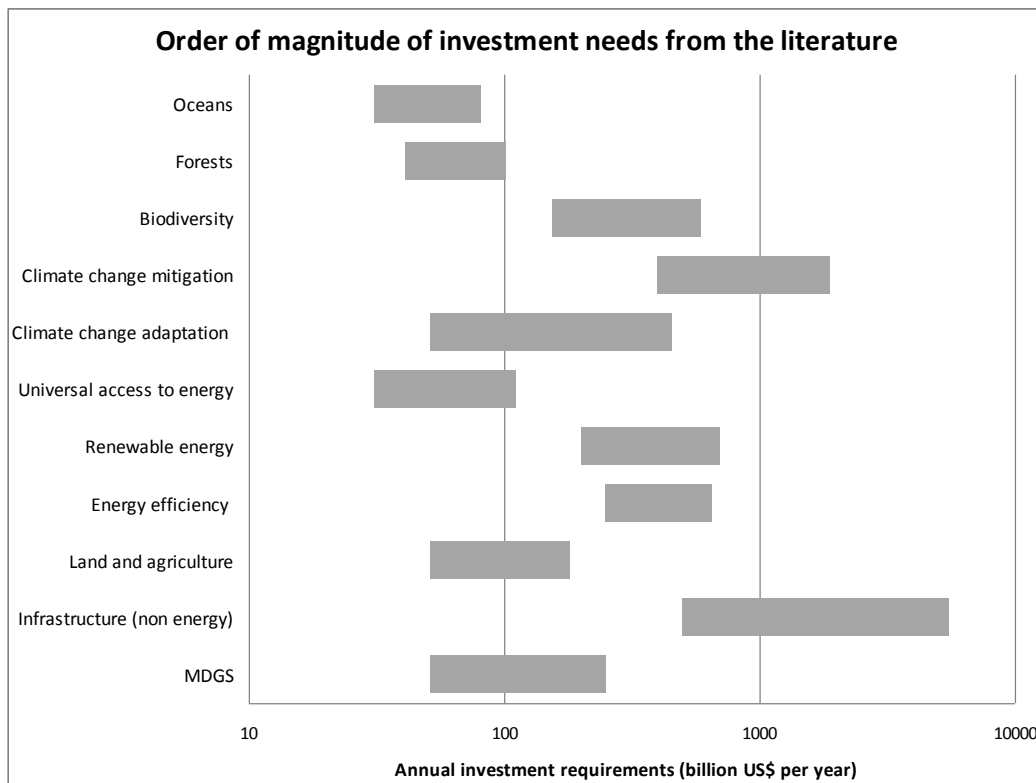
¹²UNTT Background Paper 1, 2013; World Economic Forum, 2013, *Green Investment Report 2013*

¹³Stein, P., Goland, T. and Schiff, R. (2010). “Two Trillion and Counting”. IFC and McKinsey & Company.

¹⁴ UNTT Background Paper 1

¹⁵ IPCC, 2014, *Climate Change 2014: Mitigation of Climate Change*. Summary for Policy Makers

Figure 2: Orders of magnitude of investment requirements for various sectors taken from the literature



Source: UNTT Background Paper 1, x-axis in logarithmic scale

C. Emerging patterns of resource flows

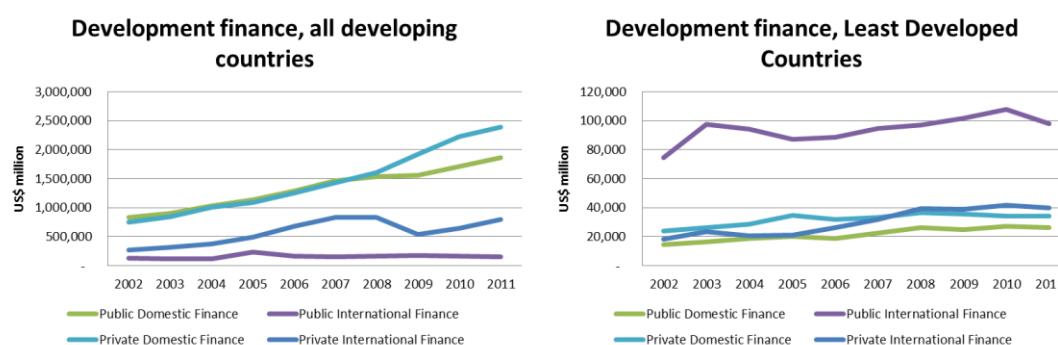
(36) Despite large needs, the emerging patterns of resource flows highlight the opportunities for mobilizing financing needed to support the achievement of sustainable development. Global savings remain robust, at around US\$ 22 trillion a year (inclusive of public and private sources), despite a temporary decline due to the crisis.¹⁶ The stock of global financial assets – a placement for only a small portion of annual global savings – is estimated to be around US\$ 218 trillion.¹⁷ Even a small shift in the way resources are allocated would have an enormous impact.

(37) All four types of finance - public and private, domestic and international – have increased since 2002. Domestic finance has grown rapidly in recent years, representing by far the greatest share of financing sources for most countries (see Figure 3). In many developing countries, particularly in LDCs, public international finance remains crucial.

¹⁶ Calculation based on IMF, World Economic Outlook April, 2014, at PPP exchange rates.

¹⁷ Report of the Secretary-General, *Follow-up to and implementation of the Monterrey Consensus and the Doha Declaration on Financing for Development*, A/68/357

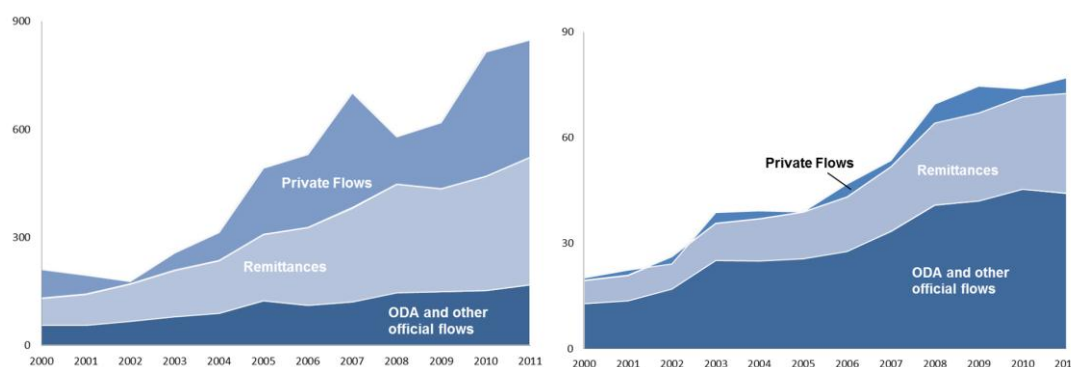
Figure 3: Development finance in developing countries and Least Developed Countries



Source: Cluster 1 report, based on OECD, World Bank data¹⁸

(38) International financial flows to developing countries increased rapidly over the last decade, mainly driven by growth in private capital flows and remittances, though official development assistance (ODA) also strengthened, as depicted in Figure 4.

Figure 4: Financing flows to Developing Countries (left) and Least Developed Countries (right), in billions of US\$



Source: OECD DAC Stats, World Bank Migration and Remittances Data

Public domestic resource mobilization

(39) Public domestic finance in developing countries more than doubled between 2002 and 2011, increasing from US\$ 838 billion to US\$ 1.86 trillion.¹⁹ In absolute terms, this growth mainly reflects developments in middle-income countries. Domestic public finance also doubled in low-income countries, though it remains insufficient to meet sustainable development needs. Tax revenues account for about 10 – 14 per cent of GDP in low income countries, which is about one third less than in middle income countries, and significantly less than in high income countries, which achieve tax to GDP ratios of 20 - 30 per cent.²⁰

¹⁸ As aggregated on capacity4dev.ec.europa.eu/ffd

¹⁹ <http://capacity4dev.ec.europa.eu/ffd/document/data-2000-2012-delinked>

²⁰ World Bank, 2013, *Financing for Development post-2015*.

(40) In many countries, tax evasion and avoidance hinder domestic resource mobilization. In addition, illicit financial outflows, including tax evasion across borders, have undermined tax collection. Estimates of illicit financial flows, by nature clandestine, vary widely, but point to substantial numbers.²¹

(41) Domestic public resources are also impacted by subsidies. For example, in 2011 pre-tax energy subsidies amounted to US\$ 480 billion, primarily in developing countries, and post-tax energy subsidies amounted to \$1.9 trillion, primarily in developed countries.²² Similarly, in agriculture, producer support subsidies among OECD members total US\$ 259 billion in 2012.²³ Eliminating these would allow public resources to be redirected to other priorities. In all subsidy decisions, however, any adverse impacts on the poor and the environment need to be addressed, either through appropriate compensating policies or through better targeting.

(42) There has been considerable change in the landscape of sovereign debt of developing countries since the Millennium Declaration. External debt amounted to 22.6 per cent of GDP in developing countries in 2013, as compared to 33.5 per cent a decade earlier.²⁴ The debt difficulties of heavily indebted poor countries (HIPCs) have largely been addressed under the terms of the HIPC Initiative and the Multilateral Debt Relief Initiative (MDRI).

(43) Some countries covered under HIPC have begun to issue debt on international markets, facilitated by a low interest rate environment. The issuance of public debt in domestic currencies (which, unlike external debt, does not subject the issuing country to foreign exchange risk) has also grown, reflecting the development of local capital markets. For example, local currency government debt in Sub-Saharan Africa increased from US\$ 11 billion in 2005 to US\$ 31 billion in 2012.²⁵ However, much of this increased issuance is short-term. Excessive growth in both domestic and international debt poses risks to economic sustainability, underscoring the need for prudent debt management.

(44) Nonetheless, the aggregate picture masks growing debt problems in some countries. Two low income countries are currently considered to be in debt distress, with 14 at high risk and 28 at moderate risk of distress.²⁶ Debt sustainability is particularly problematic in some small states. In 2013, the average ratio of public debt to GDP of small state developing countries amounted to 107.7 per cent, vs. 26.4 per cent for developing countries as a whole.²⁷ At the same time, a few developed countries have also experienced sovereign debt distress.

²¹See: UNTT Background Paper 2

²²The IMF defines consumer subsidies to include two components: a pre-tax subsidy (if the price paid by firms and households is below supply and distribution costs) and a tax subsidy (if taxes are below their efficient level). IMF, 2013, *Energy subsidy reform – lessons and implications*, Washington, D.C.

²³ OECD, 2013, *Agricultural Policy Monitoring and Evaluation*, Paris

²⁴UN, 2014, *MDG Gap Task Force Report 2014*, New York

²⁵AFMI, 2013 – This figure relates to a sample of 29 sub-Saharan African countries in AFMI database

²⁶IMF, 2014, *List of LIC DSAs for PRGT-Eligible Countries*, 05 June 2014, accessed on 28 July 2014. Available from <https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>

²⁷UN, 2014, *MDG Gap Task Force Report 2014*, New York

Domestic private finance

(45) Financial systems in many developing countries rely primarily on the banking sector. Though domestic credit has grown substantially over the past decade, in many countries, banking sector credit is primarily short-term. For example, in some countries in Africa, short-term credit accounts for up to 90 per cent of bank financing,²⁸ vs. 50-60 per cent for developing countries as a whole.²⁹ In addition, gross domestic savings rates in many LDCs remain significantly below the amount necessary to drive sustained domestic investment.

