CHAPTER 3
The Right Kind of Financing
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"The private sector will play a pivotal role in financing the post-2015 development agenda."
From Billions to Trillions: Transforming Development Finance

1. Setting the Context for Financing the SDGs

Sustainable development comes with a price tag—approximately $4 trillion annually in developing countries alone. With current investment in SDG-relevant areas running at an estimated $1-1.5 trillion, there is a $2.5 trillion gap to fill. The largest share of this will need to be spent on infrastructure: social (schools, clinics, water and sanitation) and economic (transport, power, telecommunications), with as much as $1 trillion a year extra needed by 2020. The precise figures can be no more than informed guesswork but they nevertheless present an intimidating challenge.

The sums involved are enormous; the timeframe short and at stake is not only the future of the poorest millions but also the credibility of donors and other funders. Funding for the MDGs has fallen short by tens of billions of dollars a year and although this is far from the only reason for the uneven progress, it is the most obvious one and should have been the one most easily addressed. If funding for the MDGs has proved too difficult to find then what are the prospects for financing the more ambitious SDGs?

While there may be consensus on the need for both public and private financing of the SDGs, there is no agreement on the appropriate balance between them. The divisions are ideological as well as practical. Some argue that a substantial increase in private finance (most of which will have to come from outside the countries most in need of financing) undermines state control and national ownership. It is viewed as amounting to a privatisation of public goods that diverts both power and profits into the hands of foreign companies (or donor agencies) and raises important issues of transparency and accountability. Others contend that private capital is more efficient, cost effective and potentially less likely to be lost to corruption. Additionally, there will simply not be enough public money available. From this perspective, there is no option other than to draw significantly on international private finance.

1.1. Public Sector Financing

Rapid and sustained domestic growth is necessary to increase the pool of funds available for SDG-related investment, but is not a solution in the short-term. Development is closely correlated to government spending: some 82% of the world’s poor live in countries with annual public expenditure of less than PPP $1,000 per person. Although the poorest countries have increased their tax revenue as a share of GDP, it remains at less than 14%, lower than in middle-income countries and significantly less than the 20-30% in developed nations.

Domestic tax reform is equally urgent. Increasing revenues through more effective and more efficient tax regimes is a priority but it is also not a short-term endeavour. At a national level, it requires...
changes in capacity and in mind-sets. Tax administrations need practical support through better training, pay and technology for staff, while tax codes need to be fairer and fiscal policy needs to be more redistributive. Moving enterprises from the informal to the formal sector is a long-term challenge that must be met to improve domestic tax take. As corruption is always a risk when tax rates are raised, tax policy and rates will have to be determined judiciously, to prevent evasion and avoidance.

Tax is increasingly becoming a topic of international debate. The ease with which multinational companies are able to use the differences in national tax regimes to shift profits from one jurisdiction to another led some civil society groups to propose a global system of taxation221—a proposition that met with little success at the 2015 Financing for Development Conference.

Coupled with the growth in tax havens, these measures of tax avoidance prompt developing countries to compete against each other to offer the most attractive tax incentives to business. This creates opportunities for multinational firms to ‘shop around’ for the best investment location based on tax policies between countries that otherwise have similar endowments, such as land, labour, or natural resources. To be sure, tax havens also benefit politicians of many governments who have deposited their undeclared incomes in the same tax havens. Even this problem is dwarfed by the losses incurred through illicit financial flows out of developing countries. In 2012, these amounted to an estimated $991 billion. Asia accounted for the largest share of this but in GDP terms, Sub-Saharan Africa suffered the most.222

Faster and better economic growth, more efficient and fairer national and international tax regimes, international tax cooperation, eliminating tax evasion, reducing tax avoidance and a crackdown on illicit financial flows offer enormous potential but they will not prove easy to achieve and their benefits will be gradual and incremental.223They also depend on political will, global cooperation and availability of money. Helping developing countries build capacity to mobilise more domestic resources will itself be expensive and will not happen quickly.

The most immediate source of public financing to implement the SDGs in developing countries is international overseas development aid (ODA). The expansion in the scale and scope of the SDGs compared with the MDGs implies a corresponding increase in development assistance. This seems unlikely however, certainly in the amounts required. The commitment by developed countries to give 0.7% of national income in aid dates back to 1970.224The target was re-affirmed in the 2002 Monterrey Consensus and in 2005 the 15 member countries of the European Union pledged to achieve it by 2015. Of the 28 members of the OECD DAC, only five currently meet or exceed the target: Sweden, Norway, Denmark, Luxembourg and the UK. In 2014, total DAC development assistance stood at $135.2 billion, a decrease on the previous year in real terms.225

Importantly also, the overall share of aid going to the poorest countries has decreased over recent years.226 The apparent paradox is often explained by the fact that aid is in some cases used as a political tool, granted to countries that are political allies, and not necessarily those who need it most.227 There are also problems at the recipients’ ends. There is no guarantee that ODA will

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**We will work to improve the fairness, transparency, efficiency and effectiveness of our tax systems, including by broadening the tax base and continuing efforts to integrate the informal sector into the formal economy in line with country circumstances.**

Financing for Development Outcome Document, paragraph 21220

**Domestic spending on fundamental social needs, such as education and health, are often overwhelmed by the amount of illicit money flowing out of the economy, and, with it, domestic resources that could be mobilized to address basic human needs.**


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Chapter 3: The Right Kind of Financing
be used for intended purposes, and recipient countries often lack the infrastructure to manage significant financial inflows. The problem of Dutch Disease\textsuperscript{228} can occur. If unchecked, it can lead to macroeconomic instability or to unintended consequences such as overvalued domestic currency, eroding export competitiveness. Even if all developed countries were to meet their 0.7\% target, there are serious questions whether developing countries could absorb such flows.

While a more favourable global economic climate in the coming years could see aid levels rise, the appetite among donor countries for meeting ambitious targets nevertheless seems to be diminishing. The EU has revised its 2005 pledge, promising to meet the 0.7\% figure only ‘within the time frame of the post-2015 agenda’\textsuperscript{229} (i.e. by 2030). Regardless of whether the target is finally reached, this has implications for fulfilling the SDGs\textsuperscript{230}, particularly when set next to the even lower proportions of development assistance provided by non-EU rich countries.

