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FINANCING FOR SUSTAINABLE DEVELOPMENT – WHAT OPTIONS FOR THE INTERNATIONAL COMMUNITY AND SDC?

An ambitious post-2015 agenda with sustainable development and poverty eradication at its core will require an equally ambitious and comprehensive financing strategy. This DP brief assesses some debated components of the current OECD-DAC measurement of ODA and possible implications for Switzerland. Furthermore, it examines opportunities for Switzerland and the SDC to scale up sustainable development finance in light of the new Federal Council Dispatch[1] on Switzerland's international cooperation 2017-2020 (dispatch on cooperation), the forthcoming post-2015 agenda and the UN Financing for Development Conference.

2015 is a decisive year for financing for sustainable development: The international community is negotiating an ambitious post-2015 framework with the Sustainable Development Goals (SDGs) at its core. To ensure the agenda's implementation, the third UN Conference on Financing for Development, to be held in Addis Ababa from 13 to 16 July 2015[2], will aim to agree on a comprehensive and holistic financing strategy. An important input to the conference is the report[3] of an intergovernmental committee of experts that presents various policy options for financing sustainable development. In parallel, development ministers of the Organisation for Economic Co-operation and Development (OECD-DAC) plan to modernise the measurement of official development assistance (ODA) to meet the demands of the new SDG agenda.

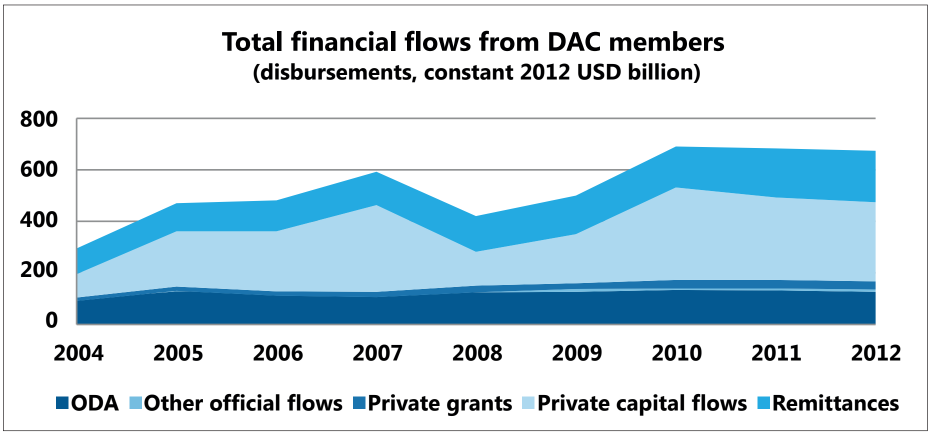
A global financing strategy needs to take into account the evolving development finance landscape. Not only goals but also actors and sources of development finance are changing dynamically. For instance, the total volume of international commercial, governmental and private resources received by developing countries has more than doubled since 2000. Developing countries are able to attract private capital flows such as foreign direct investments, loans or portfolio equity. Also workers' remittances continue to rise steadily. In 2012, mostly private non-aid sources accounted for over 80% of net external financial flows to developing countries.[4]

1 In 2012, the Swiss Parliament adopted the Federal Council Dispatch on Switzerland's International Cooperation 2013-2016 (dispatch on cooperation), which sets out the overall strategy for the operations of the Swiss Agency for Development and Cooperation (SDC) and the State Secretariat for Economic Affairs (SECO) and contains individual framework credits. The new dispatch on cooperation will cover the period 2017-2020 and and include the framework credit of the Human Security Division of the FDFA.

2 UNGA Resolution (2014), (*A/RES/68/279*).

3 See ICESDF (2014), Final Draft, *Report of the Intergovernmental Committee of Experts on Sustainable Development Financing*.

