XIV Ministerial Forum
for Development in
Latin America and the Caribbean

Unlocking Financing for Social Development

Friday 30 September 2022
10.30 am-12.30 pm

RECALIBRATING…
GETTING BACK ON TRACK TOWARDS THE SDGs

Table 4: Unlocking Financing for Social Development
Friday 30 September 2022 | 10.30am-12.30pm

Technical Note

Introduction

In 2015, the international community committed to a shared global vision towards sustainable development – the 2030 Agenda – including 17 Sustainable Development Goals (SDGs). To achieve the SDGs, annual investment requirements across all sectors have been estimated at around USD 5-7 trillion (UN, 2022). With the realization that meeting the Goals by 2030 would require filling an annual financing gap initially estimated at USD 2.5 trillion (a figure that has now been updated to USD 4.2 trillion[1]), the Addis Ababa Action Agenda (AAAA) called upon a broader mobilization of resources, including private ones. Member States of the United Nations committed "to a new social compact…[including] social protection systems and measures for all, [and to] make every effort to meet the needs of all communities through delivering high-quality services that make effective use of resources". It was understood that holistic approaches and systemic changes would be needed to finance the 2030 Agenda, and that countries would need to mobilize resources from all societal actors and all private individuals and households, in a manner that leaves no one behind. The AAAA intended to provide a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social and environmental priorities, and commitments to developing integrated national financing frameworks to finance the SDGs at the national level.

With less than a decade to go until 2030, current investment levels are far from the scale needed to achieve the SDGs. Although global financial assets are estimated at almost USD 469 trillion, most of these resources are not being channeled towards sustainable development at the scale and speed necessary to fulfill the 2030 Agenda.

In addition, the COVID-19 pandemic derailed many years of progress. Latin America and the Caribbean (LAC) has been disproportionately affected by COVID-19 as a result of pre-existing structural inequalities in the region, high levels of informal labor and fragmented health services. Although only 8.4% of the world's population lives in Latin America, the region concentrated 28% of total global deaths (over 1.6 million deaths) and generated 22 million new poor[2]. Just over half of the households in the region have not recovered their pre-pandemic income levels, despite government transfers and other benefits, and most vulnerable and poorest groups have been affected the worst (in particular, women[3]). In this context, the achievement of the SDGs is at risk and progress towards them hinges on countries' ability to scale up spending in important areas like health, education and infrastructure.

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[1] OECD (2020).
[2] ECLAC (2022b) and https://ourworldindata.org/
[3] WB UNDP High-Frequency Household Surveys 2021 (waves 1 and 2).

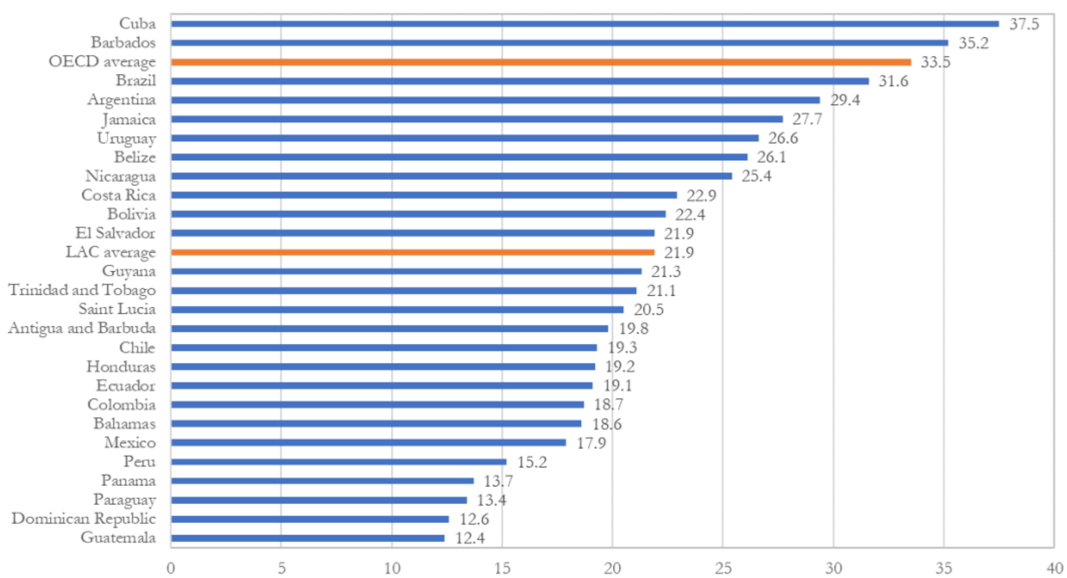
Unlocking Financing for Social Development

1. *Increasing Tax Revenues and Efficiency in Public Spending*

Given that many developing countries still collect limited tax revenue, building tax capacity is a worthy endeavor. About a third of emerging market economies have tax-to-GDP ratios lower than 13%, a threshold documented as a tipping point for development[4].

