

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

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

In Brief

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

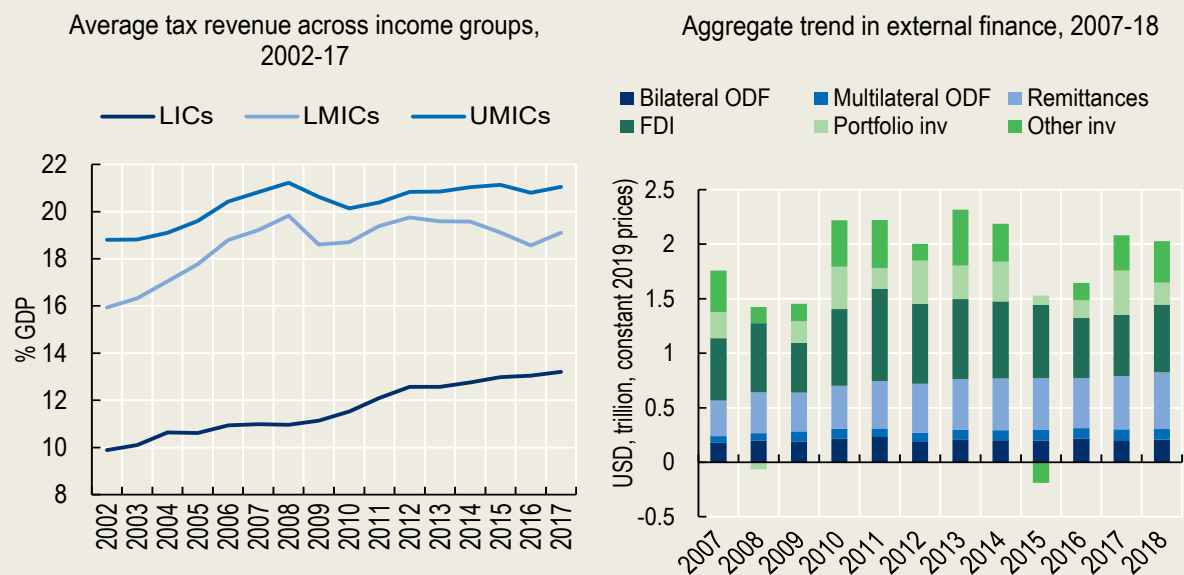
Tax revenue is the only long-term, viable source to fund public expenditure. It is also the largest source. In 2017, countries eligible to receive official development assistance (ODA) collected USD 5.3 trillion in tax revenue, more than double the sum of external inflows that year. Since the early 2000s,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

