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Financing for development to respond and recover in an era of interrelated and global crises

Note by the UNCTAD secretariat

Summary

The impact on developing countries of current interrelated and global crises, including the pandemic, rising climate adaptation costs and the war in Ukraine, is considered in this note. The high level of pre-pandemic debt burdens and the cost-of-living crisis have accentuated the trade-offs faced in developing countries between short-term adjustments to macroeconomic shocks and commitments to sustainable and inclusive development under the 2030 Agenda for Sustainable Development. Taking stock of progress in some areas, further policy options to scale up affordable and sustainable development finance are suggested in this note.

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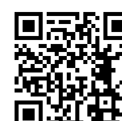

I. Introduction

1. The substantive topic and guiding questions for the sixth session of the Intergovernmental Group of Experts on Financing for Development were approved by the Trade and Development Board through a silence procedure that ended on 13 July 2022. The approved guiding questions were as follows:

(a) How can available and new finance for crisis response from domestic and international, public and private sources benefit, and access to these be enhanced for, developing countries?

(b) What policies should be prioritized to mobilize and manage various resources to support the 2030 Agenda for Sustainable Development, while considering challenges such as debt vulnerability, including unsustainable debt?

(c) Beyond addressing ongoing crises, how can growing Sustainable Development Goals-related financing gaps in the least developed countries and low-income and middle-income countries be closed through the use of public resources and additional instruments that incentivize private sector finance?

2. This topic corresponds to that of chapter I of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, particularly paragraphs 12, 13 and 17, and to action areas A, B, C, E and F in chapter II. In chapter I, on a global framework for financing development post-2015, consideration is given to "delivering social protection and essential public services for all", "scaling up efforts to end hunger and malnutrition" and "protecting our ecosystems for all". In chapter II, challenges and priorities are set out with regard to domestic public resources, domestic and international private business and finance, international development cooperation, debt and debt sustainability and addressing systemic issues.[1]

3. An overview of the impact of the interrelated and global crises on developing countries is provided in chapter II. A summary of available and new crisis finance from domestic and international, public and private sources is provided in chapter III. The longer-term challenge of achieving the Goals, as well as development financing needs in the least developed countries and low-income and middle-income countries, is considered in chapter IV. Possible national, regional and international policy initiatives, to close the financing gap and help achieve the 2030 Agenda, are considered in chapter V.

II. Interrelated and global crises: Overview

4. By end-2021, there were signs of a global recovery from the economic effects of the pandemic, yet the recovery was unevenly distributed among country groups. In developing countries, recovery was reflected in higher growth rates and improved export revenues in 2021, leading to some improvement in the external debt-to-gross domestic product (GDP) and debt-to-exports (of goods and services, including tourism revenues) ratios. The average debt-to-GDP ratio in low-income and middle-income countries fell from 29.2 per cent in 2020 to 27.3 per cent in 2021. Similarly, while the total debt-to-exports ratio rose from an average of 100 per cent in 2010 to 159 per cent in 2020, it fell to 127 per cent in 2021, reflecting the impact of the economic recovery relative to the depressed levels in 2020. However, high levels of debt and unsustainable debt situations have persisted in many developing countries. The debt-to-GDP ratio improved overall in developing countries, yet in lower middle-income countries the ratio of 30.4 per cent was markedly higher than the 2009–2021 average of 26.5 per cent and did not improve in 2021. In low-income countries, the debt-to-GDP ratio in 2021 was 39.4 per cent, higher than the level in 2020 and greater than the 2009–2021 average of 29.4 per cent. In the least developed countries, the debt-to-

[1] A/RES/69/313. See TD/B/EFD/1/2, TD/B/EFD/3/2, TD/B/EFD/4/2 and TD/B/EFD/5/2 with regard to domestic resource mobilization, development cooperation, multilateral finance and responses to the pandemic.

GDP ratio rose in 2021, to 40.9 per cent, and was higher than the 2009–2021 average of 32.9 per cent. Interrelated and global crises, including the pandemic and climate change-related events, have led to an increase in total government debt (internal and external) in developing countries, from 58 to 65 per cent of GDP in 2019–2021. At least 108 developing countries have experienced higher levels of debt following the pandemic.[2]

5. In 2020, nearly 60 developing countries spent more on external debt servicing on public and publicly guaranteed debt as a share of general government revenues than they spent on health in 2019.[3] Since 2011, external debt servicing on public and publicly guaranteed debt in the least developed countries has increased threefold, nearly attaining levels last seen prior to the launch of the Heavily Indebted Poor Countries initiative. By 2019, prior to the pandemic, external debt servicing in the least developed countries was twice the level of domestic general government health expenditure.[4]

6. Moreover, since 2021, the cost of living for households worldwide has increased significantly, reflecting lingering supply chain and logistical disruptions due to the pandemic, the recovery of food demand following the global economic recovery in 2021 and speculative trading in commodities that gained momentum following the onset of the war in Ukraine in February 2022.[5] The impact of the latter on food prices has moderated, yet the real food price index was still at a historically high level of 137.9 in July, comparable only with the previous peak in 1974 (137.5) and well above levels in the past two decades (figure 1). Net food-importing countries at a high risk of debt distress are the most vulnerable to an increase in the prices of imported food and, in developing countries, the poorest 20 per cent of households, who spend more than 50 per cent of their budget on food, are disproportionately affected.[6]

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[2] A/77/206.