As can be seen in Figure 1, in LAC, the average tax-to-GDP ratio was 21.9%, though tax revenues fell by 8% on average and by 0.8% as a share of GDP that year because of the pandemic.[5] Following this contraction in 2021, and shown in Figure 2, government revenues rose sharply in 2021 as economic activity and imports rebounded.

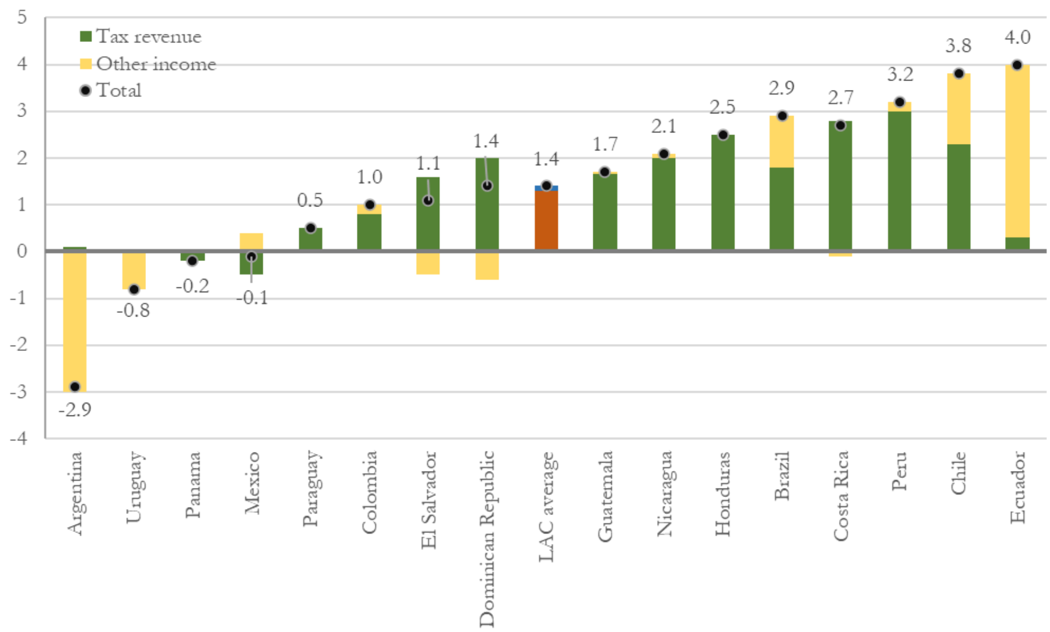
Figure 1: Total tax revenues in 2020 represented almost 22% of GDP in LAC, showing that there is still room to expand resources



Source: OECD et al. (2022).

[4] Gaspar et al., 2016.
[5] OECD et al., 2022.

Figure 2: Following a contraction in 2020, total revenues increased sharply in LAC in 2021 (year-on-year variation in total revenue, 2020–2021, percentage points of GDP)



Source: ECLAC (2022).

Another issue to consider is that, compared to other countries of similar income levels, the region's tax burden remained low and heavily biased towards regressive taxes on the consumption of goods and services. Concrete actions to reduce tax evasion rates, review tax expenditures and adapt tax frameworks to international best practices to mobilize additional domestic resources could be considered to advance the development agenda.

A discussion that must happen in parallel to expanding resources refers to giving public spending a strategic orientation, which can result in significant savings and ensure spending is redirected to areas where it will result in the greatest impact for development. This is even more important now, under the current context of reduced fiscal space, which makes it harder to balance the immediate need to mitigate the global rise in energy and food prices and the longer-term objective of closing social, productive and environmental gaps.

