DIRECTOR

DEVELOPMENT CO-OPERATION DIRECTORATE

Jorge Moreira da Silva

Financing for Sustainable Development

Global Advisory Pool Mechanism

- **The COVID-19 crisis will increase inequalities for current and future generations** if not all have access to quality FSD advisory services to ensure the choice of the best financial partner, instrument, terms and conditions.
- **Empowering countries to design their own sustainable development finance strategies** in an increasingly complex FSD landscape is essential to accelerate advancement towards the SDGs and ownership of development strategies (in line with the Paris Declaration on Aid Effectiveness and the Accra Action Agenda).
- **Financing the recovery in developing countries will require further financial innovation** to have greater impact with severely constrained resources.
- **Sustainable recovery in OECD countries could divert even more resources from developing countries and increase the SDGs financing gap** if no assistance is provided to develop comparable SDG compatible bankable projects in developing countries.
- **Lessons from the previous debt crisis should be learnt** – debt relief or restructuration should be an opportunity to repurpose financing and use fiscal space for SDG alignment; transparency and good governance will decide of the long-term sustainability of SDG financing.

I. Background

The new profusion of financing actors and instruments that characterises the SDGs era presents both risks and opportunities for partner countries. The 2015 Addis Ababa Action Agenda (AAAA) called on a broad diversity of actors to mobilise domestic and external financial resources in pursuit of sustainable development. While the variety of actors and financing instruments provides opportunities to mobilise more and better-tailored financing solutions, it also adds a layer of complexity and risk: as the number of actors and instruments increases at a fast pace, so does the number of possible combinations across the different financing sources. The *2019 OECD Global Outlook on Financing for Sustainable Development* suggested that partner country government had more than 2,000 instruments to choose from.

Partner countries can have a hard time navigating the dynamic Financing for Sustainable Development (FSD) landscape, and deciding from among the multiple financing options available. In recent years, through its transition finance work, the OECD has raised the attention of development stakeholders on the importance of helping partner countries better manage, anticipate and adapt to changes affecting their access to, or the terms and conditions of, their financing[1]. At key stages of their development (e.g. change of income category or graduation of specific support windows), partner countries lose access to some financing

[1] An approach labelled as Transition Finance.

sources and gain access to new ones: this requires them to carefully assess and review their financing options in light of their evolving circumstances.

Exogenous factors, such as the COVID-19 pandemic, add to the complexity and volatility of partner countries' financing landscape. In the weeks following the outbreak of the COVID-19 pandemic, for example, many developing countries lost access to the financial markets – only to regain access a few weeks later. In parallel, development partners created a number of new financing facilities with different objectives and scope to help developing countries address the health, economic and social impact of the crisis. The crisis also accelerated the looming debt crisis with Zambia first defaulting on a loan less than 9 months after the inception of the sanitary crisis.

II. The issue

Partner countries' financing decisions can carry long-term consequences and negatively influence their development prospects. Inefficient financing decisions can constrain future access to finance and, in the worst-case scenario, lead to situations of financial distress, as evidenced by the rising debt vulnerabilities observed in developing countries[2]. In many cases, development partners did not heed early warnings about partner countries' insufficient understanding of the terms, conditions and risks involved by newly available financing instruments[3].

Existing financial support mechanisms leave a key challenge unaddressed. Many partner countries have weak or inadequate capacity to identify, understand and choose from among the plethora of financing partners and instruments available to them at different stages of their development. In some cases, domestic governance issues (lack of transparency about loans contracted by SOEs, agencies in charge of infrastructure, sub-national governments, etc.) aggravate the problem. Yet, these aspects remain unaddressed by most existing support mechanisms. A number of development partners already provide solutions for upstream FSD activities, such as development finance assessments[4] or SDG financing strategies[5]. At the other end of the spectrum, the IMF and the World Bank provide much needed support on debt sustainability analysis, debt management and debt restructuring. This leaves partner countries with no support for a critical segment of the FSD cycle: the choice of the best partners and instruments to implement their SDG financing strategies.

A global advisory service to help countries identify FSD partners and instruments best fit for purpose

A well-targeted technical assistance (that could be supplemented by capacity-building programs) for FSD could help fill the support gap. The objective of this program could be twofold: (i) to help partner countries navigate the complex financing for sustainable development landscape and identify the partners and instruments best fit-for-purpose; and (ii) to build partner countries' capacity to find and negotiate the best terms and conditions so they are able to meet their financing needs at the lowest possible cost, and at terms that do not jeopardise their creditworthiness.