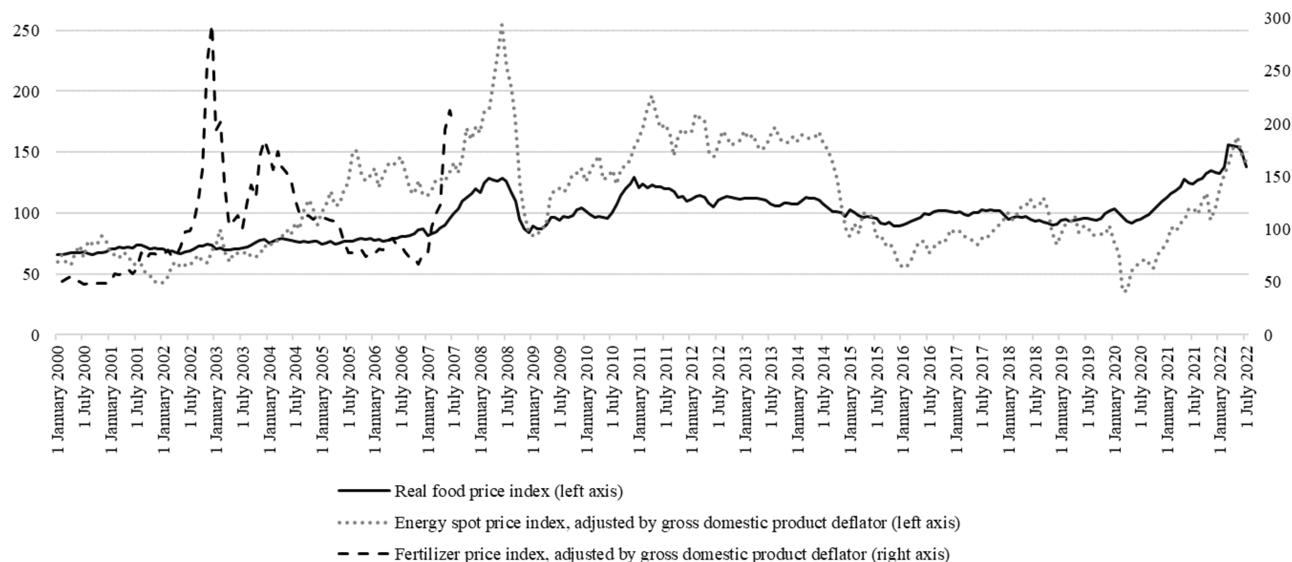
[3] The latest year for which comprehensive data exist. UNCTAD secretariat calculations, based on data from the International Monetary Fund (IMF).

[4] UNCTAD secretariat calculations, based on data from IMF.

[5] See https://www.ifpri.org/blog/covid-19-and-rising-global-food-prices-whats-really-happening and UNCTAD, 2022, *Trade and Development Report 2022: Development Prospects in a Fractured World – Global Disorder and Regional Responses* (United Nations publication, Sales No. E.22.II.D.44, Geneva).
Note: All websites referred to in footnotes were accessed in September 2022.

[6] United Nations, Global Crisis Response Group on Food, Energy and Finance, 2022a, Global impact of war in Ukraine: Billions of people face the greatest cost-of-living crisis in a generation, available at https://unctad.org/webflyer/global-impact-war-ukraine-billions-people-face-greatest-cost-living-crisis-generation.

Figure 1
Monthly food, fertilizer and energy indices
(2014–2016 = 100)



Source: UNCTAD secretariat calculations, based on data from the Food and Agriculture Organization of the United Nations (real food price index), Refinitiv (energy spot price index under Standard and Poor's Goldmann Sachs commodity index) and the World Bank (fertilizer price index).

7. The price indices for fertilizers and energy have also risen significantly. With regard to fertilizers, average increases of 77 per cent in June 2021–June 2022 reached a peak comparable only with the previous peaks in 1974 and 2008.[7] With regard to energy, prices fell marginally below the recent peak in March 2022. Fertilizer prices remain on a steep upward trend, raising the prospect of food shortages and further rises in prices in 2023, in a context in which, in 2022, 345 million people were already acutely food insecure or at a high risk of food insecurity in 82 countries.[8] Moreover, even if international food prices continue to fall (as they have, on average, from the peak in March 2022), it is unclear whether this will fully translate into domestic price reductions for end-consumers. In the second quarter of 2022, consumer price inflation in emerging markets and developing countries is estimated to have been 9.8 per cent.[9]

8. At the same time, increasingly frequent extreme weather events have had a significant effect on increases in debt levels.[10] This is not only because many heavily indebted developing countries are vulnerable to climate change, but because climate-related disasters affect the tax base and fiscal costs, making borrowing more expensive.[11] In 2020 and 2021, some 131 climate change-related extreme weather events were recorded in 42 countries in Africa, costing some $7 billion–15 billion in 2020 alone, with costs projected to reach $50 billion per year by 2040, and global warming scenarios suggest that by 2050, the worst affected regions, namely, East and West Africa, will face a projected

[7] UNCTAD secretariat calculations, based on data from IMF and the World Bank.

[8] United Nations, Global Crisis Response Group on Food, Energy and Finance, 2022a and United Nations, Global Crisis Response Group on Food, Energy and Finance, 2022b, Global impact of war in Ukraine: Energy crisis, available at https://unctad.org/webflyer/global-impact-war-ukraine-energy-crisis.

[9] See https://www.imf.org/en/Publications/WEO/Issues/2022/07/26/world-economic-outlook-update-july-2022.

[10] See https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/06/24/Building-Resilience-in-Developing-Countries-Vulnerable-to-Large-Natural-Disasters-47020.

[11] M d Chamon, E Klok, VV Thakoor and J Zettelmeyer, 2022, *Debt-for-climate swaps: Analysis, design and implementation*, IMF Working Paper No. 162.

cumulative reduction of 10 per cent in GDP-per-capita growth.[12] The impact of climate change-related extreme weather events on debt levels is magnified by the lack of access to concessional financing in many climate-vulnerable countries, particularly small island developing States, to address loss and damage in the aftermath of an event.[13]

9. A withdrawal of the pandemic-related fiscal stimulus in advanced economies and a slowing global economy are likely to dampen export opportunities in developing countries. Moreover, the tightening of global financial conditions, in particular in the wake of tightened monetary policy in the United States of America after April 2021, meant that the initial rebound in capital flows to developing countries from end-2020 was reversed, with net capital flows to these countries again turning negative in September 2021. This has led many developing countries to experience currency depreciations, financial stress and, in some cases, acute debt default risks. On the domestic side, inflationary and exchange rate pressures, combined with rising borrowing costs, have triggered monetary tightening and expenditure cuts in a wide range of developing countries.[14] These, in turn, stymie economic growth and threaten livelihoods.

10. There is little immediate prospect of a return to easier global financial conditions, with the focus of central banks in the major advanced economies remaining, for now, on anchoring longer-term inflation expectations in their economies, irrespective of the associated risks of economic recessions, destabilized financial markets and a rapid withdrawal of capital from developing countries. Increasing geopolitical tensions can compound such risks by further reducing prospects for a globally coordinated expansionary policy response that would boost real investment and inclusive income growth worldwide.

11. The present situation appears to resemble the years preceding the debt crises of the 1980s and the situation in the 1990s, which for many developing countries was a lost decade for development. Then, as now, a period of robust growth and easy financial conditions was followed by leaner times and increasing debt burdens. A series of macroeconomic shocks, including increasing inflation in some cases, and an abrupt, sharp tightening of global financial conditions, pushed many developing economies into financial distress and debt crises. Yet there also are significant differences in comparison with these earlier episodes. Openness to global financial flows is now much more broad-based than in the 1980s and 1990s. Partly in response to increasing incidences of exogenous macroeconomic and financial shocks, developing countries have been stockpiling foreign exchange reserves and their domestic financial markets have matured. Such adjustments have helped to more easily weather frequent macroeconomic shocks and to routinely borrow from abroad in their currencies. However, as foreign investors play a significant role in local currency bond markets, the build-up of foreign reserves has not eliminated vulnerability to exogenous financial shocks, and foreign currency denominated external debt has also continued to grow in a context of, until recently, easy access to international financial markets. Developing countries are thus more exposed than ever to volatile investment behaviour and capital flow reversals, with ensuing adverse impacts on debt servicing burdens, as well as monetary and fiscal space.

