



## Closing the SDG Financing Gap in the COVID-19 era<sup>1</sup>

### Scoping note for the G20 Development Working Group<sup>2</sup>

Context: the impact of COVID-19 on financing for sustainable development

**The COVID-19 pandemic and the global economic crisis are reversing progress towards the Sustainable Development Goals (SDGs) and reducing available resources to finance crisis mitigation and recovery measures.** The health crisis quickly turned into an economic crisis of large magnitude with potentially long-lasting effects on sustainable development. The dual demand and supply shock spared no country, but hit harder those without the financial and technological means to handle the health crisis and lockdowns. More developing countries (90 of 122 low and middle-income) entered into economic recession than at any time since the Second World War (OECD, 2020). This is in contrast to the global financial crisis, which resulted in negative growth, mostly in developed countries. As a result, inequalities have increased: millions of people are falling back into poverty and hundreds of millions more are losing their jobs and livelihoods. Populations at risk, including youth and women who lost access to basic services such as education or health, have suffered most.

**Before the pandemic hit, progress to achieve the SDGs was mixed and financing was falling short.** The pre-COVID-19 USD 2.5 trillion annual SDG financing gap corresponds to about USD 500 billion for low-income countries and USD 2 trillion for other developing countries, or respectively 15% and 4% of GDP of additional spending per year (Gaspar et al., 2019<sup>[1]</sup>). Tax revenue in about one-third of developing countries (46) was below 15% of GDP and below 20% of GDP in about two-thirds (79) of ODA-eligible countries – that is, below the thresholds commonly considered to be necessary for effective state functioning. Developing countries also entered the crisis with lower fiscal buffers than in the 2008-09 crisis.<sup>3</sup>

**Rising public debt and debt servicing costs, particularly in the poorest countries, were putting SDG financing levels under increasing pressure.** Of the 69 countries applying the low-income countries debt sustainability analysis in 2019, half were either already “in debt distress” or “at high risk of debt distress”, compared to 23% in 2013 (IMF, 2020<sup>[2]</sup>). Government debt had soared on expectations of high growth, including in low-income economies where it rose by 20 percentage points on average after large declines in the 2000s. Non-financial corporate debt also ballooned in emerging markets,

<sup>1</sup> This scoping note has been prepared at the request of the Italian G20 Presidency by the OECD and UNDP as background information for discussions in the 1<sup>st</sup> G20 Development Working Group meeting on 24-25 February 2021.

<sup>2</sup> This scoping note was also discussed in its updated and final version at the 1<sup>st</sup> Meeting of the DWG Thematic Working Group on Financing for Sustainable Development 31 March 2021.

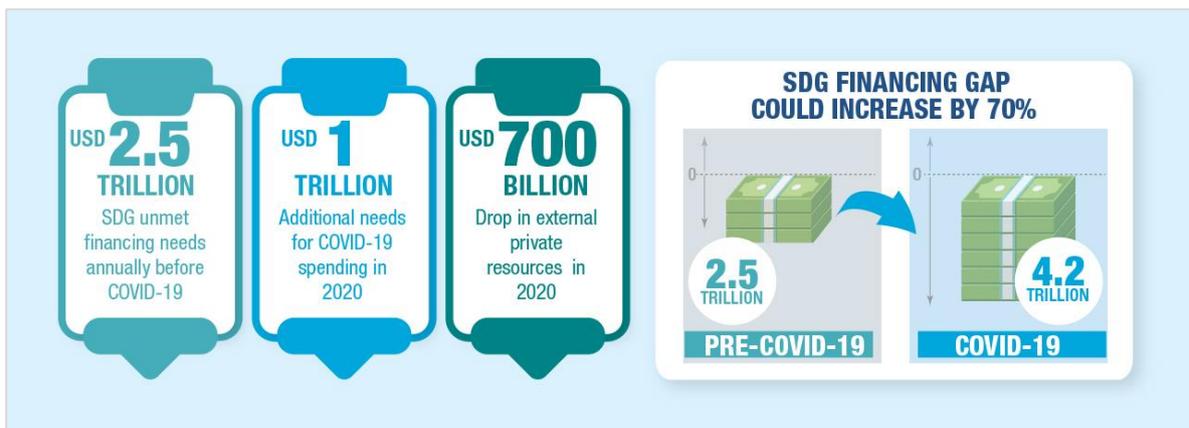
<sup>3</sup> <https://www.imf.org/external/pubs/ft/ar/2019/eng/>

from USD 1.6 to USD 3.8 trillion between 2009 and 2019, leading to vulnerabilities and to “sudden stops” in international credit (Avdjiev, McGuire and von Peter, 2020<sup>[3]</sup>).

**The gap to finance the SDGs was expected to increase in 2020 by 70% from USD 2.5 trillion to USD 4.2 trillion** due to an initial USD 700 billion drop in external private finance (remittances, FDI, portfolios flows, etc.) and an emergency response public spending gap of USD 1 trillion in developing countries (OECD, 2020<sup>[4]</sup>)

Since then, the monetary and fiscal policy measures in advanced economies have reversed capital outflows from developing countries. China’s recovery has been another important factor. However, domestic resource mobilisation in developing countries will decline as economic activity declined for the first time in decades. External private flows remain volatile and dependent on low interest rates in advanced economies. While a V-shaped recovery is emerging in some countries, the impact could be more protracted in many of the poorest countries. As of early 2021, the SDG financing gap in developing countries is estimated to have increased by at least 50%, USD 1.2 trillion, totalling USD 3.7 trillion in 2020.

**Figure 1. The SDG financing gap was projected to increased**



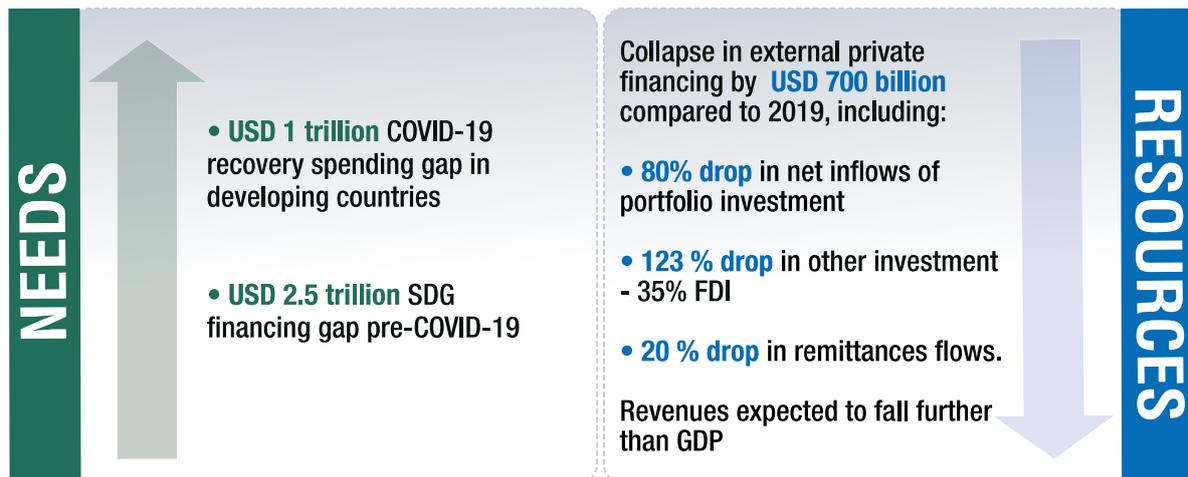
Source: OECD Global Outlook on Financing for Sustainable Development 2021.