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

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

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

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



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

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

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

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

2.1. Mapping the financing for sustainable development landscape

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

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

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

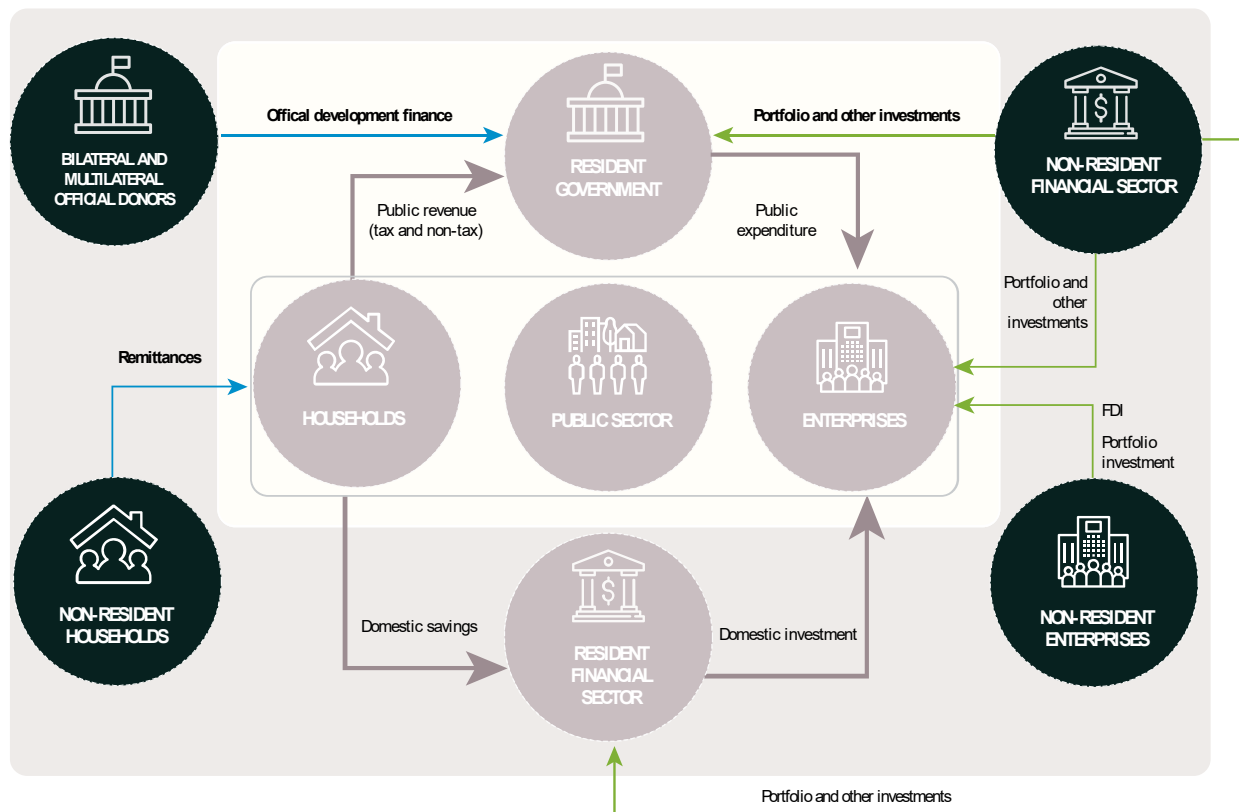
	Public	Private
Domestic	Tax revenue	Commercial investment
	Public resource rents and royalties	Private savings
	Public long-term debt (domestic)	Domestic private debt
	Public savings	Domestic philanthropy
	Sovereign wealth funds	Domestic remittances
External	ODA	FDI
	Other official flows	Portfolio investment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

Note: Resources shown in blue are discussed in Sections 2.2 and 2.3. Flows depicted in green are discussed in section 2.4. Resource categories and instruments listed are not necessarily distinct. For instance, some resources provided from South-South co-operation may be similar to flows classified as official development assistance. Further, sustainable impact investment and blended finance are specific modalities of private investment and can be domestic and external, involving public and private finance.

Source: Authors based on OECD (2020^[7]), “Transition finance ABC methodology: A user’s guide to transition finance diagnostics”, <https://doi.org/10.1787/c5210d6c-en>.

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

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



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

Source: Authors

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

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

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

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

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

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

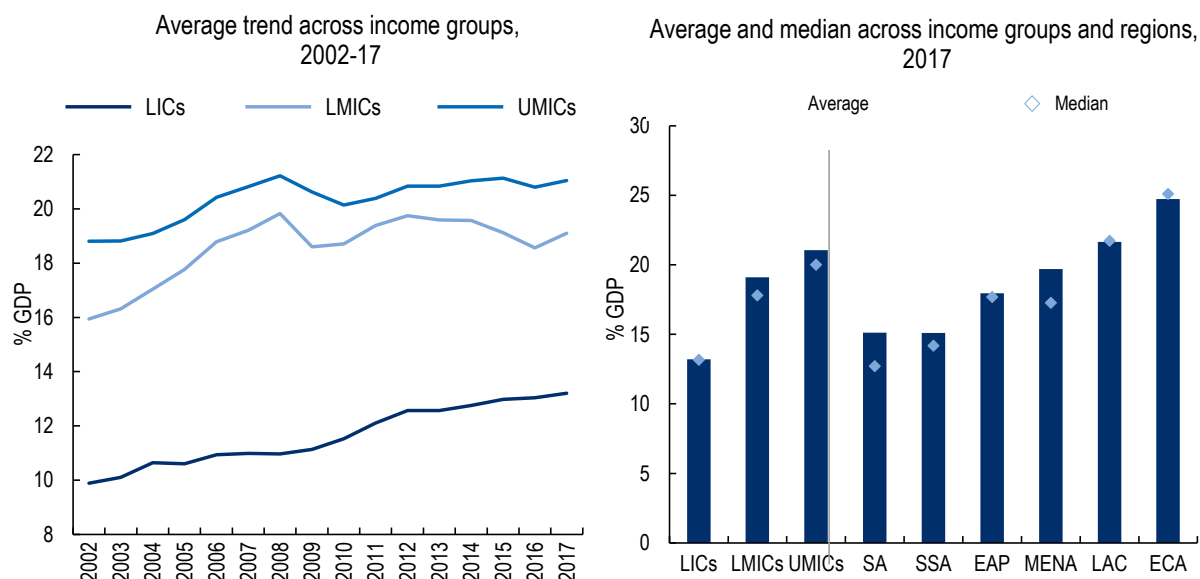
Tax revenue is the primary public revenue source to fund public goods and services, provide social protection systems, and invest in public infrastructure. In 2017, total tax revenue in developing countries amounted to USD 5.3 trillion, more than twice the sum of total external inflows. SDG target 17.1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