4 Development Initiatives (2013), *Investments to end poverty*. OECD (2013), *"the where" of development finance*. OECD (2014), *The new development finance landscape: developing countries' perspective.*



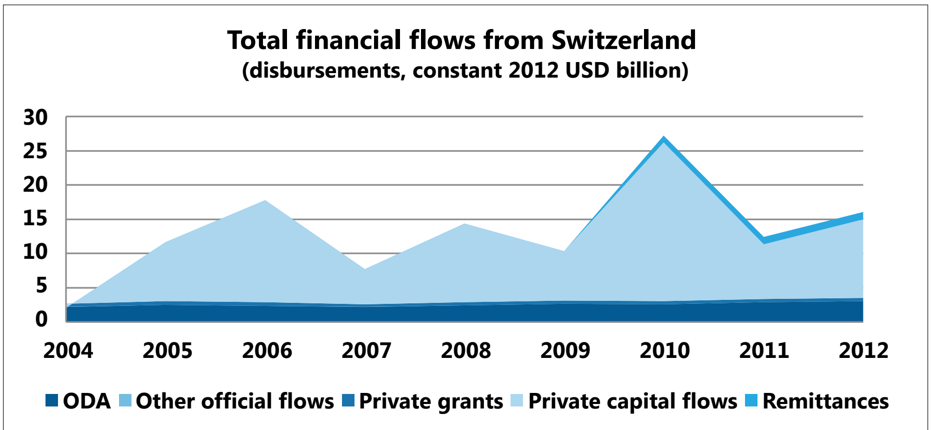


Figure 1: External finance to developing countries from DAC members and Switzerland (2004-2012) *Source 1 SDC illustration, OECD data*

The financing needs of a post-2015 development agenda are vast.[5] To address these needs in light of the dynamic development finance landscape, a more comprehensive financing strategy is required. More specifically, it should a) include national and international financial flows; b) combine the use of public and private resources; and c) be based on the comparative advantages of different existing and additional flows. In other words, the new financing framework should go beyond aid.

Despite this dynamic, ODA continues to be the main international source of financing in the poorest countries. In many least developed countries (LDCs) ODA accounts for up to 70% of available external resources. This makes aid an essential resource for poverty reduction. In middle income countries (MICs) ODA is smaller as a percentage compared to other flows. Here it addresses social inequality, acts as a catalyst for other resources or contributes to the provision of global public goods.

ODA DEFINITION UNDER SCRUTINY

The dynamic context of development cooperation puts the current ODA concept under scrutiny. The OECD development ministers plan to modernise the measurement of ODA and thereby also its role and definition in the post-2015 era.[6] However, incentives for a radical change in the ODA measurement and definition are limited as it would affect OECD members' ranking in terms of the United Nations' target to commit 0.7% of rich countries' gross national income (GNI) to ODA. With donors' increasing declarations of loans as ODA, there is an urgent need to revise the definition of concessionality. Moreover, the post-2015 goals to be pursued by ODA are broader than 10 years ago, challenging the list of activities with ODA eligibility.[7]

5 See ICESDF (2014) part B for a comprehensive attempt to quantify needs. For poverty eradication in all countries (USD 1.25/day standard) the annual investment requirements amount to USD 66bn; global annual requirements in infrastructure – water, agriculture, power, transport, buildings, industrial or forestry sectors – amount to between USD 5-7 trillion; and SMEs' unmet need for credit an estimated USD 3.5 trillion in developing countries. Additional financing for the provision of global public goods through climate compatible scenarios is estimated to be of several trillion US dollars per year.

6 The statistical ODA measure of the OECD-DAC remains crucial, notably to distinguish development cooperation from other areas such as trade or defence. Discussions for a complementary measure of "total official support for development" (TOSD) are under way in parallel to the more cautious ODA revision. They will continue in 2015 and aim to take into account the universal post-2015 agenda and discuss the accounting of climate finance.