Note: Estimations in Figure 1. above were based on GDP projections released several months following the crisis. One year later, forecasts reveal a more optimistic picture of external private finance (i.e. a 13% drop in total external private resources). However, a decline in domestic revenues would further widen the gap.

**The pandemic has magnified the “scissors effect” of the SDG financing gap by increasing financing needs and decreasing availability of resources.** In March 2020, emerging markets experienced portfolio outflows of USD 83 billion, an impact that was faster and more sizeable than in previous sudden stops (OECD, 2020<sup>[5]</sup>; Institute of International Finance, 2020<sup>[6]</sup>). The Institute of International Finance (2020<sup>[7]</sup>) projected that net inflows of portfolio investment and other investment to emerging markets in 2020 could drop by 80% and 123%, respectively, compared to 2019 levels. Inflows to low- and middle-income countries could decrease by 35% for FDI and by 20% for remittances compared to 2019 levels (World Bank, 2020<sup>[8]</sup>). For sub-Saharan Africa, government revenues could decline by 12% to 16% compared to a non-COVID-19 baseline scenario.<sup>4</sup> In Asia-Pacific, losses are expected to be particularly high in tourism or resource-reliant economies, at more than 15% in Papua New Guinea and Tonga, and above 25% in Sri Lanka and Fiji.<sup>5</sup> In the LAC region, revenues collected from all major taxes dropped by between 10 and 20% from April to September 2020, with excises particularly strongly-affected.<sup>6</sup>

**Advanced economies implemented large monetary and fiscal stimulus packages while developing countries face a COVID-19 recovery spending and financing gap.** Based on the recession as forecasted it is estimated that developing countries would have required an additional USD 800 billion to USD 1 trillion to respond to the crisis at a comparable magnitude of spending by advanced economies. This includes USD 100 billion in low-income countries, or 5% to 6% of the GDP of these countries; low-income economies represent about USD 85 billion of this gap, or 6% of their GDP. Sub-Saharan Africa, as a whole, would need to increase its packages – of about 1% of GDP – by about 6% of its GDP, or USD 100 billion, in line with the magnitudes found by the United Nations Economic Commission for Africa<sup>7</sup> and others.

**Figure 2. The scissors effect demonstrates a widening SDG financing gap in developing countries**



Source: OECD Global Outlook on Financing for Sustainable Development 2021.

The international community committed to “leave no one behind”, as set out in the Addis Ababa Action Agenda on Financing for Development (AAAA) and the 2030 Agenda for Sustainable Development. G20 Leaders have repeatedly recognised the key role of the G20 in contributing to the implementation of the 2030 Agenda for Sustainable Development and of leading by example. Developing countries are most reliant on external financing to deliver emergency response. The multilateral system must provide emergency support for health and social services (e.g. vaccine delivery). The lack of international co-operation risks failing the most crucial test: that of vaccinating widely enough to eradicate COVID-19 everywhere. This failure could lead to an unmitigated economic and social disaster. Vaccination is so far confined to a limited number of countries. Ten countries represent around 90% of total vaccination doses administered. Worse, while some of these countries have ordered enough doses to vaccinate their entire population 3 to 5 times over, many countries in the world remain entirely deprived of vaccines at this time.<sup>8</sup>

**Closing the SDG financing gap in developing countries requires a holistic approach that promotes finance and investment in long-term and sustainable resilience.** The pandemic has demonstrated that no one is safe until everyone is safe. The global recession due to the pandemic and ensuing lockdowns in 2020 affected all countries. The 2030 Agenda and the SDGs remain the best blueprint to successfully build back better after the crisis, and the Addis Ababa Action Agenda remains the best framework to finance the goals. These agendas set out the ambitious strategy needed for a more holistic approach to finance sustainable development. With all sources of financing under stress, none will be sufficient on its own to ensure that developing countries surmount the crisis. The holistic approach to financing development of the AAAA offers several levers that should be better exploited to overcome the inequalities. The trillions of dollars currently misaligned in the

<sup>7</sup> This is indicated in the communiqué of the African Ministers of Finance on 13 March 2020, published by the United Nations Economic Commission for Africa. See <https://www.uneca.org/stories/communiqu%C3%A9-african-ministers-finance-immediate-call-100-billion-support-and-agreement-crisis>.

<sup>8</sup> [https://read.oecd-ilibrary.org/view/?ref=1060\\_1060309-xi2i240d24&title=We-must-not-fail-humanity-s-greatest-test](https://read.oecd-ilibrary.org/view/?ref=1060_1060309-xi2i240d24&title=We-must-not-fail-humanity-s-greatest-test)

system, for instance, represent existing resources that could be shifted to where the needs are most acute – both to avoid the collapse of financing in developing countries and to build back a better, more sustainable and resilient system.

### Three pillar approach to close the gap

All resources called upon in the Addis Ababa Action Agenda – public, private, domestic, external – are required to fill the SDG financing gap. The trillions are in the system. Total financial assets held by banks, institutional investors or asset managers are valued at more than USD 378.9 trillion and have grown at 5.9% year on year since 2012, due to increased financial intermediation (International Development Finance Club, 2020[28]). More than 80% of financial assets are held in advanced economies. Shifting only 1.1% of global financial assets toward SDG financing needs in developing countries would be sufficient to fill the USD 4.2 trillion gap. However, it will require setting in place the right policy incentives to make a shift of the trillions possible.

**The overall objective is to support developing countries' efforts, through enhanced mobilisation, alignment and impact of financing for sustainable development, to recover from the current crisis and reach the SDGs by 2030.** To that effect and building on the work initiated by the KSA presidency notably the Financing for Sustainable Development Framework<sup>9</sup> as well as the debt suspension and treatment efforts,<sup>10</sup> the Italian presidency has proposed that the DWG focus on exploring innovative strategies to maximize the efficiency and effectiveness of available resources, both within the DWG process and in synergy with other relevant thematic areas and processes of the G20 notably in the finance track,<sup>11</sup> with a particular focus on innovative financing instruments and to increase the capacity of capacity of low-income countries to design, implement and evaluate integrated national financing frameworks.<sup>12</sup> **Figure x.** presents the potential to mobilise resources for development by making better use of each resource's leveraging power, ensuring a common language for sustainable finance and investment, including broader actors, and increasing the quality of existing flows to achieve greater SDG impact.