(46) Domestic bond markets have also grown substantially, driven primarily by sovereign debt issues. Corporate bond markets, though growing, remain small. On average, private debt securities were only 5 per cent of GDP in middle income countries, compared to 34 per cent in high income countries in 2010. The lack of long-term bond markets limits the availability of long-term financing in many countries. Similarly, the depth of equity markets stood at nearly 60 per cent of GDP in high income countries; in low and middle income countries it amounted to only 20 and 28 per cent respectively.³⁰

(47) The presence of institutional investors in developing countries has, however, been growing, and could potentially increase resources available for long-term investment in sustainable development. Emerging market pension funds are estimated to manage \$2.5 trillion in assets, and are expected to increase significantly.³¹ A sizable portion of these portfolios is invested in domestic sovereign debt. In some developing country national pension funds have also been investing directly in national or regional infrastructure, including in South Africa, Ghana, Chile, Mexico and Peru.

(48) There is also a growing emphasis on the environmental, social, and governance impacts of investments. An increasing number of companies are reporting on these factors (referred to as ESG reporting) and have signed on to initiatives such as the Principles for Responsible Investment and the UN Global Compact. Nonetheless, the share of investment subject to ESG considerations remains small relative to global capital markets, at 7 per cent or US\$ 611 trillion of investments in the US\$ 12143 trillion global capital market in 2010.³²

International public finance

(49) The development contribution of ODA improved in the wake of the adoption of the Monterrey Consensus in 2002, with increased attention paid to making ODA more effective while increasing its volume. ODA reached an all-time high of US\$ 134.8 billion in net terms in 2013, after

²⁸K. Kpodar and K. Gbenyo, *Short- Versus Long-Term Credit and Economic Performance: Evidence from the WAEMU*, IMF Working Paper, WP/10/115, May 2010.

²⁹BIS database

³⁰UNTT, Background Paper 2, 2013, based on the basis of Global Financial Development Database, World Bank

³¹Inderst, G. and Stewart, F., 2014, *Institutional Investment in Infrastructure in Developing Countries: Introduction to Potential Models*, World Bank

³²Principles for Responsible Investment, 2011, *Report on Progress 2011*.

falling in 2011 and 2012.³³ Nonetheless, only 5 OECD DAC donors reached the 0.7 per cent of gross national income target.

(50) ODA continues to provide essential financial and technical cooperation to many developing countries (see Figure 4), including least developed countries and many African countries, landlocked developing countries, small island developing states, and countries affected by conflict. In most countries with government spending of less than PPP\$ 500 per person per year, ODA accounts for an average of more than two-thirds of international resource flows, and about one-third of government revenues.³⁴ About 40 per cent of ODA currently benefits LDCs.³⁵ However, ODA to LDCs, particularly in sub-Saharan Africa, has fallen in recent years, and according to preliminary results from donor surveys this trend is likely to persist.³⁶

(51) The Leading Group on Innovative Financing for Development has pioneered on a voluntary basis a number of fund-raising mechanisms to raise additional resources, including the international solidarity levy on air tickets,³⁷ the funds from which are contributed to UNITAID to help purchase drugs for developing countries. Eleven countries using the euro currency are currently envisioning a financial transaction tax from 2016, albeit without earmarking funds for development or financing of global public goods as of yet. Some countries (e.g. France) have, at the national level, put in place a financial transaction tax, with part of the proceeds used to finance ODA programmes.³⁸

(52) There has also been a proliferation of sustainable development related international funds and delivery channels. These include global sector funds, premised on multi-stakeholder partnerships that bring together governments, private sector, civil society, as well as traditional and emerging donors, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria, the GAVI Alliance, and the Global Partnership for Education.

(53) Only ten years ago, multilateral climate finance was provided by a small number of large funds, which were associated with the United Nations Framework Convention on Climate Change (UNFCCC). There are now over 50 international public funds. Over this period, governments designed and reformed institutions such as the Global Environment Facility (GEF), the Adaptation Fund (AF), the Climate Investment Funds (CIF), and most recently the Green Climate Fund (GCF), as well as new evolving financial instruments such as performance-based payments for reducing emissions from deforestation, degradation, and forest conservation (REDD+). Nonetheless, there remains a large gap between climate finance needs and resources. In particular, progress towards implementing the financial commitments under the United Nations Framework Convention on Climate Change (UNFCCC) has been slow.

³³ OECD, 2014, *Aid to developing countries rebounds in 2013 to reach an all-time high*, 2014

³⁴ Development Initiatives, 2013, *Investments to End Poverty*, p. 44

³⁵ 32 per cent of ODA, including both bilateral net and imputed multilateral ODA to LDCs, was allocated directly to LDCs in 2012, and an estimated 52 per cent of ODA unallocated by country could also be attributed to LDCs, bringing the total to 40 per cent; see: OECD, 2014, *Targeting ODA towards countries in greatest need*, April 2014

³⁶ Idem

³⁷ As of 2013, the levy was implemented by Cameroon, Chile, Republic of the Congo, France, Madagascar, Mali, Mauritius, Niger and Republic of Korea (in addition, Brazil does not impose the levy but makes a budgetary contribution equivalent to what the levy would have mobilized).

³⁸ Some countries have chosen not to implement these instruments as of yet.

(54) South-South cooperation – a complement to North-South cooperation – continues to grow rapidly, more than doubling between 2006 and 2011. While data on concessional South-South flows is incomplete, they are estimated at between \$16.1 and \$19 billion in 2011, representing more than 10 per cent of global public finance flows. Non-concessional South-South flows, such as foreign direct investment (FDI) or bank loans, have also expanded dramatically in recent years.³⁹

International trade and cross-border private finance

(55) Global trade also continues to grow, albeit at a slower pace than before the international financial and economic crisis, and trade flows have assumed increased importance for resource mobilization in many developing countries. For LDCs, the average trade-to-GDP ratio has risen from 38 per cent in 1990 to 70 per cent in 2011.⁴⁰ The rise of global value chains in trade has tightened the link between trade and investment flows.

(56) Gross flows of FDI to developing countries reached \$ 778 billion in 2013, exceeding FDI to developed economies. FDI is the most stable and long term source of private sector foreign investment. However, LDCs receive only a small fraction (less than 2 per cent) of these flows.⁴¹ In sub-Saharan Africa, FDI is driven primarily by investment in extractive industries, with limited linkages to the rest of the economy. Furthermore, the contribution of FDI to sustainable development is not uniform. In recent years, the composition of FDI appears to be changing. For example, globally, investment in finance and real estate increased from 28 per cent in 1985 to nearly 50 per cent of total FDI in 2011, whereas investment in manufacturing fell from 43 per cent to 23 per cent over this time.⁴²

(57) The nature of international portfolio investment in emerging markets has evolved over the past fifteen years, as many countries' markets have deepened and become more globally integrated. In particular, as domestic debt markets have grown, foreign investors have increased their purchases of local currency debt, and now play a dominant role in some emerging markets. However, these flows have been very volatile, reflecting a short-term orientation of international capital markets.⁴³ In the United States, for example, the average holding period for stocks has fallen from about 8 years in the 1960s to approximately six months in 2010.⁴⁴

(58) Private cross-border transfers from individuals and households have also grown substantially. An estimated US\$ 404 billion was remitted to developing countries from migrants in 2013, representing a more than ten-fold increase in recorded remittances from 1990, when they

³⁹United Nations, 2014, *Trends and progress in international development cooperation*, Report of the Secretary-General, E/2014/77

⁴⁰ Calculations are three-year averages based on UNCTAD Stat, 2014, accessed 8 August 2014.

⁴¹ UNCTAD, *World Investment Report*, 2014

⁴² UNCTAD FDI Database

⁴³ Report of the Secretary-General, 2013, *International Financial System and Development*, A/68/221

⁴⁴ LPL Financial, Weekly Market Commentary – August 6, 2012. Available from: <http://moneymattersblog.com/login/login/wp-content/uploads/2012/08/WMC080712.pdf>

were estimated at less than US\$40 billion.⁴⁵ In addition, philanthropic finance from private individuals, foundations and other organizations to developing countries amounted to approximately US\$ 60 billion in 2013, with the majority coming from private donors in developed countries.⁴⁶ Philanthropic actors are particularly engaged in global sectoral funds, such as in the Global Fund to Fight AIDS, Tuberculosis and Malaria and the GAVI Alliance.

(59) A portion of international inflows has been used by some countries to build foreign exchange reserves, in part as a form of self-insurance against the volatility of international capital flows. Foreign exchange reserves increased from \$2.1 trillion to \$11.7 trillion from 2000 to 2013. Developing countries, primarily emerging market countries, hold almost \$8 trillion, with the top five emerging market countries holding around 65 per cent of this.⁴⁷

⁴⁵ World Bank, *Migration and Development Brief 22*, April 11, 2014. World Bank, *Migration and Remittances Factbook 2011*, 2010.

⁴⁶ Hudson Institute, 2013, *Index of Global Philanthropy and Remittances 2013*, Washington, D.C.

⁴⁷ Data based on IMF Article IV Reports and IMF *International Financial Statistics*

V. Strategic approach

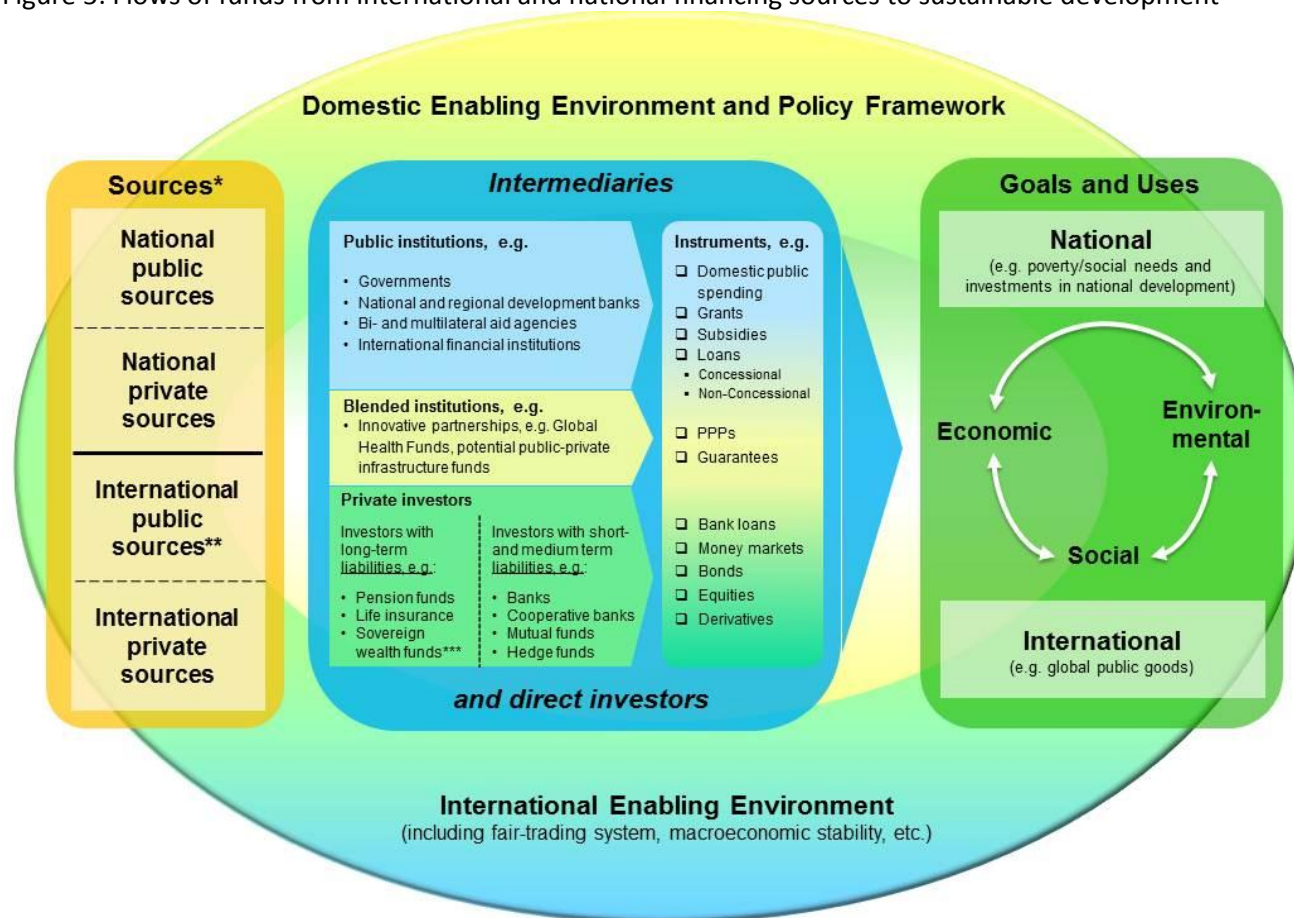
(60) Figure 5 illustrates the analytical framework that has guided us in formulating this sustainable development financing strategy. Financial sources can be arranged into four categories: domestic public, domestic private, international public and international private sectors. The challenge for policymakers is to channel and incentivize more of these diverse and decentralized sources of financing into desired investments in sustainable development.

