



Challenges of financing human and sustainable development

Accelerating progress to achieve the Millennium Development Goals (MDGs) will serve to advance human development and also to lay a solid foundation for the pursuance of sustainable development goals after 2015. But considerable financing challenges are to be overcome to address environmental degradation and secure sustainable energy and much of these are additional to those of achieving the MDGs. Most developing countries will require a huge amount of upfront investment in order to realize sustainable development goals.

The *World Economic and Social Survey (WESS) 2013 on Sustainable Development Challenges*, underlines that financing the economic, social and environmental pillars of sustainable development raises a number of concerns. The huge size of investment requirements will necessitate a high volume of public resources to be raised and invested, in view of a lack of incentives for long-term private investment. This is likely to trigger macroeconomic trade-offs that need to be addressed in tandem with options to achieve the rapid and sustained economic growth that helps create fiscal space and maintain solid development standards.

Costly investments...

Achieving the MDGs by 2015, for example, would require a significant increase in public spending. The *Survey* shows that under a baseline scenario delineating the currently expected pace of economic growth and existing public spending priorities and budget financing policies in 27 developing countries, substantial progress towards achieving the MDGs is attainable, but the majority of these countries would not fully meet by 2015 a set of targets for primary school completion, reduction of child and maternal mortality, and expanded coverage of drinking water and sanitation. These countries would need to scale up their public spending to meet these targets by 2015; in ten cases, for example, the additional public spending required would be around 5 to almost 10 percentage points of GDP per year—irrespective of the financing source, equivalent to 15 to 48 per cent of total public spending per year depending on the country. The vertical axis of the Figure shows the additional public investment required as a percentage of GDP (during 2010-2015).

...with macroeconomic trade-offs

Different ways of financing the additional spending requirements to meet the said MDG targets have different macroeconomic implications. Financing the spending through domestic sources, simulating a financing strategy of direct taxation, tends to yield a *less* positive impact on GDP growth than does

a strategy of using a foreign source of financing. The Figure shows that for each country the observation for foreign financing is to the right of that of direct taxation along the horizontal axis, implying a lesser negative impact on GDP growth. This simulation result is due to the fact that increased direct taxation depresses private disposable incomes and therewith aggregate domestic demand. The crowding out of private consumption and investment thus depresses GDP growth, which is reflected in a reduction of private demand for, as well as provisioning of, social services. This feedback effect requires the government to invest even more to compensate for the loss of private spending in social sectors in order to ensure that MDG targets are met, thereby incurring more additional public spending. The Figure shows that for each country the additional public spending in the scenario using foreign financing is *below* that of increased direct taxation (the vertical axis).

Yet there are trade-offs associated with foreign financing to be considered too. It is well known that an inflow of foreign currency may lead to real exchange rate appreciation, harming the tradable sector. This will be particularly the case when the amounts are spent on non-tradable social services, as would be required to meet MDG targets. The appreciation of the real exchange rate may lead to resource allocation away from dynamic export industries that negatively affects GDP growth in the absence of an adequate policy response. The Figure shows that GDP growth in the scenario of foreign financing is lower than in the baseline for a number of countries.

Feasibility of domestic and external financing

Another challenge is whether the countries can effectively realize access to the alternative sources of finance and whether it is economically feasible to use it. First of all, domestic financing through taxation may not be an easy option, because existing tax burdens on those parts of the economy which are in the tax net are already considered high in many developing countries. Second, the foreign financing route is also becoming problematic. On the one hand, if this financing comes in the form of loans, then it increases the debt burden. On the other hand, a continued financial crisis in developed countries is making prospects of aid and concessional financing for developing countries increasingly limited and uncertain. A feasible financing strategy would likely involve a combination of sources.