### Figure 3. A three-step approach to shifting finance towards the SDGs

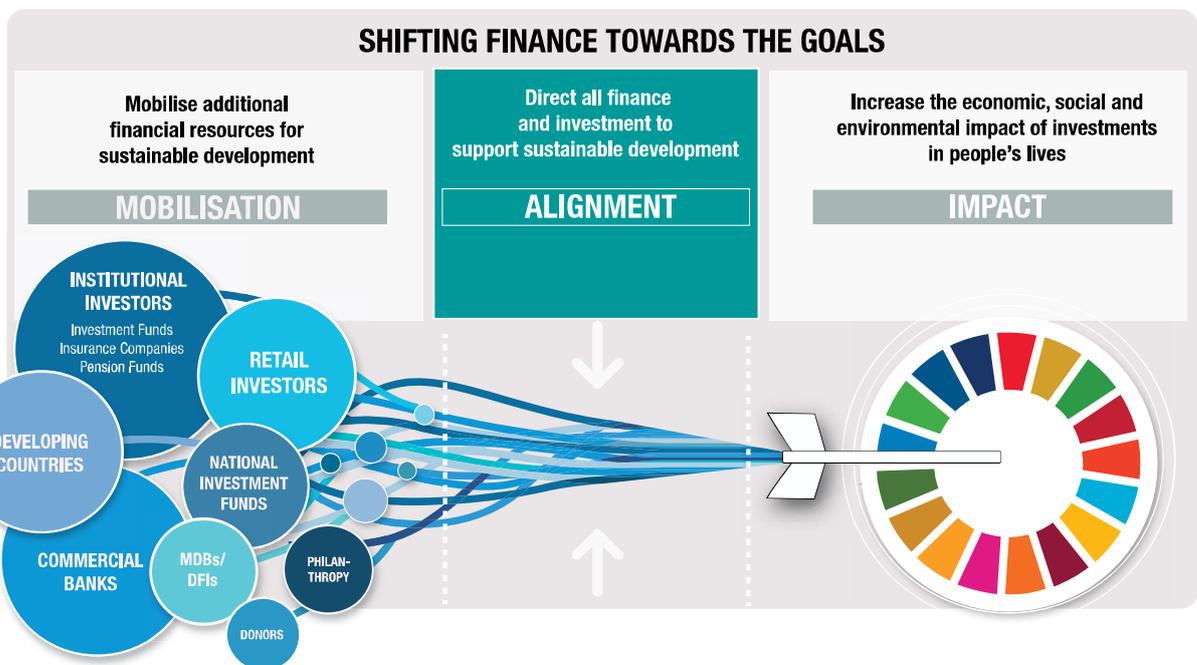
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<sup>9</sup> G20 Financing for Sustainable Development Framework, developed by the DWG in 2020 and endorsed by G20 Leaders in the [G20 Riyadh Leaders' Declaration](#).

<sup>10</sup> G20 Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond the DSSI

<sup>11</sup> The 2021 work plan of the International Financial Architecture Working Group (IFA) includes relevant efforts, including the continuation of the work on debt-related issues (DSSI; Common Framework; examination of ways to improve the architecture for sovereign debt restructuring; etc.) and on “leveraging development finance and enhancing coordination among development partners” (based on IMF analysis, proposing possible further steps on external financing needs in low income developing countries in the coming years and sustainable financing options; WBG work and deployment of instruments in new ways to mobilize private financing to these countries; implementation of country-owned pilot platforms; etc.).

<sup>12</sup> G20 Issue Note “Sustainable Development”, 1<sup>st</sup> G20 Sherpa Meeting on 21 and 22 January 2021.



Source: (OECD, 2018<sup>[9]</sup>), *Global Outlook on Financing for Sustainable Development 2019: Time to Face the Challenge*

This scoping note identifies key challenges of the Financing for Sustainable Development (FSD) agenda in the COVID-19 era and points toward key areas where DWG members could advance international efforts to both avoid the collapse of resources for emergency response in the short-term and to help build back better for sustainability over the long-term. Different elements underpin decision-making for Finance for Sustainable Development. They relate to two interrelated questions: what are the resource and instruments available to make investments in the SDG possible? And what are expenditures necessary to achieve the largest impact towards the SDGs?

The key challenges of the international FSD agenda can best be highlighted around three pillars, that are: Mobilisation (of resources); alignment (to the SDGs and the Paris Agreement), and achieving impact at country-level.

**Structure of the scoping note:**

- I. Mobilising and leveraging finance where needs are greatest (e.g. innovative finance instruments in developing countries)
- II. Aligning finance to the SDGs and the Paris Agreement to ensure no country and no goals are left behind
- II. Achieving SDG impact at country-level (i.e. through country-led national finance plans)

I. Mobilising and leveraging finance where needs are greatest (e.g. innovative finance instruments in developing countries)

With the outbreak of COVID-19, official development finance remains the bedrock of international co-operation and is vital for poorer and fragile developing countries. In 2019, figures of Official Development Assistance (ODA) totalled USD 153 billion, or a ratio of ODA to gross national income (GNI) of 0.31%, and reaches hundreds of developing countries.<sup>13</sup> Especially in the context of COVID-19, ODA has played a key role, targeting social sectors such as healthcare, which is particularly

<sup>13</sup> 2020 figures of Official Development Assistance will be released later in April 2021.

important in terms of financing vaccines and other treatments - related to COVID-19 as well as clean water, sanitation and education, which often struggle to attract private investment (2021 OECD Global Outlook on Financing for Sustainable Development).

**The pandemic demonstrates the need for co-ordinated approaches and partnerships across all actors to address global financing challenges.** From bilateral and multilateral providers' emergency debt support response and foundations' pledges to help deliver vaccines and health treatment to the private sector with governments ramping up support for COVID-19 financing instruments – all actors are stepping up to respond to the crisis. The value of co-ordination is clear: no single actor can tackle global challenges alone.

**While preliminary results from a survey conducted of members of the OECD's Development Assistance Committee on their response to the COVID-19 suggest a strong push by members to step up support and action, the overall level of ODA could decline in 2020 given pressure on DAC members' own budgets.** The OECD calculates that if OECD/DAC members keep the same ODA-to-GNI ratios as in 2019, total ODA could decline by as much as USD 11 billion to USD 14 billion, depending on a “single-hit” or “double-hit” recession scenario for member countries' GDP (OECD, 2020[7]). OECD/DAC members agreed to “strive to protect ODA budgets” during the COVID-19 crisis (OECD DAC, 2020[6]) and reaffirmed the important contribution of ODA to the immediate health and economic crises and longer-term sustainable development, particularly in Least Developed Countries (LDCs) (OECD DAC, 2020). Political will is key to safeguarding ODA and to meet the UN targets of 0.7% of Gross National Income (GNI) as ODA to developing countries.