III. Crisis responses: Access to finance for liquidity and solvency

12. By far the greatest response to the pandemic, and the only truly global one, was the new general allocation by IMF in August 2021 of special drawing rights equivalent to about $650 billion, the greatest allocation to date. As members benefit from such allocations in proportion to existing quotas in the Fund, over 60 per cent of the allocation was directed to advanced economies, which, it may be argued, are the least in need of supplementary foreign exchange reserves. The 150 developing country members received 37.4 per cent of the allocation, equivalent to about $243 billion, $144 billion of which was directed to

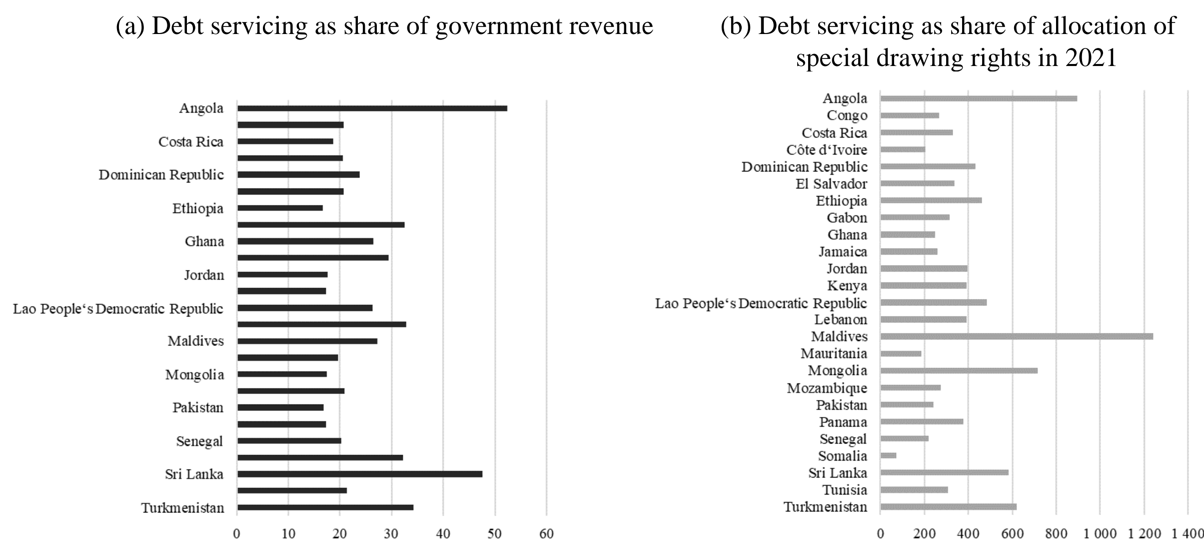
[12] African Development Bank, 2022, *African Economic Outlook 2022: Supporting Climate Resilience and a Just Energy Transition in Africa*, Abidjan.

[13] P Mohan and E Strobl, 2021, The impact of tropical storms on the accumulation and composition of government debt, *International Tax and Public Finance*, 28:483–496.

[14] UNCTAD, 2022.

high-income countries; the allocation was valuable because such allocations do not create any new debt in recipient countries and do not have policy conditionalities.[15] Moreover, even comparatively small amounts received through the allocation significantly increased reserves in low-income countries, such as Chad (by 130 per cent), Burundi (197 per cent) and Sudan (230 per cent). More generally, the high levels of debt in many developing countries meant that the allocation served as a timely source of liquidity. In most of the developing countries with the highest average level of debt servicing on external public and publicly guaranteed debt (23 of 25 countries), average levels were more than twice the level of special drawing rights allocated in 2021 (figure 2). This allocation was welcome, yet the data serve to show why countries are requesting further allocations.

Figure 2
Highest average public and publicly guaranteed debt servicing burdens: First 25 developing countries, 2018–2020
(Percentage)



Source: UNCTAD secretariat calculations, based on data from IMF.
Note: Country classifications are in UNCTAD, 2021, *Handbook of Statistics* (United Nations publication, Sales No. E.22.II.D.2, Geneva).

13. Aside from the allocation of special drawing rights, international responses to the pandemic have consisted primarily of a combination of new multilateral emergency lending and temporary and partial suspensions of debt service payments. By mid-April 2021, the IMF Catastrophe Containment and Relief Trust had cancelled $965.3 million in debt service payments for 31 of the poorest developing countries over a two-year period.[16] The Debt Service Suspension Initiative of the Group of 20 enabled the deferral of $12.9 billion in official bilateral debt service payments by 48 of 73 eligible poor countries in 2020–2021.[17] This represents around one tenth of the estimated $103.3 billion paid in external public debt servicing over the period by eligible countries under the initiative.[18] The inability under this initiative to ensure private creditor participation and include a wider range of vulnerable developing countries has been noted.[19] Beyond debt service cancellations and deferrals, by March 2022, IMF had put into place new, largely

[15] UNCTAD, 2021, *Trade and Development Report 2021: From Recovery to Resilience – The Development Dimension* (United Nations publication, Sales No. E.22.II.D.1, Geneva).
[16] See https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/12/17/Catastrophe-Containment-and-Relief-Trust-Fifth-Tranche-of-Debt-Service-Relief-in-The-511094 and https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker.
[17] United Nations, Inter-Agency Task Force on Financing for Development, 2022, *Financing for Sustainable Development Report 2022* (United Nations publication, Sales No. E.22.I.6, New York).
[18] UNCTAD secretariat calculations, based on World Bank international debt statistics.
[19] See A/RES/76/193, https://unsdg.un.org/resources/liquidity-and-debt-solutions-invest-sdgs-time-act-now and United Nations, Inter-Agency Task Force on Financing for Development, 2022.

concessional lending for eligible countries, amounting to $170.5 billion, and the World Bank had approved over $150 billion to address the pandemic through a range of projects.[20]

14. The global financial safety net, comprising conditional and unconditional emergency lending by IMF, regional financial arrangements and bilateral currency swap arrangements between central banks, enlarged tenfold after the global financial crisis. At the outbreak of the pandemic in March 2020, financing available through the net was roughly $3.7 trillion, or about 4.5 per cent of global GDP. However, this did not cover all countries equally, and low-income countries and some lower middle-income countries are excluded from the greatest and most unconditional crisis finance elements, such as new regional financial arrangements and currency swaps. Moreover, the global financial safety net remains uncoordinated and largely bilateral in nature. However, the recent expansion of the global financial safety net does not address these structural flaws, despite deteriorating international financial conditions and the prospect of further monetary tightening in developed countries in 2022. In January–June 2022, 16 currency swap arrangements were created or renewed (compared with 23 in the same period in 2021), none of which involved low-income countries and only two beneficiaries of which were lower middle-income countries, namely, India and Indonesia.