### 1.2. Private Sector Financing

Given this context, the enthusiasm amongst wealthy nations for private finance becomes more apparent. The private sector is the third and final piece in the financing puzzle alongside domestic resources and overseas aid. Private financing for development is obviously not a new idea. To some degree, it has always been part of the funding mix and it was given an official stamp of approval as far back as the 2002 World Summit on Sustainable Development\textsuperscript{231} and the 2002 International Conference on Financing for Development in Monterrey.\textsuperscript{232} Long before the SDGs, private finance had been identified as an important element in supporting the MDGs although it was not accorded the kind of attention and focus it currently commands. This is presumably because financing needs are now so much greater although there is suspicion amongst civil society that the enthusiasm for private finance is connected to donor reluctance to commit fully to the 0.7\% target.\textsuperscript{233} Certainly, the less the amount of aid, the greater is the need for alternative sources of funding.

In theory, the private sector offers huge potential, not only because of the depth of its available funds but also the potential for cumulative impact and the under-exploited opportunities in developing country markets. The cash holdings of multinationals total around $5 trillion, Sovereign Wealth Funds hold a further $6 trillion in assets, pension funds in developed countries alone have reached at least $20 trillion\textsuperscript{235} and signatories to the Principles for Responsible Investment represent some $59 trillion of assets.\textsuperscript{236} In theory, tapping into this vast reserve of private capital could unleash a flood of investment, thereby creating jobs, boosting tax revenues, improving government finances and reducing aid dependency. It should be a simple matter of matching supply with demand.

Despite this apparent potential, private finance remains controversial and will only become more so. Many in civil society do not appear convinced, preferring instead to highlight measures to increase domestic revenues and aid and downplay the contribution from private sources.\textsuperscript{238} The scepticism reflects concerns over the developmental impact of private financing – such as the financialisation
of infrastructure projects that focuses on developing infrastructure as an asset class for investors, with expected high level of returns that could imply trade-offs with ensuring that such infrastructure meets the needs of the poorest in line with the SDGs.\textsuperscript{249}

These concerns are not the only ones. The money may exist but it is not necessarily available and nor is it lying idle. There are certainly many developing countries, especially in parts of Asia, where investment is attractive and will no doubt continue to flow regardless of the SDGs. The same is not true of the poorest countries where the need is greatest. Encouraging foreign investment on the scale required, and making it work for the poor, are two of the most urgent challenges facing the international community yet neither one is easy and both together more challenging still. Private finance is less likely to find its way to places where funds are needed most because of inherent risks and lack of assurance of rewards. The poorest countries are not on the cusp of an investment boom, certainly not one that is targeted at sustainable development. The focus therefore needs to shift from quantity to quality. Concerns over the proposed speed and size of proposed infrastructure investments (with references not just to “giga” but “tera” size projects in the trillions) risk undermining the very principles the SDGs seek to embody: inclusivity and sustainability.\textsuperscript{240}

There should be two priorities:

- **First, investing for the SDGs.** This means the use of innovative financing mechanisms blending public and private finance to facilitate projects that are explicitly focused on the poorest communities and carried out at a pace and on a scale appropriate to the management and absorptive capacity of the recipient country.

- **Second, getting investment right.** If existing foreign direct investment (FDI) cannot be made to work better for the society as a whole, it is doubtful whether any new investments will prove different (even assuming the opportunities can be identified). The focus should be on better management of FDI.

In the context of the SDGs, blending mechanisms to leverage private sector involvement in development facilitate projects that would otherwise be too risky, too expensive or too complex for either the private or

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**Innovative financial instruments, such as blending using equity, loans and guarantees, can be important for mobilising private investment for policy priorities that support sustainable development and poverty eradication. Blending can be used to leverage private finance for development by sharing the risk and reducing costs. These instruments can contribute to green growth, job creation, innovation and support climate action, amongst other things.**

EU Council\textsuperscript{241}

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**2. Incentivising Investment in the SDGs through a Blending of Public and Private Funding**

With public resources insufficient and private resources risk-averse, the hope is that part of the solution to financing the SDGs will lie in imaginative combinations of the two. Over the last decade, there has been a trend towards expanding various forms of innovative financing designed to harness the complementary strengths of public and private sectors. The projected expense of meeting the Goals means this trend will continue and almost certainly accelerate. The rationale is simple and seemingly strong – public resources can have a multiplier effect by “crowding in” private capital. Given the enormity of the needs and the limited amount of aid available, this is a powerful attraction and explains why donors are increasingly enthusiastic about the potential of various forms of leveraged finance. Private capital is being positioned as central to financing the SDGs and aid is viewed as a key means of unlocking it. The EU has repeatedly emphasised its support for measures to blend public and private resources\textsuperscript{242} and the OECD is also calling for a greater share of aid money to be spent on attracting private investment.\textsuperscript{243}

In the context of the SDGs, blending mechanisms to leverage private sector involvement in development facilitate projects that would otherwise be too risky, too expensive or too complex for either the private or
the public sector alone. Aid can be used as a catalyst to spread and reduce risk and improve returns for private investors while financially underpinning the affordability and accessibility of infrastructure, and services. Blended finance mechanisms are diverse but essentially they seek to combine grants with loans from commercial lenders or publicly owned institutions. Each party has its own, distinct role to play. The public finance role is to take the kind of risks the private sector will not take, such as being the guarantor of first loss and to catalyze private sector participation wherever possible. The public finance element of blended finance can be provided as cash, goods or services: for example, direct grants, technical assistance or measures to reduce risks for private sector investors (interest rate subsidies, loan guarantees, investment guarantees, political risk coverage, etc.).