(61) As depicted in Figure 5, financing decisions, in all cases, whether public or private, are influenced by national policy frameworks and the international financial architecture, the extent of appropriate and effective financing institutions, and the design and development of instruments to facilitate and help overcome impediments to investment in sustainable development. In this spirit, the following precepts guide our strategic approach.

- 1. Ensure country ownership and leadership in implementing national sustainable development strategies, along with a supportive international environment.** Each country is responsible for its own development. The implementation of sustainable development strategies is realized on the national level. However, national efforts need to be complemented by international public support as necessary, and an enabling international environment.
- 2. Adopt effective government policies as the lynchpin of a sustainable development financing strategy.** All financing is done within the context of national and international policy environments that set rules, regulations, and incentives for all actors. Thus, effective institutions and policies and good governance are central for the efficient use of resources and for unlocking additional resources for sustainable development.
- 3. Make use of all financing flows in a holistic way.** Meeting financing needs for sustainable development requires optimizing the contribution from all flows, including public, private, domestic and international. Each type of financing has specific characteristics and strengths, based on different mandates and underlying incentives. Maximizing synergies, taking advantage of complementarities, and building on an optimal interplay of all financing sources is essential.
- 4. Match financing flows with appropriate needs and uses.** Different sustainable development needs and project characteristics require different types of public, private, and blended financing. While private financing will be essential, all private finance is not the same. Long term sustainable development investments should be financed with long term funds.
- 5. Maximize the impact of international public finance.** ODA plays a crucial role for countries where needs are greatest and the capacity to raise resources is weakest. The use of financing instruments and their concessionality should be appropriate to the level of development of each country, their specific conditions, capacities and capabilities, as well as the nature of the project.

- 6. Mainstream sustainable development criteria in national financing strategies.** Finance should support the economic, social, and environmental dimensions of sustainable development. This requires policies and incentives to incorporate sustainable development into financing strategies and implementation approaches. Sustainable development criteria should be included in public budgets and private investment decisions as appropriate.
- 7. Exploit synergies across the economic, environmental, and social dimensions of sustainable development.** Different sustainable development objectives often overlap. Financing should be designed to exploit synergies and support policy coherence for sustainable development, while taking account of potential trade-offs. Thus, financing instruments can be used to address several policy objectives simultaneously. This would be best coordinated within the context of national sustainable development strategies.
- 8. Adopt a multi-stakeholder, people-centered and inclusive approach to achieve tangible results on the ground.** Consultations with all stakeholders, including civil society and the private sector, will enable governments and policymakers to better appreciate the diverse needs and concerns of people in the formulation and implementation of sustainable development policies at all levels. In this regard, gender equality and the inclusion of marginalized groups, such as indigenous peoples and persons with disabilities must be ensured.
- 9. Ensure transparency and accountability of financing at national, regional and international levels.** Transparency and accountability must underpin all financing to enhance legitimacy and effectiveness. Government providers of assistance and partner countries should strive for a more harmonized and coherent mutual accountability, with improved data collection and strengthened monitoring, while ensuring country ownership. Private financial flows should be monitored more effectively and made more transparent.

Figure 5: Flows of funds from international and national financing sources to sustainable development*



* The size of boxes does not represent financing volumes/importance
 ** There can be cases where international public finance also directly supports the implementation of international objectives
 *** Sovereign wealth funds handle public money, but are managed like private investors

VI. Options for an integrated sustainable development financing strategy

(62) In each category of finance, decision-making is decentralized among the separate institutions and actors. Funding decisions in domestic and international private sectors are inherently dispersed among multiple actors, and the delivery of international public funds is also highly fragmented, despite efforts at coordination. Cohesive financing strategies, based on the principle of country ownership, are thus essential to facilitating the coordination of diverse sources of financing. In light of the cross-cutting dimensions of financing strategies, coordinated national decision making is needed. Governments should also effectively communicate their strategic frameworks.

(63) In what follows, we highlight particular policy areas pertaining to each of the four groups of financing sources, as well as blended finance, and suggest a toolkit of policy options and financial instruments, to be used within a cohesive national sustainable development strategy. Notwithstanding the wide range of options proposed below, the choice of specific policy measures should be determined by domestic political considerations and other country-specific circumstances.

A. Domestic public financing

(64) There are three primary roles for domestic public finance: 1) increasing equity, including through poverty reduction; 2) providing public goods and services that markets will eschew or underprovide and enacting policies to change incentives of private actors; and 3) managing macroeconomic stability.⁴⁸ In addition, domestic resource mobilization reinforces a country's ownership of public policy and allows countries to move toward financial autonomy. National public finance strategies should reflect these motivations as they guide the implementation of sustainable development strategies.

Promote tax reform, tax compliance and deeper international cooperation

(65) Domestic resource mobilization depends on many factors, such as size of tax base, a country's capacity to collect and administer taxes, tax elasticity, the volatility of sectors being taxed, and commodity prices. While optimal tax policy design is necessarily reflective of a country's economic and social situation, governments should follow generally accepted principles of sound public finance management, e.g. tax systems should be fair, efficient and transparent. Governments may also prioritize real income gains at the bottom of the income distribution through progressive tax policies, such as "earned-income tax credits", and VAT exemptions on basic goods and services. More generally, the tax base should be as wide as possible, while maintaining equity and efficiency. Indeed, widening the tax base has been instrumental in recent advances in tax collection in many developing countries, including LDCs and SIDS. Key indicators of success in tax reform include high level political commitment, administrative and policy reform and strong leadership in the revenue

⁴⁸Richard Musgrave, 1959, *Theory of Public Finance*, New York

administration.⁴⁹ Socially balanced user fees for some public services may be warranted so that beneficiaries contribute to the cost of the service, though they are not encouraged for essential social services.

(66) However, there are limits on what individual governments can accomplish on their own in the globalized economy. For example, national jurisdictions sometimes compete with other countries through offers of tax incentives to attract and hold employers, eroding the tax base of both competing countries. Ending harmful tax competition needs to be based on cooperation between competing countries, while respecting the sovereign right of countries to design their national tax regimes. This would generally be done in a regional or international forum. Such forums can also stimulate cooperation to stem illicit financial flows, as discussed in Section VII.⁵⁰

(67) Whereas, to date, technical assistance to the revenue and customs sector has attracted a minimal share of ODA,⁵¹ going forward more focus should be placed in responding to national requests for strengthening fiscal management capacity and capacity building for domestic resource mobilization. In addition, examples of successful reforms can inspire policy design elsewhere. The benefits of broader international forums on tax cooperation are palpable. (See Section VII.) Additional capacity building efforts should target institutional capacities to collect adequate revenues from extractive industries.

(68) In resource-rich countries, the management of natural resources is particularly critical. Fiscal rules governing the extractive industries should ensure that the public interest is appropriately compensated. Governments can also design policies to ensure that a share of resource earnings are saved and invested for the benefit of future generations, as in sovereign wealth funds (SWFs). When tax revenues from resource extraction are volatile, governments can accumulate surplus earnings in years of high prices and smooth government expenditures in years of low prices through commodity stabilization funds. International cooperation is needed to tackle the illicit trafficking of natural resources, including from countries in situations of conflict. Transparency and anti-corruption programs, including voluntary initiatives, are also relevant in many cases.

Ensure good financial governance and public financial management

(69) Combating corruption plays an important part in complementing efforts to improve domestic revenue mobilization. Corruption can have adverse effects on businesses, individuals and public financial management. High scores on corruption indicators are also strongly associated with low public revenue. To advance the fight against corruption, all countries should strive to ratify and implement the United Nations Convention against Corruption and should make further combined efforts, particularly on prevention, enforcement and stolen asset recovery. (See Section VI.C.).

⁴⁹“Report to the G20 Development Working Group by the IMF, the OECD, UN and World Bank: Supporting the Development of More Effective Tax Systems.” <http://www.imf.org/external/np/g20/pdf/110311.pdf>

⁵⁰While there is no agreed on definition of illicit flows, for the purpose of this report, we define illicit flows as money that is illegally earned, utilized and, in either case, transferred across borders, and includes profits hidden from tax administrations.

⁵¹ OECD, IMF, UN, World Bank Group (2011). Supporting the Development of More Effective Tax Systems. Available from <http://www.imf.org/external/np/g20/pdf/110311.pdf>

(70) A central element of good financial governance is proper planning and execution of the budget. Generally accepted principles of good budgeting address the stages of formulation, approval, execution and audit. These principles should ensure that public spending is consistent with national sustainable development strategies, inclusive of environmental, social, economic, gender, and other goals. Planning and execution of budgets should be based on transparency, legitimacy, accountability and participation of citizens, consistent with country capabilities and circumstances. In this regard, domestic public sector internal and external control mechanisms, such as supreme audit institutions, that ensure spending is in line with intended purposes should be implemented and strengthened. Furthermore, fiscal decentralization can strengthen local governance and create local ownership for the disposition of funds.

(71) It is common in normative budget policy discussions to ask if specific subsidies continue to be warranted. Countries should review the efficacy of all subsidies as a matter of sound fiscal management. Countries should consider rationalizing inefficient fossil fuel subsidies that encourage wasteful consumption by removing market distortions, in accordance with national circumstances, including by restructuring taxation and phasing out those harmful subsidies, where they exist, to reflect their environmental impacts. Such actions should fully take into account the specific needs and conditions of developing countries and minimize possible adverse impacts on their development in a manner that protects the poor and affected communities.⁵²

(72) Similarly, countries should correct and prevent trade restrictions and distortions in world agricultural markets, including by the parallel elimination of all forms of agricultural export subsidies and all export measures with equivalent effect, in accordance with the mandate of the Doha Development Round.

(73) Procurement systems need further strengthening in many countries to ensure fair competition. As part of budget execution, authorities may wish to align their procurement policies with national sustainable development strategies, which implies defining minimum environmental and social standards for public sector suppliers, taking into account domestic situations. In this respect, sustainable procurement can have the added benefit of promoting sustainable technologies. Public procurement systems can also promote the development of sustainable local businesses.

(74) Financial auditing and control should be complemented by monitoring and evaluation of economic, social and environmental impacts, in line with country capacities and circumstances. Strengthened national and independent audit and evaluation agencies could be assigned this responsibility, as could other politically and socially anchored oversight mechanisms, including in the Parliament. Capacity development initiatives, including the exchange of knowledge and experiences, can help improve policy design, budget processes and budget implementation.