15. Perhaps the most far-reaching initiative developed following the pandemic has been the Common Framework for Debt Treatment of the Group of 20, which is intended to complement the Debt Service Suspension Initiative by addressing the need for deeper restructuring and effective debt relief following the pandemic and in the context of interrelated crises.[21] The framework has the same eligibility criteria as the Initiative, in addition to joint IMF and World Bank debt sustainability assessments. Eligible debt includes all long-term external public and publicly guaranteed debt. The envisaged treatment follows Paris Club procedures to address unsustainable debt burdens in debtor countries, in particular the Evian approach agreed in 2003 to provide debt treatment to countries not included under the Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief initiative.[22] Eligible countries agree to join an upper credit tranche IMF-supported programme to restore debt sustainability and to share necessary information regarding all public sector financial commitments with IMF, the World Bank and other creditors participating in the framework, while respecting commercially sensitive information. Moreover, participating debtor countries are required to seek at least equal treatment for the terms agreed in a legally non-binding memorandum of understanding with other official bilateral and private creditors. The framework represents a meaningful step in the reform of the international debt architecture, but has several shortcomings, including its limitation to bilateral creditors and countries eligible for the Debt Service Suspension Initiative.[23] To date, only three eligible countries, namely, Chad, Ethiopia and Zambia, have opted to join, in early 2021. In June 2022, the official creditor committee for Zambia, which includes China, helped unlock a loan of $1.3 billion from IMF to Zambia.[24] However, progress has been slower for the other two participating countries.

16. Multilateral crisis responses to date may therefore not be decisive enough to help developing countries address the multiple issues arising from interrelated health-related, environmental and macroeconomic challenges. This is all the more of concern as the fiscal space available to developing countries for domestic resource mobilization has, on average and for all country groups, narrowed over the peak years of the pandemic. Changes in public deficits and gross government debt as shares of GDP from 2018 to 2020 are shown in figure 3. The deterioration of these fiscal indicators was most marked in high-income countries; the deficit grew from 2.4 to 10.4 per cent of GDP and the level of government debt rose from 99 to 120 per cent of GDP, reflecting significant fiscal rescue packages. The

[20] See https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker and https://www.worldbank.org/en/news/press-release/2021/06/30/world-bank-financing-for-covid-19-vaccine-rollout-exceeds-4-billion-for-50-countries.

[21] Group of 20, 2020, Statement: Extraordinary G20[Group of 20] Finance Ministers and Central Bank Governors' Meeting, 13 November. See A/77/206 and UNCTAD, 2022.

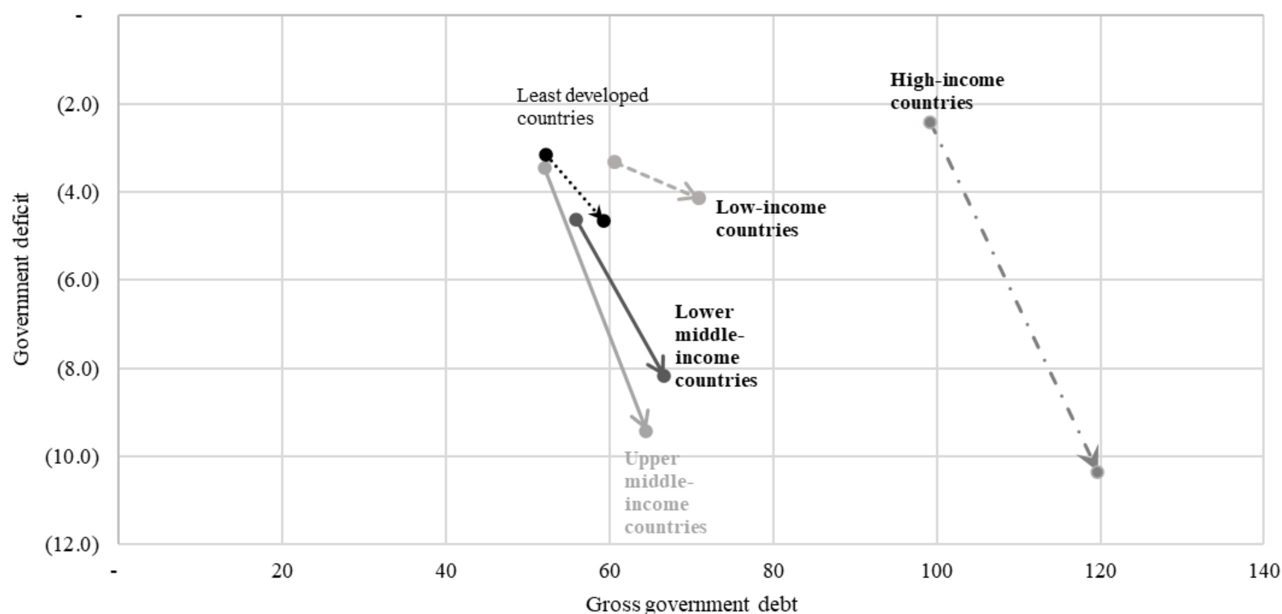
[22] See https://clubdeparis.org/en/communications/page/evian-approach.

[23] See United Nations, Inter-Agency Task Force on Financing for Development, 2022.

[24] *Financial Times*, 2022, China agrees landmark debt relief deal for Zambia, 30 July.

deterioration was also significant in upper middle-income countries; the deficit grew from 3.4 to 9.4 per cent and the level of government debt rose from 52 to 64 per cent. In low-income countries, the deficit grew from 3.3 to 4.1 per cent and the level of government debt rose from 61 to 71 per cent. Developing countries therefore typically did not expand fiscal expenditure and government debt as much as high-income countries, due to their considerably smaller fiscal spaces. Yet these already limited spaces have now shrunk further, negatively affecting future ability to mobilize and direct public investment towards achieving the Goals and addressing climate change. This situation will be critical in countries facing extensive austerity programmes as a condition of debt relief, such as under the Common Framework for Debt Treatment.