Information on the efforts of G20 countries who are not reporting ODA but are providing official development finance could be enhanced by reporting under the new measurement tool, the Total Official Support for Sustainable Development (TOSSD) or by reporting to the UN IEAG on other indicators under the SDG 17. A mechanism is currently missing to collect further information on the efforts of G20 countries not reporting on ODA and in support of the UN IEAG on other indicators under SDG 17.

**Immediately following the outbreak of the COVID-19 pandemic, the development community took action to prevent the collapse of financing in developing countries through debt service suspension.** G20 finance ministers agreed in April 2020 to a Debt Service Suspension Initiative (DSSI) which would allow eligible countries to defer their debt service for 2020 in an effort to provide some fiscal breathing space for the poorest countries. This initiative was extended to the first half of 2021, with the option of further extension until the end of the year. As of February 2021, 46 countries (of 73 eligible countries) had requested of their official bilateral creditors to suspend their debt payments in 2020, and 13 had obtained an extension for 2021, for a total temporary relief of USD 5.7 billion out of a possible USD 11.5 billion in 2020. The difference reflects the below potential demand from eligible countries and imperfections in implementation by creditor countries. Indeed, some countries have not requested a standstill at all because of fears of triggering default clauses on their private commitments or worries that they would not be able to borrow from non-concessional sources. Furthermore, DSSI did not manage to induce private creditors to participate voluntarily; any further restructuring of debt will need to include them in re-establishing debt sustainability (OECD, 2020<sub>[10]</sub>). In November 2020, the adoption of the Common Framework for debt restructuring beyond the DSSI, paving the way for restructuring their debt stock, including from the private sector. Chad, Ethiopia and Zambia have already requested to enter such a procedure.

**No source of financing on its own is sufficient to close the gap. Their interplay is required. The Addis Abba Action Agenda recognised the importance of promoting the catalytic effects of ODA, including to leverage public and private resources (AAAA para 54)<sup>14</sup>.** The World Bank-IMF Development Committee meetings<sup>15</sup> called on the development finance community to invest ODA in the private sector to mobilise “from billions to the trillions” needed to narrow the SDG financing

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<sup>14</sup> <https://sustainabledevelopment.un.org/frameworks/addisababaactionagenda>

<sup>15</sup> [https://olc.worldbank.org/system/files/From\\_Billions\\_to\\_Trillions-Transforming\\_Development\\_Finance\\_Pg\\_1\\_to\\_5.pdf](https://olc.worldbank.org/system/files/From_Billions_to_Trillions-Transforming_Development_Finance_Pg_1_to_5.pdf)

gap. As a result, a policy shift took place among the international community towards the mobilisation of multiple sources of finance using ODA budgets, including an increased engagement with the private sector through innovative financing approaches, such as blended finance<sup>16</sup> and impact investing<sup>17</sup>. Blended finance involves the use of different financial instruments to address unfavourable risk-return profiles of investment in developing countries. Innovative instruments include – amongst other - SDG bonds, green bonds or result-based financing mechanisms.

**Blended finance presents growing opportunities to mobilise private finance for the SDGs.** International efforts have worked on advancing blended finance approaches and its potential has been highlighted in numerous publications (DFI Working Group on Enhanced Blended Concessional Finance for Private Sector Projects<sup>18</sup>, Blended Finance in the LDCs 2020<sup>19</sup> or the Tri Hita Karana Roadmap for blended finance<sup>20</sup>). For example, the use of blended finance to mobilise private resources has resulted in USD 205.1 billion of private finance mobilised by development finance between 2012-18; 17 DAC members now engage in blending, and 167 facilities were launched over 2000-16 to pool finance for blending (OECD, 2020<sub>[11]</sub>). A wide variety of blended finance instruments exist, including direct investments, credit lines, bonds, de-risking instruments such as guarantees and insurance, hedging, grants, and technical assistance.

**Private finance mobilised through blended finance could be strengthened to reach countries and sectors most in need.** Despite the growth of the blended finance market, private finance is mostly being mobilised in middle-income countries, in sectors with a clear revenue stream, such as banking and financial services, energy and industry, mining and construction. OECD data shows that the use of blended finance and innovative instruments remains limited in certain developing countries, particularly the Least Developed Countries (LDCs) and fragile and conflict-affected states. For example, only 6% or USD 13.8 billion of the private capital mobilised in 2012-2018 went to LDCs and USD 28.8 billion went to fragile states.<sup>21</sup> Only 6% targeted social sectors (such as water and sanitation, education and health) with only 1.36% (USD 2.1 billion) targeting water and sanitation from 2012-2017.<sup>22</sup> Effective blended finance instruments include guarantees and technical assistance.<sup>23</sup> Most of the private finance (60%) was mobilised through multilateral organisations, while bilateral blending was mainly driven by a few donors. OECD data shows a positive relationship between blending opportunities and economic, political and environmental security. In fragile settings, development partners should expect higher operating expenses and demand for support, as blended operations often take longer to prepare and require significant upfront technical assistance.<sup>24</sup>

**Figure 4. Amounts mobilised from the private sector by official development finance (2012-2018), by year and instrument**

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<sup>16</sup> Blended finance is defined as the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries.

<sup>17</sup> Social impact investments (SII) are defined as an approach to investment that does not only mobilise private financing to contribute to achieving the SDGs, but, most importantly, catalyses innovative, new approaches, to social, environmental and economic challenges. Altogether, SII is composed of three main elements: (i) the intention to generate a (ii) long lasting positive impact on people and the planet by (iii) supporting innovative solutions to pressing social issues.

