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Filling the finance gap

The evidence shows that public funding for the SDGs is well below what is needed. Private investment can help fill the gap but isn't a substitute for public funds and isn't compatible with all development needs

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Meeting the UN Sustainable Development Goals (SDGs) requires the sustained mobilisation of large-scale public and private resources. But with just over 10 years to go before the Goals' 2030 deadline, countries have yet to fulfil their Addis Ababa Action Agenda financing

◀ **Seven-year-old Edeline Jean stands on the foundation of the new earthquake- and hurricane-resistant building at Caimite National School, Haiti, which was funded by UNICEF. Although there are many examples of private investment in the education sector, its utility is constrained by the need to put investors before 'clients'**

commitments, while many lack the scale of resources necessary to achieve the Goals. Filling this financing gap will require a broad range of interventions: not only increased public and private investments, but also public service improvements, regulatory changes, transfers to vulnerable populations and behavioural changes.

Each of these intervention categories is critical for SDG success. Yet in the face of domestic resource mobilisation challenges, static or declining aid levels, rising debt burdens and increased trade tensions, policymakers have increasingly targeted private finance as among the most promising areas for funding growth.

At the UN Financing for Sustainable Development Forum in April 2019, the UN Secretary-General, President of the General Assembly and President of the Economic and Social Council all emphasised the importance of unlocking more and better-aligning private capital for SDG advancement.

As private markets comprise the largest parts of the economy in most countries, unlocking their resources to fill development financing gaps is widely viewed as essential. However, so far the quantity of private capital invested in and aligned with the SDG agenda has been limited. These are both for reasons that investors can rectify and others that they, alone, cannot.

SDG financing flows

There are multiple categories of SDG financing, the sum of which includes all outlays of both public and private domestic and international funds for Goal-related purposes.

Public SDG financing includes all SDG-related budget or state-owned enterprise funding for capital and operating expenditures, as well as for transfers to vulnerable populations. Official financing flows with SDG impacts include official development assistance and other official flows.

The remainder of SDG financing flows come from private or blended SDG financing. Private SDG financing includes private development assistance from individuals and charities, and other private flows (the main subject of this article).

Other private SDG flows refer to all SDG-related financing at market terms from private-sector resources. These include international bank and bond lending and, notably, direct investment. Blended finance is a hybrid category that refers to philanthropic, public or official development finance deployed to mobilise private capital for development purposes.

Assessing SDG financing needs

Although the limited availability of data and standardised criteria make SDG needs assessments difficult, the world's estimated financial needs for achieving the SDGs are between \$5 trillion and \$7 trillion a year. Having found approximately \$3 trillion so far, we need an extra \$2 trillion to \$4 trillion a year between now and 2030. While an objectively large figure, this amount constitutes just a small fraction of the \$87 trillion in gross world output, according to figures from the International Monetary Fund (IMF).

For the world's 31 low-income countries (LICs), which have the furthest way to go, and 51 lower middle-income countries, the SDSN estimates that the SDG funding gap is between \$1.4 trillion and \$3 trillion per year.

In late 2018, the IMF and SDSN found that the world's 59 poorest countries face a particular challenge: they will need to increase their budget outlays significantly to achieve the SDGs, significantly outstripping their current and potential domestic revenues. These countries' public financing needs are between \$300 billion and \$528 billion per year between now and 2030, or approximately 40 to 50 per cent of their GDP.

The IMF concluded that even if LICs increased their tax-to-GDP ratios by five percentage points of GDP within the next 10 years, they would still only be able to finance one third of the additional \$528 billion that they will need to spend in 2030 to fund the core work of achieving the SDGs.

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Given the size of the remaining financing gap, most SDG financing efforts emphasise resource mobilisation rather than assessing resource needs. While this is hugely important, SDG financing needs assessments provide critical data and guidance to policymakers, investors and donors. Needs assessments can facilitate greater alignment between investment policies, financial flows and financing needs to enable and incentivise financing for the areas with the greatest needs and the potential for social returns.

Mapping private finance to SDG needs

Just as financing needs assessments are important for optimising SDG resource plans, so too are reviews of financing sources' compatibility with the development needs they are mobilised to meet.