Figure 3
Developing countries: Changes in public deficits and gross government debt as shares of gross domestic product before and after the pandemic, by country group, 2018 and 2020
(Percentage)



Source: UNCTAD secretariat calculations, based on data from IMF.
Note: Country classifications by gross national income per capita are World Bank classifications. The Bolivarian Republic of Venezuela is included in the lower middle-income countries group. Afghanistan, Lebanon, Libya, Palau, Somalia, Syria and Macao, China, are not included due to the lack of data.

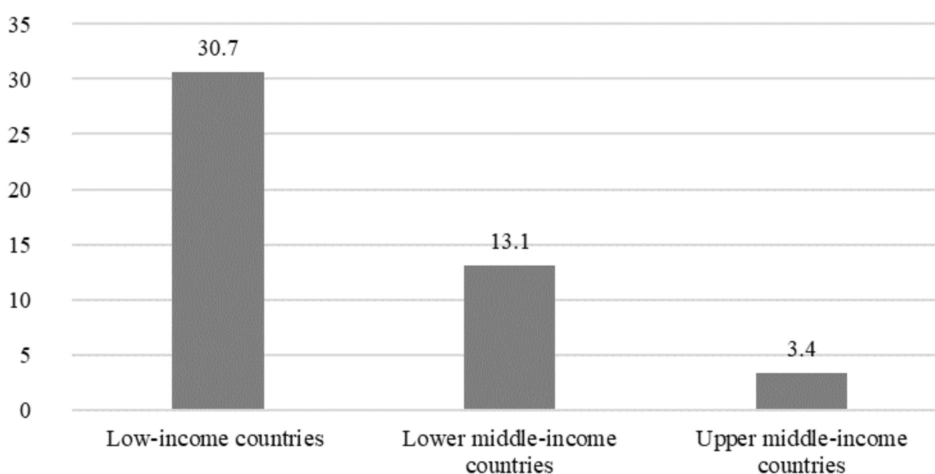
IV. The development financing gap: A search for resources

17. National responses to interrelated global crises mean that financing gaps in achieving the Sustainable Development Goals will grow as investment and expenditure is postponed in order to deal with acute crises. At end-2021, UNCTAD estimated a composite financing gap over a six-year period for different country groups, comparing external financing needs (associated with external debt amortization, current account deficits, the pandemic and other exogenous macroeconomic shocks and the cost of achieving the Goals, including with regard to climate adaptation) with expected government revenue and private capital inflows.[25] The annual development financing gap, expressed as a share of the cumulative projected GDP, by country group, is shown in figure 4. Updates in the calculations include estimates of macroeconomic risks and shocks (e.g. with regard to the war in Ukraine, monetary tightening in advanced economies and expectations of a global recession in 2023) and the implications for external imbalances, government revenue and

[25] TD/B/EFD/5/2.

private capital inflows. The development financing gap in low-income countries, at 30.7 per cent, is significant.

Figure 4
Estimated development financing gap as share of gross domestic product, by country group, 2020–2025
(Percentage)



Sources: UNCTAD secretariat calculations, based on data from IMF, national sources, the United Nations Environment Programme, the United Nations University-World Institute for Development Economics Research and the World Bank, as well as on UNCTAD, 2014, *World Investment Report 2014: Investing in the SDGs[Sustainable Development Goals] – An Action Plan* (United Nations publication, Sales No. E.14.II.D.1, New York and Geneva).

Note: Country classifications by gross national income per capita are World Bank classifications. The figure for upper middle-income countries excludes China. Sustainable Development Goal costs have been computed as weighted averages by country income group, including with regard to energy, transport, telecommunications, water and sanitation, food security and agriculture, health, education and climate change mitigation and adaptation. See TD/B/EFD/5/2.

18. There is little assurance that future crises will not place the achievement of the Goals further out of reach.[26] On the domestic side, addressing the financing gap requires developing countries to improve tax collection, by both widening the tax base and raising the effective tax rate. In 2021, low-income and lower middle-income countries achieved a tax revenue-to-GDP ratio of 15 and 16 per cent respectively, compared with 35 per cent in high-income countries and 28 per cent in upper middle-income countries.[27] In both low-income and lower middle-income countries, the ratio has been flat or on a declining trend in recent years. However, even if low-income and lower middle-income countries increased the tax revenue-to-GDP ratio by 5 per cent in the coming years,[28] the scale of the additional spending required to achieve the Goals would eclipse this improvement, and further support from international sources, including financial institutions, and the private sector is required.

19. In 2020, low-income and middle-income countries received $539 billion in remittances, or 77 per cent of the global value.[29] In low-income countries, remittances represented 2.6 per cent of GDP; by comparison, official development assistance represented 5.2 per cent (the inclusion of multilateral donors increases this figure to

[26] With regard to progress achieved to date, see E/2022/55.
[27] UNCTAD secretariat calculations, based on data from IMF.
[28] Suggested as feasible based on V Gaspar, D Amaglobeli, M Garcia-Escribano, D Prady and M Soto, 2019, Fiscal policy and development: Human, social and physical investments for the SDGs[Sustainable Development Goals], IMF Staff Discussion Note No. 3.
[29] See https://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data.

10.9 per cent).[30] In lower middle-income countries, remittances have been the single most important source of income from abroad since 2015, representing 4.6 per cent of their combined GDP in 2020, which is higher than the levels of official development assistance (0.39 per cent of GDP) and foreign direct investment flows (1.4 per cent). For many poor households in developing countries, remittances represent a lifeline, particularly during an economic crisis, yet remittances depend on long-term social links and the prosperity of the diaspora that sends them. Moreover, their value may be undermined by high transaction costs: target 10.c under the Goals is to, by 2030, reduce to less than 3 per cent the transaction costs of migrant remittances. At present, costs are twice this amount, and up to nearly thrice in some regions.[31]

20. More broadly, net capital flows to developing countries have been closely associated with global financial conditions and the growth performance of developing countries over the past two decades. However, such flows turned negative in September 2021, ending a rebound since the fourth quarter of 2020 closely related to the new allocation of special drawing rights in 2021. The tightening of United States monetary policy, reflected by a sharp increase in the yield of 10-year treasury bonds in mid-2020–mid-2022, has been associated with a flight to quality and a sell-off of developing country bonds and equities, leading to near-record portfolio outflows of $108.8 billion in the first quarter of 2022. Foreign direct investment inflows largely compensated for these outflows in developing countries as a group; however, sub-Saharan Africa experienced net capital outflows from end-2020 and into 2022.[32]