Blended finance is not about the wholesale public underwriting of the private sector – but it should be about using public sector funds in a manner that is aligned to public sector goals. There is surely more that public financial institutions could and should be doing in a manner that is aligned with the SDGs, such as providing innovative finance to support new and innovative investment products that focus on specific social outcomes, such as social impact bonds and social impact investments. A special task force of the Group of 8 (G8) industrialised nations focused on social impact investment testifies to the interest in deploying the financial sector to target specific social objectives. Many of the growing set of public and private investors seeking to achieve social impact do so by investing in organisations that either sell products or services that benefit a specific target population or provide employment to target populations – approaches that align well with targeting the poorest. Supporting further innovation can establish business models that specifically deliver on the fulfilment of human rights and other social development goals set out in the SDGs.

To date, however, much of the discussion has been focused on delivering on the enormous infrastructure needs (see below) and on the role development finance institutions (DFIs) are expected to play in many new SDG investments. DFIs can help catalyse private finance, set up rational financing structures for projects, as well as develop innovative finance products and solutions for development. With respect to specific transactions, they generally have primary responsibility for identifying suitable opportunities, coordinating and pooling the necessary finance from different sources (including their own funds), providing first loss guarantees, providing capacity-building and technical support and monitoring implementation.

It is worth noting that DFIs are largely self-financing and without making money on their loans and equity investments, they would go out of business (or require a new injection of public funds). Is their business model one that focuses narrowly on economic development in developing countries or on sustainable development? Underlying these different perspectives is the tension between simultaneously pursuing development objectives and financial returns. As with so much of the discussion around the private sector and development, assumptions are made based on the dynamic role business plays in the general economy. Development is understood in different ways by different constituencies. Is an infrastructure project or business growth in a poor country inherently developmental? Some argue yes on the basis that both strengthen the economy. Others argue no on the basis that it depends on who really benefits and who bears the costs. A common understanding is necessary around this core question. If there is no agreement on expected development outcomes should public aid be used in this way? These are critical questions in relation to the SDGs that must be considered together with some further sobering considerations:

- **Shifting of aid money from public to private recipients** – If more aid is directed towards leveraging the private sector but aid levels themselves do not increase substantially, from where will existing donor funds be diverted? Given the wide range of development needs outlined in the SDGs and therefore the multiple calls on limited funding, any decision to increase support to private sector projects will mean shifting aid from other objectives. It risks being perceived as subsidising private profit and ignoring...
the deeper issue of why foreign investment is not flowing of its own accord. Justifying higher levels of aid spending on private sector projects will be difficult in light of the other increased demands of the SDGs for scaling up financing.

• **The challenge of coordination across a wide range of institutions** – An important key to success moving forward is the massive coordination effort needed. Money is expected to pour into 2030 development agenda financing but who will play the global traffic cop to ensure that financing is aligned with the SDGs? This is a global finance governance gap that must be filled quickly if the grand aspirations of the SDGs are to be met in as coherent and efficient a manner as possible. Less obvious is who can play this role meaningfully. Past experience, following the 2002 Monterrey Conference on Financing for Development is not encouraging. The recognised need for coordination among the MDBs, IFIs and UN agencies came essentially to naught, with no institution able to lead in coordinating. None of the characteristics of the existing financial players change with the SDGs, meaning there is still no clear lead. The Financing for Development Outcome document highlights the need for coordination but not strongly enough, given that there appears to be insufficient consistency of approach among DFI and other public finance actors who are likely to be active in financing the SDGs. The challenge is even greater these days, with the rising stock of new financing sources. The private sector is often on the scene before public financing institutions, meaning that the role the public sector plays in structuring deals and applying environmental, social and human rights safeguards can go awry from the very start of transactions.

• **Lack of safeguards for strategic, upstream decision-making on projects** – One of the reasons public finance is important is because it usually comes with a degree of safeguards – including protections for environmental, social and human rights dimensions. However, as important as these safeguards are, even with their existing faults, they apply too far downstream (at least for large projects) to influence key, strategic choices made by the host country – such as which resources should be prioritised for development, which infrastructure routes best serve the most needed population, and where major social service infrastructure should be situated. These strategic choices should be guided by transparent host country procedures to engage their populations in deciding on development choices and the use of cost-benefit analysis that specifically incorporates environmental, social and human rights externalities to ensure that projects really do deliver on the SDGs. But it was precisely because the host countries that needed investment urgently lacked even the most basic safeguards that the MDBs began to develop their own set of environmental and social safeguards that apply when their financing is used. The SDGs demand attention to an even wider range of impacts yet the capacity of the countries most in need of financing to manage those strategic choices is still limited. This means a renewed emphasis on public sector financing partners to develop new tools and methods to work with host country partners to support prioritisation for larger scale development projects that are better aligned with the SDGs.

• **Lack of consistent environmental, social and human rights safeguards for a coherent approach on the use of public funds** – If more public money will be used to absorb some of the financial risks to companies in order to facilitate large-scale projects, a key concern is what safeguards, if any, will be put in place to ensure that proper process is followed, that relevant international sustainability standards are applied, and that development objectives are met. The Financing for Development Outcome Document has helpfully called for environmental, social and human rights safeguard systems for all development banks, including the new development banks such as the Asian Infrastructure and Investment Bank and the BRICs Bank. However that still leaves out many actors who may be involved in financing SDG projects. This puts even more emphasis on the need for strong coordination to ensure the most stringent safeguards apply to all actors participating in project financing.

In short, blending could be seen as part of a potential sea change for development finance, which effectively shifts ODA from the public to the private sector, while at the same time helping to replace ODA with private finance.

Eurodad 253

Chapter 3: The Right Kind of Financing
• **Need for robust accountability for impacts** – Accountability for the development impact of projects risks becoming a “pass the parcel” game – whoever is left holding the parcel when the music stops must ex-post account for impacts of a project. Instead, intended development objectives and accountability mechanisms should be an integral part of SDG project design from start to finish. A number of DFIs have agreed to work together towards harmonizing a set of indicators to track development results. This is a start towards a more coherent approach but will need to be revisited in light of the far more ambitious SDGs to understand as a first step whether all players have the same concept of “development impact.” This should be accompanied by monitoring and evaluation carried out by independent, external parties for large projects. DFIs should set the example of ensuring the availability and effectiveness of grievance mechanisms for impacts on stakeholders affected by SDG projects, with processes that can provide remedies for harm caused, and enforce changes to ensure non-repetition of harms.

