Co-leaders working note
22 July 2020

Follow-up on the High-Level Event on Financing for Development
in the Era of COVID-19 and Beyond

Discussion Group I: External Finance and Remittances, Jobs and Inclusive Growth

Co-leads working note

INTRODUCTION

Reiterating our support for the Addis Ababa Action Agenda for FFD, the Sendal Framework for Disaster Risk Reduction, the Paris Agreement on Climate Change, and the 2030 Agenda, we embark on the work of discussion group 1 of developing a menu of policy options for dealing with the impact of Covid-19 on external finance (private and public), remittances, jobs and inclusive growth.

An overarching consideration for our work shall be the need to fully align all policy options with the SDGs.

We are mindful of the need to base our outcome on comprehensive, up-to-date, and accurate data on trends in development finance, in all its aspects. We rely on the Member States, international organizations and other stakeholders to develop the menu of policy options based on the guidance provided by this note, taking into account their expertise and experience on the issues at hand.

<u>1. PRIVATE INVESTMENT AND FINANCE</u>

Background

1. ***Foreign direct investment***

The COVID-19 crisis is expected to cause a dramatic fall in FDI. Global FDI flows are anticipated to decrease by up to 40 per cent in 2020, from their 2019 value of $1.54 trillion. This would bring FDI below $1 trillion for the first time since 2005. After a further projected decrease of 5 to 10 per cent in 2021, FDI flows are only expected to recover in 2022. A rebound in 2022, with FDI getting back to pre-pandemic levels, is possible only in a best-case scenario.

Challenges for the mobilization of private finance (investors perspective)
An enabling environment is essential but nor sufficient for the mobilization of private finance. Institutional investors and banks have identified additional obstacles that impede investments for sustainable development: risk-adjusted returns on investment products are too low; limited scale of investment opportunities; excessive regulation; underdevelopment of human capital; insufficient support for investments through risk insurance, guarantees, etc.; internal evaluation and incentive systems which do not encourage new types of investment; difficulty to ensure that the investment product is actually "sustainable" (due diligence competence and capacity). In addition, investments are constrained by risks that

cannot be quantified or controlled, including political instability, lack of a clear and stable policy environment, local currency volatility and external shocks, such as natural disasters.

2. Financial instruments to mobilize private finance

A variety of instruments is available to share risks between the public and private sectors in order to broaden the range of situations where financial markets can provide solutions. These instruments can (i) boost financial returns for investment with positive externalities; (ii) increase the supply of financing (either directly or through financial institutions); and (iii) manage risks through diversified portfolio approaches. Different instruments may be more suitable in different country contexts and sectors. Examples include concessional loans and grant co-financing; private equity and venture capital; line of credit to financial institutions and credit guarantees; co-lending /investing platforms; securitization; and insurance and risk guarantees; and collective investment vehicles (CIVs), such as blended finance funds and facilities.

Boosting private investment is attractive but also poses risks. For example, when investment takes the form of blended finance structures or public-private partnerships (PPPs), it is essential that these are properly designed (clearly defining the risk reducing roles and responsibilities of the public and private sector) so that they do not constitute contingent liabilities that can end up weighing down public accounts.

Mechanisms should be implemented to put the OECD DAC Blended Finance Principles into practice: Firstly, ensure that blended finance programs or projects are aligned with national priorities and plans and that involve local and national actors. Secondly, the primary focus of all blended deals should be development impact, with the SDGs at the core (a shift from a focus on financial returns to development impact). Concessional resources should be allocated where the impact is the greatest and not where it is easiest to make deals. Third, analysis should always include assessments of the cost of blending versus other financing mechanisms (in some cases, public investment might be more appropriate, even if a complex blended deal could be arranged). Finally, transparent reporting on results and impact is critical both to decision-making and to monitoring and review, as is participation of stakeholders. Forthcoming OECD Guidance will help donors implement the OECD DAC Blended Finance Principles.

With regards the development of private investment -both domestic and international- it requires the existence of sound financial systems. However, according to recent IMF estimates, 40% of low-income countries have financial systems under stress. Therefore, it is important to implement reforms aimed, among other things, at strengthening the liquidity of the financial system, guaranteeing deposit balances or providing adequate frameworks for resolving credit institutions. The strengthening of financial systems also acts as a catalyst for the expansion of SMEs, which generally require adequate access to credit to sustain their activity. Smaller firms also benefit from a boost to private investment, because of the knock-on effects that this usually generates at the local level.

With this in mind, the following options could be considered:

Menu of options

Instrument/project level:

(1) Project planning:
- Develop scalable pipelines of investment-ready projects based on national strategies and planning.
- Scale up support by the international community to help countries build the internal capacity necessary to deliver cost-efficient, low-carbon and resilient investible projects.
- Enhance availability and quality of data, as well as information sharing, on competitive SDG investments.