21. In 2021, official development assistance commitments by 30 members of the Development Assistance Committee fell short of the target of 0.7 per cent of gross national income; only five members achieved the target.[33] In 2021, net total official development assistance from members amounted to $167.9 billion, representing 0.31 per cent of the combined gross national income of members of the Development Assistance Committee, an increase from $162.6 billion in 2020.[34] However, in 2020, only $114.9 billion of official development assistance was disbursed to developing countries, of which $65.8 billion (57 per cent) was directly allocated to developing countries, with the remainder attributed to unallocated flows, which refers to activities that benefit a region and activities undertaken in donor countries, such as administrative costs. Since 2014, over 40 per cent of disbursed official development assistance allocations have been attributed to such flows.[35]

22. The pandemic served to highlight the role of (both regional and multilateral) development banks and the need for sufficient and reliable capital bases.[36] In 2010–2019, regional development banks expanded gross official development assistance and other official flows to developing countries by, on average, 5 per cent per year, but in 2020, such flows increased by 46 per cent, from $42 billion in 2019 to $60 billion in 2020.[37] The majority of total flows from regional development banks is directed to lower middle-income
(42 per cent) and upper middle-income countries (51 per cent), with 20 per cent directed towards low-income countries and the least developed countries. However, IMF, the United Nations and the World Bank, as well as other multilateral organizations, including the European Commission, the European Investment Bank and regional development banks, direct the majority of flows to low-income countries and the least developed countries.

[30] UNCTAD secretariat calculations, based on data from the Organisation for Economic Co-operation and Development (OECD) and the World Bank.

[31] See https://www.worldbank.org/en/news/press-release/2022/05/11/remittances-to-reach-630-billion-in-2022-with-record-flows-into-ukraine.

[32] UNCTAD, 2021, and UNCTAD, 2022.

[33] See https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/ODA-2021-summary.pdf.

[34] See https://data.oecd.org/oda/net-oda.htm.

[35] UNCTAD secretariat calculations, based on OECD methodology. See https://www.oecd-ilibrary.org/fr/development/development-co-operation-profiles_5d646dd8-en.

[36] See https://unctad.org/webflyer/public-banks-and-covid-19-combatting-pandemic-public-finance.

[37] UNCTAD secretariat calculations, based on data from OECD.

23. The scale of the financing gap makes it clear that there is an urgent, critical role for private finance, with high hopes for blended finance. Blended finance is described as the use of catalytic funding from public and philanthropic sources, to mobilize additional private sector investment to achieve the Goals.[38] Blended finance flows have averaged $9 billion per year in the past five years, but halved in 2020, to $4.5 billion.[39] OECD expands the definition of blended finance, to include mobilized private finance and the use of financing instruments by development finance institutions, with an average value of $50 billion in each of the last three years.[40] This falls far short of the transformation of development financing "from the billions to the trillions".[41] Such private flows have benefited relatively few middle-income countries, with 20 countries having received more than half of such flows in 2018–2020 and low-income countries and the least developed countries having received 18 per cent of total flows. Proponents state that development finance institutions largely use concessional funding to reduce their risks and not to mobilize commercial partners.[42] In addition, the risk appetite of private investors suggests that without a change in global financial dynamics, there is little reason to believe that private finance will deliver the qualitative jump needed in development financing in the near future.

V. Policy options: Scaling up development finance

24. Developing country efforts to mobilize domestic resources should take centre stage in the push to achieve the Sustainable Development Goals, but this presupposes that their domestic fiscal spaces will not be regularly squeezed by exogenous macroeconomic shocks. International economic governance should be proactive in facilitating domestic resource mobilization and in providing access to affordable and sustainable external financing. Some progress has been made at the interface of national and international policy efforts, for example with regard to debt transparency, yet more needs to be achieved. Moreover, as stated by the Secretary-General of the United Nations in a recent report, "while the challenges to achieving a sustainable energy transition towards net zero greenhouse gas emissions remain significant, especially in terms of globally coordinated investments, increasing political will and promising recent technological developments show a way forward".[43]

25. From a financing perspective, developing country endeavours to increase tax revenue have been hindered by the international corporate tax system, which dates from a model developed at the League of Nations in the 1920s. This includes the separate entity principle, which considers affiliates of multinational enterprises to be independent entities, and the arm's length principle, whereby the taxable transactions between the different entities of multinational enterprises are treated as if they were unrelated. This system has allowed such enterprises to minimize tax bills, with estimates (depending on methodology, time period and country coverage) indicating potential losses for developing countries exceeding two per cent of GDP.[44]

26. Progress has been made in the form of the two-pillar solution recently proposed under the Base Erosion and Profit Shifting project of OECD and the Group of 20. This solution favours an international corporate tax reform that allows profits to be taxed where profit-generating economic activities are performed.[45] It includes the reallocation of some

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38 Convergence, 2021. *The State of Blended Finance 2021*, Washington, D.C.

39 Ibid.

40 See TD/B/EFD/3/2 and https://stats.oecd.org/Index.aspx?DataSetCode=DV_DCD_MOBILISATION.

41 See TD/B/EFD/5/2.

42 Convergence, 2021.

43 E/2022/58.

44 UNCTAD, 2019, *Trade and Development Report 2019: Financing a Global Green New Deal* (United Nations publication, Sales No. E.19.II.D.15, Geneva).

45 OECD, 2021, *OECD Secretary-General Tax Report to G20[Group of 20] Finance Ministers and Central Bank Governors*, OECD Publishing, Paris.
Note: Related measures were scheduled for implementation beginning in 2023, but approval processes have stalled in both the United States and the European Union. See *The Wall Street*

taxing rights to jurisdictions in which sales occur or users of digital services are located. However, since such rights only extend to a predetermined share of residual profits, the proposal would affect only 78 of the 500 largest multinational enterprises in the world.[46] The proposed solution also includes a global minimum tax of 15 per cent, designed to prevent companies from shifting profits to countries with lower levels of taxation in order to minimize tax liabilities, yet only 40 per cent of the additional tax revenue from a minimum tax is likely to be directed to developing countries.[47] The complexity of the proposed measures will create a significant burden for tax administrations, particularly in developing countries. In response, the ministers for foreign affairs of the States members of the Group of 77 and China, at their forty-fifth annual meeting in November 2021, "reiterated the need to strengthen international cooperation on tax matters, recognizing with concern that there is still no single global inclusive forum for international tax cooperation at the intergovernmental level".[48] A global taxation entity is also a recommendation of the United Nations High-Level Panel on International Financial Accountability, Transparency and Integrity.[49] One proposal in this regard has recently been presented by civil society organizations.[50]