7 For further information see DIE (2014), *The future of the ODA concept*; CGDEV (2014), *Straightening the measuring stick*; alliancesud (2014), *The dilution of development aid?*

ODA reform at the OECD-DAC: Concessionality and activities with ODA eligibility

A clear definition of concessionality is required. The DAC qualifies loans as ODA if they are concessional. Such loans involve lower interest rates, longer pay back times or direct subsidies – in short, they are more generous than market terms.[1] In a world of low interest rates, whether a loan counts as ODA depends largely on what meaning is assigned to a criterion called "concessionality in character". Donors interpret this criterion differently, which has led to diverse practices in issuing loans and to inconsistent statistics.[2]

OECD ministers have decided to make cautious revisions to the range of activities that fall in to the definition of ODA. A possible expansion could include measures related to peace and security activities, such as disarmament or counter-terror actions in developing countries. In addition, some DAC members argue for excluding the costs of admitting refugees to donor countries.

The discussed measurement reforms would hardly change SDC's ODA volume or current Swiss ODA notification. On the one hand, Switzerland is a grant donor – it mainly issues funds that do not have to be paid back by developing countries. Therefore, a change in loans' measurement would not alter its ODA reporting. On the other hand, Switzerland has the highest percentage of refugee in-donor costs compared to all other DAC countries.[3] In absolute terms, removing these expenditures from the ODA concept would not affect the volume of the SDC's budget, as they arise at the Federal Office for Migration. However, their exclusion from ODA would imply a drop in Switzerland's international ODA/GNI ranking. For instance in 2013, the Swiss ODA/GNI ratio of 0.47 would have decreased by 0.07 percentage points. There is however little support among the DAC members to exclude refugee costs. In the ODA debate, Switzerland aims to clarify the definition and measurement criteria, not a change in substance, and to make sure that it reflects donor effort for expenditures with a clear development purpose.

1 Concessional loans represent an important part of ODA. In 2012, total gross ODA for all DAC countries amounted to USD 140bn, of which USD 15.5bn (11%) for loans and equities. Currently, 11 DAC members provide concessional loans.

2 According to *DCD/DAC(2013)2* the EU, France and Germany currently include in their ODA reporting substantial volumes of loans at harder terms than IBRD loans classified as non-concessional (in some cases with interest rates more than 2% above those charged on IBRD loans). Moreover, these loans are mainly used in MICs to which the World Bank extends loans only on non-concessional terms. Therefore, the mathematical calculations need to be revised, i.e. how and whether to use a grant equivalent method (as opposed to cash flow method) and with what rate of discount (e.g. fixed or differentiated, taking into account the risks).

3 Refugee costs corresponded to 21% in 2012 and 18% in 2013 of total Swiss ODA, compared to the DAC average of 3%.

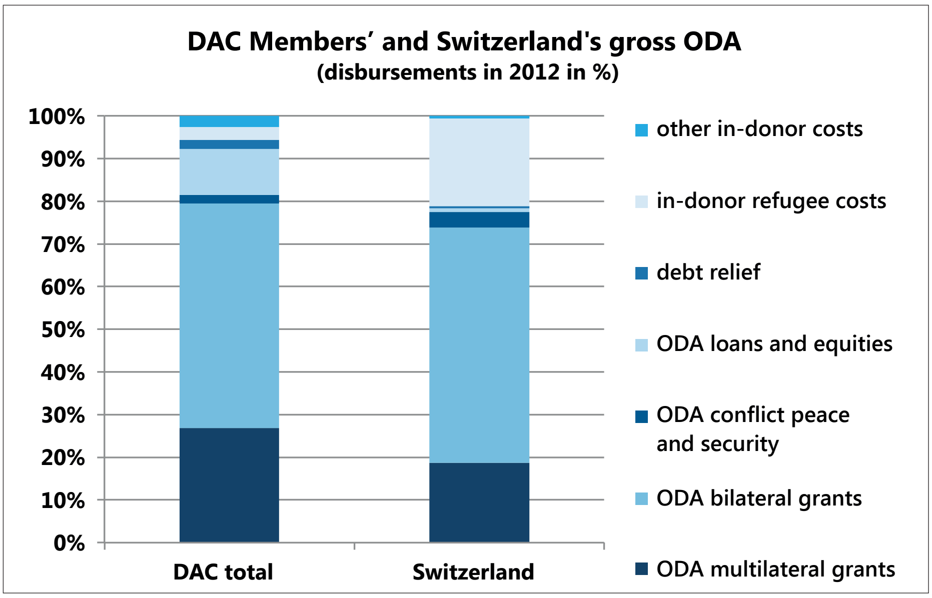


Figure 2: DAC and Swiss composition of gross ODA *Source 2 SDC illustration, OECD data*