Some countries in the region are already making progress in linking the SDGs to their planning instruments, the budget and the national public investment plans. In many cases, however, these are rather ex post exercises on budget definitions, which constitute a first step towards a real budget-2030 Agenda link, as highlighted in the Voluntary National Reports (VNR) presented by the countries[6]. Already in 2016, Costa Rica presented information on the programmed and executed budget for that year, linking it to the SDGs, which were in turn grouped according to the priorities of the National Development Plan. It was observed in the report that the

[6] https://hlpf.un.org/vnrs

SDGs with the largest allocated budget were those with the greatest challenges in 2016: SDG 1, SDG 5, SDG 8, SDG 9, and SDG 10.

Similarly, in its 2016 VNR, the Mexican government indicated its intention to align more than 400 indicators under the control of the Secretary of Finance and Public Credit with the 232 global indicators of the 2030 Agenda. This effort materialized and was presented in the 2018 VNR. In this report, it was highlighted that during fiscal year 2018, 80.7% of budget items were directly linked to compliance with the SDGs.

In turn, Guyana began its integration of the SDGs into the national planning system through the harmonization of its development plan, Vision 2040. Based on this exercise, the next step was the integration of the SDGs into the national budget process. Since 2017, government agencies have been required, at the budget formulation stage, to explicitly identify potential alignment between Vision 2040 programs and the SDGs. With this, the national budget is recognized as the key means of implementation for both Vision 2040 and the SDGs and other political priorities.

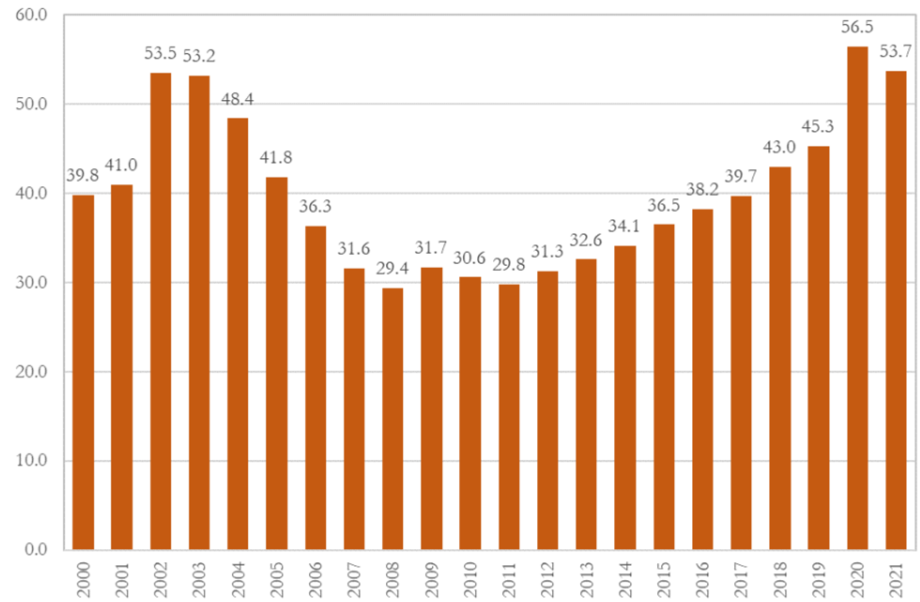
Another case to highlight is Cuba, a country that in its 2019 VNR indicated that through the Plan of the Economy and the Annual Budget they identified and defined the resources and capacities necessary to achieve the SDGs in the country. The association exercise not only considers national resources, but also from international cooperation and others. In addition, it is an exercise that is conducted both nationally and locally.

The countries in LAC are devoting time and resources to link the SDGs with the national budget, understanding this process as a practice that will strengthen policy coherence, increase transparency and accountability, and improve comparability with the other countries in the implementation of the 2030 Agenda (Hege and Brimont 2018). However, for this to be fully accomplished, greater technical, legal and institutional changes are needed that reform the budget systems to establish real links between the budget and planning.

2. *Financing Development with Public Debt*

In 2021, the gross public debt/GDP ratio of Latin America's central governments decreased slightly, owing mainly to the recovery of economic activity – gross public debt represented 53.7% of GDP on average, down from 56.5% in 2020. Despite this improvement, gross public debt remains at a historically high level, above those recorded in the 20 years prior to the pandemic (Figures 3 and 4). In the Caribbean, central government gross public debt remained stable, averaging 89.1% of GDP at end-2021 (see figure I.19). Nonetheless, there were significant differences between countries (Figure 5).