⁵²Reservations were expressed by several Member States to paragraph 225 of the Rio+20 outcome document, A/CONF.216/16, chapter I, resolution 1, paragraph 225 (see General Assembly 123rd plenary meeting, 2012, [A/66/PV.123](#)).

Internalize externalities and mainstream environmental sustainability

(75) There is a large potential role for fiscal reforms in promoting environmental sustainability. Policy measures such as “cap and trade” and carbon taxes seek to curb carbon emissions by raising the price of emissions and “internalize externalities”. Carbon markets remain relatively small, however, with only 7 per cent of the world’s emissions covered.⁵³ Furthermore prices for traded emission permits have been volatile and too low to impact the development and deployment of clean technologies. Governments that set up cap and trade schemes need to set sufficiently tight caps, monitor volatility and set appropriate regulations. At the same time, 13 countries have initiated some form of national or sub-national carbon taxes.⁵⁴ Although there has been some debate on the competitiveness effects associated with taxing carbon emissions, European countries that have had carbon taxes in place for over a decade have seen neutral or slightly positive effects on GDP.⁵⁵

(76) Governments should also consider other policies to change investment patterns, such as direct emission restrictions on investments, subsidizing research and development of clean technologies, including carbon capture and storage technologies, tax incentives, feed-in tariffs, energy efficiency or renewable energy targets, pollution rights, and payments for ecosystem services.

(77) Environmental accounting, which incorporates environmentally relevant financial flows and accounts on the use of natural resources, is another mechanism that can help policymakers internalise externalities. GDP is a crucial measure that governments use to assess the economic performance of countries, but by not incorporating natural capital, it can lead governments to ignore an inefficient allocation of investment. The System of Environmental-Economic Accounting (SEEA) could facilitate greater public investment in sustainable development.

Address inequity and the social protection imperative

(78) Governments should use fiscal policies (both tax and spending) to address inequalities, fight poverty, improve water and sanitation, and support other social services, in particular to benefit low income, vulnerable and marginalized groups. A frequent call is to give priority to public investment projects that are “pro-poor” and gender sensitive.

(79) Structural vulnerabilities, which affect the poor and other socially excluded groups, women, persons with disabilities, indigenous peoples, migrants, minorities, children, older persons, youth and other marginalized groups, can be reduced by aiming for universal provision of basic social services.⁵⁶

⁵³ Climate Economics in Progress 2013, Chapter 1: Carbon prices and markets around the world (Climate Economic Chair, 2013), p. 28

⁵⁴ World Bank, 2014, *State and Trends of Carbon Pricing*, p. 25

⁵⁵ Mowery, David C, Richard R. Nelson and Ben R. Martin (2010).

⁵⁶ UNDP, 2014, *Human Development Report 2014: Sustaining Human Progress*, New York

(80) In addition to offering protection against risks, social protection can contribute to equitable growth by reducing poverty and inequality, raising labour productivity, and enhancing social stability. Countries should consider policies to strengthen “social protection floors”, which, as per the findings of the International Labor Organization are affordable in most countries out of domestic revenues, but warrant international assistance for the poorest.⁵⁷ Insurance services offer further opportunities to create a safety net for households, including for example insurance products that cover healthcare, life risks and agriculture. However, private insurance is not usually effective at covering those most in need, so government policies remain crucial. There is also an urgent need for governments to invest adequately in disaster risk mitigation and in systems that build resilience against shocks, as well as in environmental preservation, especially in areas where local populations depend on natural resources.

(81) Productive and decent employment is the most important form of income security. Most people rely on earnings from work as their main source of income. Macroeconomic and fiscal policies that promote full and productive employment, as well as investment in human capital, are therefore central to poverty reduction and increased equity.

Effectively manage public debt

(82) Debt financing can represent a viable option to provide funding for public spending on sustainable development. At the same time, debt needs to be effectively managed, with the goal of ensuring that debt obligations can be serviced under a wide range of circumstances. Governments should make regular use of analytical tools to assess alternative borrowing strategies and the associated risks, better manage their assets and liabilities, and restrain from irresponsible borrowing. Treasury departments should aim to increase the issuance of long-term bonds in local currencies, particularly to domestic investors, as such issuance would reduce the foreign exchange risk of the government. At the same time, as agreed in the Monterrey Consensus, creditors share responsibility with the sovereign debtor to prevent and resolve debt crises, including providing debt relief where appropriate. They should be held responsible to adequately assess credit risk, improve credit screening and reduce irresponsible lending to high-risk countries.

(83) The International financial institutions and the UN system have been developing standards for prudent management of government debt. Countries that have already reached a high level of debt need to ensure that the growth of public debt does not exceed expected GDP growth to avoid financial distress. In this regard, the World Bank–IMF Debt Sustainability Framework (DSF) is designed to help guide low-income countries and their donors in mobilizing financing while reducing the chances of an excessive build-up of debt by setting a debt threshold. In addition, international institutions are providing technical assistance to strengthen local capacities in this area. This should be maintained, along with commitments to transfer finance, technology and capacity to enable developing countries build the human and institutional capabilities to effectively manage public debt. (See Section VII for a discussion of systemic issues and sovereign debt resolutions.)

⁵⁷ILO, 2011, *Social protection floors for a fair and inclusive globalization*, Geneva

Explore the potential contributions of national development banks

(84) In the absence of sufficient long-term private sector financing and investment in sustainable development, many countries have established national development banks (NDBs) and other public institutions to support long-term investment. The combined assets of the International Development Finance Club (IDFC), a group of 20 national, bilateral, and regional development banks, amount to over \$ 2.1 trillion in 2010.⁵⁸ NDBs can play an important role, for example, in financing SMEs, infrastructure, and innovation. As NDBs have specific knowledge of domestic markets, they are often well suited to provide relevant capacity development and assistance in private project management. Recent studies have also shown that some NDBs also played a valuable countercyclical role, especially in cases of crisis when private sector entities become highly risk-averse.

(85) Governments can use NDBs to strengthen capital markets and leverage investments in sustainable development. For example, some NDBs finance (part of) their activities through the issuance of bonds that allocate funds raised to a particular use, such as green infrastructure with the proceeds allocated to specific classes of investment (e.g. green bonds).

(86) There are, however, challenges for policymakers with regard to NDBs. Policymakers should ensure that public development banks do not undertake activities that the private sector will competitively provide. Importantly, provisions should be in place to avoid inappropriate political interference with the operation of the bank, and to ensure efficient use of resources, particularly with regard to leveraging private sector investment in sustainable development.

B. Domestic private financing

(87) In understanding the role of the private sector in financing sustainable development, it is important to recognize that the private sector includes a wide range of diverse actors, from households to multinational corporations and from direct investors to financial intermediaries, such as banks and pension funds. Private resources have historically been a key driver of domestic growth and job creation.

(88) Private financing is profit-oriented, making it particularly well suited for productive investment. However, the quality of investment matters. There continues to be a dearth of domestic long-term investment necessary for sustainable development, even while there is a growing understanding among the private sector that commercial interest and public policy goals can be realized at the same time.

(89) There is thus a role for governments to develop policies to help incentivize greater long-term investment in sustainable development. An enabling environment is essential for reducing risks and encouraging private investment. In addition, governments can work to develop local capital markets and financial systems for long-term investment, within a sound regulatory framework.

⁵⁸See http://www.idfc.org/Downloads/Press/03_idfc-expert/IDFC_Press_Release_Green_Finance_Mapping_11-20-13.pdf

Provide access to financial services for households and micro-enterprises

(90) Recent studies indicate that stable, inclusive and efficient financial markets have the potential to improve peoples' lives by reducing transaction costs, spurring economic activity, and improving delivery of other social benefits, particularly for women.⁵⁹ Expanding the scope and scale of financial services offered to the poor, older persons, women, persons with disabilities, indigenous people and other underserved populations is important to help achieve sustainable development objectives.

(91) Households of all income levels, even the poorest, use basic financial services, namely payments, savings, credit and insurance. The poor, particularly those in least developed countries, mainly use informal financial service providers. Indeed, more than half of the working-age adults in the world are presently "unbanked" by formal providers, with the vast majority in developing countries.⁶⁰ If affordable and appropriate financial services were available at reasonable proximity, all indications are that people would use them.⁶¹ Many governments have thus provided and/or welcomed providers of financial services for the poor, including through microfinance institutions, cooperative banks, postal banks and savings banks, as well as commercial banks.

(92) The best way to implement financial inclusion varies by country. Nonetheless, there are some elements that have worked well across countries, including support for the development of credit bureaus for assessing borrower loan-carrying capacity. Developments in information and communication technologies can make it possible for poor people to receive financial services at low cost without having to travel long distances to bank branches. Branchless banking and mobile banking technologies can be used in making Government-to-People payments (wage, pension and social welfare payments) with lower administrative costs and less leakages. Bringing more people into the formal financial sector is believed to also have a beneficial effect on tax collection. Furthermore, regulation is important to ensure responsible digital finance and avoid abusive practices.

(93) Surveys demonstrate that a lack of awareness of financial products and institutions is a barrier to their utilization, particularly for insurance. The public sector can promote strengthened financial capability, including financial literacy, while also expanding consumer protection. In particular, financial service providers should be required to disclose key information in a clear and understandable, preferably uniform, format. Policymakers should also enact clear standards for treating consumers fairly and ethically, and set up uniform recourse mechanisms for effective resolution of disputes across the industry. In this regard, governments might establish consumer protection agencies to oversee the necessary framework for consumer protection within a country context.

⁵⁹ See CGAP, 2014, *Financial Inclusion and Development: Recent Impact Evidence*", Focus Note No. 92, April 2014

⁶⁰ Asli Demirguc-Kunt and Leora Klapper. 2012. "Measuring Financial Inclusion: The Global Findex Database." Policy Research Working Paper 6025, World Bank, Washington, DC.

⁶¹ United Nations, *Building Inclusive Financial Sectors for Development* (New York, 2006).

(94) Though it is only one aspect of financial inclusion, a lot of attention has been paid to microfinance. There is a wide global network of forums and international support networks in the public and non-profit microfinance sectors, which speaks to the vibrancy of the industry. Nonetheless, microfinance remains outside of the regulatory framework in many countries. With the growth of microfinance institutions, both managers and regulators should be concerned about the need to balance expanding access to financial services with managing risks, including social risks of household indebtedness.

Promote lending to small and medium-sized enterprises

(95) An important area where access to financial services (in this case, credit) is insufficient relates to small and medium-sized enterprises (SMEs), which in many countries are main drivers of innovation, employment and growth. More than 200 million SMEs lack access to financial services worldwide. Frequently, SMEs' financial needs are too large for the traditional moneylenders and microcredit agencies, while large banks tend to bypass this market, due to administrative intensity, the lack of information and the uncertainty of credit risk. By providing credit information, credit registries/bureaus, and collateral, and insolvency regimes could help extend SME access to credit.

(96) Long- term bond markets are limited in many developing countries, and alternative vehicles for financing innovative start-ups, such as angel investors and venture capital funds, are largely missing in many developing countries. NDBs can play an important role here. To support greater access to finance for SMEs, a calibrated interplay of private and public banks can also be used. For example, one model used by development banks is to provide concessional public funding to the commercial banking sector, which on-lends the funds at a preferential rate for SMEs. Instruments can encompass guarantees, loans, interest-rate subsidies, equity and equity-linked investments as well as access to services and information. Many countries also maintain other forms of support for SMEs, such as low interest government loan programs. Cooperative banks, post banks and savings banks are also well suited to offer financial services to SMEs, including developing and offering more diversified loan products.