Not without economic growth

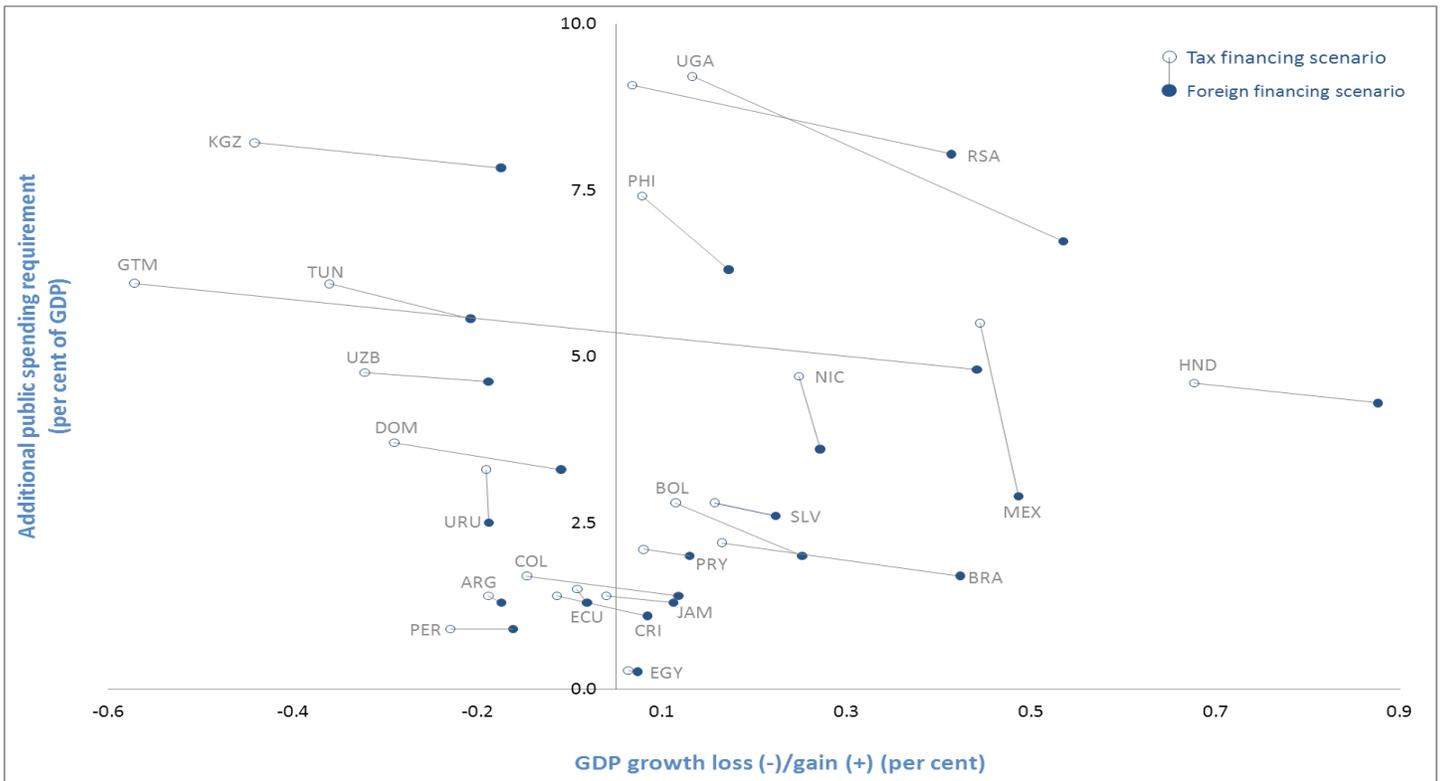
Countries will require more rapid and sustained economic growth to reduce and make feasible the financing associated

with stepping up upfront public investments but this is proving difficult for many countries. Furthermore, the near-term crowding-in impact on growth of investments made in pursuance of the MDGs may be modest or may not even materialize depending on the financing strategy (see Figure). The gestation lag for the fruition of investments made to pursue development goals in terms of higher GDP growth also needs to be taken into account. This is particularly true for investments in the education and health sectors. Children need to go through one or more educational cycles and there needs to be improved child and maternal health care today for there to be a pay-off in terms of healthier students and workers several years from now. The *Survey* examines this hypothesis and shows evidence that GDP could experience an additional percentage point growth of 0.2-1.0 after 2015, owing to the delayed impact of MDG-related investments. Realizing these economic gains will also depend on other investments being made in industries that create enough employment opportunities for the better-educated graduates entering the workforce.

Policy concerns to be addressed

In sum, policy makers need to address the following concerns in their assessments of feasible financing strategies for development: (i) pursuing development goals might demand the investment of significant public resources; (ii) financing strategies need to be carefully assessed in order to establish the feasibility and optimality of alternative strategies to minimize negative macroeconomic impacts; (iii) in view of the real access to, and the macroeconomic feasibility of using a particular source of finance, most developing countries likely require a financing strategy including both domestic and foreign sources; (iv) rapid and sustained economic growth is required to make the financing associated with accelerating upfront public spending more feasible; and (v) new investments are needed in areas of the economy capable of creating enough employment opportunities for the better-educated graduates entering the workforce, in order to secure potential long-term economic benefits of development investments.

Public spending and GDP growth under two alternative MDG financing scenarios, 2010-2015 (deviation from a baseline scenario)



Source: Scenario analyses conducted by national researchers and government experts, with technical support from UN/DESA in close collaboration with the World Bank and other partners.

Note: Under the MDG financing scenarios public spending rises until defining a path towards meeting a set of five targets by 2015. Additional public spending requirement and GDP growth loss/gain refer to the difference between the estimate of, respectively, public spending and GDP growth under each of the MDG financing scenarios and the estimate for the same variables under a baseline scenario. Observations are not presented for 4 countries for which one of the financing options was not considered.

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