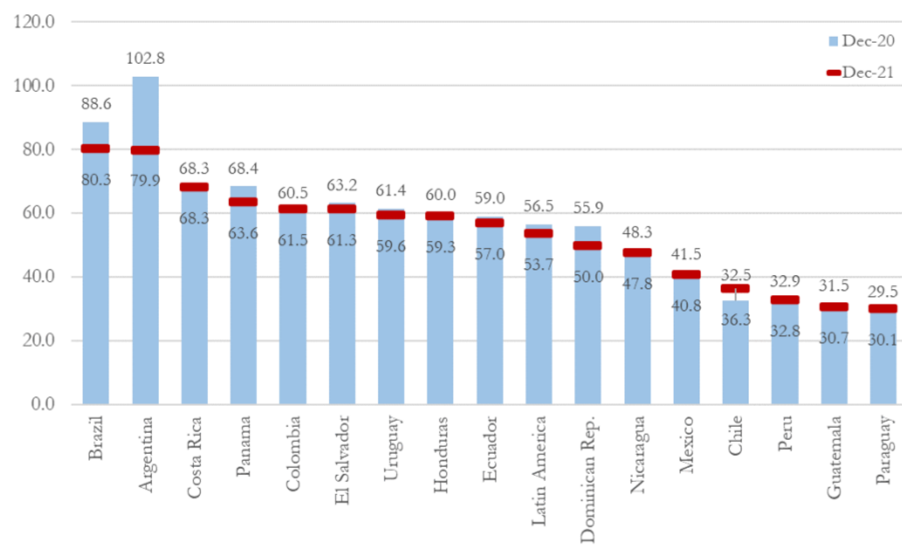
Figure 3: Gross public debt dropped in Latin America in 2021 but remains at a historically high level (central government gross public debt, 2000–2021, percentage of GDP)



Source: ECLAC (2022).

Note: Figures for Nicaragua are preliminary as of June 2021. Figures for Brazil refer to the general government.

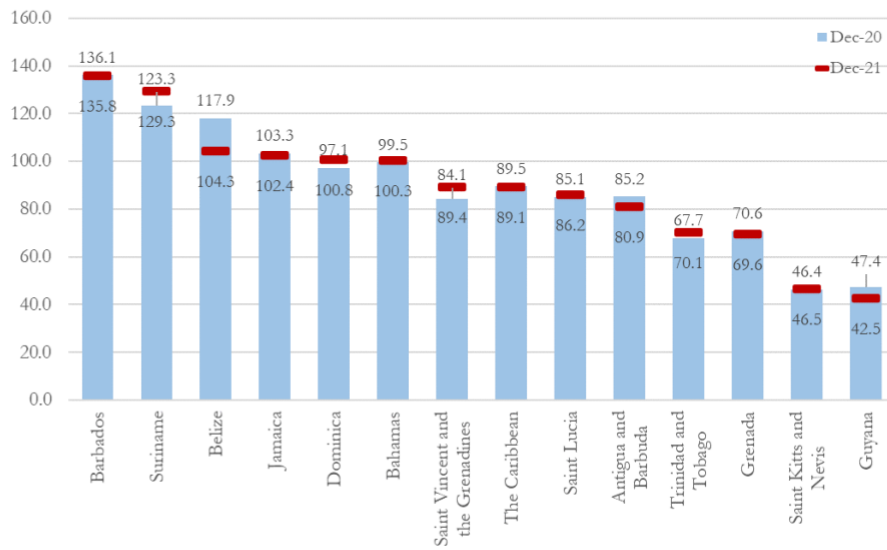
Figure 4: Gross public debt dropped in most Latin American countries in 2021 but remains high (central government gross public debt, December 2020 and December 2021)



Source: ECLAC (2022).

Note: Figures for Nicaragua are preliminary as of June 2021. Figures for Brazil refer to the general government.

Figure 5: Gross public debt dropped in half of the Caribbean countries in 2021 and remains high across the region
(central government gross public debt, December 2020 and December 2021)



Source: ECLAC (2022).
Note: Figures for Guyana refer to the public sector.