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

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

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

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



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

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

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

Tax revenue was below the necessary threshold for effective state functioning

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Domestic private investment is at risk amid economic recession and uncertainty

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

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

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

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

The domestic financial sector in developing economies does not provide reserves

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

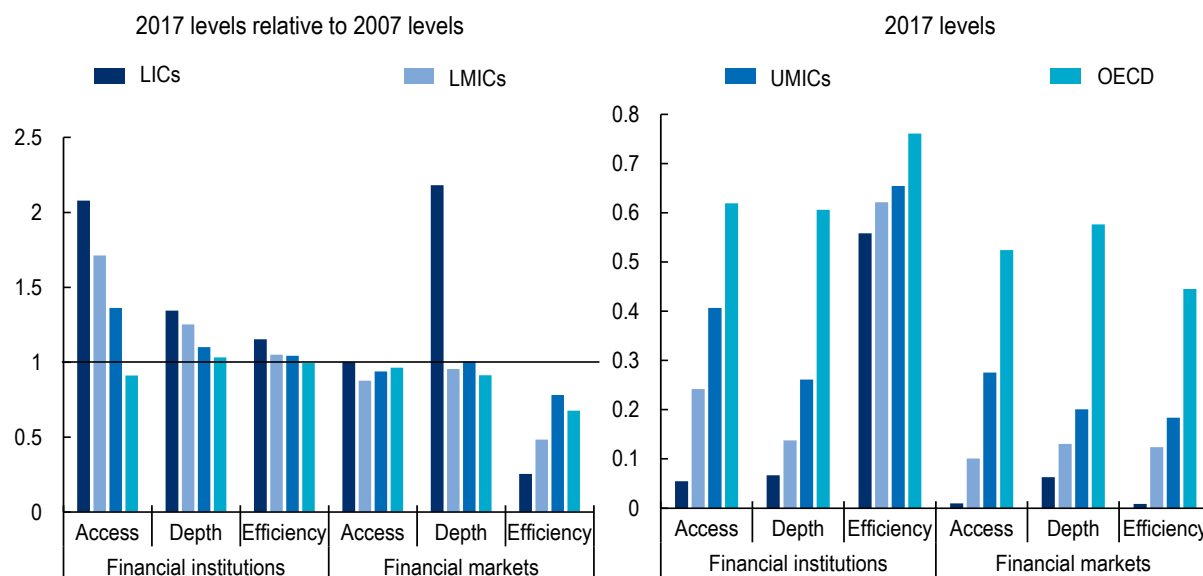
A well-functioning financial sector can be a key driver of economic growth. The financial sector consists of three components: financial institutions, financial markets, and the regulatory framework managing institutions and markets. For lower income countries, financial institutions such as commercial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

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

The remainder of this section utilises IMF indicators to analyse trends in financial sector development. Figure 2.3 (right panel) shows the 2017 index rankings of for ODA-eligible countries by income group across the three indices of development of financial institutions and markets: depth, efficiency and accessibility and (left panel) how the rankings have changed since 2007.³ The figures illustrate that the financial sector both in terms of institutions (measured by private sector credit, pension fund assets, insurance premiums, etc.), and markets (measured by stock market capitalisation, international debt securities, etc.) of ODA-eligible countries remains limited compared to OECD countries, despite some progress with respect to depth of financial markets in LICs since 2007. The efficiency of financial markets,

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

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



Note: The figure shows the non-weighted average by country group. The findings for OECD countries are as of 30 April 2020. Countries by income group are ODA-eligible countries for which data are available. LICs are low income countries; LMICs are lower middle-income countries; and UMICs are upper middle-income countries.