(97) Lending to SMEs is considered high risk by many bankers due to lack of information and uncertainty of credit risk. Credit is often insufficient, even when there is ample liquidity in the banking sector. However, a diversified portfolio of SME loans can significantly reduce risks. Securitization of diverse portfolios of SME loans, potentially sourced across a variety of banks to ensure greater diversification, can potentially increase funds available for SME lending. However, safeguards need to be in place to address risks in "lend-to-distribute" banking, as highlighted during the financial crisis, so that the issuer maintains a stake in keeping the loans performing (such as rules that require banks to maintain a percentage of each loan on their balance sheets).

Develop financial markets for long-term investment and enhancing regulations to balance access and stability

(98) A well-capitalized banking sector and long-term bond markets allow domestic companies to meet their longer term financing needs – without taking foreign exchange risks associated with borrowing in foreign currency. Local bond markets can thus play an important role in financing long-

term sustainable development. To successfully develop local capital markets, policymakers need to build institutions and infrastructure, including supervision, clearing and settlement systems, effective credit bureaus, measures to safeguard consumers, and other appropriate regulation.

(99) Institutional investors, particularly those with long-term liabilities, such as pension funds, life insurance companies, endowments, and SWFs are particularly well-suited to provide long-term finance (though international institutional investors have tended to invest with a short term time horizon in recent decades, see Section VI.D.) To nurture the development of an institutional investor base, policymakers need to develop an institutional, legal and regulatory framework. This includes securities laws, asset management regulations, and consumer protection. Policymakers could provide rules for transparent processes, sound governance, and an efficient enforcement system. There are numerous examples of successful regulatory frameworks from developed and emerging market countries, though policymakers in developing countries should adapt these to local conditions, and be flexible to update them in response to changing market conditions.

(100) In general, financial markets need to be developed with care as bond and equity markets often demonstrate high volatility, especially in small markets that lack liquidity. To limit excessive volatility that can impact the real economy, regulations can be enacted in conjunction with capital account management tools to deter “hot money”. In some areas, developing a regional market might be effective in achieving a scale and depth not attainable in individual small markets. Partnerships between nascent markets and established global financial centers can support the transfer of skills, knowledge and technology to developing countries, though care should be taken to adapt these to local conditions.

(101) On the flipside, it is important to note that the financial sector can grow too large relative to the domestic economy. Above certain thresholds financial sector growth may increase inequality and instability, in part due to excessive credit growth and asset price bubbles.⁶² It is therefore important for all countries to design strong “macro-prudential” regulatory frameworks.

(102) A robust regulatory framework should consider all areas of financial intermediation, including shadow banking ranging from microfinance to complex derivative instruments. Enhancing stability and reducing risks while promoting access to credit presents a complex challenge for policymakers, since there can be trade-offs between the two. Policymakers should design the regulatory and policy framework to strike a balance between these goals. For example, the European Union included special provisions (e.g. Capital Requirement Directive IV) in its implementation of Basel III to reduce the capital cost of lending to SMEs. There are also calls for financial sector regulatory systems to be widened from focusing on financial stability to include sustainability criteria.

⁶²IMF, 2013, *Financial Crises: Explanations, Types, and Implications*, IMF Working Paper WP/13/28, January 2013, Washington D.C.

(103) Islamic finance has also generated important mechanisms that can support sustainable development financing.⁶³ Islamic financial assets have grown rapidly in the last decade, including in the areas of infrastructure financing, social investments and green investments. The investment vehicles used in Islamic finance, which are based on shared business risk, improve depth and breadth of financial markets by providing alternative sources of financing. These financing structures might offer lessons on how to develop a class of new long-term investment.

Strengthen the enabling environment

(104) It is well known that strengthening the domestic policy, legal, regulatory and institutional environment is an effective way for governments to encourage private investment. To better mobilise and effectively use finance, policy measures should focus on easing the bottlenecks within the country context. As a result of such efforts over the past decade, many developing countries have reduced excessive complexity and cost that businesses pay to start and maintain operations. While the structure of reforms varies between countries and regions in line with their historical experience, culture and politics, policymakers can strengthen the enforceability of contracts, the protection of creditor and debtor rights and the effectiveness of trade and competition policies, streamline business registration regimes, and promote the rule of law, human rights and effective security. Investment in infrastructure and essential public services, as well as human capital, would also help to make the business environment more attractive. Political instability, macroeconomic instability and policy uncertainty are significant obstacles to doing business in any country, underlining the importance of sound policies more broadly.

Strengthen economic, environmental, social and governance (EESG) and sustainability considerations in the financial system

(105) Policymakers should aim to foster sustainability considerations in all institutions and at all levels. This can be done by encouraging joint reporting on both economic returns and environmental, social and governance (ESG) impacts – which can be referred to as EESG reporting. In addition, appropriate regulations, such as portfolio requirements and other measures in line with domestic conditions can be used to strengthen these considerations.

(106) There are signs of a strengthened focus on EESG considerations in some financial markets. Increasing numbers of private sector actors have signed on to the Equator Principles for project financiers, Principles for Responsible Investment, and Principles for Sustainable Insurance, which set standards for private investors. Similarly, the Sustainable Stock Exchanges Initiative aims to explore how exchanges can work with investors, regulators, and companies to enhance corporate transparency, report performance on EESG issues, and encourage responsible long-term approaches to investment. Knowledge of these initiatives within many businesses and financial institutions remains limited. It is thus important to scale-up awareness and capacity building, in both public institutions and financial market firms. In this regard, governments could encourage financial market

⁶³ Islamic finance is based on the principles of Islamic law. Its two basic principles are the sharing of profit and loss and the prohibition of the collection and payment of interest.

firms to train their employees on EESG issues, which could be included in qualifying exams and courses for industry licenses.

(107) An important consideration in sustainable development is the emissions impact of financing activities. In this context, some pension funds, albeit relatively smaller funds have begun to monitor the emissions of their portfolios on a voluntary basis⁶⁴, allowing fund managers to recognize the risks they are already bearing. Policymakers could play a catalytic role in this area by encouraging index providers to accelerate work on the design of benchmarks and encouraging transparency regarding emissions impact, particularly in public investment funds (e.g. public pension funds).

(108) A key question is whether largely voluntary initiatives can change the way financial institutions make investment decisions. Policymakers could consider creating regulatory frameworks that make some of these practices mandatory. To be most effective, these policies should be based on extensive engagement between the private sector, civil society, financial regulators, and policymakers. In this regard, several countries have already mandated some ESG criteria, including South Africa, Brazil, Malaysia, France and the UK, among others. More research should be done on the impact of different mechanisms. International organizations can create a platform for sharing experiences on both successes and failures of various instruments and arrangements.

C. International public financing

(109) International public finance plays a central role in financing sustainable development. Similar to domestic public finance, there are three functions of international public finance: poverty eradication and development; financing the provision of regional and global public goods; and maintaining global macroeconomic stability within the context of the broader global enabling environment. (See Section VII.) International public finance should complement and facilitate national efforts in these areas, and will remain indispensable in implementing sustainable development. ODA in particular will remain critical and should be focused where needs are greatest and the capacity to raise resources is weakest.

Meet existing commitments

(110) ODA remains an important source of external public financing for developing countries, particularly LDCs. ODA reached record levels in 2013, though it still remains significantly below the internationally agreed target of 0.7 per cent of GNI, averaging 0.3 per cent of GNI in 2013. Similarly, despite commitments to allocate 0.15 - 0.20 per cent of GNI as ODA to LDCs in the Istanbul Programme of Action, ODA to LDCs amounts to only 0.09 per cent of GNI, on average.⁶⁵

(111) In 2010, the Parties to the Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC) agreed that developed countries committed, in the context of meaningful mitigation actions and transparency on implementation, to a goal of mobilizing jointly USD 100 billion dollars per year by 2020 to address the needs of developing countries, which will be

⁶⁴ <http://www.rafp.fr/press-releases-fr-ru137/Press-releases-2014-ar619>

⁶⁵ OECD, 2014, *Aid to developing countries rebounds in 2013 to reach an all-time high*, April 2014

drawn by a wide variety of sources (public, private, bilateral, multilateral, including alternative sources).

(112) Member States of the United Nations should honor their commitments in full and in a timely manner, and neither ignore nor dilute them. Member States should in particular acknowledge the large financing gaps in LDCs and other vulnerable countries. Further effort is needed to maintain and increase ODA allocated to LDCs and those most in need.

Make use of all international public financing sources and instruments

(113) A number of governments have joined together to develop innovative mechanisms to mobilize additional international concessional resources for development and poverty eradication. The international community should further explore innovative mechanisms, with a view to financing global sustainable development. (See Section IV.C.)

(114) South-South Cooperation (SSC), as a complement to North-South cooperation, is a diverse and increasingly important category of voluntary intergovernmental assistance that can facilitate sustainable development, in accordance with the Nairobi outcome document of the United Nations Conference on South-South Cooperation (2009), endorsed by the GA Resolution 64/222. A number of Southern providers of assistance have decided to further strengthen their work, including inter alia through additional evidence-based analysis of South-South cooperation experiences and evaluation of South-South cooperation programmes. Additionally, the High-Level Committee of South-South Cooperation adopted the decision 18/1 (2014), which makes recommendations regarding the UN System, including an invitation for the Secretary-General to include in his synthesis report concrete steps to further strengthen South-South Cooperation.

(115) Triangular cooperation is a further useful complement, which has the potential to improve the effectiveness of development cooperation through sharing of knowledge, experience, technology and financial resources from emerging economies and traditional donor countries.

(116) International public funds that are less concessional than ODA, such as some loans from the International Monetary Fund (IMF), the World Bank and the other international and regional financial institutions (IFIs), are key sources of medium and long-term finance for the countries that draw upon them. Important financing modalities include public loans to governments, equity and debt finance for the private sector and a range of blended financing instruments, including risk-mitigating instruments such as credit and political risk guarantees, currency swaps and arrangements combining public and capital market funds (e.g. on traditional infrastructure projects). When employed according to country and sector needs, and building on their specific advantages, they can help mitigate risk and mobilize more upfront financing than would be available from budget resources alone, as discussed in Section VI.E on blended finance. It is also important to ensure that LDCs are not refrained from accessing, solely on the basis of their income, less concessional funds from IFIs and DFIs. Financially viable projects should instead be considered on a case-by-case basis, while keeping in mind debt sustainability considerations (see Figure 6).

Use international public resources efficiently and effectively

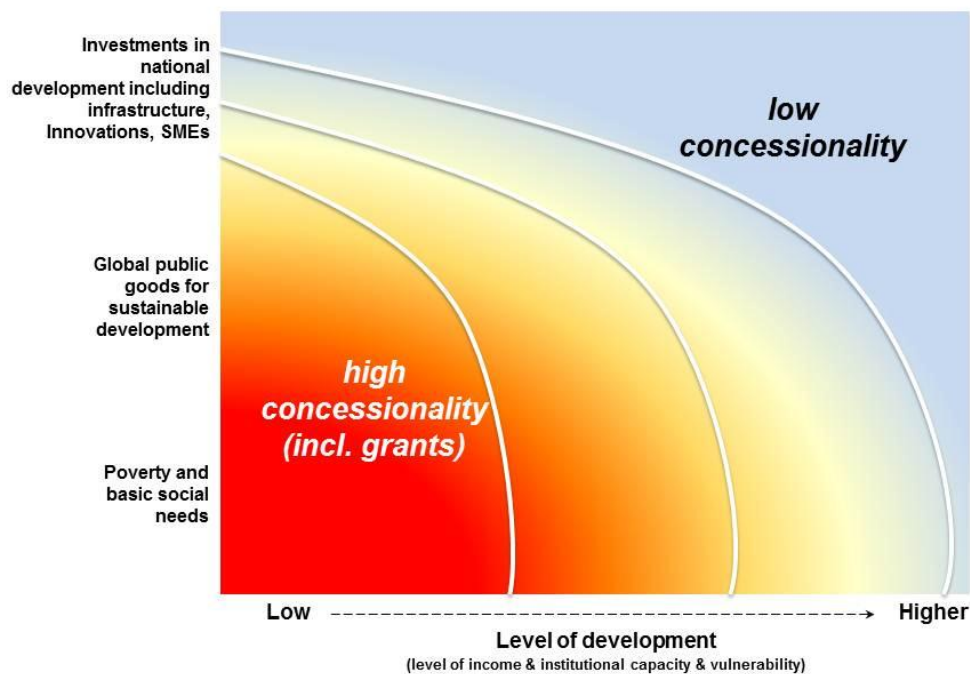
(117) International public finance ultimately represents taxpayer funds, putting an extra burden on both concessional and non-concessional public financial intermediaries to deploy them efficiently and effectively. ODA should be focused where needs are greatest and the capacity to raise resources is weakest, including LDCs, SIDS, LLDCs and the poorest in all developing countries, with a sufficient portion of ODA concentrated on the eradication of extreme poverty, as well as the reduction of all forms of poverty and meeting other basic social needs.