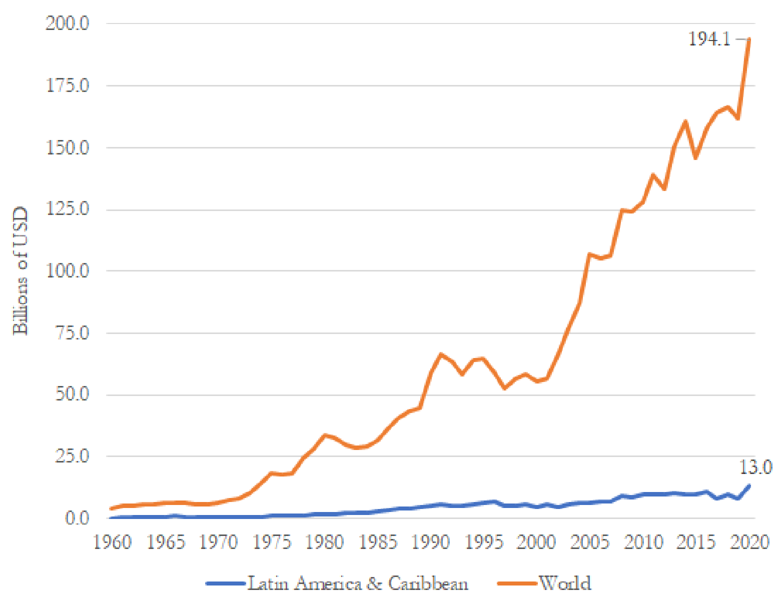
The COVID-19 shock has worsened the baseline for debt sustainability and SDG investments. The fiscal outlook for developing countries was significantly more challenging in 2020 than it was in the previous year. At the same time, the global pandemic and ensuing recession have also caused sustainable development setbacks across many SDG investment areas. Creating fiscal space for public investment in the SDGs, particularly in heavily indebted countries, has become an even greater challenge.

Given the amount of capital needed to reach sustainable development goals, over-reliance on traditional debt financing can ultimately prove counterproductive. Incentivizing funding alternatives and partnerships that promote non-debt-creating capital flows can help. In addition, as suggested in the Financing for Sustainable Development Report 2022 (UN, 2022), "debt vulnerabilities will need to be addressed in a holistic way: "Authorities should build credible medium-term policy frameworks which balance the needs for short-term support and investments in recovery with medium-term fiscal sustainability, for example, through integrated national financing frameworks (INFFs)". The international community can contribute to these efforts by increasing debt transparency, which includes improving the generation and monitoring of relevant data. As highlighted by ECLAC (2021), "middle-income countries, such as those in Latin America and the Caribbean, require multilateral cooperation through the expansion and redistribution of liquidity and debt reduction to enhance their policy space to foster a sustainable recovery and advance their economic and social development".

3. *The Role of Official Development Assistance in LAC*

Overall aid from Development Assistance Committee countries rose in 2020 and 2021. However, ODA flows to LAC countries, mostly middle-income and high-income countries, remain lows as can be seen in Figure 6. In 2020, LAC received a total of USD 13 billion compared to USD 194 billion being distributed globally. In other words, with ODA might be an important source of financing for development in some parts of the world, it is not a major contributor in LAC.

Figure 6: Net official development assistance and official aid is not a major contributor of financing for development in LAC (current USD)



Source: Development Assistance Committee of the OECD, Geographical Distribution of Financial Flows to Developing Countries, Development Co-operation Report, and International Development Statistics database.

4. *Advancing the SDGs with Private Sector Engagement*

Private flows can contribute substantially to the 2030 Agenda. The real challenge is to align the trillions invested daily in capital markets, with the SDGs. This includes resources from institutional investors, banks and retail investors, as well as remittances, foreign direct investment (FDI) and private philanthropy. Shifting just 1% of total global financial assets – estimated at USD 469 trillion[7] – could bridge the existing financing gap. Moreover, by joining forces, the public and private sectors can ensure that existing investments are better aligned with the 2030 Agenda, and help bridge the estimated USD 4.2 trillion annual investment gaps for delivering the SDGs.

[7] https://www.credit-suisse.com/media/assets/corporate/docs/about-us/research/publications/global-wealth-report-2021-en.pdf

However, a significant proportion of private flows are not aligned, and in some cases are even incompatible, with the SDGs. In addition, despite claims of focusing on social and environmental impacts, few investors are transparent when it comes to monitoring and tracking their contributions. This reduces scrutiny as well as transparency, with potentially damaging effects to the 2030 Agenda.