(2) Financial instruments:
- Promote innovative financing vehicles, tools, and platforms, including blended finance structures where appropriate, to channel capital flows into sustainable investment opportunities, particularly in the areas of health, hygiene, and nutrition areas.
- Support the development of finance instruments that address the impact of COVID-19, such as innovative social and sustainability bonds, and facilitate their alignment with the SDGs
- Develop instruments and tools based on guarantee systems for private direct investment in developing countries and for the expansion of existing systems, including sound SDG-impact assessment procedures and ESG safeguards.
- Enhance the possibility for investment funds to invest in SMEs in developing countries.
- Explore viable instruments for the coverage of interest rate or exchange rate risks in low income countries.
- Promote alternatives to boost external financing in local currency.

(3) Other institutional instruments:
- Provide incentives for ESG investors, such as tax benefits for certified sustainability or SDG themed investment products (e.g. green bonds)
- Develop and expand instruments for strengthening the capacity of public managers in low-income countries in the field of PPPs.
- Adapt incentive and rewarding schemes in MDBs, DFIs to prioritize SDG impact vs primarily high leverage.

Policy level:

- Strengthen institutional and regulatory frameworks to build a conducive enabling environment for sustainable investments as an important driver of inclusive growth and job creation, including transparency, legal stability, and predictability.

- Facilitate close collaboration at domestic and international levels between project developers, governments, multilateral and regional development banks, and private investors to scale up long-term investment and address risks, including through public-private partnerships.
- Consider the establishment of international standards for sustainable investment, including impact investing, SDG investment, and SDG oriented PPPs:
    - Globally, establish a single comprehensive and robust global SDG management system standard that incorporates the elements of the ISO 26000 guidance on social responsibility for companies, development finance institutions and investors with mandatory reporting requirements and transparency to avoid "SDG-washing".
    - Develop more transparency and competition rules for SDG-oriented PPPs and blended finance instruments to level the playing field and avoiding crowding out private sector, including through measuring impact, harmonizing reporting on additionality, and ex ante transparency procedures (transparency of bidding processes, terms and conditions of finance, make grants part of the bidding process).
- Include SDG performance (and, eventually, certification) as a main requisite/criterion in national and international public tenders.
- Implement the UNECE principles on People-first PPPs to set the institutional requirements for a new model of PPs aligned with the SDGs.
- Propose a Planet-People-PPPs Initiative globally to enhance the transition from traditional PPPs to SDG-focused PPPs.

3. The role of public investment

Background

In the immediate months of Covid-19 lockdown and social distancing, public banks and public investment took the lead role and it is likely they will continue to do the heavy lifting in the recovery and reconstruction phase. Public banks and investors are mandated to provide the long-term, patient and catalytic finance that is required. Even before Coronavirus, the public sector accounted for 87 to 91 per cent of infrastructure investment spending in developing countries. Hence, it is likely that public investment will continue to dominate infrastructure spending and transformation – particularly in sectors with limited cash flow potential to repay the private sector, such as sanitation and education – when affordable access for all has to be provided. While financial engineering can be used to create instruments that attract private investment even in these cases, it can be cheaper to use public finance. Technical support can help developing countries determine the most cost-effective capital structure and build institutional capacity for project planning, preparation and negotiation (FfD report 2020).

<u>With this in mind, the following options could be considered:</u>

Menu of options

- Capitalize multilateral, regional and national development banks so that they can better support national country needs and regional projects. The heritage multilateral public banks need increased capitalization as well as governance structures that more fully reflect today's global political economy. For regional and national public banks, other sources of increased capital could be to align better with Sovereign Wealth Funds, which are currently holding at least $7 trillion of assets by recent estimates, but typically not directed towards developmental lending; and to bring in new countries as bank shareholders; or seeking a more integrated approach between such financial institutions and regional capital markets (UNCTAD Report 2019 p 26).

- Pension funds and insurances companies hold trillions of dollars in assets that could support SDGs. One of the challenges in mobilizing these investors is the lack of scale in many projects, especially in smaller countries. Financial instruments that bundle smaller deals together could help provide a solution. Another solution would be strengthening collaboration between global and local institutional investors (FfD report 2020 page 68).

- At the international level, multilateral institutions like the IMF should offer concrete low-cost hedging mechanisms for governments of developing countries to manage exchange-rate risks coming from international shocks, averting the boom-bust financial cycles of recent decades and putting the global economy on a sustainable path. (Coronavirus shock UNCTAD_ march 2020).

2. REMITTANCES

Background

Remittance flows are expected to drop by about $100 billion in 2020, or roughly 20 percent from their 2019 level, and the sharpest fall in recent history, as migrant employment, and wages plummet as a result of COVID-19. Disruptions are estimated to hit one billion people: 200 million migrants who send money to their 800 million relatives. The impact of the fall in remittances is further aggravated by the return of migrant workers to their home economies, and resultant reintegration and re-training needs.