Source: Authors based on (IMF, 2019^[27]), *Financial Development Index Database*, <https://data.imf.org/?sk=F8032E80-B36C-43B1-AC26-493C5B1CD33B>.

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

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

2.3. Historic pressures on external resources

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

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

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

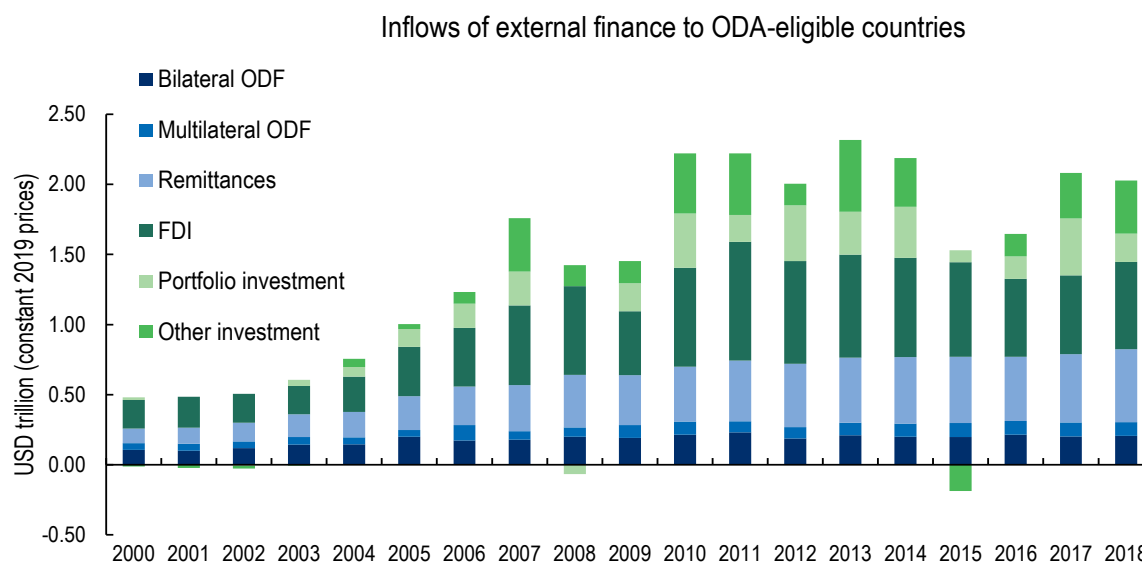
2.3.1. Total external resources were insufficient to fund the global goals prior to (coronavirus) COVID-19

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

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

In 2018, external finance for sustainable development amounted to a total of USD 2 trillion. FDI (30.6%) and remittances (25.7%) accounted for more than half of this volume, followed by other investment (18.7%), ODF (15%) and portfolio investment (10%). While the 2018 volume of external finance is an increase over 2015, it is still below the 2013 peak of USD 2.32 trillion. As shown in Figure 2.4 volumes of FDI, portfolio investment and other investment were lower in 2018 than in 2013.⁴ Drops in external private investment, especially to China, were responsible for the USD 845-billion plunge in 2015 from 2014 levels. ODF, however, has remained stable and remittances continue to increase.

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



Note: The largest sample possible for ODA-eligible countries was used for each year shown in this figure.