Recent events have shown how threats of climate change, conflict and health shocks like COVID-19 have highlighted growing systemic risks and interconnections between economic, social and environmental issues. As the 2021/22 Human Development Report[8] highlights, there is a new uncertainly complex driven by the planetary pressures of the Anthropocene and political and social polarization, but these pressures can be eased by purposeful societal transformations. This demands fundamental changes to much of the way the world currently operates – including energy transitions, energy taxation or carbon pricing, for instance, and leveraging the positive potential of new technologies. While there are risks from the expansion of artificial intelligence, it can also enhance labor by creating new tasks, new jobs, and new industries, as pointed in the report. More effective fiscal policy as well as better structured and universal social protection systems can positively impact the world and build resilience. And the deepening of level of engagement of civil society is pushing new ground and pushing to address structural social, economic and political imbalances. The private sector also has a role to play in this shift.

However, the short-term nature of financial markets implies that risks and opportunities critical for sustainable development are often overlooked by businesses and investors. Although they increasingly consider sustainability-related risks, they tend to focus on those with a direct material impact on company financial performance in the near term and often lack the tools to conduct in-depth sustainability assessment of companies they finance. In addition, businesses do not actively consider the impact of their activities on the environment or other negative impacts they might impose on our communities and much of the private sector does not have the necessary know-how to pursue both profit and sustainable development. As highlighted in the Financing for Sustainable Development Report 2021, the economic system needs a shift in the way we understand businesses, relying on a business model that works for everyone, including employees, suppliers, customers and local communities, and promoting a strengthened partnership between government and the business sector.

The so-called *fourth sector*, defined as enterprises that blur the line between traditional business approaches and social and environmental objectives, is an example of these shifts. These businesses strive for profitability and revenues while also focusing on delivering social and environmental benefits, with a purpose driven vision. This is also driven by the fact that investors and consumers are changing their own preferences and priorities, which affects investment and consumption decisions. New generations want to invest and consume through firms that incorporate economic, social and environmental concerns as part of their foundational objectives.

In this sense, a 2019 report by the Center for the Governance of Change and the Ibero-American General Secretariat (SEGIB for its name in Spanish) shows that two out of three individuals surveyed in eleven countries in Latin America believe that companies should explicitly contribute to the SDGs, while 86% think that enterprises with social impact should be recipient of donations, pay less taxes and have priority in government

[8] https://report.hdr.undp.org/

procurement. This shows how people see the value of this change in the approach where firms contribute to social, economic and environmental objectives.

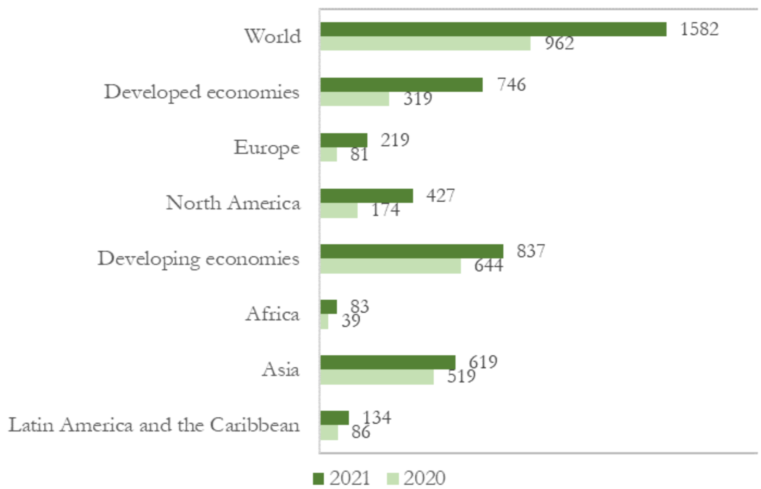
These companies have been consolidating organically in recent years and in the European Union they already represent close to 8% of GDP and employ 7% of its active population. According to a follow up study conducted by SEGIB and the Polytechnic University of Madrid (2020)[9], in the analysis of seven countries, which represent 87% of the total Ibero-American GDP, there are more than 170,000 companies with a purpose, which generate 6% of the region's GDP and employ almost 10 million people. What is more, this report shows that the current and potential contribution of fourth sector organizations to the 2030 Agenda is very significant. The cases of nine Ibero-American companies from various sectors were analyzed and it was found that they have a measurable impact on 15 of the 17 goals of the 2030 Agenda, including end of poverty (SDG 1), health and well-being (SDG 3), gender equality (SDG 5), decent work and economic growth (SDG 8), reduction of inequalities (SDG 10), sustainable cities and communities (SDG 11), and responsible production and consumption (SDG 12).