Lowering remittances costs and increasing access to remittances is an urgent priority, and countries committed to work towards this end.

SDG 10 and Addis Ababa Action Agenda set the following target on remittances: 'By 2030, reduce to less than 3 per cent the transaction costs of migrant remittances and eliminate remittance corridors with costs higher than 5 per cent.'

The G20 also committed to reducing the cost of sending international remittances and aligned its work with the 2030 Agenda.1 As of 2019, G20 Members have implemented a number of cost reduction measures.

Despite some reduction, and persisting regional differences, the global average cost of sending $200 remains high at 6.8 percent in the first quarter of 2020, only slightly below the previous year. This has a large impact on receiving families, as each percentage point in transaction costs deprives them of about $5.5 billion per year.

Among the factors accounting for the high costs of transfers in some corridors are the cost of compliance with anti-money laundering and countering the financing of terrorism (AML/CFT) regulations, as well as the decline in correspondent banking relationships in some countries.

Mindful of already ongoing international processes to deal with the impact of Covid-19 on remittances, which should be referred to, the following options could be considered:

Menu of options

- Increase competition in the global remittance corridors to help lower costs. This could be done through lowering capital requirements on remittance services and opening up postal, banking, and retail networks to nonexclusive partnerships with remittance agencies.

- Greater use of digital technologies can also help reduce costs. Of the various remittance service providers, bank transfers have the highest cost at 10.5% and fintech/mobile operators charge the lowest at 3.37%. Emerging fintech solutions are able to extend direct person-to-person or phone-to-phone money transfers across national and currency borders, resulting in lower costs.

- Blockchain technology should be considered as a tool for advanced service. Its integration can accelerate payment systems, open access, enhance the rate of clearing and settlement, and reduce transaction costs. Access to these new payments technologies must be encouraged alongside addressing potential issues of compliance.

- Global common standards and improved information sharing (including digital IDs) can also help to reduce costs. These standards can mitigate potential risks for banks, enhance transparency for cross-border payments and counter the decline in the number of correspondent banking relationships.

3. OFFICIAL DEVELOPMENT ASSISTANCE AND OTHER OFFICIALLY SUPPORTED RESOURCES FOR THE SDGs

Background

Official development assistance (ODA) increased in 2019 to $152.8 billion, according to the grant equivalent methodology.

The international community has joined forces to provide external finance to support developing countries' response to COVID-19 but it is unclear to what extent flows are additional to pre-COVID aid budgets or whether spending has simply been re-prioritized from other sectors. Given the impact of the pandemic on the national budgets of major donors, ODA flows may decline. Nevertheless, donor countries and multilateral organizations are making every effort in funding various initiatives to combat COVID-19. Preliminary data on COVID-19 response by bilateral providers, multilateral organizations and philanthropic foundations have been collected by the OECD in a specific survey (which will be published in August).

There have been growing amount of official flows from by bilateral and multilateral providers other than ODA. Particularly under the current circumstances of the COVID-19 pandemic, engaging all sources of international official support that duly respect international standards in a transparent manner and maximizing aid effectiveness, including by supporting institution building for economic growth and stimulating domestic funds in recipient countries, are even more important.

From 2019 onwards, these broader flows are captured in the new statistical measure of TOSSD. Moreover, other sources of finance that produce benefits at the global level are even more important than ever. While some of these investments will not quality for ODA, they will do for TOSSD if they directly contribute to the SDGs.

<u>With this in mind, the following options could be considered:</u>

Menu of options

Short-term: Mitigating the Covid-19 fall-out

- ODA providers should make every effort to meet the 0.7 per cent aid commitment, with a focus on LDCs of disbursing at least 0.15 to 0.20 per cent of their GNI and the most vulnerable countries. Expand access to concessional finance to countries most in need by revising access criteria to consider factors beyond per capita income, such as vulnerability

- The use of reverse graduation processes and exceptional/temporary support measures (stimulus packages and innovative support measures) for countries about to or have recently graduated.

- Ensure full financing of the Access to COVID-19 Tools (ACT) Accelerator, to accelerate development, production, and equitable access to COVID-19 tests, treatments, and vaccines (e.g. the Gavi advance market commitment (AMC) for COVID-19) and promote a Global Pharmaceutical Industry Compact to ensure Universal Access to COVID Tools, inter alia through adapting the sale price of medicines according to the country's HDI.

Medium to long-term: Building back better

- Strengthen ODA, TOSSD and other forms of international development cooperation for risk reduction financing, including to improve:

   - trade and investment environment, including legislation, tax systems, vocational training etc.
   - health, hygiene, and nutrition systems
   - quality infrastructure to address medium to long term needs in the communication and financial sectors
   - leveraging ICT and other frontier technologies to overcome the challenges brought on by COVID-19 including in health and education.