<sup>18</sup> [https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/bf/bf-details/bf-dfi](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf/bf-details/bf-dfi)

<sup>19</sup> [Blended Finance in the LDCS 2020 - UN Capital Development Fund \(UNCDF\)](#)

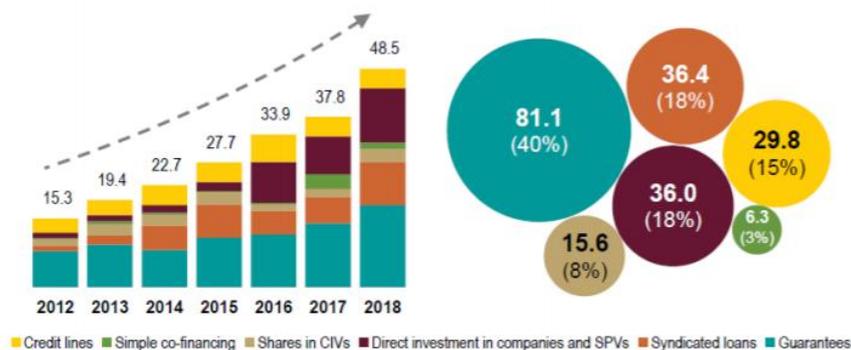
<sup>20</sup> [The Tri Hita Karana Blended Finance Platform](#)

<sup>21</sup> [https://www.oecd-ilibrary.org/development/blended-finance-in-fragile-contexts\\_f5e557b2-en](https://www.oecd-ilibrary.org/development/blended-finance-in-fragile-contexts_f5e557b2-en)

<sup>22</sup> <http://www.oecd.org/dac/blended-finance-in-the-least-developed-countries-2019-1c142aae-en.htm>

<sup>23</sup> <https://www.oecd.org/development/making-blended-finance-work-for-sdg-6-5efc8950-en.htm>

<sup>24</sup> [https://www.oecd-ilibrary.org/development/blended-finance-in-fragile-contexts\\_f5e557b2-en](https://www.oecd-ilibrary.org/development/blended-finance-in-fragile-contexts_f5e557b2-en)



Source: OECD 2020

**Principles for blended finance have been developed as a policy tool for providers of development finance**, whether they are official providers, development co-operation agencies, philanthropic foundations or private sector stakeholders. The values of such principles in advancing a wider use of blended finance approaches has been recognised in previous G20 DWG documents.<sup>25</sup> Applying such principles and tailoring blended finance to the local context and dedicating appropriate resources for monitoring and evaluation, can help better direct resources to countries and sectors most in need. As an example, members of the OECD DAC adopted five Blended Finance Principles for Unlocking Commercial Finance for the SDGs, which aim to ensure that blended finance is deployed in the most effective way to address the financing needs for sustainable development, by mobilising additional commercial capital and enhancing impact.<sup>26</sup>

**Figure 5. Example of Blended Finance Principles**



Source: OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals.

**Analytical work on the topic of blended finance has been conducted in collaboration with several international organisations in order to guide global efforts.** As an example, the OECD DAC Blended finance Principles were elaborated in close co-ordination with other international initiatives on

<sup>25</sup> See the 2018 G20 Call on Finance for Inclusive Business (under Argentinian presidency); the 2019 G20 Development Working Group Key Elements of Quality Infrastructure for Connectivity Enhancement towards Sustainable Development (under Japanese presidency); and the 2020 G20 Financing for Sustainable Development Framework (under KSA presidency).

<sup>26</sup> The OECD DAC Blended Finance Principles are one such example, they are available at <https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/> the OECD has been working on translating these principles into detailed guidance notes for practitioners and investors. .

blended finance, such as the DFI Enhanced Principles on Blended Concessional Finance for Private Sector Projects<sup>27</sup>, which are targeted at the operational level. The multi-stakeholder platform Tri Hita Karana (THK) Roadmap for Blended Finance, launched by Indonesia in 2018, as well as global networks such as Convergence are other examples. The THK Roadmap was recognised by the DWG as an example of a multi-stakeholder platform to advance blended finance principles and common values in support of the SDGs.<sup>28</sup> For blended finance to work effectively, a common policy framework and guidance are essential. Blended finance still lacks a common framework that could support a wider application of these approaches and secondly there is very limited data on the size or shape of the blended finance market. For an effective implementation of the blended finance principles, further work is needed to develop detailed guidance notes, which practical tools to practitioners and investors to effectively engage in blended finance and which provide evidence and case studies.

**Beyond blended finance instruments, other forms of innovative financing mechanisms such as funds and incentive mechanisms for social protection have proven effective.** The Leading Group on Innovative Financing for Development, which began work in 2006, has a longstanding history of co-ordination among development finance providers and developing countries to promote innovative financing mechanisms that generate additional ODA financing. Work by France to implement a solidarity tax (airline levy) demonstrates the possibility to generate billions of dollars to finance the SDGs. It also shows the potential of tax policy to help to help support international public goods and leaving no one behind. Other funds led by multilateral organisations can further raise resources in support of the emergency response.

**Debt capital markets are also crucial sources of long-term funding to help close SDG financing gaps and mobilize capital for sustainable development.** SDGs bonds are fixed income instruments whose proceeds are earmarked exclusively for new and existing projects contributing to achieve the SDGs. Interestingly, bonds are the only financing mechanism that cuts across a broad set of actors involved in the realization of the SDGs, including corporates, governments, municipalities or development banks. The bond market is also a longer-term, lower-risk asset class that matches the profile of SDG activities and has enough scale — with US\$ 6.7 trillion of annual issuance — to fill the SDG financing gap<sup>29</sup>. **Although green, social, and sustainability bonds (GSS), are increasingly popular, they only make up a fraction of the overall bond market and are dominated by issuers from developed countries<sup>30</sup>.**

**The SDGs bond market is still in its nascent stage and the greatest SDG gaps still remain in emerging countries.** There is still a need to establish the needed common language, provide issuers with safeguards, governance and guidelines and boost investors' confidence, and all in all minimize the risks of SDG washing. Furthermore, scaling up SDGs bonds in emerging markets and developing economies (EMDE), where the SDGs investment needs are the greatest could allow to tap into new sources of finance. This is especially true, as the crisis has magnified the scissor effect of SDG financing in developing countries: spending needs are increasing while financial resources are declining.

- For investors, SDGs bonds in EMDE can combine two benefits: yields and a positive contribution to the SDGs.<sup>31</sup>
- For issuers, SDG bond issuance provides a means to broaden their investor base.

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<sup>27</sup> [https://www.ifc.org/wps/wcm/connect/a8398ed6-55d0-4cc4-95aa-bcbabe39f79f/DFI+Blended+Concessional+Finance+for+Private+Sector+Operations\\_Summary+R....pdf?MOD=AJPERE&S&CVID=IYCLe0B](https://www.ifc.org/wps/wcm/connect/a8398ed6-55d0-4cc4-95aa-bcbabe39f79f/DFI+Blended+Concessional+Finance+for+Private+Sector+Operations_Summary+R....pdf?MOD=AJPERE&S&CVID=IYCLe0B)

<sup>28</sup> 2019 G20 Development Working Group Key Elements of Quality Infrastructure for Connectivity Enhancement towards Sustainable Development.