Yet, as the report also shows, the institutional architecture to allow these companies to flourish is still significantly underdeveloped, in part because it is not yet clear what kind of institutional framework can enable these types of investments and entrepreneurship, and how the government can adapt instruments for this type of purpose driven private sector development. At the moment, these companies lack a specific legal framework that contemplates their hybrid nature, and operate in a system that separates for-profit companies from entities with a will to have an impact. This leads them to face unnecessary duplicities (for example, registering as both limited companies and foundations), be under inadequate tax regimes, and participate in financing systems that value their profitability more than their aim for positive impact. Changes are needed to provide certainty to investors and considering their specific challenges in terms of corporate governance and fiscal transparency. In LAC, many countries have taken steps to put into effect new laws and legal frameworks aimed at supporting entities that combine commercial activity with environmental and social impact. However, the road ahead is still long and full of challenges.

In parallel to this, foreign direct investment (FDI) could make a significant contribution to economic growth and support faster transfer of technology and skills, job creation, and innovation. After a sharp decrease of 45% in 2020 (the largest decline recorded in developing regions that year), FDI flows rebounded in LAC in 2021, growing by 56% to USD 134 billion, according to UNCTAD' World Investment Report 2022 (UNCTAD 2022). This represents 16% of overall FDI flows into developing economies (Figure 7). Although FDI flows rose in all three subregions in Latin America and the Caribbean (excluding financial centers), a few national economies suffered further declines due to the pandemic's continued economic effects and, in some cases, political instability (Figure 8).

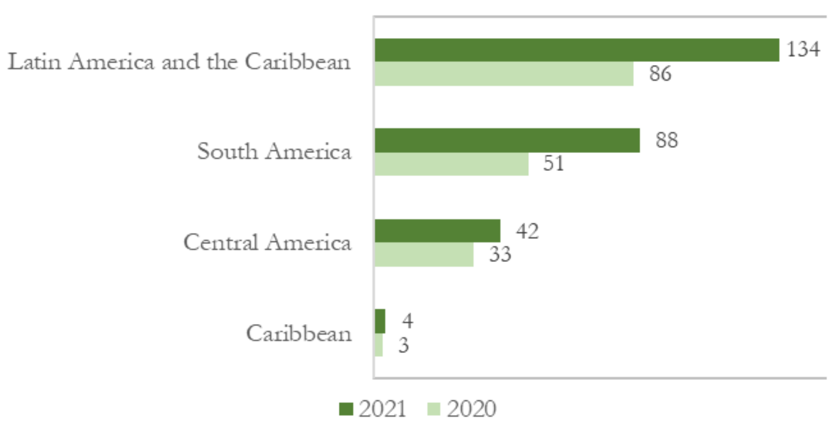
[9] https://www.segib.org/wp-content/uploads/01-Segib-INFORME-Espa--ol.pdf

Figure 7: Following a large drop in 2020, FDI inflows recovered in LAC in 2020 (billions USD)



Source: UNCTAD (2022).

Figure 8: FDI flows rose in all subregions in Latin America and the Caribbean, 2020-2021 (billions USD)



Source: UNCTAD (2022).

In order for the region to expand its appeal to FDI, public policies should support a favorable investment climate, with efforts to strengthen governance, build fair and predictable tax systems, efficient and transparent regulatory frameworks, and rule of law. Government policy incentives for financial decision making should be more directly aligned with the achievement of sustainable development and policy frameworks that ensure financial decisions are informed by a full appreciation of all the risks that relate to the SDGs should be implemented. In addition, through blended financing, development partners can catalyze additional private capital (OECD, 2018). One way for governments to accelerate private investment is to review risks typically associated with infrastructure projects and address those they can control. Private investors base their decisions on risk-adjusted returns. By mitigating risks, governments lower infrastructure project financing costs, which impact the viability of capital-intensive projects.

Although philanthropic flows are only about 5% of official development assistance, they have been growing substantially and can have an important impact on key sectors, for instance in health care (OECD, 2018). Private foundation funding targets largely middle-income economies, and only about a third of flows go to the least developed economies. Further resources from philanthropy could be tapped for development. However, private philanthropy is not organized in a systematic way and responds to the preferences of individual donors rather than being directed to the SDGs.