27. Another area in which considerable progress has been made is the availability of high-quality debt data, an indispensable prerequisite for the ability of Governments and the international community to minimize the risk of debt crises and to take timely remedial action when these occur. To achieve further concrete improvements in debt transparency, debt transparency needs to be recognized as a public good from which both lenders and borrowers benefit. Placing the burden on either voluntary disclosures by an increasingly complex group of lenders or independent improvements at the national level by borrowers produces piecemeal results. Instead, adopting an approach that recognizes the common responsibilities and benefits that characterize a global public good could be embodied through the establishment of a publicly accessible registry of debt data for developing countries. Following the UNCTAD principles on promoting responsible sovereign lending and borrowing, such a registry would allow for the integration of debt data by both lenders and borrowers at the level of particular transactions in a way that ensures the interoperability of data across direct and indirect sources of reporting.[51] Support for such a registry includes support from experts and agencies participating in the United Nations initiative on financing for development in the era of the pandemic and beyond, as well as civil society organizations.[52] Further efforts are required to identify the conditions and the timeline involved in the establishment of such a registry under the guidance of the United Nations.

28. Improved domestic resource mobilization and enhanced debt data transparency are critical in improving future policy designs for addressing financial and debt distress. However, achieving the Goals over the next decade will require more drastic action, including publicly led programmes to provide a targeted stimulus to finance their achievement. Additional and upfront multilateral and international measures to mitigate the accumulation of unsustainable debt burdens and address the development financing gap include meeting official development assistance commitments, rechannelling special drawing rights and ensuring a coherent approach to sovereign debt restructuring.

Journal, 2022, Global Minimum Tax Suffers Fresh Setback as EU[European Union] Fails to Agree on Implementation, 17 June.

46 See https://www.econpol.eu/publications/policy_brief_36.

47 See https://taxjustice.net/2021/06/04/is-today-a-turning-point-against-corporate-tax-abuse/.

48 See https://www.g77.org/doc/Declaration2021.htm.

49 A/C.2/76/L.28/Rev.1.

50 See https://www.eurodad.org/un_tax_convention.

51 See https://unctad.org/topic/debt-and-finance/Sovereign-Lending-and-Borrowing.

52 See United Nations, 2020, Initiative on financing for development in the era of the pandemic and beyond, available at https://www.un.org/tr/node/81536, and https://www.eurodad.org/transparency_of_loans_to_governments.

A. Official development assistance

29. Developed countries need to meet official development assistance commitments, of allocating 0.7 per cent of donors' gross national income in general and of allocating 0.15 to 0.20 per cent to the least developed countries in particular. In 2020, official development assistance allocations were $22.4 billion to low-income countries (5.16 per cent of their combined GDP); $29.2 billion to lower middle-income countries (0.39 per cent) and $14.2 billion to upper middle-income countries (0.06 per cent). In 2014, official development assistance allocations fell below 3 per cent of the combined GDP of the least developed countries; allocations have not risen above this level since then. In 2020, if members of the Development Assistance Committee had met the target of allocating 0.7 per cent of gross national income, allocations would have amounted to 10.9 per cent of the combined GDP of low-income countries; 0.84 per cent of the combined GDP of lower middle-income countries; and 0.13 per cent of the combined GDP of upper middle-income countries.[53] Such allocations would go a long way towards addressing the development financing gap, particularly in low-income countries.

B. Special drawing rights

30. In addition to providing new financial resources, the new allocation of special drawing rights in 2021 provided momentum for discussions on how to better leverage special drawing rights for development, an issue raised by UNCTAD since the conception of special drawing rights by the international community in the late 1960s.[54] Part of this discussion is on the voluntary rechannelling of unused special drawing rights from developed countries to developing countries. The Group of Seven and the Group of 20 have noted the need to rechannel $100 billion to low-income and middle-income countries.[55] Doing so would more than double the value of the allocation in 2021 for these countries. To date, pledges by members of the Group of 20 have fallen short of this target, reaching around $60 billion, and actual transfers only began in July 2022. Questions remain about the modalities of rechannelling special drawing rights, primarily through IMF trust funds (Poverty Reduction and Growth Trust and newly established Resilience and Sustainability Trust). Rechannelled special drawing rights are not donated but loaned, remaining on donor country balance sheets to maintain status as reserve assets. Rechannelling through IMF trust funds means they reach developing countries in the form of new, conditional lending, rather than unconditional reserve assets. Developing country development banks with preserved holder status for special drawing rights, with local knowledge advantages, could provide for the optimal allocation of rechannelled special drawing rights to long-term developmental projects. Multilateral development banks and other prescribed holders could use special drawing rights as a financial asset on balance sheets and as a means of exchange with countries or other international financial institutions.

31. There are two options in this regard. First, multilateral development banks could simply on-lend special drawing rights. This approach could help maintain the reserve asset status of special drawing rights by mimicking the IMF Poverty Reduction and Growth Trust process and operating as an encashment regime, whereby a portion of available funds would be held as a reserve to meet encashment calls by developed country creditors in case of balance-of-payments or reserve difficulties, and credit risk could be mitigated by a reserve account, possibly held in hard currency. Second, countries could use excess special drawing rights as capital contributions to multilateral development banks that, as banks, would be expected to leverage their equity and multiply by, for example, three or four, the impact of rechannelled special drawing rights. The latter approach is more risky, as the use of special drawing rights for longer-term development purposes requires some degree of

[53] UNCTAD secretariat calculations, based on data from OECD.

[54] UNCTAD, 1985, *The History of UNCTAD: 1964–1984* (United Nations publication, Sales No. E.85.II.D.6, New York).

[55] Group of Seven, 2021, Summit communiqué: Our shared agenda for global action to build back better, 13 June; Group of 20, 2021, Rome leaders' declaration, 31 October.

maturity transformation, that is, the transformation of a liquid asset into a longer-term investment.

32. Any approach to the voluntary rechannelling of special drawing rights requires the design of rules for their transparent and accountable use, and these remain unclear at present. Nevertheless, overall, this is an important initiative and further progress to facilitate the rechannelling of special drawing rights is urgently necessary. However, beyond the voluntary rechannelling of special drawing rights, the need for new allocations to respond to ongoing global crises, such as the war in Ukraine and a possible global recession in 2023, should also be taken into consideration. An even more far-reaching option to increase the developmental impact of special drawing rights would require substantial governance reform, such as by delinking the issuance of special drawing rights from the IMF quota system, to create new asset classes linked to particular purposes, such as achieving the Sustainable Development Goals and environmental objectives.