2.1. **Blending Public and Private Finance – The example of Infrastructure PPPs**

Financing “sustainable and resilient” infrastructure is one of the biggest needs identified in the SDGs. The bulk of the financing for infrastructure globally currently comes from domestic budgets with the rest provided by a combination of private and international public sources. Blended finance to support infrastructure projects is not new. What is new is the projected scale, the expected outcomes and the target countries. Generating $1 trillion worth of extra investment in infrastructure would be a challenge under any circumstances. To meet the SDG targets, it is estimated that some $200-300 billion of the total investment required will need to be spent on ensuring investments are climate friendly and around 85% spent in low and lower-middle income countries. In other words, more money directed towards riskier and more expensive projects (at least in the short-term) in poorer countries. Inevitably, higher-cost and higher-risk investments will need higher public subsidies in order to attract private capital.

The enormous scale and complexity of the financing needed raises some additional challenges:

• **Keeping the focus on the poorest** – There is a real danger that the poorest in the poorest countries will be unfairly treated or ignored in the rush to get projects underway. A critical question has apparently been ignored: what are the implications of spending hundreds of billions of dollars on infrastructure over the next five years in countries with weak governance, poor protection of individual rights or systemic corruption? Experience shows that large investments in countries where the rights of the most vulnerable are ignored can have damaging impacts on the lives and livelihoods of those affected. How can this level of investment be undertaken under current conditions without severe consequences for the rights of people often marginalized in society? In addition, do all the players even have their eye on the poorest? The obvious point is worth restating: not all institutions share the same...
commitment to being ‘SDGs-compliant’ (nor a common understanding of what this even means). There is no agreed set of objectives, standards, monitoring frameworks or common idea of what a development impact looks like.

- **A needed dose of realism about governance capacity** – What financial, management and absorptive capacities exist within poorer countries to handle sudden and substantial injections of investment? An internal evaluation of the World Bank Group’s support for PPPs noted that, “countries need to be sufficiently mature to apply the concept of PPPs wisely.” There is a reason why only 4% of PPPs are in low-income countries and there is a reason why the IFC’s portfolio of investments through financial intermediaries is concentrated away from the poorest countries. Making investment work and delivering returns for private investors requires more than capital. Identifying and supporting necessary reforms and building up relevant expertise is an important function of institutions like the World Bank and IFC but it will prove to be a lengthy process in poorer countries.

- **Competition in the hunt for bankable projects: stimulating better outcomes or a race to the bottom** – Will the increasingly competitive business to fund infrastructure projects in developing countries, with different institutions, not to mention different private sector investors and their advisers, chasing an inevitably limited number of the most viable projects, lead to better outcomes? The contribution to the SDGs masks the underlying competition between the growing number of institutions that mobilise private capital. All these bodies, both traditional and emerging, will be under pressure to justify themselves through numbers. This risks success being measured in quantity not quality and potentially undermines the place of safeguards for those for whom projects are supposed to be delivered. As a result, this kind of competition could easily result in a “race to the bottom” in order to get new projects off the ground, or the repackaging of otherwise viable projects within the SDG umbrella to tick boxes or benefit from public subsidies. All parties (including donors) will have a clear financial self-interest in keeping related costs to a minimum to stretch public funds.

There has been a proliferation in partnership bodies focusing on infrastructure development, ranging from:

- the newly established Global Infrastructure Facility (GIF) hosted by the World Bank
- the donor-run Private Infrastructure Development Group (PIDG)
- EBRD’s Infrastructure Project Preparation Facility (IPPF)
- the Asian Development Bank’s Asia Pacific Project Preparation Facility (AP3F)
- the African Development Bank’s Africa50 Initiative
- G20 mandated Global Infrastructure Hub (the Hub)
- The new BRICS Bank and the Asian Infrastructure and Investment Bank (AIIB).

While both GIF and the Hub are also designed to be coordination and knowledge-sharing resources, and some are project preparation facilities, there is a real danger of overlap and competition.

- **Learning lessons from earlier experiences**: Are the designers of SDGs’ blended finance mechanisms heeding lessons learned from earlier processes? The dangers of this massive scaling up of efforts to leverage private finance should be seen in the context of the debate over the actual value of current initiatives. Concerns have been voiced on multiple counts, including: the actual developmental impact in terms of targeting the poor; the sustainability of debt and the long-term costs particularly in relation to PPPs; the potential for crowding out private finance (rather than crowding it in); the transparency and accountability of projects; the hands-off and inconsistent approach to applying standards and the absence of proper systems for accountability, monitoring and evaluation.
Chapter 3: The Right Kind of Financing

### Large-Scale Independent Evaluations of Existing Blended Finance Mechanisms for PPPs or Infrastructure – Findings on Long Term Development Impact

Several independent evaluations of different forms of blended finance have been conducted in recent years. All have questioned the evidence for the developmental impact of the projects reviewed.

The Independent Evaluation Group of the World Bank noted that, “To shed more light on important aspects of public service delivery – for instance, access, pro-poor aspects, and quality of service delivery – PPPs need to be measured in a more multifaceted manner. But such data are rare.”

A report by the World Bank on behalf of the G20 Investment and Infrastructure Working Group found: “The literature on PPPs is abundant and covers best practice for most – if not all – steps of a country engaging in as PPP... However, ex post assessments of how PPPs worked out and delivered on their promise of efficiency gains and increased access and service levels are rare, and if available, are only partial.”

An evaluation of DFID’s work with business carried out by the Independent Commission for Aid Impact (ICAI) recommended that, “DFID needs to do more to translate its high-level intentions into sufficiently detailed operational plans and provide clear guidance on when, why and where it will engage with business. There is a risk that targets for LEG may distort DFID’s spending decisions.”

The mid-term evaluation of the EU-Africa Infrastructure Fund (ITF) – a blending mechanism designed to support investment in infrastructure – found that, “The original objectives of the ITF, whilst still relevant, are too broad, do not sufficiently show the flow of inputs, outputs, outcomes and impacts and do not reflect the evolving context as well as current and future challenges, e.g. the role of private sector investment, good governance and risk management.”