(118) International public finance will also have an important role in financing investments in national development, such as infrastructure. Some of these investments are profitable, and international public finance can catalyze private financing for sustainable development in such areas. (See section VI.E on blended finance.) In conjunction with this, international public finance should also respond to the growing need for financing for global public goods, without crowding out traditional development assistance.

(119) Acknowledging the multiple roles that international public finance will need to play in the sustainable development agenda, the Committee recommends that the level of concessionality of international public finance should take into account both countries' level of development (including their level of income, institutional capacity, and vulnerability) and the type of investment, as depicted in Figure 6. Concessionality should be highest for basic social needs, including grant financing appropriate for least developed countries. Concessional financing is also critical for financing many global public goods for sustainable development. For some investments in national development, loan financing instruments might be more appropriate, particularly when the investment can potentially generate an economic return.

(120) The international community has had on its agenda for many years a commitment to boost the effectiveness of development cooperation, through strengthened mutual accountability in the relationship between an ODA-receiving country and its donors. This, among others, is a concern of the Development Cooperation Forum of the United Nations (DCF), established in 2007. Through its regular multi-stakeholder dialogues and policy analysis, the DCF provides guidance, inter alia, on how to manage international financial and technical cooperation for development more effectively. The pursuit of effectiveness was further marked by four meetings of the High Level Forum on Aid Effectiveness in Rome (2003), Paris (2005), Accra (2008) and Busan (2011), which led to the establishment of the Global Partnership for Effective Development Cooperation (GPEDC). The first High-Level Meeting of the GPEDC was held in April 2014 in Mexico City.

Figure 6: Indicative targeting of international public financing according to countries' levels of development and different sustainable development needs



1

(121) A further concern raised in the Committee with respect to development effectiveness relates to the fragmentation of international public financing and the decentralized and independent decision-making processes of bilateral and multilateral donors. Donor countries should improve the management and coordination of international public support, though increased joint planning and programming on the basis of country-led strategies and coordination arrangements. They have long sought to reduce the burden of disparate reporting requirements, compliance with which absorbs considerable resources in the receiving country. The call thus continues to go out for transparent and harmonized financing conditions, procedures and methodologies.

(122) In order to reduce the fragmentation and complexity of environmental and climate finance, in particular, effective rationalization of the overall architecture is needed. In the area of climate finance, the UNFCCC Parties agreed to establish the Green Climate Fund as an operating entity of the financial mechanism of the Convention under Article 11. It will serve as a multilateral instrument through which governments and other fund providers could channel grants and concessional loan resources to support projects, programmes, policies and other activities in developing countries.⁶⁶ A significant share of new multilateral funding for climate change adaptation should flow through the Green Climate Fund, as agreed at UNFCCC COP 16.

⁶⁶ GCF/B.07/11.

(123) At the same time, partner capacities need to be strengthened in order to better manage assistance from diverse providers, as part of their national sustainable development financing strategies. Countries should jointly create and use facilitative platforms to encourage operational coordination among international funds and initiatives. Funds and programs, including environmental funds, need to support synergies across sectors at the national and local levels. The rules of the existing funds and instruments should be adapted to ensure that they encompass all relevant activities in a synergistic way.

D. International private financing

(124) Similar to domestic private finance, international private finance contains a wide range of flows, including foreign direct investment (FDI), portfolio flows and cross-border bank loans. Some of these flows are blended with public finance as discussed below (Section VI.E). International institutional investors, including sovereign wealth funds, hold an estimated US\$80-90 trillion in assets, representing an enormous potential source of investment. However, to date their investment in sustainable development – in both developed and developing countries–has been low. Pension funds, for example, invest only 3 per cent of their global assets in infrastructure.⁶⁷ This highlights the need for government policies to help overcome obstacles to private investment, in conjunction with additional public spending. As such, many issues discussed under domestic private finance (Section VI.B) apply here as well, but this section focuses on issues particular to cross-border investments.

Channel international funds towards long-term investment in sustainable development

(125) FDI remains the most stable and long-term source of private foreign investment to developing countries, and has a critical role to play in financing sustainable development. However, policymakers need to monitor the quality of FDI to maximize its impact on sustainable development. Governments should, as appropriate, adopt policies that encourage linkages between multinational enterprises (MNEs) and local production activities, support technology transfer, provide local workers with opportunities for further education, and strengthen the capacity of local industry to effectively absorb and apply new technology. Corporations that embrace human rights principles, labour, environment and anti-corruption values, as in the Global Compact or other international social and environmental standards, may serve as a model for other enterprises. At the same time, host governments should require all companies, including foreign investors, to meet the core labor standards of the International Labor Organization, and encourage EESG reporting, making sustainable development an essential element in company strategies.

(126) Investors are unlikely to invest long-term in countries where they have concerns about policy and regulatory regimes, highlighting the importance of an enabling environment, as discussed in Section VI.B on domestic investment. Furthermore, investors often point out that a major impediment to investment is the lack of ‘bankable projects’ competitive with other investment opportunities, underscoring the need for capacity development for project preparation in many countries.

⁶⁷UNTT Background Paper 3: Challenges in raising private sector resources for financing sustainable development

(127) At the same time, investors—including those with long-term liabilities, such as pension funds, life insurers, and SWFs— have been hesitant to invest in long-term sustainable development projects across a wide range of policy and regulatory regimes.⁶⁸ One impediment is that many investors do not have the capacity to do the necessary due diligence to invest directly in infrastructure and other long-term assets. Instead, when they do make these investments, they do so through financial intermediaries, whose liabilities and incentive structures tend to be shorter-term. (See Figure 5 for a breakdown of long-term and shorter-term investors.)⁶⁹ If long-term investors were to bypass intermediaries and invest directly, they could adopt a longer-term horizon in their investment decisions. However, it is often not cost effective for diversified investors to build this expertise in-house. There is thus a need for new instruments in this area. For example, investor groups could build joint platforms, e.g. for sustainable infrastructure investments. This is already beginning to happen (e.g. South African pension funds setting up a jointly owned infrastructure fund). Public actors, such as multilateral and bilateral DFIs, can also help set up investment platforms, as discussed in Section VI.E on pooled financing.

(128) In addition, policies can be designed to lengthen investment horizons, such as through a reduction of the use of mark-to-market accounting for long-term investments (in which portfolio valuations are adjusted daily, thus incorporating short-term volatility into portfolios) and changes to performance measurement and compensation (to change incentives, and potentially incorporate sustainability criteria), among others.

Manage volatility of risk associated with short-term cross-border capital flows

(129) While private capital flows to developing countries have risen during the past decade, some types of flows remain highly volatile. Conventional approaches to managing volatile cross-border capital flows have focused on macroeconomic policies to enhance an economy's capacity to absorb inflows. However, these policies are often not sufficiently targeted to stabilize financial flows and may have undesired side effects. Policymakers should thus consider a toolkit of instruments to manage capital inflows, including macroprudential and capital market regulations, as well as direct capital account management.⁷⁰

(130) In addition, international coordination of monetary policies of the major economies and management of global liquidity can reduce global risks. Similarly, stronger regional cooperation and dialogue, and regional economic and financial monitoring mechanisms can help stabilize private capital flows at a regional level.

⁶⁸ *ibid*

⁶⁹ While large fund managers manage more liquid portfolios in-house, most investors use external managers for such investments. See UNTT 2013, Background Paper 3

⁷⁰ Stiglitz, et al, *Stability with Growth*, Oxford University Press, 2006.

Facilitate the flow of remittances and private development assistance

(131) Migrant remittances represent a large source of international financial flows to some developing countries. However, remittances fundamentally differ from other financial flows in that they represent a private transaction and are often based on family and social ties. Remittances enable households to increase consumption and invest in education, healthcare and housing.⁷¹ Policymakers and IFIs should explore innovative approaches to incentivize investment of remittances in productive activities, including through issuance of diaspora bonds.

(132) The cost of remitting funds, however, remains extremely high, at 8.4 per cent of the amount transferred.⁷² Increased cooperation between remitting and receiving countries should aim to further reduce the transaction costs and barriers for remittances. The G20 initiative to lower the cost of remittances is an important effort in this regard, and should be continued and strengthened. However there is some evidence that international banks are reducing their role in this sector,⁷³ as an unintended consequence of a closer monitoring of banks in response to money laundering. Policy measures might be needed to ensure competition and monitor costs.

(133) Philanthropy, i.e. voluntary activity by foundations, private citizens and other non-state actors, has also significantly expanded in its scope, scale and sophistication. It has provided significant resources for global health funds in particular (see Section VI.C.) In addition to financial resources, philanthropy provides intellectual capital, technical capacity and extensive experience. Better data on philanthropic flows could help better assess their impact, improve coordination and help to streamline financing, reduce overlap, and maximize their sustainable development impact.

E. Blended finance

(134) Policymakers have recently shown considerable interest in a class of development financing opportunities called “blended finance” that pool public and private resources and expertise. Blended finance encompasses a large portfolio of potential instruments, including instruments provided by DFIs to leverage private finance (e.g. loans, equity investments, guarantees etc.), as well as traditional public private partnerships (PPPs) (see Table 1 below). But it goes beyond these structures to encompass structured public-private funds and innovative ‘implementing partnerships’ between a wide range of stakeholders - including governments, civil society, philanthropic institutions, development banks and private for-profit institutions. When well designed, blended finance allows governments to leverage official funds with private capital, sharing risks and returns, while still pursuing national social, environmental and economic goals in areas of public concern.

(135) It is important to note however that poorly designed PPPs and other blended structures can lead to high returns for the private partner, while the public partner retains all the risks. Careful

⁷¹ IMF, 2013

⁷² World Bank, 2014, *Migration and Development Brief 22*. April 11, 2014

⁷³ <http://dealbook.nytimes.com/2014/07/06/immigrants-from-latin-america-and-africa-squeezed-as-banks-curtail-international-money-transfers/>

consideration needs to be given to the appropriate use and structure of blended finance instruments, as discussed below.

Strategically assess the use of blended financing and innovative partnerships

(136) Blended finance can be a useful financing tool when the overall benefit of a project or investment is sufficiently large that an attractive benefit is still available to the public sector after the private partner is compensated. It can be used in a range of areas, such as infrastructure projects and innovation. There is a strong case for blended financing to facilitate investments that are just below the margin of real or perceived commercial viability, and cannot be unlocked by an enabling policy and institutional environment alone, but also serve public interest. On the other hand, blended finance between the public and for-profit private sector is less well suited to contribute to the provision of basic development needs that do not offer an economic return.