33. A related proposal has been made by the Prime Minister of Barbados, involving the annual issuance, over 20 years, of $500 billion in special drawing rights for a climate finance trust that would auction low-interest loans, backed by special drawing rights, to investment projects proposing the highest levels of reductions in or removals of greenhouse gasses. Environmental, social and governance-related conditionality would be attached to the loans, for which both public and private actors would be allowed to bid. The trust would aim to invest in assets that are liquid and guarantee a high credit quality. Such a proposal requires considerable political will to change the purpose and governance of the issuance of special drawing rights. It also gives private finance a considerable role in the design of the energy transition and decarbonization strategies, potentially undermining the role of public policy in setting priorities, coordinating investments and building institutional capacity to manage the transition to a low-carbon global economy.[56]

C. Sovereign debt restructuring

34. The need for a coherent international approach to resolving sovereign debt crises, when they occur, is more urgent than ever. Current arrangements for handling sovereign debt issues are fragmented, with different procedures for diverse types of external sovereign debt (bilateral, multilateral or debt owed to private creditors), further complicated by the increasing importance of domestically issued debt held by non-residents and associated questions as to whether to differentiate between resident and non-resident holders of local currency debts in sovereign debt restructuring. The establishment of a multilateral legal framework for debt restructuring to facilitate timely and orderly debt crisis resolution with the involvement of all official (bilateral and multilateral) and private creditors would significantly facilitate the provision of debt relief. Such a framework should include debt sustainability assessments incorporating long-term external financing needs, including for the achievement of the 2030 Agenda and the targets of the Paris Agreement under the United Nations Framework Convention on Climate Change. There are a range of suggestions as to how to structure the international aspects of promoting general principles or guidelines for sovereign debt restructuring, such as the basic principles on sovereign debt restructuring processes adopted by the General Assembly in September 2015.[57] The essential feature of any statutory approach to sovereign debt restructuring is that legal decision-making in related cases would be governed by a body of international legal norms and regulations agreed in advance as part of an international debt workout mechanism and that the purpose of any sovereign debt restructuring facility would be to provide transparent, predictable, fair and effective debt resolution that is binding for all parties, as well as universally enforceable.[58] In view of the pervasiveness and gravity of external debt problems across developing countries, the further exploration of options, for example

[56] See https://unfccc.int/sites/default/files/resource/Her_Excellency_Ms._Mia_Mottley_Prime_Minister_of_Barbados.pdf and https://barbadostoday.bb/2021/11/12/persaud-pushes-plan-to-raise-climate-investment/.

[57] See UNCTAD, 2019.

[58] See A/RES/69/319.

through a commission of experts under the United Nations, should be sought. In order for multilateral efforts to scale up development finance to be successful, the creation and allocation of roles for the private sector is critical. As noted, Goals-related private finance has to date remained below early expectations, suggesting that incentive structures and regulatory approaches require revision and improvement.[59]

35. One avenue is through the increased use of innovative financing instruments that help mitigate and manage external debt burdens, such as State-contingent debt instruments. Such instruments adjust debt service payments either continuously, such as by indexing payments to GDP or gross national income, or discretely, such as through clauses whereby predefined natural disaster events reduce debt servicing obligations. The former involves debt repayments determined on the basis of a country's capacity to pay, that is, with debt service payments reduced during slow-growth periods, which are normally accompanied by reduced government revenue and, therefore, payment capacity. The latter is particularly attractive in small island developing States; for example, hurricane clauses can provide cash-flow relief following a natural disaster, when financing needs are high and new funding is limited. Two important drawbacks of State-contingent debt instruments are that they can be discrete, and therefore lack a secondary market, and that creditors face uncertainty as to investment returns, and may therefore require a premium to hold such instruments. However, offering such higher-yield instruments may serve to broaden the investor base, with an associated wider spread of risks during periods of stress.

36. Another avenue of contingent financing is debt-for-climate swaps, that is, agreements that provide partial debt relief conditional to debtor commitments to undertake climate-related investments. Considerable progress has been made at the regional level in this regard, for example, through the Climate/SDGs[Sustainable Development Goals] Debt Swap Mechanism (Debt Swap/Donor Nexus initiative) of the Economic and Social Commission for Western Asia and the Debt for Climate Adaptation Swap and the Caribbean Resilience Fund of the Economic Commission for Latin America and the Caribbean.[60] However, the attractiveness of this instrument is limited by high transaction and monitoring costs, for example, related to investment project choice, performance monitoring and coordination, although these may be reduced in the context of regionally coordinated initiatives; and by the fact that swaps typically involve debt relief only by one class of creditor. The economic desirability of this instrument depends on the sustainability of existing debt and the causal impact of potential natural disasters on this sustainability. If existing debt is unsustainable, it is preferable to first restore sustainability through comprehensive debt restructuring, then support climate-related investment through climate-conditional grants or loans. If debt is sustainable but the debtor lacks the fiscal space to undertake climate investment, debt-for-climate swaps provide additional fiscal space only if the climate-related expenditure takes precedence over debt service, for example, as in the arrangement in Belize in 2021 involving several counterparties.[61]

37. Despite their appeal from an analytical perspective, there has been little uptake of State-contingent debt instruments to date, with issuance mostly limited to debt restructuring contexts.[62] This may reflect the liquidity and/or novelty premiums demanded with regard to new instruments, but may also reflect concerns regarding data accuracy (e.g. with regard to timely GDP data) and first-issuer moral hazards related to novel designs. Multilateral organizations and international financial institutions could help strengthen the design of State-contingent debt instruments, for example, by purchasing the issuance of gross

[59] See United Nations, 2020.

[60] See United Nations, Inter-Agency Task Force on Financing for Development, 2022, and https://foroalc2030.
cepal.org/2022/sites/foro2022/files/the_eclac_debt_for_climate_adaptation_swap_initiative_and_cari
bbean_resilience_fund_feb2022_002.pdf.

[61] Chamon et al., 2022.

[62] EP Caldentey, FG Villarreal and NC Moscoso, 2022, Innovative financing instruments in Latin America and the Caribbean, available at https://mobilizingdevfinance.org/research-material/innovative-financing-instruments-latin-america-and-caribbean.

national income-linked bonds; helping to develop a market for such instruments; and providing technical support for data provisioning.[63]

38. Further debate and discussion will be needed to improve the design of innovative financing instruments and public–private coordination mechanisms, to guide and facilitate private investment into long-term Goals-related projects,[64] in particular in the current context of recurrent global crises and potentially worsening outlooks for global economic dynamics.

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[63] C Cohen, SMA Abbas, M Anthony, T Best, P Breuer, H Miao, A Myrvoda and E Togo, 2020, The role of State-contingent debt instruments in sovereign debt restructurings, IMF Staff Discussion Note No. 6.

[64] See United Nations, 2020.