A case in point is the Global Infrastructure Facility (GIF), a flagship new initiative hosted by the World Bank. The GIF became operational in April 2015 with an initial capitalisation of $100 million and the intention of mobilising significant resources from institutional investors. Over the next three years, the GIF will invest in 10-12 projects as part of its pilot phase. A minimum of 20% of these projects need to be in low-income countries – meaning that 80% do not.

The GIF’s primary objective is “to increase private investment, particularly long-term finance, in complex Emerging Market and Developing Economies (EMDEs) infrastructure projects.” It includes poverty reduction and inclusive and sustainable growth amongst its impacts but as it acknowledges itself, “The GIF is not structured to monitor long term impact – that is, to what extent GIF-supported projects contribute to its ultimate development goals of poverty reduction and inclusive and sustainable growth in EMDEs.”

Other similar initiatives such as the Private Infrastructure Development Group, have more explicit poverty reduction goals, but for the most part, poverty reduction and sustainable development are assumed outcomes and seemingly secondary to the greater imperative of encouraging investment.

### 3. Getting Investment Right – Making the Most of Foreign Direct Investment

FDI is already the dominant financing mechanism in developing countries. In 2013, such investment to developing countries reached $778 billion, more than half of the global total of FDI. The basic numbers disguise huge disparities, however. While Asia accounted for over 29% of the total, Africa received less than 4% and, worldwide, FDI inflows into the poorest countries amounted to $57 billion – again, less than 4%. Countries with the highest poverty rates received the least foreign investment and therefore remained the most dependent on aid whereas those countries more able to attract FDI tended to be...
comparatively richer. Additionally, FDI in the least developed countries has flowed into relatively few sectors, most obviously primary commodities, with heavy concentration in the extractives sector. This is still true today although less so than previously.

The degree to which foreign investment is a driver as opposed to an outcome of development may be debatable but there is little doubt that it can play a part in creating a virtuous circle of rising wealth and lower aid dependency. FDI offers many benefits – although whether these are realised depends on many factors. FDI brings capital, technology and knowledge. It can boost employment, stimulate competition, promote local industry through supply chains, improve infrastructure and encourage trade.

FDI may offer real potential but it still needs to be attracted into the countries that need it most. There are good reasons why the poorest countries command such a small share of the global total, including high risk and low returns, a poor governance and investment climate and political barriers thrown up in order to protect domestic industries and wider economic sovereignty. Instability and fragility are also major reasons why FDI is shy. These are formidable obstacles and ones that have to be removed or at least reduced rather than navigated around. But the SDG ambition is not simply to increase investment in developing countries per se but to increase it in ways consistent with sustainable development objectives and in SDG-related areas. This implies investment that has a tangible (positive) impact on the poorest communities and/or that addresses specific goals such as inclusive and sustainable growth, decent work, an expansion in healthcare or education and wider access to water and proper sanitation. Collectively, these constraints suggest the intention of doubling annual investments for sustainable infrastructure over the next five years looks (as noted above) optimistic and highlights one of the major contradictions in the discussions around financing. The necessity of putting in place the right conditions to attract investment is repeatedly emphasised but the difficulty of doing so within a short period is not properly acknowledged. Even the 15-year timeframe of the SDGs may not be compatible with the scale of the challenge, at least not in relation to attracting the private sector contribution needed to meet financing needs.

There is a risk indeed in promoting new investment without building capability and infrastructure in countries that may have been historically incapable of managing significant inflow of investment. The real urgency therefore is not in identifying new sources of FDI but in first supporting and encouraging countries to put in place the systems and structures that will ensure investment contributes to the greater good of the society.

The emergence of the BRICS as important, perhaps even predominant, sources of financing for infrastructure in countries reinforces this point. Aid from non-OECD Development Assistance Committee (DAC) countries increased four-fold between 2000-2011 totalling more than $15 billion but, by comparison, trade between Africa and the leading emerging countries collectively known as BRICS is expected to reach more than $500 billion this year, with 60% of this from China making it Africa’s single largest trading partner. India is growing in importance as well with its share of trade with Africa currently around one-third of China’s but rising. Africa may have gotten all the headlines in recent times but it is not the only focus of attention. China has announced that investments in Latin America will reach $250 billion over the next 10 years. It is important for BRICS investors to operate in ways that are consistent with the emerging consensus on supporting SDGs.
The priority needs to be on the management of FDI and this will require concerted support in the following areas, particularly from donors:

- **Support overall governance reform alongside sector-specific reforms** – Developing country governments urgently need to put in place the appropriate legal and policy frameworks to facilitate large-scale infrastructure projects, the focus of some of the infrastructure project preparation facilities (see below). While this is necessary, the world will have missed important opportunities if such reforms become self-contained islands of protection within states that are otherwise failing their populations.

- **Ensure coherence amongst private sector development (PSD), FDI and responsible business promotion** – The SDGs “warrants a re-look at FDI policy and attraction efforts, to ensure efforts to attract FDI are good for the economy, social equity and environmental sustainability.” There is increasing recognition that to maximise the value of FDI, whether as part of global value chains (see Chapter 2) or otherwise, coordination between FDI policies and other policy areas (trade, industrial/SME development, and environment, social and human rights standards) are important to ensure FDI contributes to sustainable development. Coherent donor messages in policy and technical assistance are critical in ensuring partner governments and businesses adhere to international standards.

- **Align investment and trade agreements with the SDGs** – The SDGs are prompting reviews of international investment / investment protection agreements to calibrate the right balance between investor rights and obligations, country needs and obligations and the protection of stakeholder rights. UNCTAD’s Investment Policy Framework for Sustainable Development (IPFSD) seeks to address “systemic flaws” in the current system and support the need to mainstream ‘sustainability’ in investment strategies. The OECD has also newly updated its Policy Framework for Investment. These frameworks, and the treaties negotiated pursuant to them provide an important opportunity for signaling what is expected or required of private actors with respect to investment protection. For example, one solution would be to stipulate that only those investors that can demonstrate compliance with international standards, such as the OECD Guidelines for Multinationals, would be eligible for protection under investment protection treaties.