<sup>29</sup> <https://www.unglobalcompact.org/library/5713>

<sup>30</sup> <https://pressroom.credit-agricole.com/news/emerging-market-green-bond-issuance-hits-52-billion-in-2019-and-can-help-weather-shocks-amundi-and-the-ifc-reveal-in-new-report-2da6-94727.html>

<sup>31</sup> [202005-EM-Green-Bonds-Report-2019.pdf \(ifc.org\)](https://www.ifc.org/wps/wcm/connect/202005-EM-Green-Bonds-Report-2019.pdf)

**Building a market for SDG investments in developing countries will require enough scale, liquidity, transparency and diversification to attract large institutional investors** and finance a broad set of private- and public-sector activities in support of the SDGs. Key challenges need to be addressed to enable more rapid expansion of the market, include the need for harmonized guidance and standards to ensure investor confidence as well as an effective contribution to the SDGs.<sup>32</sup>

## II. Aligning finance to the SDGs and the Paris Agreement to ensure no country and no goals are left behind

**Financial market actors recognise the need to integrate environmental, social and governance (ESG) criteria into their business or investment decisions, for the benefit of both clients and society.** According to the European Central Bank, assets of funds with an ESG mandate have grown by 170% since 2015 and investors have pivoted towards ESG funds since the onset of the coronavirus crisis. Shifting even a small share of the almost USD 380 trillion of assets under management in the global economy towards more sustainable use would have a significant impact on the SDG financing gap (OECD, 2020). Obstacles that prevent from aligning finance with the SDGs must be tackled. Among the main obstacles are a lack of transparency in sustainable finance, mostly due to the proliferation in standards (currently, over 185 sustainable finance initiatives exist, both public and industry led), a lack of accountability with regards to non-financial returns, and a lack of coherence driven by missing or wrong incentives and fragmented regulations.

**However, the absence of interoperable rules on reporting non-financial returns has resulted in selective reporting or cherry-picking of results,** rather than additionality<sup>33</sup> or net impact.<sup>34</sup> Rating agencies, for example, generally focus on financial performance and do not include non-financial performance with their own methodologies, or include it to limited extent. Boffo, Marshall and Patalano (2020<sub>[12]</sub>), in a report on ESG investing for the OECD, demonstrate that prioritisation of criteria can be complex. For some ESG rating providers, high E (or environmental) ESG scores positively correlate with high carbon emissions. The E score captures metrics such as renewable energy management, resource use, water output and management, impact on ecology, and biodiversity as well as carbon footprint, although it does not prioritise carbon footprint or intensity.

**Sustainability standards have proliferated over recent years.** The UN identifies 115 multi-stakeholder initiatives involving 5 181 constituent members that seek to grow the sustainable finance market (Van Acker and Mancini, 2020<sub>[13]</sub>). The expanding system of sustainability products, certifications and standards is complex and many policy makers now find it impenetrable. The complexity has other implications. Research published by ShareAction (2020<sub>[14]</sub>), for instance, suggests that membership in initiatives as the PRI does not guarantee a strong approach to responsible investing. Another study found that only half of all companies subscribing to the PRI mention the SDGs in their reporting, and as few as 10% provide details on how they actually integrate the SDGs in their investment strategy (Novethic, 2019<sub>[15]</sub>). International initiatives are helping to identify common issues, themes and solutions to improve the alignment of finance with

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<sup>32</sup> The bond service offering of UNDP can be a conduit to achieving the use of innovative finance instruments, specifically offering support to sovereign entities and ministries on the issuance of thematic bonds. This service provides a credible, efficient and impactful way to deliver on the SDGs and deliver fiscal space in a post-pandemic period. Applying the SDG Impact Bond Standards, lends to the standardization of frameworks for identifying the concrete contributions to the SDGs.

<sup>33</sup> Additionality refers to the extent to which a new input (action or item) adds to the existing inputs (instead of replacing any of them) and results in a greater aggregate. See the Impact Management Project glossary at <https://impactmanagementproject.com/glossary/#>.

<sup>34</sup> Net impact refers to positive and negative and primary and secondary long-term effects produced by an intervention, directly or indirectly or intended or unintended. See the Impact Management Project glossary at <https://impactmanagementproject.com/glossary/#>.

the SDGs, to bolster impact investment and management, and to uphold the commitment to end “SDG washing”.

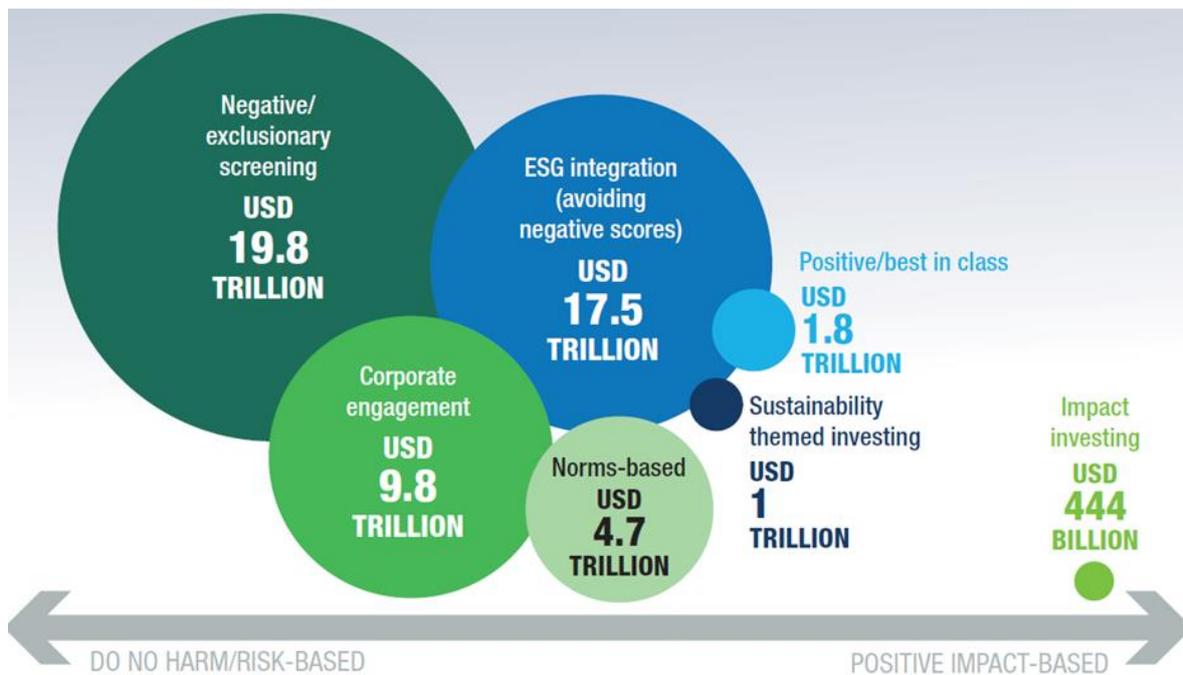
**Yet, the sustainable finance market remains immature.** Consequently, assessing its magnitude is challenging. The market is growing, spurred by shifts in demand from across the finance ecosystem that are being driven by the pursuit of traditional financial value and by the pursuit of non-financial, values-driven outcomes. However, estimates of financing that qualifies as “sustainable” vary significantly, ranging from as high as USD 30.7 trillion<sup>35</sup> to as low as USD 3 trillion (IMF, 2019<sub>[16]</sub>). Sustainable finance can reflect different levels of ambition: for example, investment could be labelled as solidarity, responsible, ethical, “green”, “sustainable”, for impact, etc. The discrepancy in estimated volumes of sustainable financing, and the lack of consensus on terminology and standards of sustainable finance, are emblematic of an immature market. In addition, some prominent private sector actors are also urging mainly higher-quality sustainability standards.<sup>36</sup>

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<sup>35</sup> This is the estimate for assets under management in 2018 that the Global Sustainable Investment Alliance defines as sustainable.