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[2] According to the IMF, 28 low-income countries are currently at high risk of debt distress, and at least 7 are already in debt distress: https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf.

[3] In Zambia, for example, several studies, including an OECD Transition Finance Diagnostic conducted in 2018, alerted on the risks stemming from the country's abrupt shift from official and mostly concessional, to private and commercial finance (offering shorter maturity, flexible rates and increasing the country's exposure to the risk of currency fluctuation). In November 2020, Zambia defaulted on its Eurobond.

[4] E.g. UNDP's Development Finance Assessments (DFAs) and OECD's Transition Finance Diagnostics (TFDs)

[5] UNDESA is currently developing a set of guidance materials to design Integrated National Financing Frameworks (INFFs), which will be made available on the INFF Knowledge Platform.

For development partners, helping countries avoid the traps of the FSD landscape is key to ensure the resilience of ODA investments and avoid contributing to debt distress. Such a mechanism would complement, and should work in partnership with, existing efforts from development partners to build the capacity of partner countries along the other segments of the FSD cycle (e.g. the support to design SDG financing strategies provided by UNDP or the debt management capacity building provided by the IMF and the World Bank, including under the most recent G20 initiatives).

Other similar initiatives are widely acknowledged for their effectiveness and impact[6]. The experience of the OECD/UNDP-led Tax Inspectors Without Borders (TIWB) in deploying and integrating experts supporting highly confidential core state functions in developing countries could be particularly instructive to inform the design of this new mechanism (see Box 1 below). The Advisory Centre on WTO Law is another interesting example of pooling independent expertise on trade dispute settlement and offering it at low cost to countries with limited relevant legal expertise.

To ensure sound technical expertise and impartial advice, the program could take the form of a resource pooling mechanism. The program, to be sponsored by donors, would provide FSD advice to partner countries seeking impartial third-party financial expertise at low cost. The capacity building should be provided through a "learning by doing approach" and could cover areas such as: screening of investment and financing opportunities, building a pipeline of SDG-compatible bankable projects, financial modelling and valuation for complex financial transactions, identifying the best combination of financing partners and instruments (e.g. blended finance), or negotiating terms and conditions.

The technical assistance and capacity-building mechanism for FSD could rely on five core principles:

1. **Technical expertise** – Ensure advice is based on sound technical expertise, including in-depth understanding of the variety of financing sources and instruments available (ODA, OOF, financial markets, foreign direct investment, blended finance, etc.) with the possibility to leverage sector-specific knowledge when necessary (e.g. access to climate finance);
2. **Country-ownership and demand-driven approach** – Support should be provided based on demand from partner countries, and contribute to building local capacity through handholding and transfer of skills to ensure it leaves partner countries with sustainable expertise;
3. **Impartiality** – The mechanism should be hosted by a neutral actor (i.e. not a lender) to avoid conflicts of interest, and could take the form of a resource pooling mechanism granting or advancing funds to partner countries to seek impartial third-party financial advice and capacity building;
4. **Multi-levels of governance** – A major capacity challenge for partner countries relates to the multitude of actors with the ability to access finance (e.g. obtain grants or contract debt) within each partner country (ministries, sub-national and non-sovereign entities, state-owned enterprises, etc.). When requested by partner countries, assistance and capacity-building for specific actors should be adapted to their specific needs;
5. **Strategic partnerships** – Recognise existing and complementary support provided by development partners in other segments of the FSD cycle (e.g. UNDP on Development Finance Assessments, WBG/IMF on debt management), and ensure interventions are coordinated.

Box 1. The example of the OECD/UNDP-led Tax Inspectors Without Borders initiative (TIWB)

[6] Examples of such initiatives hosted by the OECD include Tax Inspectors Without Borders (tax audits), BEPS support (Base Erosion and Profit Shifting), or Paris 21 (statistical capacity-building). Other similar capacity-building initiatives include the Advanced Center for WTO Law (ACWL) and the African Legal Support Facility (ALSF) hosted by the African Development Bank.

Launched in 2015 as a joint OECD/UNDP Initiative, TIWB is a niche form of assistance providing direct and practical help through a "learning by doing" approach on live tax audit cases. The Initiative identifies demand from host countries, areas of assistance, and manages a network of partners and a roster of validated experts. Tools and mechanisms have been developed and managed for efficient end-to-end deployment, including covering sensitive confidentiality and liability issues. TIWB's transfer of knowledge approach is focused on practical handholding, not substitution of local staff.