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

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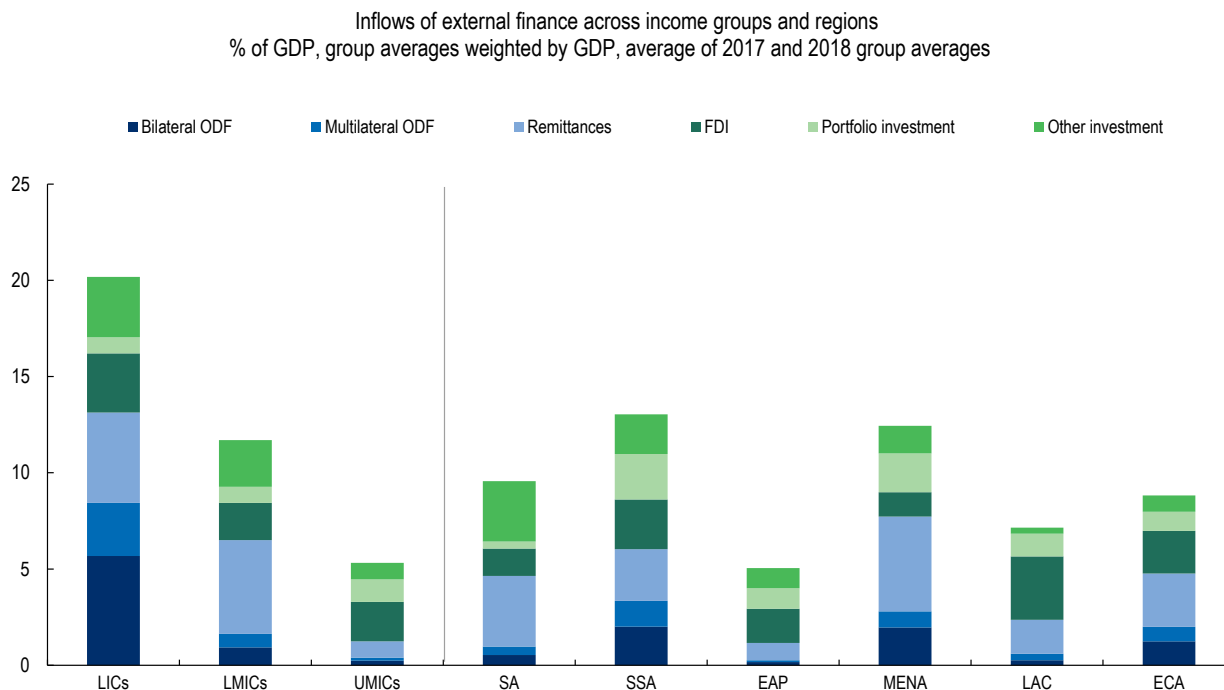
Private investments to upper middle-income countries drive the volatility in external finance inflows. These countries, particularly in East Asia in Latin America and the Caribbean, receive the bulk of private investments. External inflows are more volatile in these country groups than in low-income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

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

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

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

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



Note: The largest sample possible for ODA-eligible countries was used for each year.

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

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

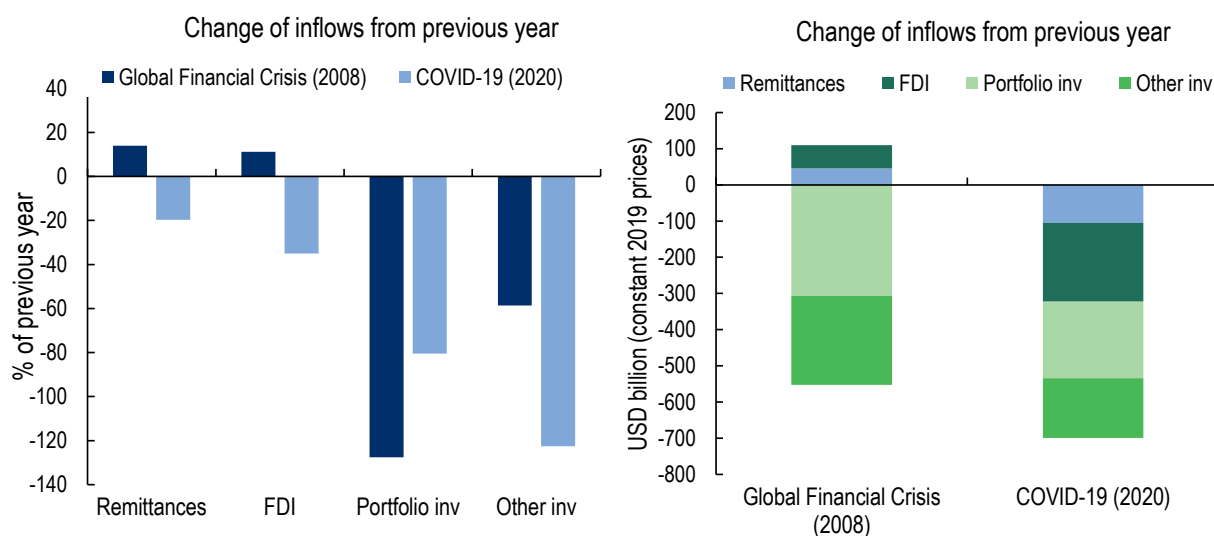
The historic significance of the current landscape is evident when the projected decline in external finance inflows in 2020 is compared with the 2015 and 2008 drops. While the economic fallout and impact of COVID-19 will depend on the level and composition of individual financing sources, it is expected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