(137) Blended finance projects should be transparent and accountable. Participation in projects should be selected in a fair and open process. To further improve their sustainable developmental impact, poverty, environment, and gender aspects should be addressed in the project design phase.

(138) In undertaking blended finance projects, project costs need to be carefully assessed. Private investors often demand upward of 20–25 per cent annual returns on ‘bankable projects’ in developing countries. These costs need to be offset by efficiency gains or other benefits to make their use attractive. Furthermore, projects often struggle to deliver as planned, in both developed and developing countries, with a 25-35 per cent failure rate of PPPs in developed countries due to delays, cost overruns and other factors,⁷⁴ and even higher failures in developing countries. It is therefore important for policymakers to engage in blended finance structures with careful planning, design and management in order to strike a balance between economic and non-economic returns, and to ensure fair returns to citizens. Significant capacity is needed to design workable structures that share the risks and rewards fairly. ODA and other forms of assistance can play a role in capacity building of developing countries in this regard.

(139) Engagement in isolated PPPs, managed in silos, should be avoided. The investing public entity should carry out a number of projects simultaneously and thereby take a portfolio approach for pooling funds for multiple projects, similar to risk diversification carried out by DFIs and the private sector. In such an approach, mechanisms with equity “upside” would allow for gains from successful investments to compensate for losses on failed projects. This would be particularly appropriate for investments in innovation, where both risks and returns are extremely high.

⁷⁴ Directorate-General for External Policies of the Union, April 2014, *Financing For Development Post-2015: Improving The Contribution Of Private Finance*, p. 30

Table 1: Blended Finance Instruments

| Category | Description | Examples | | Prevalence |
|-------------------------------|---|---|---|-------------|
| Loans | <ul style="list-style-type: none"> Majority of ODA-eligible, bilateral loans are provided from government to government for investments in economic infrastructure and water and sanitation infrastructure, and are provided to middle income countries Development Finance Institutions (DFIs) also make loans directly to the private sector. While many DFIs operate below a commercial rate of return, the majority of their activity is not ODA eligible. | | | High |
| Direct Market Interventions | <ul style="list-style-type: none"> A direct transfer of resources from donors to the private sector, either through grants, or through equity investment. | Viability gap funding | Financial contribution to make investment commercially viable | Low |
| | | Challenge funds and innovation ventures | Competitive process to award funding for innovative projects, and to support expansion to scale for those proving success | Medium |
| | | Equity | Transfer of resources in return for an ownership stake | Low /medium |
| | | First-loss funding | Funding generally designated as a subordinate equity interest | Low |
| Risk Based Instruments | <ul style="list-style-type: none"> Donors take on some portion of the risks associated with private sector or partner government activity. Credit is thereby made available, or the cost of credit is reduced | Credit guarantees | Provision to protect financier from default | Low |
| | | Political-risk insurance | Protection against select (rare but costly) policy-oriented risks | Low |
| Performance Based Instruments | <ul style="list-style-type: none"> Future commitments by governments or donors to transfer resources to the private sector upon pre-specified conditions being met. Provide the private sector with flexibility in delivering outcomes (rather than outputs) and can, for example, facilitate credible government commitment to payment schedules when there are large upfront private sector investments required. | Advanced market commitments (AMCs) | An ex-ante commitment for public purchase of supply | Pilot |
| | | Social or development impact bonds | Contingent contract with a particular investor for repayment on delivery of impact-based results | Pilot |
| Public Private Partnerships | <ul style="list-style-type: none"> A modality of cooperation with the private sector based on a combination of instruments or negotiated outcomes Require other inputs (such as experience, expertise and bankable projects) in addition to the employment of the financial instruments listed. Donors can facilitate PPPs by: <ul style="list-style-type: none"> Providing technical assistance and/or project preparation facilities that offer support to both government and the private sector Directing multilateral organisations to bolster their efforts at facilitating PPPs Providing other financial incentives to make PPPs more attractive | | | Medium |

(140) In addition, innovative partnerships have been developed to finance sustainable development, and particularly global public goods. For example, the Global Fund to Fight HIV/AIDS, Tuberculosis and Malaria, pools philanthropy, traditional public sector and innovative financing and has further used innovative governing structures and allocation mechanisms to provide targeted assistance.

Explore the potential contributions of DFIs in support of blended finance

(141) DFIs, both multilateral and bilateral, can play an important role in blended finance. DFIs should continue to make efforts to optimize their balance sheets and make full use of their risk bearing ability, including by the use of all instruments, such as concessional/blended loans, equity, guarantees as well as non-concessional financing and innovative instruments. If these instruments are used to overcome existing financial barriers, they can have a considerable impact on the mobilization and use of private funds for sustainable development.

(142) As discussed in section VI.D on private international finance, in areas where impediments to direct investment exist, including infrastructure, innovation and SMSEs, there is a need for new financing structures that can better pool and share investment risks, along with increased public financing. Such platforms can be national or global. At the national level, the United Kingdom recently developed a Pensions Infrastructure Platform that will facilitate investment from British pension funds in public infrastructure projects backed by the UK Treasury. Similarly, the French “CDC” (Caisse des depots et consignations) has been converting households’ savings deposited in a specific savings account (Livret A) to fund social housing projects as well as local governments’ infrastructure projects.

(143) In addition to pooling funds, these types of platforms pool expertise and knowledge between investors and the government, and help overcome some of the informational constraints that impede direct investment. Other countries could consider creating similar platforms within existing DFIs and/or stand-alone platforms or country funds. In addition, entities with high credit ratings can also issue long-term (say 20-30 year) bond financing to leverage these structures, which can facilitate investment by long-term funds that are unable to invest directly. Similarly, the World Bank is developing a Global Infrastructure Facility (GIF) which will seek to mobilize additional resources and leverage these in support of infrastructure investments, including through complementary measures to strengthen the policy and regulatory environments and improve project quality. The African Development Bank has launched the Africa50 Infrastructure Fund.

Strengthen capacity development efforts

(144) Blended finance valuations and contracts are typically complex and require significant public sector capacity for design, negotiation and implementation. Public institutions need to build and cultivate expertise and capacity accordingly, and here ODA can make a critical contribution. Project preparation funds would also need to be commensurately increased. The preparation of robust feasibility studies, which multilateral and bilateral DFIs could support, is critical to the successful costing, structuring and delivery of these mechanisms. Capacity building efforts should focus on

feasibility studies, negotiation of complex contracts, and the professional management of partnership activities. Efforts should, however, aim to develop local skills and capacity, rather than exclusively focusing on specific projects. Appropriate enabling environments need to be created as well. International development actors and governments could establish policy dialogues to build a knowledge base and 'skills bank', and to share information and lessons learned about blended finance at the national, regional and/or global level. Increased cooperation and dialogue with investors, bankers and companies would also be needed.

VII. Global governance for financing sustainable development

(145) To mobilize the financing detailed in the preceding section and to facilitate its effective use according to national priorities, it is necessary to have an adequate enabling international environment and policy architecture that provides the policy space necessary to implement effective national sustainable development strategies. This entails open and dynamic world trading and investment systems that are deemed fair to all, support sustainable development and poverty reduction and that respect social and environmental standards. An enabling international environment that reduces fragmentation and complexity of international public finance (including environmental finance) would ensure adequate capitalization of existing funds and simplification and harmonization of rules for international public funds. (See Section VI.C.) It could expand international cooperation on innovative financing, particularly with regard to global public goods. An enabling international environment includes active global cooperation to remove the sources of international financial volatility, while striving to reduce global financial fragility. Other actions include completing ongoing reform processes of development banks and the IMF, deepening international cooperation on taxes and illicit flows, regulating banks and shadow banking systems and strengthening the means for cooperatively resolving sovereign debt difficulties. In short, it entails a strengthened global partnership for sustainable development.

Strengthen systemic coherence and global economic governance

(146) The global economic environment is overseen by separate and sometimes uncoordinated international bodies. Reflecting its existing mandate, the United Nations has the ability to serve as the global forum to bring the specialized international institutions and authorities together without challenging their respective mandates and governance processes. There is also a need within the UN system to reinforce the coherence of financing frameworks that developed out of two major strands of development debate – the Post-Monterrey and the Post-Rio+20 means of implementation. More broadly, there is a need to strengthen the integration and harmonization of existing international mechanisms, frameworks and instruments, including through the UN System Chief Executives Board, while avoiding the proliferation of new support vehicles as much as possible.

(147) The effectiveness and legitimacy of international organizations also needs to be further strengthened. The IFIs, including the World Bank and the other international development banks, and specialized mechanisms such as the Global Environment Facility and the Green Climate Fund, have the potential to increase the mobilization and deployment of finance for sustainable development, and to facilitate learning and knowledge sharing within their respective mandates. They would also be well placed to significantly expand the use of risk sharing instruments. It is important for IFIs to continue to take steps to align their own business practices with sustainable development objectives. Other proposed initiatives, such as reserve pooling and trade facilitation mechanisms, also have roles to play. The international community will benefit from such experimentation and innovation.

(148) In addition, a further review of the governance regimes of the IFIs is necessary to update their decision making processes, modus operandi and priorities, and to make them more democratic and representative. The IMF and the World Bank have been making efforts to further integrate the

voices of emerging market and developing countries, to reflect their growing importance in the global finance and development arena. These efforts should be brought to fruition.

(149) The normative, analytical and operational activities of the United Nations should also be better coordinated at the global, regional and national levels. Stronger efforts should be made by the UN system to implement fully the provisions of UN GA resolution 67/226 on the Quadrennial Comprehensive Policy Review (QCPR) and to achieve further progress towards ‘Delivering as one’. On the whole, it is important to encourage flexibility, effectiveness, transparency, accountability and innovation within existing institutional frameworks to promote more effective cooperation and partnership approaches, especially to implement the post-2015 development agenda.

Adopt trade and investment rules that are fair and conducive to sustainable development

(150) In a globalized world, economies seek to benefit from dynamic trade and investment opportunities. International trade is overseen by a multilaterally agreed system that seeks to be universal, rule-based, open, non-discriminatory and equitable. At the same time, there are numerous bilateral and regional agreements setting additional rules for trade and international investment.

(151) Global negotiations on strengthening international trade rules have been stymied for many years. The World Trade Organization’s (WTO) Ninth Ministerial Conference held in Bali, Indonesia in December 2013, produced a package of agreements to advance the multilateral trade agenda (including a Trade Facilitation Agreement and a series of decisions on agriculture, development and LDC issues), but remaining disagreements have stalled its formal adoption. Additional issues relevant to sustainable development are included in the mandate of the Doha Round, such as the liberalization of trade in environmental goods and services, and the implementation of duty-free, quota-free market access for all LDCs. WTO ministers have committed to consider a final work program to conclude the Doha Round of multilateral negotiations that began in 2001. It is time to address politically sensitive issues, such as agricultural export subsidies, and signal that global cooperation on trade liberalization in the interest of global development is still possible.

(152) To further facilitate the participation of the poorest countries in the international trading system, in accordance with their own nationally owned strategies, “aid for trade” and the Enhanced Integrated Framework for assisting developing countries and LDCs in particular are of central importance. Trade-related technical assistance, capacity building and trade facilitation and efforts to mainstream trade into development policies should all be reinforced.

(153) In addition, the increased prevalence of global value chains has tightened the link between trade and foreign direct investment.⁷⁵ To achieve a better balance between investor rights and the sovereign capacity for recipient states to regulate within areas of public interest, the international community could consider, as appropriate, a further elaboration of standards for investment in

⁷⁵ UNCTAD, 2014, *The role of trade in financing for sustainable development*, Input prepared for the ICESDF

areas that directly impact domestic sustainable development outcomes, and ensure that investments do not undermine international human rights standards.