There are a number of steps that donors, business and civil society can take to improve the outcomes of investments, often working together at the country level:

- **Increase transparency** – The transparency antidote is an important step on the path to building accountability into the DNA of investments, especially those linked to delivering on the SDGs. The clear push for transparency – around revenue, contracts and tax, started with the extractives sector given the importance of natural resources to many developing country economies. Significant progress has been made, largely as a result of the global Publish What You Pay campaign and the creation of the Extractive Industries Transparency Initiative (EITI) – a multi-stakeholder initiative involving governments, business and civil society. EITI implementing countries disclose information on tax payments, licenses, contracts, ownership, production and other key elements around resource extraction.

While EITI itself is exclusively focused on extractive industries, the principles and approach that underpin it have important ramifications for strengthening the governance of other areas of natural resources that are often crucial in the least developed countries, and in strengthening the role and legitimacy of civil society in participating in open, public debates about the management of national wealth. These important principles should extend to other areas of public ownership. If infrastructure is to be a primary focus of FDI in the coming years, then it is imperative that systems are put in place to ensure maximum possible transparency in contracts, payments and cost and profit sharing arrangements.

- **Strengthen linkages with local economies/local content** – Any foreign investment has the potential to multiply its development impact through technology transfers, building relevant technical and management capacities and increasing local business opportunities. Although local content requirements have increasingly become standard features of contracts with multinationals, particularly oil, gas or mining multinationals, these may not be realistic, especially in LDCs, and may not be easily met by one company working alone. As a result, investments too often become self-contained bubbles...
rather than hubs for a wider eco-system of economic activity. While some companies have tried to expand the scope of their positive impacts in this area (e.g. through capacity-building and skills training of local suppliers), others have done as little as possible. None has achieved as much as it might have done given coordinated support, assistance and, in some cases, forceful encouragement. Local content requires a much more strategic approach that combines the efforts of governments, companies and donors. Large-scale investments have enormous potential to act as a catalyst in otherwise struggling economies but, thus far, this potential has not been fully realised.

- **Encouraging effective Multi-stakeholder Initiatives (MSIs)** – There is little point in advocating for more investment if it is carried out in such a way as to undermine development objectives through environmental damage, human rights abuse or conflict with communities. Over the past two decades, a growing number of collaborative MSIs have been established to minimise the negative impacts resulting from different types of foreign investment – usually focused on operations in countries with significant regulatory gaps. MSIs have the potential not only to address the problem of variable regulatory requirements across different countries but can also be a stimulus to progressively setting higher standards while building local capacity. They differ from the types of partnerships set out in Section C below because their primary focus is on collectively setting – and implementing – norms and standards in particularly challenging circumstances where appropriate regulation is lacking – rather than on wider scale funding or delivering a particular public service, as many public-private partnerships do. MSIs negotiate broad principles and standards as well as operational and context-specific expected actions and systems of monitoring and accountability. These efforts develop their own governance structures and share the broad aims of improving corporate performance on sustainability issues – often a combination of environmental and social issues or with a particular focus on human rights. They also contribute to closing governance gaps at national and international levels.

MSIs have the potential to contribute to the SDGs, but will also need to “up their game” to maximise impact including through robust reporting, monitoring and assessment of member performance, critical not only in bolstering legitimacy but also in ensuring long-term change in company and state performance. These initiatives will also need to give greater consideration to how they can play a more active role earlier in the investment cycle to prevent corporate involvement in human rights abuses or other negative impacts.
Chapter 3 Conclusion and Recommendations
SDG Partnership Principles for the Use of Public Funds for Goal 17

The financing needs of the SDGs are enormous and public finance may not be sufficient, but private capital will not offer a panacea. The trajectory from billions to trillions may be right but the urgency of fundraising has overwhelmed the necessary consideration of whether and how money for implementation efforts can be properly spent. Target-setting without setting the principles on how to reach them can lead to a blind pursuit of targets without regard to consequences. Money will continue to flow to safer areas where returns are assured, rather than to locations where the need is greatest – which is what the SDGs set out to achieve. There is a need to encourage more responsible investment in the poorest countries but attempting to do this at a speed and on a scale that ignores political fragility and macroeconomic instability, weaknesses in governance structures, administrative capacity and policy frameworks, and as well as lack of capabilities can become counter-productive. This Report has particularly emphasised the need to focus on strengthening good governance as a first step. These are the improvements that will ultimately unlock the trillions of dollars.

Corporate responsibility standards are designed to minimise harm but this cannot be the extent of the ambition of development assistance. The lesson of the last 15 years is that although economic growth has delivered prosperity to many, growth remains uneven; it is a blunt instrument. Too many people are blocked from sharing in its benefits. The individual achievements have not matched the wider ambition of delivering development for all. The SDGs reflect important changes in our understanding of development – that human capital development is crucial for economic development. Growth without sustainability is a false promise of advancement. Projects that deliver economic growth are essential (assuming they are carried out responsibly) but it is not the role of development assistance to subsidise them unless other public or social objectives are being met. Aid needs to be more carefully targeted at public private partnerships (PPP) or projects that specifically support the poorest and most disadvantaged. To get there, a clear framework is required for the use of public funds for blended mechanisms under SDG 17. Such a framework would help ensure that public funding is used for programmes and projects that not only support the SDGs in theory but in practice. A higher bar should be set for projects that draw on public money.

As is recognised repeatedly in this Report, there is certainly value in engaging the private sector in the huge task ahead to deliver on the SDGs. There is also real value in using development assistance to leverage private finance – but only where that partnership is focused on delivering on the SDGs. A shared set of SDG Partnership Principles is needed as part of the SDG implementation process to clarify what constitutes compliance with the SDGs and therefore when it is appropriate to use public funds. Such Principles could be used by all partners – governments (as host, home or donors), business and civil society – as a framework for implementation of partnerships involving the private sector and public funds under SDG 17.