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

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

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

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



Note: All data refer to ODA-eligible countries. The sudden stop of capital flows in 2015 is not shown here, as it would have included a USD 556-billion drop relating only to China. Other investment excludes IMF lending and Special Drawing Rights allocations.

Source: Historical remittance data based on KNOMAD (2020^[41]), *Remittances inflows (database)*, <https://www.knomad.org/data/remittances>. Historical FDI, portfolio investment and other investment data refer to net incurrence of liabilities and are from IMF (2020^[5]), *Balance of payments (database)*, <http://data.imf.org/bop>, and national central bank data. COVID-19 projections are based on combining historical data with projections on remittances and FDI by the World Bank (2020^[33]), “COVID-19 Crisis through a migration lens”, <https://openknowledge.worldbank.org/handle/10986/33634>, with portfolio and other investment data by the Institute of International Finance (2020^[32]), *IF Capital Flows Report: Sudden Stop in Emerging Markets*, https://www.iif.com/Portals/0/Files/content/2_IIF2020_April_CFR.pdf.

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

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

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

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

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

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

External private investment underperformed before the COVID-19 pandemic

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

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

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

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

External private investment will remain low in 2020

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

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

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

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

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

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

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

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

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

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

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

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

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

Prior to COVID-19, remittances levels increased steadily

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

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

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

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

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

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

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

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

Remittance levels will depend on migration and the global economic recovery

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

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

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

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

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

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

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

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

Preliminary data for 2019 suggest that net ODA flows from DAC member countries, on a cash basis, also have remained stable and increased slightly, by 0.1% in real terms, over 2018 (OECD, 2020^[49]). On a grant equivalent basis, the new standard ODA accounting adopted by the DAC for the headline figure of ODA, total ODA rose by 1.4% in real terms in 2019 from 2018.⁵ To better reflect the recipient perspective and assess a longer time span, official development finance flows are presented on a cash basis, i.e. the actual cash flow between donor and recipient countries. On the cash flow basis, net bilateral ODA flows to least developed countries (LDCs) increased by 2.6% in real terms in 2019. Net bilateral ODA inflows to countries in sub-Saharan Africa increased by 1.1% in real terms, by 0.4% to low-income countries and by 3.8% to lower middle-income countries. Upper middle-income countries, in contrast, experienced a decline of net bilateral ODA flows by 9% in real terms.