- Capitalize on blended finance, including through national development banks and other local financial actors such as local pension funds, with a focus on reinforcing country ownership and strengthening sustainable development impact, particularly on disadvantaged population groups. This should be based on judicious use of blending in circumstances where determined to be the best suited tool. Capacity development towards these efforts can help countries identify and apply instruments, in line with national financing plans.

- Pursue risk-informed, climate smart development cooperation, including:
   - More vigorous efforts to finance climate actions to support the national priorities of the countries to build back better against the adverse impacts of climate change including climate induced disasters.
   - Concentrate the most concessional flows on adaptation building on Nationally Determined Contributions, National Adaptation Plans and support biodiversity goals.

- Promote technical cooperation and capacity building on fiscal policies, sound tax systems and increasing domestic resources mobilization, as well as reinforce the need to further progress on zero tolerance to tax avoidance).

4. DECENT JOBS AND INCLUSIVE GROWTH

The pandemic is causing an unprecedented magnitude of labor marker disruption (which is equivalent to 400 million full-time jobs in the 2nd quarter of 2020), that will require large-scale public policies and resources to bolster the creation of decent jobs and deal with the adjacent ripple effects of the job losses in the formal sectors for the informal economy.

In emerging and developing economies (LMICs), policy responses to the pandemic were as rapid as in developed economies, but the fiscal packages were much smaller. On average, fiscal stimulus measures amounted to 2.3 per cent of GDP in these countries, which reflects their more constrained fiscal environment. On the whole, the measures they adopted account for just 2.5 per cent of the global fiscal stimulus (ILO 2020) which contrast with fiscal measures in advanced economies that account for 88 per cent of the global fiscal stimulus.

The rather limited resources in developing countries tended to be used to support vulnerable businesses, fund payment deferrals and provide emergency relief for the most vulnerable groups through non-contributory cash transfers (mainly special allowances and grants), in-kind support and public works programmes. Despite these efforts, the limited coverage of unemployment benefits and other forms of social protection schemes have made it more challenging to effectively contain the damage in emerging and developing countries, particularly for workers and households relying on the informal economy. In many low-income countries (LICs), the situation is even more challenging because fiscal space is extremely limited. This fiscal capacity has been further eroded by a sharp decline in commodity prices, export earnings, remittances, and foreign investment (see above).

Without large-scale international support, stimulating the economy and employment through fiscal measures will be beyond the reach of many of these countries (see pp. 13-16 ILO monitor: COVID 19 and the world of work (policy responses)).

<u>With this in mind, the following options could be considered:</u>

Menu of options

On social protection:

- Provide strategic priority of public financing to policies and programmes that can produce better outcomes in terms of jobs and income support, especially for vulnerable groups.

- Provide large-scale international support for expanding social protection schemes in developing countries for worker and most vulnerable households (including unemployment benefits, sickness benefits and social assistance).

- Establish a Global Fund for Universal Social Protection financed through global FTT and digital tax.

- “100% Decent Work Initiative”: widespread value-chain standards and compacts to ensure 100% respect to labor rights and environmental and disaster risk reduction standards and legislation.

- Encourage all UN countries to actively and constructively participate on the negotiation of the legally binding instrument on Business and Human Rights in order to improve the 3rd draft that will be debated in the 6th session in October in Geneva.

On inclusive growth:

- Provide international support for managing the fall in remittances through creative policies and financial tools, including through public and private funding and job creation.

- Address the loss of export earnings in developing countries as a result of the pandemic-induced slow-down in international trade through bold and creative options.

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Issues to be considered by Discussion Group 2:

- SDG-based national budgeting. The identification of how the public budget of each ministry contributes to the SDGs is an essential condition to achieving SDG-oriented management. It can also ensure coherence among all the policies contributing to the SDGs, establishing the necessary incentives for private investment to be oriented towards achieving the SDGs, as well as public investment and spending.

- Implement a minimum global financial transaction tax and a digital tax and use the proceeds for international development to address the socioeconomic impact of COVID-19, aligned to the SDGs.

  Increase access to financial resources to local governments and sub-national authorities, decentralization of decision-making and financing of territorial and local 2030 strategies. Set up concrete policies and regulatory frameworks to increase flow of development financing to locally defined SDG strategies.
  In a post-crisis environment, addressing the tax challenges of the digitalisation of the economy and ensuring that MNEs pay a minimum level of tax will become more prominent.

- The unprecedented nature of the crisis is prompting a reflection on whether some new tax measures could be contemplated, and more traditional ones reconsidered. This could include reflections on how to support progressivity of the overall tax system.