The SDGs include multiple provisions for access to merit goods and public goods, as well as to protection from natural monopolies. These entitlements are traditionally provided with public financing, given their recognition as

fundamental rights to which all people should have access regardless of ability to pay, and the tendency of the market to under-provide or under-regulate them.

There are many examples around the world of private investment in these types of goods and services, notably in the healthcare and education sectors. Acute shortages of public and official funding in these areas mean the trend is likely to increase. Yet the impact and utility of private finance in these areas is constrained by its prioritisation of returns over access, and its accountability to investors over 'clients'.

Recognising this, there are multiple pillars of the 2030 Agenda with which private finance and public–private financing partnerships are well aligned. These include infrastructure funding for roads, rail, power and fibre-optic networks. The Global Infrastructure Hub estimates that Africa alone will require $3.3 trillion to meet its SDG infrastructure goals by 2040, most of which will be spent on road and electricity network construction.

Governments and international groups like the G20 have taken many steps to facilitate increased private investment in infrastructure projects, but so far there has been no significant growth in private investment levels. As the UN's 2019 *Report on Financing for Sustainable Development* finds, the public sector "still largely dominates infrastructure spending in low and middle-income countries, accounting for 87 to 91 per cent of infrastructure investments".

Private investment in unregulated natural monopoly sectors can also endanger SDG progress by driving prices up and wages down in the absence of competition. Since 1990, the average wage share of world gross product has fallen from 57 to 52 per cent, largely due to market concentration. This has exacerbated income inequality and undermined SDG progress.

Geographic targeting of development finance

While all countries have significant areas for improvement and face their own unique challenges in achieving the SDGs, the shortfall that LICs face between their domestic revenues and SDG resource needs set them apart. Given LICs' particular need for external financing, it follows that SDG-aligned flows would predominantly target LICs. This is not the case for either official or foreign private financing flows, though limited data make it difficult to draw conclusions about corresponding levels of domestic private investment and philanthropy for development.

The Organisation for Economic Co-operation and Development (OECD) reports that LICs, which are home to over 70 per cent of the world's population, received just 20 per cent of official development assistance in 2017, taking in only $29 billion of the $147 billion allocated as aid for that year.

The UN Conference on Trade and Development's *World Investment Report 2015* estimates that a single type of profit-shifting cost developing countries around $100 billion a year in lost annual revenues, though additional research must be done in this area to produce more data and estimates.

The world agreed upon an ambitious, urgent and achievable agenda in 2015 to which leaders committed political and financial capital. To achieve this goal, the UN has challenged the world to shift the scale of the SDG financing conversation from billions to trillions. The magnitude of this mandate and the persistent SDG funding shortfall have focused stakeholders on matters of funding quantities, sometimes at the expense of funding qualities, particularly with regard to how financing sources and incentives align with the 2030 Agenda.

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Similarly, a 2018 OECD report on private philanthropy for development found that philanthropic flows also skew away from the world's poorest countries: just one third of private development assistance funds go to LICs and 67 per cent to middle-income countries, in which only 22 per cent of the world's population resides (high-income countries are not eligible for development assistance funds).

Private investment flows – and foreign direct investment (FDI) flows in particular – are similarly concentrated outside the poorest countries. Only five per cent of total international private capital flows for developing countries go to LICs.

Finally, the geography of financial flows matters as much for what flows out as for what flows in. As the percentage of FDI in developing countries has grown relative to those countries' gross domestic product (roughly tripling since the 1980s), the significance of FDI as a source for tax revenue has also grown.

However, pervasive profit-shifting by private investors has cost countries tens – even hundreds – of billions of dollars, hitting poor countries hard.

There is no question that private capital has a significant role to play in filling the SDG funding gap. But its mobilisation should be as a complement to public and official financing flows, not a substitute for them. To improve our understanding of where and how to focus financing mobilisation efforts, more research is needed on the country-level funding needs to achieve the SDGs. The SDSN is doing this needs assessment work as co-chair of an SDG costing group initiative it launched with the IMF, OECD and World Bank as co-chairs and leaders.

As UN Secretary-General António Guterres neatly put it when opening the April 2019 Financing for Development Forum: "Policy frameworks are key to reducing risks, creating an enabling business environment, incentivising investment in public goals, and aligning financial systems with long-term sustainable development." ●