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

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

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

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

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

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

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

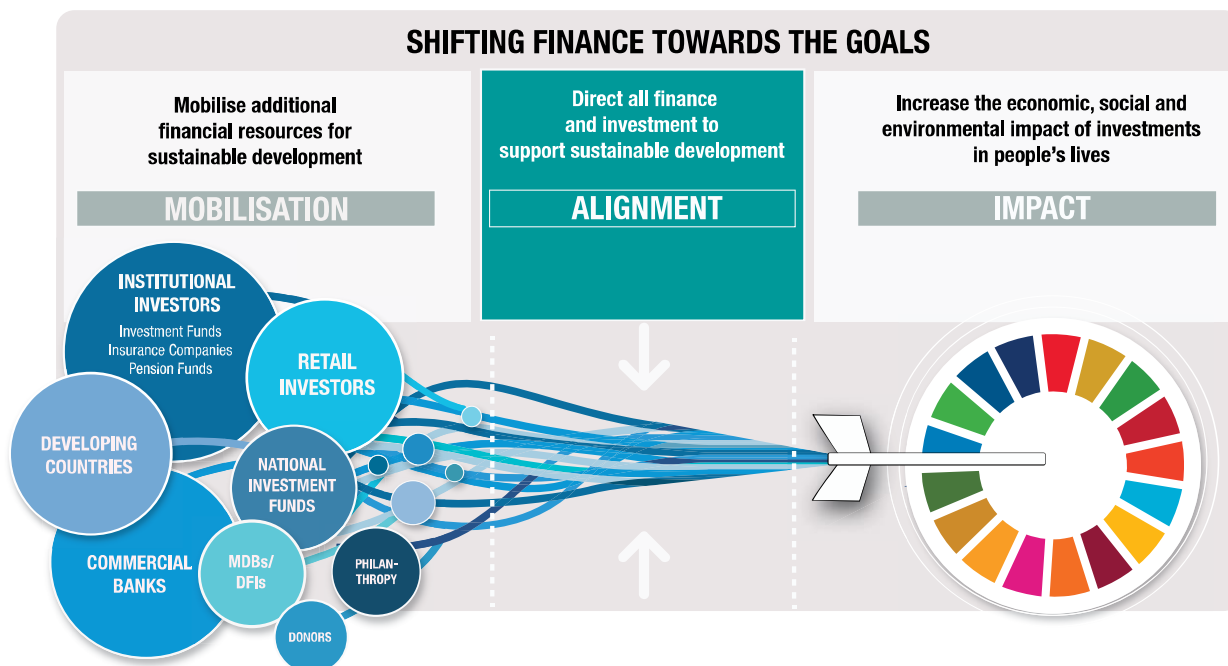
2.4. The call for better measures of quantity and quality of resources

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

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

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

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



Note: Multilateral development bank (MDB) and development finance institutions (DFIs)

Source: OECD (2018^[26]), *Global Outlook for Financing Sustainable Development 2019: Time to Face the Challenge*, <https://doi.org/10.1787/9789264307995-en>.

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

2.4.1. Recent progress to improve measures of quantity and mobilisation

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

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

Private resources plays an increasingly important role to finance sustainable development

Private philanthropy is increasing and highly concentrated in social sectors

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

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

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

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

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

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

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

Reporting on public resources beyond the OECD DAC has improved

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

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

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

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

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

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

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

Islamic financing promotes social responsibility

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

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

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

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

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

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

Results from 42 responding providers to the TOSSD data survey provided a first estimation of the additional financing captured in the framework, showing an estimated USD 33-billion worth of additional activities in 2017 not yet captured in current international statistics⁹ (OECD, 2019^[67]). Providers already reporting to the DAC accounted for USD 20 billion of this amount and South-South providers and other multilateral institutions reported the remaining USD 13 billion. An additional USD 3 billion was collected as external official resources in Indonesia. Taken together, these estimated flows represent an increase of 60% over the current official development finance statistics. Based on the survey, preliminary estimates of total TOSSD expenditure show USD 215 billion for Pillar 1 (cross-border flows) and USD 80 billion for Pillar 2 (global and regional expenditures) in 2017. Private finance mobilised amounts to another USD 40 billion in 2017.

The case study of Indonesia finds that TOSSD is appropriate for reflecting the financing for sustainable development provided by Indonesia. It also shows that the support extended by South-South providers goes beyond SSC to include, for instance, food aid, infrastructure building, etc. An additional thematic case study, conducted on tracking peace and security expenditures in support of the SDGs and in particular SDG 16 (Bejaroui, Gaveau and Benn, 2019^[66]), found that based on initial estimates, the TOSSD expenditures for peace and security amounted to USD 16 billion in 2017.¹⁰

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

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

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

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

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

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

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

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

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

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

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

Increasing the granularity of FDI data will improve alignment

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

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

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Notes

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

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

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

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

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

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

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

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

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

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



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