<sup>36</sup> Among them Larry Fink, Chairman and Chief Executive Officer of BlackRock, the world's largest asset manager with more than USD 7 trillion in assets under management. In a recent open letter to corporate executives, he calls for greater transparency and more widespread and harmonised sustainability standards (Fink, 2020<sub>[41]</sub>)

**Figure 6. Lack of consensus on terminology and standards for sustainable finance**



*Note:* The amounts in the figure do not add up to the estimated USD 30-trillion estimate sustainable investments due to double-counting/overlap across several categories.

*Source:* Authors calculations, based on Global Sustainable Investment Alliance (2018<sup>[17]</sup>), *Global Sustainable Investment Review 2018*, [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf); European Sustainable Investment Forum (2018<sup>[18]</sup>), *European SRI Study 2018*, <http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf>; Responsible Investment Association Australasia (2019<sup>[19]</sup>), *Responsible Investment Benchmark Report: Australia 2019*, <https://responsibleinvestment.org/wp-content/uploads/2019/07/RIAA-RI-Benchmark-Report-Australia-2019-2.pdf>.

**A stronger sustainable finance market could accelerate investment in the SDGs.** The SDGs create USD 12 trillion in private sector investment opportunities annually (10% of GDP), mainly in food and agriculture, cities, energy, and materials. Health and well-being and could generate up to 380 million jobs. Achieving SDG 5 (gender equality) alone could unlock up to USD 28 trillion for global GDP by 2025 (Business and Sustainable Development Commission, 2017). Investors with trillions of dollar in assets under management (AUM) can make efforts to reduce misalignment, including by avoiding negative externalities such as carbon emissions but also broader SDG-related risks, etc. A survey of the 75 largest asset managers found that 48% of investors are developing an approach to the SDGs. They also are taking preventive measures to facilitate greener *and* more sustainable forms of finance by, for example, developing asset classes beyond equities such as green bonds (e.g. asset managers and investment banks) and leveraging capital markets to mobilise more finance directed to developing countries (e.g. public development banks). Institutional investors such as pension funds, sovereign wealth funds and insurers are integrating ESG considerations and better monitor and evaluate ESG risk reduction in ways that are compatible with the SDGs and based on accountability for sustainable development impact.

**The UN system and its partners took action before the crisis to begin development of a common framework for SDG alignment.** The UN Secretary-General accelerated the financing for sustainable development agenda in 2018 with the adoption of the Strategy for Financing the 2030 Agenda roadmap (UN, 2018<sup>[20]</sup>). Estimating global gross private sector financial assets at hundreds of trillions of dollars, the report urged that all available finance be channeled towards sustainable development. It further called for a transformation of the financial system to leverage opportunities to increase investments in the SDGs at scale. Such a market will require efforts to ensure interoperability of standards, SDG definitions and taxonomies as well as improved ESG disclosure

and will need enough scale, liquidity, transparency and diversification to attract large institutional investors.

**A global consensus is emerging that public and private finance must make a positive contribution to sustainable development, using the SDGs as a basis for measurement.** The Global Investors for Sustainable Development (GISD) Alliance has adopted a definition of sustainable development investing that promotes positive impact as a prerequisite and suggests that investors can strengthen their contribution through active ownership, including engagement for more sustainability in companies, sectors and projects and more investment in developing countries (GISD Alliance, 2020<sup>[21]</sup>). To help bring about this positive contribution to sustainable development, there is a need to first close the gap between high-level principles and reporting standards for impact. In the area of impact, the Impact Management Project (IMP) provides a forum for building global consensus around how to measure, manage and report impacts. The project brings together several public and private actors along the investment value chain, including both practitioners and standard-setting organisations such as the OECD.<sup>37</sup> Five standard setters<sup>38</sup> have agreed to work together on a comprehensive corporate sustainability reporting. Facilitated by the IMP, this work will help provide the basis for a comprehensive corporate reporting system.

**OECD-UNDP have worked on a framework for the alignment of financial flows – both public and private - with the SDGs, which could serve the international FSD agenda in the post-COVID-19 era.** Policy makers and academics are increasingly calling into question the traditional model of economic growth that holds that the only aim of business is financial return: they point to the climate crisis, rising inequalities and the global pandemic as evidence of the need to integrate long-term, non-financial returns into the equation (Badré, 2020<sup>[22]</sup>). In support of national and regional initiatives, the French G7 Presidency in 2019 mandated the OECD and UNDP to define a “robust common framework for SDG-compatible finance” (G7 France, 2019<sup>[23]</sup>). The aim of such a framework is to create a roadmap, identify building blocks, engage different communities in a coherent manner, and set out long-term objectives and recommendations needed to achieve alignment. [The Framework for SDG aligned finance](#), launched by UNDP/OECD in November 2020, engaged in consultations with a group of 80+ actors, provides 3x3x3 matrix to frame the issues, solutions, and ways forward that will be complemented by action plans specific to each type of financial player – both public and private - to facilitate these commitments.

**The Framework for SDG aligned finance recognises the growing realisation that the twin goals of higher financial and non-financial returns require better management of long-term risks.** “SDG alignment” seeks to raise the accountability of different sources of public and private financing by carrying out an assessment of how financing is targeted across two dimensions:

**1) Equality:** resources should be mobilised to leave no one behind and fill the SDG financing gaps, particularly developing countries. Although developing countries represent 84% of the world’s population, they hold less than 5% of global financial assets (excluding China), demonstrating a lack of stable financial reserves to serve as a buffer during crisis and to finance the recovery.

**2) Sustainability:** to increase the sustainability of finance, managing risks and targeting impacts, and avoid green and “SDG washing”, i.e. the use of sustainability labelling or branding without reliable assessment of how financing impacts progress towards the global goals. Resources should accelerate progress across the SDGs, while doing no significant harm to any single objective.