Figure 3 below sets out a proposed approach to establishing a set of SDG Partnership Principles that could be part of SDG implementation efforts.
### SDG Partnership Principles

All SDG partnership programmes or projects should:

| Objectives | Be explicitly pro-poor, inclusive and targeted at:  
|            | • Explicitly defined objectives that specifically focus on one or more SDG  
|            | • Facilitating access to services  
|            | • Enhancing capacity to participate in the economy |
| Principles for Service Design | Apply a human rights based approach and in particular:  
|            | • Be designed to respond to the Availability, Accessibility, Acceptability, Quality Standard\(^{\text{SDG}}\) to help ensure that such services benefit the poorest communities |
| Processes | Be informed by:  
|            | • social, environmental and human rights due diligence  
|            | • broad based and inclusive engagement with potentially affected stakeholders and other relevant stakeholders |
| Standards | Apply relevant standards of responsible business conduct to the private sector participants, including at a minimum:  
|            | • UN Guiding Principles on Business and Human Rights  
|            | • ILO Conventions – the ILO core labour standards & ILO conventions relevant to the partnership area  
|            | • UN Convention Against Corruption  
|            | • International environmental standards set out in multilateral environmental agreements  
|            | • Relevant international standards for the areas covered by the partnership (e.g. CFS Principles for Agriculture)\(^{\text{SDG}}\) |
| Transparency | Be transparent by default (with permitted exceptions limited to well-defined and justified areas of confidentiality), covering:  
|            | • Governance arrangements for the PPP explaining clearly how the partnership is structured and funded, listing participants and directors and others in key roles. Entities at each level of governance should be both responsible and accountable for appropriate aspects of applying the relevant standards  
|            | • Financing arrangements, (including private sector and government obligations, liabilities, including contingent liabilities and debt implications)  
|            | • Operating agreements, concession contracts or other contracts  
|            | • Impact assessments, action plans, monitoring results, evaluations  
|            | • Revenue payments, taxes, royalties or other payments made to a government and received by a government  
|            | • Periodic reporting to the public on the outcomes of the partnership |
| Accountability | Include a range of accountability mechanisms:  
|            | • Ensuring that the PPP tracks and takes accountability for its development impact, and in particular is measuring impacts on the poorest communities and those who are the hardest to reach  
|            | • Carrying out independent evaluations throughout the life of the PPP, including with input from relevant stakeholders  
|            | • Put in place specific mechanisms (such as grievance mechanisms, ombudsman, or other arrangements) that can accept and effectively address and remedy grievances from stakeholders who have been negatively impacted by the PPP. |
The inclusion of business as a partner in a global development framework assumes companies of all different sizes and all different sectors will increasingly operate according to environmental, social and human rights standards. It assumes business models will be reconfigured as necessary to ensure sustainability of products and services, sometimes perhaps at the expense of higher profits. Finally, it assumes that the business community, in partnership with states and civil society, will channel a greater share of its resources towards meeting SDG targets, through investment as well as philanthropy.

While many within the private sector might share the objectives expressed in the SDGs, the gap between business priorities and development objectives remains significant. The gap will not be closed by blind faith or vague promises and assumptions. It will be closed because a common understanding begins to emerge - one that is grounded in responsibility and informed by clear commitments. The follow-up process to the SDGs is an opportunity to close that gap.

Chapter 3 Endnotes


217 Early estimates of the costs of meeting the MDGs suggested OECD countries needed to increase their annual Development Assistance to 0.46% of Gross National Income (GNI) by 2010 and 0.54% by 2015 (UN Millennium Project). In 2013, it stood at 0.3% (OECD – DAC. www.oecd.org/dac/stats)


221 See, for example, Tax Justice Network: “Ten reasons why an intergovernmental UN Tax Body will benefit everyone.” http://www.taxjustice.net/2015/06/19/10-reasons-why-an-intergovernmental-un-tax-body-will-benefit-everyone/


224 The inclusion of business as a partner in a global development framework assumes companies of all different sizes and all different sectors will increasingly operate according to environmental, social and human rights standards. It assumes business models will be reconfigured as necessary to ensure sustainability of products and services, sometimes perhaps at the expense of higher profits. Finally, it assumes that the business community, in partnership with states and civil society, will channel a greater share of its resources towards meeting SDG targets, through investment as well as philanthropy.

225 It is notable (although not surprising) that the final text of the SDGs implicitly endorses this extended timeframe: see target 17.2 “Developed countries to implement fully their official development assistance commitments, including the commitment by many developed countries to achieve the target of 0.7 per cent of ODA/GNI to developing countries”. Available at: https://sustainabledevelopment.un.org/content/documents/7888TRANSFORMING%20OUR%20WORLD_final.pdf


228 Originally framed as 0.7% of GDP, it was revised in 1993 to GNI. The US has never formally agreed to the target. Development Initiatives: http://devinit.org/#/post/0-7-aid-target-2


230 Ibid.


234 See, for example, http://www.thesundaytimes.co.uk/sto/news/uk_news/National/article1597186.ece

235 Ibid. p.173.

236 See, for example, Tax Justice Network: “Ten reasons why an intergovernmental UN Tax Body will benefit everyone.” http://www.taxjustice.net/2015/06/19/10-reasons-why-an-intergovernmental-un-tax-body-will-benefit-everyone/


Chapter 3: The Right Kind of Financing


249 Eurodad, "A dangerous blend? The EU’s agenda to “blend” public development finance with private finance”, (2015), p.5 Available at: http://www.eurodad.org/entries/view/1544647/2015/03/13/financing-for-development-or-for-private-interests

250 See for example: http://unfccc.int/secretariat/momentum_for_change/items/8373.php


252 It should be noted, however, that political risk insurance can itself create a moral hazard, in the form of a perverse incentive to companies to take risks by investing in dangerous environments because their losses would be covered by the political risk insurance. See International Alert (2006) “Conflict and Project Finance: Exploring Options for Better Management of Conflict Risk” (http://www.international-alert.org/sites/default/files/publications/conflict_and_project_finance.pdf)