(154) In general, the proliferation of bilateral investment treaties and other trade agreements covering investment issues renders the mainstreaming of a sustainable development perspective in investment regimes more difficult. Developing countries find it increasingly difficult to navigate a highly fragmented international investment regime, which also risks curtailing policy space for host countries. Steps should be explored toward a multilateral approach to international investment regimes that more adequately balances investors preferences with the needs of residents of the countries in which they would operate, with a view to facilitating a more holistic approach in the interest of sustainable development.

Strengthen global financial stability

(155) Since the 2007-2008 global financial and economic crisis, the international community has taken important steps to address vulnerabilities in the financial sector through regulatory reform. In these efforts and in any new regulations, regulators need to strike a judicious balance between ensuring the stability of the international financial system and allowing for adequate access to finance. A stable system is essential to support growth and prevent future crises with negative economic and social consequences. However, the unintended consequences of financial regulations may adversely impact the availability of long-term financing, should be addressed by policymakers.

(156) Further progress in completing and implementing the reform agenda is essential for enhancing the stability of the global financial system. Financial regulatory reform operates through international bodies that recommend rules and regulations which individual governments then adopt in national practice. While processes of consultation have been adopted by international regulatory bodies, such as the Financial Stability Board, further steps to enhance transparency and the adequate representation of developing country interests in the key international regulatory bodies need to be taken.

(157) It is equally important to strengthen the readiness of the international system to respond to crises. The international community should continue to review the capability of the IMF and other international organizations to provide early warning and quickly take countercyclical action and equip them with adequate instruments that would improve the resilience of the global financial system.

(158) In particular, a more stable international financial system, and a strengthened global safety net, can reduce the need for countries to stockpile international reserves. Additional research on the appropriate size of reserves, along with alternative insurance mechanisms, such as those based on regional cooperation, should be pursued.

Strengthen regional cooperation

(159) Strengthened regional cooperation can play an important role in mobilizing financial resources for sustainable development. Among other things, effective regional arrangements can

provide financing for regional public goods, facilitate trade flows and attract investment into key sectors such as infrastructure. Regional cooperation also provides excellent opportunities for information exchange and peer learning in fiscal, financial and economic affairs. In addition, the recent financial and economic crisis has directed new attention to the potential of regional financial stability mechanisms (such as the Latin American Reserve Fund or the Chiang Mai Multilateralization Initiative) to serve as a first line of defense against contagion from global crises.

Enhance international cooperation on taxes

(160) International tax rules and national tax laws have not kept pace with developments in the global economy, such as highly mobile capital and the predominance of MNEs in international trade and finance. Nations devise their own tax systems to meet domestic needs and have traditionally not coordinated with foreign tax authorities. This has created opportunities for MNEs and international investors to evade and avoid taxes by structuring international transactions to take advantage of different national tax rules. Even when Governments cooperate and devise bilateral tax treaties, their terms differ with different partners, allowing firms to exploit the differences to their own advantage (treaty shopping). MNEs also take advantage of differences in national tax policies by mispricing intra-group transactions (transfer mis-pricing) and by making use of mismatches in entity and instrument characterization (hybrid mismatch).

(161) While each country is responsible for its own tax system, international cooperation on tax policy needs strengthening. The enhancement of international tax cooperation could cover country-based reporting, notification of owners, automatic exchange of tax information, transfer pricing regulations, lists of tax havens and standards for non-economic reporting. G-20 Leaders have endorsed the OECD Action Plan on Base Erosion and Profit Shifting (BEPS) and automatic exchange of information. The United Nations, with its universal membership and legitimacy, could be a catalyst for further strengthening international cooperation in this area, working with the G-20, the OECD, the IMF, the World Bank and relevant regional fora. To this end, a participatory and broad based dialogue on international cooperation in tax matters should be strengthened.

(162) Due to insufficient resources and a lack of specialized knowledge, many developing countries are at a disadvantage when dealing with tax evasion and avoidance practices. In this light, capacity development measures could increasingly focus on international taxation issues.

Fight illicit financial flows

(163) In addition to policies to counter transfer mis-pricing based on tax evasion, as discussed above, best use should be made of existing international standards and instruments in the field of anti-money laundering (including the Financial Action Task Force, FATF, and its network of regional bodies), anti-corruption (United Nations Convention against Corruption, UNCAC) and asset recovery (the Stolen Asset Recovery Initiative, StAR).

(164) Tax evasion, money laundering and corruption are facilitated by jurisdictions with regulatory regimes that allow companies and individuals to effectively hide money. Both domestic actions aimed at minimizing the flow of funds to secrecy jurisdictions and international cooperation to

increase financial transparency will be needed. They include exchange of information, country-by-country reporting and publicly available company beneficial ownership registers, effective implementation of the Financial Action Task Force (FATF) standards and asset recovery.

Strengthen sovereign debt crisis prevention and resolution

(165) Sovereign debt crises severely impede nations' efforts to finance sustainable development, with debt crises often leading to a spiral of capital flight, devaluations, rising interest rates and unemployment. Effective debt management to prevent debt crises is recognized as a priority. However when crises do occur, there is an urgent need to fairly and quickly resolve them. The international community has adopted and repeatedly strengthened a comprehensive framework for resolving sovereign debt crises in a group of heavily indebted poor countries (HIPC). For bilateral official debt, the Paris Club and its Evian approach exist to restructure debt owed to its members. However, globally the landscape for debt has changed: the HIPC initiative is almost completed, and sizeable debt is owed to non-Paris Club countries and the private sector.

(166) A survey of recent international debt restructurings has shown that the market-based approach to restructure debt owed to private creditors needs further improvements.⁷⁶ Many debt restructurings are considered insufficient and are often delayed, with high costs for the populations of debtor countries. Recent developments with regards to Argentina's holdout creditors have led to a deep concern about the ability of holdout creditors to derail the success of a debt restructuring, both for developed and developing countries.

(167) There are two alternative solutions generally proposed for handling sovereign debt restructurings: a market based contractual approach through provisions in contracts, such as collective action clauses (CACs) in bond covenants, and a statutory approach akin to national bankruptcy regimes. In 2003, partly in response to the 2002 Argentine default, the IMF proposed a Sovereign Debt Restructuring Mechanism (SDRM), though there was little political support for such a mechanism at the time. Instead, the use of CACs became widespread in emerging market bond issuance. By 2005 almost 100 per cent new international bonds issued included CACs, though a large stock of bonds without CACs remains outstanding. However, some authors have found that the presence of CACs alone may not be sufficient to ensure fair and effective debt restructurings in all cases.⁷⁷ The inclusion of aggregation clauses could help make CACs more effective with respect to holdout creditors.

(168) Discussions on how to improve the framework for sovereign debt restructuring for countries in debt distress are taking place in various official forums, in policy think-tanks and in the private sector. In particular, work is ongoing in the United Nations system, including in the IMF, UN-DESA and UNCTAD.⁷⁸ In addition, there are calls for action on an effective and fair sovereign debt restructuring and debt resolution mechanism, taking into account existing frameworks and

⁷⁶IMF, 2013, *Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework*, April

⁷⁷Bi, Chamon, and Zettelmeyer 2011; Bradley, Cox, and Gulati 2010; Das, Papaioannou, and Trebesch 2012; Stiglitz 2003

⁷⁸See http://unctad.org/en/Docs/gdsddf2011misc1_en.pdf

principles, with the broad participation of creditors and debtors, and for the comparable treatment of all creditors. Given the importance of sovereign debt crisis and debt overhangs to financing sustainable development, it is important for the international community to continue ongoing efforts to enhance the existing architecture for sovereign debt restructuring. Furthermore, collaborative efforts to improve the timeliness and coverage of sovereign debt data based on both creditor and debtor reporting systems could lead to more reliable debt sustainability assessments.

Foster harmonized monitoring and accounting systems and a data revolution

(169) Strong, relevant and comparable data is the basis for improved global governance and sustainable development follow-up. Yet, current information flows, reporting standards and monitoring mechanisms are overlapping, contradicting, incomplete in coverage and often inaccessible to development actors. In order to improve the quality of statistics, it will be important to reduce the fragmentation of current reporting frameworks and initiatives and increase their harmonization. The international community should agree on suitable monitoring frameworks for the post-2015 development agenda that keep track of sustainable development financing flows from all sources, with transparent and separate reporting for development and climate finance commitments. Efforts are also needed to work towards a harmonization and increasing integration of monitoring and accounting frameworks to consider all financing sources and their interplay at the country level. In addition, existing monitoring and reporting frameworks should be improved to avoid incentivizing the use of instruments that do not support sustainable development objectives.

(170) Accordingly, national statistical capabilities should be strengthened. Capacity building initiatives and exchanges of experiences and practices should support developing countries and LDCs in particular in tracking, monitoring and evaluating the impacts and performance of different types of financing flows. Enhanced national capacities for monitoring and accounting of financing flows, including through the adoption of appropriate standards and reporting at a country-wide level, would also contribute to ensuring mutual accountability and global transparency. The potential of combining active (e.g. reporting) and passive (e.g. websites) transparency mechanisms to ensure disclosure and transparency to stakeholders, constituencies and beneficiaries should be further explored.

(171) To enable the sharing of data, for example on blended finance, actors could establish a research data protocol, which would build on existing reporting standards and be used to collect project-related data and make it publicly available.

(172) Recent work by the World Bank provides a useful starting point for assessing sustainable development needs and related policy and financing priorities to achieving them, using a model-based diagnostics tool and drawing on a multi-country data base. The analysis has been applied to Uganda as a pilot and is being extended to 10 additional countries with diverse characteristics.

Strengthen global partnership to facilitate effective sustainable development cooperation

(173) The global partnership for development as set out in MDG 8 and the Monterrey Consensus represents a set of commitments by both developed and developing countries on promoting

development. The post-2015 development agenda will have to be underpinned by a renewed and strengthened global partnership for sustainable development, defining a compact of commitments by Member States of the United Nations, while providing space and flexibility for engagement with a wide range of stakeholders. There are global platforms aimed at enhancing the impact and effectiveness of development cooperation, including the Development Cooperation Forum of the United Nations and other existing initiatives. (See Section VI.C.)

(174) The effective cooperation for sustainable development, including its financing aspects, requires a global partnership with the meaningful involvement and active participation of developing and developed countries, multilateral and bilateral development and financial institutions, parliaments, local authorities, private sector entities, philanthropic foundations, civil society organizations and other stakeholders. Ongoing efforts to strengthen the global partnership for sustainable development cooperation should take into account relevant UN conferences and other initiatives, and be based, inter alia, on the principles of country ownership, focus on results, delivery through inclusive partnerships, transparency and accountability to one another. In this context, the complementary nature of South-South Cooperation to North-South Cooperation applies. As part of the post-2015 development agenda, the processes for boosting the impact and effectiveness of development cooperation should be continued and enhanced.

VIII. Concluding remarks

(175) In the preceding pages we have laid out the conclusions of the work we have jointly carried out over the last twelve months. We trust that the policy options presented in these pages, and the strategic approach that our work is based upon, will provide a basis for future discussion on financing sustainable development and will inform, together with the report of the Open Working Group on Sustainable Development Goals, the intergovernmental negotiations for the post-2015 development agenda.

(176) We expect that the recommendations and analysis in our report will stimulate discussions among all stakeholders and inspire new ideas and innovative solutions. Many of our recommendations call for exchanging ideas and sharing experiences between countries and for enhanced international cooperation based on a renewed global partnership for sustainable development. The third international Conference on Financing for Development and its preparatory process will bring together all stakeholders and provide an opportunity for advancing these discussions. We look forward to progress being made in these areas, in the context of the Addis Ababa Conference and beyond.