The COVID-19 crisis has bolstered investor interest in sustainable finance by highlighting risks posed by non--financial factors. On the debt market, alongside green bonds, the issuance of social bonds increased seven times between 2019 and 2020 (to about USD 150 billion), mainly to fund relief packages by government agencies and development banks. Meanwhile, green bonds continued to increase, reaching more than USD 300 billion in 2020 (compared to USD 271 billion in 2019)10. In LAC, placements of green, social and sustainability and sustainability-linked bonds reached almost USD 40 billion in the first nine months of 2021, representing 31.5% of the total amount issued in this period – this share more than tippled in comparison to 2020. Sustainability-linked bonds and social bonds represent the majority of these placements (37% and 36%, respectively).

In September 2020, Mexico became the first country in the world to issue a sovereign SDG bond with an issuance for € 750 million, with the support of UNDP, which was followed by a second issuance for € 1250 million in 2021.11 The aim was to raise resources that the government could mobilize towards programs and expenditures directly linked to the SDGs. This was possible thanks to the Mexican national budget that has been closely aligned with the SDGs and 2030 Agenda, having 78% of budget programs linked to at least one SDG12. Similarly, Uruguay is evaluating a sovereign sustainability-linked bond oriented toward environmental issues, with the support of the Inter-American Development Bank (IADB) and UNDP. Other countries in the region are also exploring the possibility of issuing sustainable bonds following these examples.

In spite of this progress, there is a need to improve the quality and comparability of data/metrics on the impact of companies on social and environmental issues. Without comparable data, investors cannot properly incorporate sustainability issues into their investment decisions and allocate capital to companies aligned with the SDGs. In addition, too many investment products and strategies claim to be sustainable without making a meaningful contribution to the SDGs. Without minimum standards or criteria, any investment can make such a claim and use sustainable development as branding. This can be misleading for investors and hurt the credibility of the industry.

[10] https://www.bloomberg.com/news/articles/2021-01-11/social-bonds-propel-esg-issuance-to-record-732-billion-in-2020

[11] https://www.finanzaspublicas.hacienda.gob.mx/work/models/Finanzas_Publicas/docs/ori/Espanol/SDG/UMS-SDG_Sustainable_Bond_Framework.pdf

[12] https://www.gob.mx/shcp/prensa/secretaria-de-hacienda-presenta-el-reporte-de-asignacion-impacto-del-primer-bono-soberano-vinculado-a-los-objetivos-de-desarrollo-sostenible?idiom=es

In order to help businesses and investors embed sustainability and the SDGs into their management systems and decision-making practices, UNDP has designed SDG Impact Standards for Enterprises, Private Equity and Fund Managers, and Bond Issuers in addition to the joint OECD- UNDP SDG Impact Standards for Financing Sustainable Development.[13]

The Road Ahead

Beyond resources, developing political and civil society consensus, enhancing state capacity, and promoting good governance are needed to achieve the SDGs.

Adequate governance among all actors – national governments, the private sector, civil society, international financial institutions and donors – is key to ensure that the available financing for the SDG agenda is effectively and efficiently mobilized, aligned and spent. Transparency and accountability are an integral part of the necessary governance, which should happen under an Integrated National Financing Framework led by the government.

Some guiding principles:

- The world needs an architecture deliberately designed to help governments, development agencies, civil society and the private sector make decisions that prioritize investment in development. The architecture will need to provide space for these actors to engage at global, regional and country levels.
- This requires fundamental change in the financial system that should include:
    - Technical capacities to innovate and create pipelines of SDG-aligned investment opportunities for both business and governments.
    - Regulation to provide incentives for SDG-aligned investment and disincentives for investments that work to undermine sustainable development.
    - Innovation in the design of financing instruments for the SDGs that bring together public and private finance, including the use of digital finance.
    - Decision making that is inclusive of a broad range of actors including government, private sector and civil society, and is supported by citizen understanding.
    - Management standards that ensure the accountability and integrity of both government and the private sector for aligning their investment decisions with the SDGs.
- The right solutions will need to be tailored to country context, across conflict and climate vulnerable countries, for example, as well as for different income groups, from high income to the least developed.
- All contexts will need to include special focus on how finance benefits the poorest.

[13] https://sdgimpact.undp.org/practice-standards.html

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