**Figure 7 provides three key actions proposed by the OECD-UNDP Framework for SDG Aligned Finance to remove obstacles to the alignment of finance to the SDGs and allows for informed investment choices.** It articulates around three mutually reinforcing sets of actions: **1. Policies** to set-up fit-for-purpose governance mechanisms that creates appropriate incentives, promote

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<sup>37</sup> A list of the organisations in the IMP Structured Network is available on the website of the Impact Management Project at <https://impactmanagementproject.com/impact-management/structured-network/>.

<sup>38</sup> The five are the Carbon Disclosure Project), the Climate Disclosure Standards Board), Global Reporting Initiative, International Integrated Reporting Council and the Sustainability Accounting Standards Board.

accountability, and prevent market fragmentation. **2. Standards** to raise the bar on sustainability and strive for transparency, accountability, and harmonization. **3. Tools** to better leverage existing resources for quantity and quality, and leave no one behind. Those three sets of actions may overlap. For instance, voluntary standards may become regulatory requirements, or taxes may at the same time be considered as policies or as tools (e.g., tax incentives). They could be refined as implementation progresses, priorities are identified by different communities, and possible feedback loops and conditions for virtuous or vicious cycles on the investment chain are mastered.



Source: <http://www.oecd.org/development/financing-sustainable-development/Framework-for-SDG-Aligned-Finance-OECD-UNDP.pdf>

**The Italian G20 Presidency decided in 2021 to re-establish the G20 Sustainable Finance Study Group.** While its detailed work plan is still discussed, this group will look to work on taxonomies, disclosure, data and ratings. The SFSG will also explore the contribution of financial, fiscal and monetary policies to sustainable development, with an emphasis on energy and biodiversity.<sup>39</sup> The DWG could create synergies with the SFSG in order to ensure developing countries fully benefit from the sustainable finance agenda, considering the mentioned risks of diversion.

### III. Achieving SDG impact at country-level (i.e. through country-led national finance plans)

**A one-size-fits-all approach will not address the wide range of vulnerabilities and local contexts across developing countries that each face very different development finance challenges.** A central challenge is that most countries lack strategies to finance the SDGs. More than 70% of Voluntary National Reviews, or 79 out of 109, reported on national development plans and strategies but did not detail how governments would finance the SDGs in 2019 (Harris, 2019<sup>[24]</sup>). Assessing SDG financing needs and available resources is challenging at national level, given the wide range of actors and growing complexity of different sources of financing that can hamper coordination and alignment with national financing strategies. Public expenditure should maximise scarce resources by setting the right incentives, playing a catalytic role and ensuring development finance “does no harm”, leaves no one behind and is aligned with the SDGs, by focusing, among other areas, on social protection, the health sector, education, water and sanitation, youth inclusion, gender equality and women’s empowerment. Issues such as financing women empowerment are cross-cutting and require a holistic approach at country-level.

**In recent years, the international community has worked collaboratively to develop a framework for assessing national SDG financing needs.** The Addis Ababa Action Agenda (AAAA) calls for

<sup>39</sup> G20 Issue Note “Sustainable Finance”.

“cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks” (para 9, AAAA). Integrated National Financing Frameworks (INFFs) provide a tool to help countries operationalise financing for development, as well as how-to financing strategies at country level. Sixty countries have thus far received financial support for designing their INFF, under the supervision of the UN Development Programme (UNDP). However, there is no pipeline of bankable SDG-compatible projects in developing countries, which the *United Nations Secretary-General’s Roadmap for Financing the 2030 Agenda for Sustainable Development 2019-2021* cites as a key constraint to channelling financing to achieve the 2030 Agenda and the Paris Agreement on climate (UN, 2020<sub>[25]</sub>). Identifying such projects requires better country-level capacities, particularly among investment promotion agencies, to formulate high-quality, bankable projects.

**The United Nations, with support from the multilateral system, have developed and are piloting INFFs in several countries.**<sup>40</sup> The Inter-Agency Task Force (IATF) on Financing for Development is developing a set of guidance materials including methodologies, tools and data in coordination with the UN, the OECD, the World Bank Group and the IMF, among others. Moreover, UNDP and the OECD have elaborated a [common framework for aligning finance with the SDGs](#), based on consultations with public and private sector representatives. By working with these and other relevant organisations, and in partnership with interested developing countries, the G20 could identify and promote effective approaches to foster learning across countries and implementation of these frameworks, in view of maximising FSD mobilisation and impact. INFFs can help serve to co-ordinate the roles of different actors in the pursuance of country-led financing strategies. INFFs are recognised as a key country-owned and country-led planning and delivery tool, to manage FSD and enhance its alignment with the SDGs.

**There are other country-led financing plans, diagnostics and tools provided by the multilateral system that contribute to and are complementary to the INFFs.** World Bank Systemic country diagnostics “identify key challenges and opportunities for a country to accelerate progress towards development objectives that are consistent with the twin goals of ending absolute poverty and boosting shared prosperity in a sustainable manner”. IMF Article IV assessments “assess economic and financial developments and discuss the country’s economic and financial policies with government and central bank officials”. The World Economic Forum has recently launched “Sustainable Development Investment Partnership (SDIP)”, which is another platform which brings together public and private sector to advance the mobilization of capital needed to achieve the SDGs. Development finance providers utilise the OECD Transition Finance Pilot studies and Toolkits ensure the strategic use of development finance within the broader mix of sources of financing at country-level. This list is illustrative of existing financing frameworks and is not intended to be exhaustive.

**The G20 has already recognised the value of country-led financing plans.** In 2020, for example, the G20 DWG Reference Framework for Effective Country Platforms called for better collaboration among development partners, with the view to maximise their contribution as a group. Harnessing better complementarities and synergies among development partners, as well as making greater use of the comparative advantages of the different partners, would help achieve the SDGs. 5 principles were identified to improve the effectiveness of country platforms, and sets out a set of voluntary, non-binding principles for effective country platforms.

**Debt sustainability can also be used as a lever to promote a greener and more resilient growth path integrated in country-level financing strategies.** The challenge of debt sustainability and other forms of resource mobilisation demonstrates the importance of ensuring not only the quantity but the quality of resources. The DSSI and Common Framework help improve transparency of external debt, including with new methodologies piloted by the International Monetary Fund (IMF) and the World Bank to make sure deferred payments are allocated to SDG-compatible expenditure. Thus, the DSSI can also be used to make government-issued SDG bonds more credible. To ensure that the resources freed up by the DSSI can be converted into investment supporting a green and inclusive

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<sup>40</sup> [www.inff.org](http://www.inff.org)

growth, debt sustainability is a core component of the INFF for many developing countries. Further synergies could be created building on national financing plans, and also drawing on the G20 Operational Guidelines for Sustainable Finance<sup>41</sup>, to advance “debt for SDG swaps” and other thematic sustainability bonds.

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<sup>41</sup> <https://www.imf.org/external/np/g20/pdf/2019/111519.pdf>

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