SDC'S OPTIONS FOR MOBILISING FURTHER FINANCE FOR DEVELOPMENT

Switzerland has developed a sound consensus regarding the different sources of a comprehensive financing strategy. The interdepartmental working paper on "Sustainable Development Finance Post-2015"[8] puts the options on the table. "We support a comprehensive financing strategy, emphasising the importance of domestic resource mobilisation (DRM), using the comparative advantage of each financing source and promoting an enabling environment for these financial sources to be generated and allocated efficiently towards sustainable development." ODA alone will not be enough. It needs to be used strategically and creatively to direct and mobilise further financial flows towards sustainable solutions.

The preparation of the new dispatch on cooperation provides a timely opportunity to further consider options for implementing such a comprehensive financing strategy. The requirements and financing needs of a post-2015 agenda are vast. Therefore, based on the interdepartmental working paper and in light of the preparation of the new dispatch on cooperation, SDC has the opportunity to advance reflections on how to mobilise more public, private and 'blended' finance by the means of ODA. Concretely, there are several options that may be considered by the international community. SDC is particularly well positioned on some of these options, including:

a) **To target ODA more closely on where it is most needed.** Focusing ODA on countries with least access to international financial resources is a way to allocate ODA effectively. Notably LDCs and fragile states often lack such capacities. Of SDC's 20 priority countries/regions, 15 are considered LDCs and 10 fragile states.[9] A second complementary possibility is to further focus on promoting global public goods in order to address global risks that disproportionally affect the most vulnerable countries and people. Tackling these global challenges are priorities in the forthcoming post-2015 agenda. With SDC's global programmes, such as those focusing on climate change or water management, SDC is well prepared to foster environmental sustainability and social inclusion. The preparation of the new dispatch on cooperation thus provides an opportunity to further assess the focus on LDCs and fragile states as well as the promotion of global public goods.

b) **To further support developing countries' own capacities in the generation and management of their domestic public and private resources.** Each country has the primary responsibility for its own sustainable development, and partner countries' domestic resources already represent the greatest share of available sources. Moreover, domestic resource mobilisation (DRM) and sound public finance management help to reduce aid dependency, build institutions, foster accountability and provide locally adapted services. Globally, despite the foreseeable importance of DRM in the post-2015 agenda, there is a considerable financing gap. Only around 0.1% of worldwide ODA supports the development of tax systems. Fragile states merely receive 0.07% for this endeavour. Switzerland considers domestic resources to be the most important financial source for development. Where necessary, these resources should be supplemented by external support. SDC thus embeds such measures in its local governance and accountability programmes. It currently provides DRM assistance in around 17 countries, involving capacity building for tax revenue collection and efficient spending.

c) **To scale up private sector involvement in projects with development impact.** The private sector can contribute to the sustainable development agenda through financing, know-how as well as by adapting its business practices. SDC has experience in engaging the private sector through public-private development partnerships (PPDP), primarily aiming at influencing companies' business activities towards more sustainable practices. Examples include the SuizAgua Colombia project by SDC's global programme Water Initiatives, reducing the water footprint of private companies. Another example is the Swiss Capacity Building Facility, an innovative PPDP with the Swiss financial sector. It contributes to financial inclusion through capacity building at the micro level in developing countries. In such PPDPs, the projects are often fully financed by private companies or investors.