255 See for example: http://unfccc.int/secretariat/momentum_for_change/items/8373.php


258 “DFIs source their capital from national or international development funds or benefit from government guarantees which ensures their credit-worthiness. DFIs can thus raise large amounts of funds on the international capital markets and provide loans or use equity on very competitive terms, frequently on a par with commercial banks. Their efficiency and expertise make them self-sustaining and even profitable” European Development Finance Institutions (EDFI). (http://www.edfi.be/cities/index.html

259 Ibid.

260 MOU on Development Results Indicators for Private Sector Investment Operations, October 2013.


262 Ibid.

263 For example, see the long running debate on the impact of the extractive industry. http://www.worldbank.org/en/topic/extractiveindustries/overview

264 The report goes on to note that “For example, the market structure of a sector must create conditions for the private sector to operate, regulatory bodies should be competent and protect operators from political interferences and ensure adequate tariffs, and public authorities need to have the skills to prepare a pipeline of bankable PPP projects to interest the private sector. Eventually, PPPs also need finance and, at times, protection against political risks. And because private sector operators require at least cost recovery tariffs, the introduction of PPPs may lead to end user cost increases.” Independent Evaluation Group, “World Bank Group Support to Public-Private Partnerships”, (2014). Available at: http://ieg.worldbank.org/evaluations/world-bank-group-support-ppp

265 MOU on Development Results Indicators for Private Sector Investment Operations, October 2013.

266 For example, see the long running debate on the impact of the extractive industry. http://www.worldbank.org/en/topic/extractiveindustries/overview

267 The report goes on to note that “For example, the market structure of a sector must create conditions for the private sector to operate, regulatory bodies should be competent and protect operators from political interferences and ensure adequate tariffs, and public authorities need to have the skills to prepare a pipeline of bankable PPP projects to interest the private sector. Eventually, PPPs also need finance and, at times, protection against political risks. And because private sector operators require at least cost recovery tariffs, the introduction of PPPs may lead to end user cost increases.” Independent Evaluation Group, “World Bank Group Support to Public-Private Partnerships”, (2014). Available at: http://ieg.worldbank.org/evaluations/world-bank-group-support-ppp

268 The PIDG, consisting of the development departments of the UK, the Netherlands, Switzerland, and Sweden, provides funding for infrastructure projects in developing countries. See http://icai.independent.gov.uk/wp-content/uploads/2015/05/ICAI-Business-in-Development-FINAL.pdf


271 Eurodad, “A dangerous blend? The EU’s agenda to “blend” public development finance with private finance”, (2015), p.5 Available at: http://www.eurodad.org/entries/view/1544647/2015/03/13/financing-for-development-or-for-private-interests

272 See for example: http://unfccc.int/secretariat/momentum_for_change/items/8373.php


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278 The PIDG, consisting of the development departments of the UK, the Netherlands, Switzerland, and Sweden, provides funding for infrastructure projects in developing countries. See http://icai.independent.gov.uk/wp-content/uploads/2015/05/ICAI-Business-in-Development-FINAL.pdf


German Development Institute, “Foreign Direct Investment – A Means to Foster Sustainable Development?”, (2008).


Mr. Marc Proksch, Chief, Business and Development Section, Trade and Investment Division, UN ESCAP, Presentation on FDI and development: towards achieving the SDGs (2014). Available at: http://www.unescap.org/resource/presentation-fdi-and-development-towards-achieving-sdgs


http://www.oecd.org/investment/pfi.htm

Roel Nieuwenkamp and Kimmo Sinivuori,”The road to responsible investment treaties,” Columbia FDI Perspectives, No. 134 November 10, 2014. The authors also suggest that this could be “complemented by actionable clauses in treaties that would ensure compliance from a contracting party to implement specific measures related or standards related to environment, human rights and labor standards.” Available at: http://ccsi.columbia.edu/files/2013/10/134-Nieuwenkamp-and-Sinivuori-FINAL.pdf

http://www.publishwhatyoupay.org

IFC encourages the public disclosure of concession fees or privatisation proceeds for infrastructure: IFC’s Environmental and Social Policy says: “53. Infrastructure Projects: When IFC invests in projects involving the final delivery of essential services, such as the retail distribution of water, electricity, piped gas, and telecommunications, to the general public under monopoly conditions, IFC encourages the public disclosure of information relating to household tariffs and tariff adjustment mechanisms, service standards, investment obligations, and the form and extent of any ongoing government support. If IFC is financing the privatization of such distribution services, IFC also encourages the public disclosure of concession fees or privatization proceeds. Such disclosures may be made by the responsible government entity (such as the relevant regulatory authority) or by the client.” Available at: www.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP_English_2012.pdf?MOD=AJPERES


These elements are drawn from the international human right framework, more particularly from the Committee on Economic, Social and Cultural Rights that uses these to explain the core elements of various economic, social and cultural rights. See for example: http://humanrights.dk/publications/saaq-manual-right-water-contextualising-indicators


Chapter 3: The Right Kind of Financing
The United Nations Sustainable Development Goals (SDG’s) offer an inspiring and inclusive vision of the future: a world free from poverty, injustice and discrimination and a healthy planet for present and future generations. It is a vision that requires a global partnership of nations and peoples – from the poorest communities to the richest countries – and it is a vision that demands unprecedented changes in both thinking and behaviour. It is a universal vision that applies to all countries and all sectors of society.

The relationship between business and development – between private gain and public good – is not as straightforward as it would appear from the SDG’s discourse. The SDG’s seem to have quietly re-imagined a new model of business, reshaped as an agent of development harnessed and channeled by governments and set to work on alleviating poverty and fostering sustainable economic growth for all. This is certainly a transformative vision of business – one that implies not only significant changes in how many businesses operate, but more fundamentally in the way the global economy functions.

As the SDGs move from pledges to practice, a much wider and better-informed debate is needed around how and in what circumstances business can add the most value. This State of Play report, the fourth in a series by the Institute for Human Rights and Business (IHRB), is a contribution towards this debate. This Report examines the underlying and at times unrealistic assumptions about the role of business and the challenges of involving business in development. The analysis in this Report offers a challenge to the notion that business can be a transformative force in development but also rejects the argument that it cannot be a constructive one.