On the financing side, despite the increased availability of private finance to developing countries, many social sectors and countries (LDCs or fragile states) are

8 Swiss Confederation (2014), *Working Paper on "Sustainable Development Finance post-2015".*

9 In 2012-13, 24% of Swiss bilateral aid (combined SDC and SECO support) went to its top 20 aid recipients, compared to 29% on average in 2007-2011. This is lower compared to the DAC level of 55% in 2010-11. For SDC, total bilateral allocations to LDCs increased from USD 225 million in 2007 to USD 413 million in 2012 (current prices). Also the share of bilateral aid to LDCs has risen (29.5% in 2007 to 32.8% in 2012), compared to the share to Lower MICs (18.3% to 18.4%) and Upper MICs (1.2% to 8.9%).

not persuasive to private investors due to high risks or low anticipated returns.[10] To increase private investment, projects with development impact need to become financially viable by changing their risk profile. This can be achieved through blending instruments or matching grants. Here, a donor provides part of the total requisite funding as ODA in order to attract additional private funding. To meet the ambitious post-2015 requirements, adequacy of scale of public instruments to mobilise further private finance is increasingly important. In this area, SDC can build on its experience with the platform 'Renewable Energy and Energy Efficiency Promotion in International Cooperation' (REPIC) where it blends investments with private companies. The Private Sector Facility (PSF) of the Green Climate Fund will offer opportunities to further involve the private sector and explore such leveraging instruments for low-emission and climate-resilient development. SDC is represented on the advisory board and holds the co-chairmanship of the Private Sector Advisory Group. There is thus scope to further develop financial instruments and partnerships with the private sector. Most promising options include areas where SDC has technical expertise, notably in health, education and vocational training but also in the segments of small and medium-sized enterprises (SMEs), environment, water and food security.

d) **To assess and adjust Swiss financial and tax policies for minimising negative impacts on developing countries.** Policy coherence for development (PCD) is about the development friendliness of (inter-) national policy areas, related to sectors like the Swiss financial sector or commodity trading.[11] The Swiss position in the interdepartmental working paper recognises that quantitative financial support alone is not conducive to sustainable development if not sustained by an enabling country-level and international policy framework. Therefore, SDC fosters PCD in partner countries, in Switzerland as well as at the multilateral level.

Switzerland is among the world's leading financial centres. There is a growing Swiss sustainable finance scene involving traditional actors like banks as well as an impact investor industry.[12] Building on this expertise, it could be a global leader on sustainable investment, thus having a substantial impact on global development. Furthermore, Switzerland is prepared to address the global challenge of illicit financial flows.[13] In the context of Switzerland's current legislative agenda, there is an opportunity to further foster a sustainable regulatory framework, including the promotion and the potential establishment of (inter-)national transparency standards as well as improved and harmonised non-financial reporting of companies. Moreover, Switzerland is continuing its effort with regard to stolen asset recovery and particularly by contributing to efforts to ensure that restituted assets benefit the population of the country to which they have been returned.

10 For further information European Parliament (2014), *Financing for Development post-2015: improving the contribution of private finance*. Or Kharas & McArthur (2014), *Mobilizing Private Investment for Post-2015 Sustainable Development*, Briefing Note, Brookings.

11 ECDPM (2013), *Putting Policy coherence for development into perspective: supporting Switzerland's promotion of PCD in commodities, migration and tax policy.*

12 E.g. *http://www.sustainablefinance.ch/*

13 According to Global Financial Integrity, estimates of illicit financial outflows from developing countries are as high as USD 5,9tn between 2001 and 2010, while foreign aid mounts to USD 677bn. For specific actions of Swiss development policy to curb illicit financial flows see SDC's DP Brief (April 2014); *Illicit financial flows: challenges and possible courses of action for Swiss development policy.*

CONCLUSION

2014 and 2015 are crucial years for sustainable development finance at the OECD and the UN. ODA needs to be used more strategically and efficiently, inter alia so as to generate additional resources for meeting the needs of the post-2015 agenda. Based on the Swiss consensus of a comprehensive financing strategy for sustainable development, SDC has the opportunity to advance these reflections while it prepares its position ahead of the international conference in Addis Ababa and the new dispatch on cooperation 2017-2020. Areas for further reflection involve ODA targeting, mobilisation of domestic resources, further involvement of the private sector as well as sustainable financial regulation and the combat of illicit financial flows.

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